INSTITUT FÜR ÖKONOMIE
UND ÖKUMENE

Best-in-Class – Good Enough?

The Contribution of Best-in-Class Ratings to Sustainable Business

Antje Schneeweiß

Publishing Information

Place of Publication and Date:
Bonn, December 2014

Publisher:

SÜDWIND e.V. –
Institut für Ökonomie und Ökumene

Kaiserstraße 201
53113 Bonn
Tel.: +49 (0)228–76 36 98 0
info@suedwind-institut.de
www.suedwind-institut.de

Bank Details:
KD-Bank
IBAN: DE45 3506 0190 0000 9988 77
BIC: GENODED1DKD

Author:
Antje Schneeweiß

Editor and Correction:
Uli Lohr, Patrick Weltin, Vera Schumacher, Leonie Stapelfeldt

Translation:
Hannah Jahberg, Sharon Pointer

Responsible according to the press law:
Martina Schaub

Cover photo:
Girls in Class in Khyber Pakhtunkhwa, Pakistan.
Photo: Vicki Francis/UK department for International Development, Flickr.com

This publication was supported by:

Union Investment Stiftung,

Stiftung Umwelt und Entwicklung Nordrhein-Westfalen,

Brot für die Welt,

Evangelischer Kirchenverband Köln und Region,

Evangelische Kirche im Rheinland,

Die Bank für Kirche und Diakonie eG- KD-Bank.

Brot für die Welt
Brot für die Welt – Evangelischer Entwicklungsdienst

STIFTUNG UMWELT UND ENTWICKLUNG NORDRHEIN-WESTFALEN

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Best-In-Class –Good enough?

The contribution of Best-in-Class Ratings to sustainable business.

List of Abbreviations:

CCC	Clean Clothes Campaign
CDP	Carbon Disclosure Project
CSR	Corporate Social Responsibility
DJSI	Dow jones Sustainability Index
GRI	Global Reporting Initiative
ILO	International Labour Organisation
Imug	Institut für Markt-Umwelt-Gesellschaft
IR	Investor Relations
NPF	Norwegian Pension Fund
NGO	Non-Governmental Organisation
OECD	Organisation for Economic Co-operation and Development
SAI	Social Accountability International
SRI	Socially Responsible Investing
UN	United Nations

The selection of pictures:

The set of pictures published on the first pages of this study shows the textile factory "Ali Enterprises" in Karachi, Pakistan, which burnt down on the 11th of September 2012. 289 people died in the fire, considered to be the worst industrial accident in Pakistani history. Only three weeks before, the company had successfully undergone an audit for the SA8000 standard.[1] After the fire, Social Accountability International (SAI) published pictures on the internet documenting the fire safety of the factory. In these pictures, fire extinguishers, escape routes and open emergency exits can be seen, and the emergency exits in the factory were marked with arrows on the floor.

The Clean Clothes Campaign (CCC) later discovered that smaller fires had earlier been caused when dust was ignited by electrical transmission lines. The employees had not been trained in fire safety and no simulation exercises had been conducted for emergency situations. Hence, when the fire broke out, it was not taken seriously. The employees did not realize the seriousness of the fire and thus reacted far too late. When the fire spread, the operators were neither aware of the emergency exits, nor of the correct use of fire extinguishers; they were trapped in the factory. In particular the workers in the basement had no chance of escaping because the fire started right in front of their only exit door.

The founding organisations of SA8000, Social Accountability International, reacted immediately and were advised by a multi-stakeholder board.[1] The SAI Advisory Board includes representatives of companies, trade unions and non-governmental organisations (NGOs), and they had already met in early October for a three-day gathering. There, they decided that all accredited auditors had to pass further training in fire safety.

The auditors of the SA8000 standard control compliance of human and labour rights in the factory, and yet tragic failures, such as that in the Pakistani factory, may occur even if external experts periodically supervise the safety situation in the factories. In contrast, sustainability rating agencies evaluate companies based on company data, guidelines, codes of conduct or reports from NGOs and the media, or from existing standards instead of their own in the field investigations. What has become clear is that, although difficult, it is particularly important for the evaluation of the compliance of human and labour rights to know the actual situation on the ground and to supervise it periodically.

Summary

With the Best-In-Class approach, attempts are made to find out which company within a sector acts the most sustainably. The information gathered by this approach increasingly influences investment decisions. In Europe in 2011, EUR 283 billion were invested in accordance with this approach and this amount is likely to increase (Eurosif 2012). This approach enables sustainability-oriented investors to spread their capital variously among all industrial sectors, including problematic sectors such as the mining or the oil sector, by always choosing the most sustainable company in those sectors. It is argued that the listing of the Best-In-Class would lead to a competition for good sustainability performances between the companies. As a consequence, the stock company would have the incentive to perform more sustainably and to improve continuously. It is not known if the Best-In-Class ratings have had this effect *de facto*, as it has scarcely been investigated.

Therefore, this study attempts to detect actual indications of the impact of the Best-In-Class approach. The objectives of sustainability rating agencies have been identified based on qualitative interviews, which were compared with the statements of 22 European stock companies regarding the importance and effect of those ratings on the companies.

There was a general consensus that the financial power of sustainability-oriented investors is too low to influence the companies on the sole grounds of capital ascendency. According to sustainability rating agencies and index providers, it is especially important to convince investors of the profitability of sustainable investments. Furthermore, the agencies' aim is to contribute to more sustainable company performance. Moreover, the interviewed companies agreed that exclusion criteria which required a change of business activities would not have any impact.

Companies estimate that the influence of sustainability rating agencies is limited. Only two companies disclosed the actual modifications they had implemented due to the ratings. Three of the interview partners made it clear that they competed for good ratings scores, while five companies responded that the ratings were an additional motivation in their efforts towards sustainability. In all cases, other stakeholders such as customers, legislators or NGOs attributed the same or a major impact.

Furthermore, the majority of the companies and the three interviewed NGOs expressed doubts about the transparency and validity of the ratings. Moreover, the extensive and time-consuming collection of data for sustainability ratings remains another problem for the companies.

The continuously updated ratings provide a valuable overview of company sustainability performance, and the ratings are also targeted at those companies which are not normally the aim of NGO-campaigns. However, their requirements for the companies are not developed through a multi-stakeholder process. Hence, sustainability rating agencies work in relative isolation from other stakeholder groups, although companies often see these stakeholder groups such as customers and local communities as more financially important for their business development than investors. Therefore, the agencies lag behind the procedures

established between the companies and their stakeholder groups, and miss the opportunity for the necessary gathering of forces to achieve further change.

Sustainability-oriented investors who want to initiate change within a company should make sure that their concerns are conveyed to companies, and are at the same time coordinated with and integrated in other stakeholder groups.

1. Introduction

For more than 20 years, companies in Europe have been under review by sustainability rating agencies regarding their sustainability performance. Since the turn of the millennium, this has been done to an increasing extent by utilising the Best-In-Class procedure.

Investment strategies of sustainability-oriented investors

The forum for sustainable investments[1] distinguishes between the following strategies of sustainability-oriented investors:

Exclusion criteria

Volume in Europe in 2011: EUR 3.8 trillion

This approach excludes investments in certain companies, sectors or countries if those investments violate specific criteria. Common exclusion criteria are the production of weapons, nuclear power (including uranium extraction), pornography, green genetic engineering, and animal experiments. These criteria represent the attitude of the investor towards ethical values and are therefore called value-based exclusions. The information needed for this approach is supplied by ratings agencies or results from business activities.

Best-In-Class strategy

Volume in Europe in 2011: EUR 283 billion

In accordance with the Best-In-Class strategy, investors only invest in the best companies within an industry according not only to ecological and social criteria, but also to the criterion of good corporate governance (ESG criteria). In one version of the Best-In-Class strategy, investors invest more capital in companies that are rated as Best-In-Class than in companies rated worse. These ratings are founded on in-depth studies on companies and industry sectors. The analyses also take environmental indicators, sustainability strategies and the supply chain management of companies into consideration. Public data are consulted, such as sustainability reports of companies as well as confidential information which is only accessible for ratings. In addition, worldwide information gathered from the media or publications of NGOs are incorporated into the evaluation. However, the rating agencies do not verify the collected data of the companies and its production locations.

Engagement and exercise of voting rights

Volume in Europe in 2011: EUR 2 trillion

[1] The forum for sustainable investments (Forum für nachhaltige Geldanlagen, FNG) is a professional association in Germany, Austria and Switzerland. Its members include banks, investment companies, insurance, ratings agencies, asset managers, financial consultants and NGOs.

The term 'engagement' indicates the long term dialogue between investors and companies with the objective of convincing the management either to generally consider social, ethical and ecological criteria, or to remedy a specific defect such as the use of child labour in the supply chain. This includes direct contact with the company and its decision makers, as well as dialogue with other organisations which possess professional knowledge in the corresponding field.

The term 'exercise of voting rights' indicates the exertion of shareholder voting rights at general meetings in order to influence or support corporate policy in terms of ecological, social or strategic criteria.

Standards-based investments

Volume in Europe in 2011: EUR 2.3 trillion

Investors pursuing this strategy invest according to compliance with international standards such as the Ottawa Convention on landmines and cluster munitions, and the core labour standards of the International Labour Organisation (ILO).

Integration

Volume in Europe in 2011: EUR 3.2 trillion

Investors who invest according to the integrated approach consider the ESG criteria within their investment decisions, integrating these into their financial analyses. Therefore, the application of ESG criteria which are related directly to the financial development of bonds is favoured.

Sustainable thematic funds

Volume in Europe in 2011: EUR 48 billion

This type of investment concerns funds which are invested exclusively in companies linked closely to sustainability, such as companies of the renewable energy sector. Distinctive strategies are often combined by the investors, and those utilizing the Best-In-Class approach can also be committed and practise their voting rights.

For all these strategies, sustainability rating agencies are usually consulted. This study focuses on sector-specific company rankings in accordance with their sustainability performances provided by agencies. This selection was made because these approaches evidently had a higher influence on companies than other approaches to sustainable investments (Häßler & Markmiller, 2013: 36 ff).

Sources: FNG, 2013:42 and Eurosif, 2012

Within this procedure, companies are surveyed with a focus on social and ecological criteria. A ranking list is created for every sector, revealing the grade of sustainability for each company in comparison with its competitors. The security papers of the best companies are more frequently purchased and are part of the increasingly popular sustainability indices, such as the Dow Jones Sustainability index family and the FTSE4Good indices.

A 50-page questionnaire was sent out to ascertain the sustainability grade of the companies, with detailed questions about, for instance, air emissions, compliance with labour rights in the supply chain, and the number of women in executive positions. The companies receive points for several subjects, and for each sub-theme within these subjects based on the collected data and the evaluation framework of the ratings agencies. For example, textile companies with a proven, extensive control of their supply chain receive a considerable number of points for this area. In the second step, this number of points is offset against the points scored in other areas, such as employee fluctuation or the advancement of women. Depending on their relevance for the sector, scores in certain subjects are given a higher weight in the evaluation than those of different, less important subjects. Therefore, in sectors with several suppliers, compliance with labour rights is given more weight than the advancement of women in the head office. At the end of the process, the companies receive one score for the social and one for the ecological performance, and then these are combined to calculate the final score.

Emergency Exit Sign at Ali Enterprises
Photo: Social Accountability International

After the evaluations of the companies and their competitors become available, they can perceive the sectors in which they have to improve their performance to achieve a higher score in the next rating. In consequence, the companies may perform more sustainably according to the deliberations of the initiators of the Best-In-Class ratings.

Sustainability indices and the "Carbon Disclosure Project"

Stock exchange indices reflect the development of a certain securities market. For the respective index, a certain number of stock companies are selected and their stock performances are summarized to a key figure. It is desirable for stock companies to be contained in an index because such stock companies are more attractive for investments.

The financial services provider, Sustainable Asset Management, based in Zurich is part of the asset manager RobecoSAM AG and developed the Dow Jones Sustainability Index World (DJSI) in 1999. This index selects the most sustainable stock companies out of the 2,500 largest companies worldwide and generates the DJSI World, currently with 333 titles. Ecological, social and economic criteria are taken into consideration during the selection process, and each subject is weighted equally. The selection exclusively follows the Best-In-Class procedure, incorporating only the best companies of each industry into the index. Exclusion criteria are not applied although investors can consider them additionally and receive information about violations of certain exclusion criteria committed by the companies. At the same time, the company compiles in total 20 sustainability indices with distinctive regional foci. RobecoSAM AG realizes yearly sustainability research projects based on extensive data provided by the companies to assess their sustainability performances. On the basis of information such as pollutant emissions, water consumption, and compliance with core labour standards, sustainability performances are rated, ranked and displayed. Once a year, the index is compiled again according to this procedure. Only the Best-In-Class remain in the index.

A further group of sustainable stock exchange indices is the FTSE4Good indices which are compiled by the Financial Times. These indices also work in accordance with the Best-In-Class principle, but they additionally consider exclusion criteria. Companies producing weapons systems would therefore not be a component of the FTSE4Good indices.

In 2000, the Carbon Disclosure Project (CDP) was founded in London by an NGO with the objective of ensuring more transparency regarding companies' environmental data. The project focuses on the publishing of information concerning greenhouse gas emissions and water consumption. Once a year, CDP collects data on CO_2 emissions, climate risks, reduction targets, and strategies. A total of 700 institutional investors supported this project in 2013, with these investors managing assets in excess of USD 90 trillion. With this amount, they own a significant proportion of the shares of the largest listed companies worldwide.

The amount of capital managed in accordance with the Best-In-Class approach has been increasing steadily since 2000. However, while capital volume grew five times from EUR 57 billion in 2005 to EUR 287 billion in 2011 (Eurosif 2013: 15), distinctively less capital is currently invested in compliance with the Best-In-Class approach than with exclusion criteria. Nevertheless, the Best-In-Class approach is still the method that involves companies most intensively. Therefore, an improvement in the sustainability performance of companies based on the involvement of the investors is best reached using this approach, in accordance with the starting point of the study. This hypothesis was confirmed in a study by Häßler and Markmiller (2012: 36).

Emergency Exit at Ali Enterprises
Photo: Social Accountability International

Numerous scientific investigations about the development of returns underline the financial advantages of the Best-In-Class approach over other conventional selection procedures (see, for instance, Kempf & Osthof, 2007). Unfortunately, only a few investigations have shown interest in whether the objective of sustainability-oriented investors to continuously improve the sustainability performances of their companies is reached as well. In the long run, the only way for the Best-In-Class approach to be convincing for investors, companies and other stakeholder groups is that at least some improvements in the sustainability performances of companies are evidently attributable to the Best-In-Class ratings.

There has been increasing criticism on the weak implementation of sustainability criteria in SRI funds sold in Germany, a market which is still weak in regard of SRI investments (for instance, Bettzieche, 2012). An overview of several funds and indices shows that all stock corporations of the DAX 30, apart from a few exceptions, are also listed in any sustainability index or fund, including companies which have not been considered to perform sustainably by many stakeholder groups. However, the argument remains that these companies, even if not acting completely sustainably, were performing relatively better than their competitors corresponding to the Best-In-Class analysis. Therefore, competition emerges between the companies, leading to more sustainable performances by all companies. In view of this reasoning, it is urgent to investigate whether and to what extent the Best-In-Class selection actually helps to achieve ecological and social objectives.

It can also be seen that large and very large institutional investors, such as pension funds which are not able to restrict their investment universe beyond a few exclusion criteria, approach the management of companies in their portfolio with critical questions on environmental, social and governance issues (ESG), in addition to the Best-In-Class approach. Beyond the selective investments, they try with their voting behaviour, critical dialogue and input at general meetings to promote awareness of sustainability concerns. The question therefore arises as to whether and how they can complement and reinforce the effect of the Best-In-Class selection procedure with their engagement.

This situation of sustainable investments cannot be seen isolated. It is part of a development during which voluntary corporate responsibility is being increasingly demanded, reported, and implemented, but also criticized. Therefore, taking into consideration ecological and social subjects in corporate reporting has become a matter of course during the last two decades. Every mining company publishes its principles of sustainability on the website. As a reaction to the flood of uncontrolled sustainability reports, the Global Reporting Initiative (GRI) developed a standard for sustainability reporting.

Responding to the attempt to establish a standard for corporate responsibility with social and ecological concerns, the United Nations Global Compact and the OECD set guidelines for multi-national companies. Moreover, the OECD guidelines contain an –albeit rather weak –Complaints Mechanism Policy. In the "Guiding Principles on Business and Human Rights" adopted by the UN in 2011, human and labour rights were substantiated, and reinforced the underlying emphasis on public responsibility.

At the same time, media reports have uncovered weak spots in these approaches. The deaths of hundreds of workers in textile factories in Bangladesh and Pakistan could not be prevented, even with auditing and certification measures and despite the fact that the majority of these factories had passed a social audit. One of the factories of "Ali Enterprises" burnt down just a couple of weeks after having successfully passed a social audit which even included fire security measures (see the accompanying set of pictures).

Many companies have tried to solve the multitude of sustainability problems caused by their business activities by laboriously searching for practicable solutions outside of the public focus. Many of them are taking this path together with non-governmental organisations (NGOS). NGOs are integrated into many multi-stakeholder boards and business dialogues, and an essential part of those dialogues is the clarification of controversial facts between stakeholders and companies, and the appraisal of measures in terms of effectiveness. While companies learn much about sustainability problems, NGOs learn to understand the situation of companies during that process.

Against this background, the interchange between sustainability rating agencies and companies has changed drastically. Twenty years ago, agencies were worrying that they might not obtain enough information from the companies under valuation, whereas nowadays corporate responsibility representatives strive to engage in dialogue with the agencies´ analysts to offer detailed information. However, they are becoming increasingly discerning with regard to the methods and results of these agencies. In view of such dynamics, this study seeks to investigate the following questions:

- What is the impact of sustainability rating agencies on the sustainability performances of companies in terms of the Best-In-Class approach?
- What is the particular achievement of those sustainability ratings in comparison with other influencing factors such as NGOs, media and legislation?
- How could this influence be shaped as effectively and efficiently as possible?

Thereby, the investigation focuses on the implementation of human and labour rights in the area of the responsibility of companies.

2. Sustainability ratings as part of a social process

Historical changes can be explained by illustrating the background motivations and intentions of the main stakeholders (Wright, 1974: 141). The background motivations of companies cannot be defined simply by their pursuit of profit. Rather, motivations and intentions are embedded in a social and historic context which influences, for instance, the kind of products made and how profit is generated.

During the Second World War, for example, the German company Drägerwerk made its profit mainly by producing gas masks and breathing devices for use in warplanes, utilising forced labour. Today, the company operates in both the medical technology industry and emergency services and has been acknowledged several times as family-friendly employer. This example clearly shows the significance of the social context for companies regarding their way of making profit. The pursuit of profit is simply a constant within the changing social context which shapes business practices.

Fright after the fire
Photo: Reuters/Akhtar Soomro

During the last two decades, this social context has shifted in favour of the endorsement of ecologically thoughtful business activities, the condemnation of human rights violations by companies, in particular in supplier firms in developing and emerging countries, and the demand for improved career opportunities for women. Sustainability ratings are one of many possible communication channels through which to confront companies with these changed social ideals and to effect adequate adjustments in their business activities.

Against this background of understanding, it seems self-evident that this study should undertake qualitative interviews with the main stakeholders participating in this process. In contrast to solely quantitative procedures, detailed questioning of these actors will provide a more differentiated picture to be drawn of the objectives of sustainability rating agencies as well as the influencing factors of companies, and enable suggested improvements to be developed as a result.

2.1 Extent and course of this study

This investigation is limited to only one area with regard to the broad range of subjects covered by sustainability ratings. As SÜDWIND has years of experience in the area of labour and human rights violations in developing countries, this study focuses on the impact of sustainability ratings on compliance with human rights in industries known for systematic violations of human and labour rights during the last decade. Many companies within these industries have responded to such accusations with extensive measures of Corporate Social Responsibility (CSR) which influenced their sustainability ratings results.

In particular, the following industries were analysed: mining, textiles, trading in tropical fruits, cocoa products and palm oil as well as the retail industry. The latter has often been affected in several ways by human and labour rights problems because several problematic product groups (for example clothing, chocolate and jewellery) are supplied by it.

For the assessment of the effect of sustainability ratings, several groups of actors were questioned. The most important groups were companies and rating agencies, while NGOs and an organization which sets standards were also questioned. In tangible terms, representatives of 37 European companies of the food, mining, clothing and retail industries were requested from April to October 2013, 22 of these participated in qualitative interviews. The companies either answered in writing (n=3), by telephone (n=15) or in personal interviews (n=4). Furthermore, four personal 20-60 minute interviews with sustainability rating agencies were carried out, in addition to three NGOs and one standard setting organization.

The interviews lasted from 20 to 60 minutes. The interview guidelines and a list of the questioned institutions are given in the appendix.

2.2 “Theory of change” as a methodical guideline

The method of investigation was inspired by the evaluation procedure, which evaluates the effect of projects which are politically influencing. The initiators developed this “Theory of Change” to understand the success of such projects (Jones, 2011: 3). The theory describes the project objectives pictured as situations in the future, the required mechanisms to achieve these objectives, the preconditions for the proper functioning of these mechanisms, and the role of other actors in achieving or thwarting success (Keystone, 2009).

Burned Factory
Photo: Reuters/Akhtar Soomro

Such a Theory of Change has led to a project “roadmap” for achieving political impact. It enables the parties concerned to evaluate the extent to which the intended objective is achieved or whether changes have occurred concerning the strategy and the process.

The objective of the interviews with the sustainability rating agencies was to establish such a Theory of Change regarding the Best-In-Class approach. In the interviews, the agencies were asked about the objectives of ratings and the preconditions needed to accomplish them. Based on their answers, a largely consistent "Theory of Change" for sustainability rating agencies in compliance with the Best-In-Class approach was formulated, and this is described in the following chapter. As a second step, this self-conception of the four agencies was compared with statements from the sample companies and NGOs.

The result revealed a conflict between the objectives and preconditions of sustainability rating agencies and the influence of sustainability ratings on the corporate sustainability policy as reported by the companies. The companies were additionally asked about the impact of other actors such as shareholders and NGOs. Therefore, it is to some extent possible to make a comparison between distinctive forms of influencing companies.

2.3 Qualitative interviews

Qualitative interviews are suitable for understanding and interpreting coherences in order to generate hypotheses (Winter, 2000: n.d.). Qualitative interviews collect comprehensive information about the object of investigation. Their results may generate suggestions for improvement. The conducted interviews were a particular type of qualitative interview, the so-called "problem-centred interview" (Witzel, 1995: 227-256), which focuses on a specific problem introduced by the interviewer, who will continually return to the problem under investigation. Such guideline-based interviews allow the respondent to develop an understanding of coherences and larger cognitive structures independently during the interview. It starts with a general introductory question followed by further detailed questions about interdependencies and influencing factors as well as appropriate examples. The interviews were in all cases concluded with specific questions about the significance of indices, exclusion criteria and the rating results for the companies (Mayring, 2002: 67ff).

This kind of investigation is called explorative research. Instead of verifying hypotheses on the basis of empirical data, this investigation aims to generate hypotheses which need to be verified during a second stage.

3. Stages of the research

3.1 Studies on the impact of sustainable investments and sustainability ratings

The number of studies on the impact of sustainable investments is limited. Scholtens (2006) assumes that sustainable investments do not have a decisive influence on companies due to their limited capital volume (Scholtens, 2006: 29). He argues that this does not only relate to the small amount of capital invested in sustainable share funds. Based on a comparison between the market capitalization of listed companies and the granting of credits to companies in selected developing and industrialized countries, he reveals that –apart from some emerging countries –the volume of credits given to companies lies clearly above their share capital volume. He concludes that sustainability initiatives focusing on the granting of credits are more effective than others focusing on the shareholders. In his opinion, ratings for investors are less effective than the financing of renewable energies, micro financing, and sustainability criteria in the project financing of major banks, such as the criteria grounded in the Equator Principles.[2]

Richardson (2009) measured the success of sustainable investment strategies by evaluating whether they were able to force companies to act in a climate friendly manner. He reached the conclusion that this had not succeeded because of the profit-fixated culture of financial markets, the relatively small amount of capital invested in sustainability, and the lack of precise sustainability criteria.

Kahlenborn et al. (2010), from Adelphi, an institution for policy advice in Berlin, focus on the impact of sustainably-oriented investors on the climate protection efforts of German stock companies in their investigation. Direct financing effects as well as the indirect effects on management were analysed. The study concluded that there was barely any direct effect on share prices and therefore none on the financing possibilities of the company. None of the investigated companies of DAX, MDAX and TecDAX had a share of sustainability-oriented investors reaching 20 % or above, which is considered the threshold for investors in order to have a material impact on companies (Kraus, Heinkel & Zechner, 2001, cited in Kahleborn, 2010).

Concerning the impact of sustainability-oriented investors on the management of stock companies, as investigated by the study, the quantitative questioning of 110 German companies (75 responses) revealed the following picture:

The narrow majority of the companies revealed that sustainability ratings institutionally reinforce the corporate sustainability departments (57%) and contribute to an improved measurement of climate data (54%). The vast majority (90% of the DAX-listed companies) regarded ratings as a measure of comparison between competitors.

However, the question concerning the impact of sustainability ratings on sustainability management, on climate protection policy, or on specific fields of climate protection, needs to be answered more carefully. Only one fifth of the DAX-listed companies stated that sustainability ratings had a considerable influence on their climate protection policy. A considerable influence on the corporate sustainability management was admitted by just 35% of the DAX-listed companies. At least 40% of the companies were induced by sustainability ratings to set themselves more ambitious emission objectives.

A further result of the study is the understanding that the influence of investors focuses on major stock companies with high scores in the ratings. The actual competition is therefore limited to a few leading companies.

The results of this study are partly confirmed by Häßler and Markmiller (2013). With the questioning of 750 major companies worldwide and a return rate of 199 questionnaires, this study remains the most extensive survey conducted on the effect of sustainability ratings. Two third of the companies responded positively to four of 15 questions concerning the impact of sustainability ratings. The majority (61%) stated that sustainability rating agencies were in second place, behind the customers and followed by the requests of investors, regarding the impact on companies to engage themselves with issues of sustainability. Around

[2] The Equator Principles are a voluntary set of guidelines for major banks for complying with social and environmental standards in project financing with loans of more than USD 10 million.

60% of the respondents assumed that sustainability analyses had a considerable (15%) or rather considerable (45.2%) influence on the objectives and strategies of the sustainability management. Regarding the measures, 68% assumed a very considerable (19%) or considerable (49%) influence.

According to Häßler and Markmiller (2013), this influence of sustainability ratings exists due to the fact that they are used as a management tool. 84% of the companies take them into consideration as a good basis for analysing the strengths and weaknesses of their sustainability management, and 96% utilize them to detect new trends. At least 64% of the companies use the ratings to review the implementation of measures in the sustainability management.

Thus, ratings serve companies as a yardstick and analysis instrument. Secondly, they provide input for the companies regarding the formulation of sustainability strategies, whereas examples for specific changes caused by sustainability ratings are rare.

Furthermore, the authors concluded that the Best-In-Class approach still has the most considerable influence on corporate behaviour compared to other strategies of sustainability-oriented investors, whereas exclusion criteria have a lesser effect. Unfortunately, the Best-In-Class approach is applied by a very small number of investors. The recommendation to investors according to the authors is to apply the Best-In-Class approach or “Engagement” for a stronger influence on companies (Häßler and Markmiller, 2013).

In 2012, the Canadian consultancy SustainAbility interviewed 30 companies about the effects of sustainability ratings on their corporate policy (SustainAbility, 2012). The study also concluded that ratings serve for more than half of the companies (57%) as a yardstick concerning their sustainability efforts. Some companies became more alert to new subjects due to the ratings. The effect decreased as soon as the companies started to develop extensive sustainability strategies by themselves and use other sources as trend radar. Companies continually criticized the complexity and lack of transparency of many ratings. Moreover, the companies preferred to explain their strategy to the agencies instead of being obliged to answer often incongruous questions. The agencies had overly focused on the collection of data and were neglecting an analysis of the information.

Conclusion: studies on the effect of sustainable investments and sustainability ratings

One material impact of sustainable investments on stock companies has not yet been proven. The Studies by Kahlenborn et al. (2010), Häßler and Markmiller (2013), and SustainAbility do, however, suggest that sustainability ratings serve as a yardstick for companies by helping them to compare themselves so that they can detect strengths and weaknesses and improve. Nevertheless, the influence on specific steps of implementation such as the introduction of new sustainability measures and strategies seems to be lower. Moreover, the transparency and efficiency of ratings are brought into question.

3.2 Studies on the impact of exclusion criteria and shareholders’ commitment

The research agency Novethik (2013) focused on the effect of exclusion criteria on companies. The study found that, on the basis of six examples, the reaction of companies towards the engagement of investors was often accompanied by campaigns from NGOs. In five of these cases, the companies reacted positively in responding to the accusations, even if only to state that they would address the problem. In the sixth case, the company was unresponsive despite being convicted of human rights violations.

Gifford (2010) examined in detail the effectiveness of committed shareholders in eleven cases. He concluded that all of them contributed to change. However, the degree of change and the proof that these changes were caused by the engagement of the shareholders differed substantially. The impact of the British pension fund manager, Hermes, the manager of 250 institutional customers and considered an active co-owner of stock companies, seems to be exceptionally strong. Hermes was successfully engaged in pharmaceutical companies which tried to prevent the licensing of life-saving drugs in developing countries. In a similar case, Hermes convinced a pharmaceutical company to relinquish a legal dispute with the South African government concerning the patent law infringements of drugs to treat HIV/Aids. In another case, a different company withdrew from Myanmar due to its intensive engagement with Hermes. It could also be observed that a range of companies complied with sustainability requirements in response to the pressure of investors. In further observed cases, the ethical investment house Calvert made a significant contribution to, for instance, the improvement of working conditions in the supply chain of a textile company.

Conclusion: studies on exclusion criteria and engagement

The studies on exclusion criteria and engagement show as well that sustainability-oriented investors do not yet have the possibility to force companies to behave in a specific way using the power of their capital. However, this does not mean that they have no impact, as a skilful combination of access to decision makers, genuine expertise, and public pressure, can lead investors to success.

4. Results of the interviews with rating agencies

Within the scope of this study, four personal one-hour interviews were conducted with the sustainability rating agencies Sustainalytics, Oekom Research and Imug, as well as with the index provider RobecoSAM,[3] to identify the Theory of Change which underlies the agencies and the operating mechanisms detected by them. The responses of the agencies are summarized and presented in the following sections:

I. Objectives of sustainability rating agencies
II. Mechanisms and preconditions of sustainability ratings
III. Discussion of the responses given in the company interviews

The responses of the interviewees concerning the objectives of sustainability rating agencies are summarized in four statements:

4.1 Objectives of sustainability rating agencies

1. More investors continuously invest an increasing amount of capital sustainably.

[3] In the following, the terms "the agencies" or "the four agencies" will be used to refer to the three sustainability rating agencies and RobecoSAM, a company providing a sustainability index and having established an in-house research department for selecting the companies incorporated in the index.

2. There is a higher level of transparency regarding corporate sustainability performance.
3. There is competition between companies for their score in sustainability rankings and the number of participating companies is increasing.
4. Companies perform in an increasingly sustainable manner regarding all relevant points.

1. More investors continuously invest an increasing amount of capital sustainably

An objective of sustainability rating agencies and equivalent index providers is to establish corporate sustainability as common criteria for investment decisions in capital markets. This means specifically that sustainability ratings are also considered a mainstream investment, and that financial analysts will ask questions regarding this subject. Their key objective is to influence investors rather than to change companies. The agencies are aware that sustainable investments have grown rapidly in the last years, but they also consider that they are still dealing with only a growing niche. It has become clear that considerable sections of the financial markets do not consider sustainability at all or only consider a few exclusion criteria on the surface.

The agencies name the continuously increasing amount of capital invested sustainably as an indicator of this success. However, one respondent pointed out that it is not known what this amount exactly means. This number merely indicates that the investors used the ratings for such an amount of capital. It is not known which modifications they caused in portfolios and whether the companies were informed that their shares had been sold or were underweight due to bad scoring. In particular, feedback from investors to companies would accelerate change, according to the agencies.

> “Sustainability rating agencies are targeting investors in the first place, not companies” (Sustainalytics).

2. There is a higher level of transparency regarding corporate sustainability performance

Another objective of agencies consists in objectively presenting the analyses concerning the sustainability of individual companies in order to allow for a comparison between companies. According to one statement, the ratings have made a decisive contribution to the objectification of the distorting presentation of corporate sustainability via the companies´ PR department and the media. Indeed, agencies perceive that the success of their ratings is confirmed by the fact that companies use these ratings as a comparative criterion for sustainability performance within the industry standard.

3. There is competition between companies for their score in sustainability rankings and the number of participating companies is increasing

All agencies considered the objective of their ratings to be the initiation of competition. There was consensus in the interviews that the competition was established the most effectively through sustainability indices. The significance of the membership in a stock index is known for the conventional stock indices. This enables the Corporate Social Responsibility department (CSR) to communicate the significance of their work with sustainable stock indices to the Investor Relations department and, hence, to the corporate department engaged with the procurement of capital. However, one respondent emphasized that it was not only about establishing a competition. This competition would only make sense if in consequence companies worked more sustainable.

The dialogue partners argued with the increasing number of companies subjecting themselves to a rating as an indicator of increasing competition. Next to the growing return rate of information requested by the rating agencies, they also saw an increasing willingness for dialogue between companies as a success.

All the agencies observed that companies increasingly request information about the ratings and their functionality and that the ratings are seen as a benchmark and opportunity for comparison with competitors. In extreme cases, companies align their CSR strategy completely with the rating system and, in effect, imitate it in view of the competition for good ratings. This development, however, was seen critically by one respondent.

> "We have to verify if the company has actually implemented this system with a process behind it and whether there is in fact a further development" (Imug).

4. Companies perform in an increasingly sustainable manner regarding all relevant points

There were considerable differences between the agencies regarding this objective. While one agency named a more sustainable business performance as the first and most important objective, another thought an objective measurement of sustainability and the convincing of investors were the primary objectives. All agencies emphasized that they were regularly raising their requirements and, therefore, were expecting a continuous improvement in the companies if they wanted to maintain their status. One agency assessed the development as generally positive as companies became more sustainable according to their measurements. Another agency stated that the average scores remained the same, meaning that by regularly raising requirements companies slightly improved their performance, but only a few companies achieved a quantum leap. The process was rather slow and sluggish.

Regarding the implementation of change, the rating agencies were rather reserved; evidence for concrete improvement due to ratings was rare. For this reason, one respondent considered the specific impact of sustainability ratings as lacking.

> "Rating agencies can contribute to the improvement of corporate environmental balance, but of course only in cooperation with other actors, in particular investors, and also with the critical public, consumers and NGOs" (Sustainalytics).

4.2 Mechanisms and preconditions to reach the objectives

> "Power of capital plus publicity is the mechanism used by ratings" (Imug).

During the interview, the sustainability rating agencies went into detail with regard to the mechanisms used to reach the objectives of more sustainable investments, more transparency of corporate sustainability performance, competition between companies for sustainability performance, and improvement of corporate sustainability performance. There was only one answer to the question of which preconditions have to be set to reach the objective of transparency and objectivity as listed below.

1. More investors continuously invest an increasing amount of capital sustainably

For two of the four agencies the key to meeting the objective was to demonstrate convincingly that sustainability-oriented companies achieve higher profits in the long term and are therefore considered a more attractive investment. If it happened that sustainable investments were permanently less profitable, rating agencies would have no prospect of success.

2. There is a higher level of transparency regarding corporate sustainability performance

The transparency of sustainability performance was pointed out as a central objective by all respondents. However, one interviewee named a precondition to the achievement of this goal, stating that the independency of rating agencies was essential. Only in this case could objective, undistorted information, and therefore real transparency, be guaranteed.

Moreover, the interviewees explained their individual procedures regarding the formation of criteria. In contrast to other subjects, considerable differences were found. One agency included the companies in the debate about forming criteria by arranging all-day workshops, whereas another agency considered their customers i.e. the investors as decisive in the evaluation of criteria. A third agency included scientists and NGOs in the process of generating the rating framework. However, the criteria were always determined by the agencies themselves and one respondent pointed out that not all the criteria could be operationalized and, therefore, several could not be considered.

All the sustainability ratings placed particular emphasis on their independence from the companies as well as from the NGOs. They saw themselves as an objective mediator between two sides pursuing their own interests. For example, subjects and information were absorbed from all sides and the decision as to which information influenced a rating score was finally made by the rating system and the sustainability analysts. Nevertheless, material verification of the data was not undertaken by sustainability rating agencies as this consideration was made on the basis of comparisons and plausibility checks.

> "The role of sustainability rating agencies is to ascertain the interests of investors concerning sustainability and to place them with companies." (Imug)

3. There is competition between companies for their score in sustainability rankings and the number of participating companies is increasing

Agencies especially saw the quality of the rating procedure and its transparency as a vital precondition for reaching this goal. Objective company ratings allow for a comparison between companies and therefore create the preconditions for competition and sustainability. The ratings and their results have to be comprehensible and the agencies themselves have to be trustworthy and must integrate and address relevant subjects from the companies' point of view. Furthermore, companies can compete due to the increasing amount of sustainably invested capital. The amount of capital is, therefore, another precondition.

The increasingly open dialogue between rating agencies and companies concerning ratings also helps to intensify the competition. Companies are confronted with the scores of their competitors and receive further information as to how they might have scored better concerning specific points.

"It is not our purpose in the first place to make sure that the companies go down the path of sustainability. It is our role to provide comparisons on a transparent and neutral basis and to identify which companies are best positioned to create competition advantages in the long term. With the Corporate Sustainability Assessment, we hold a mirror up to the companies and show them where they stand, where they are performing well and where they still can improve. We call that 'Broad Engagement' " (RobecoSAM).

4. Companies perform in an increasingly sustainable manner

To reach this objective, sustainability rating agencies and index providers named the following preconditions: rating agencies should convince companies that sustainability is profitable and that negligence of this leads to significant risks. In the opinion of all agencies, it was essential that the topics brought up in the ratings were also supported by the public.

Furthermore, the relevant rating agencies should be aware of the company's internal procedures which will enable them to change the company's sustainability performance. Not only the CSR department or the Top management should be convinced by the necessity of sustainability but all levels of the company. Meeting the requirements of sustainability is especially difficult at the middle-management level where special attention is paid to reducing costs. An important precondition for improvement concerning sustainability is the modification of the incentive structure. The inquiries from investors thereby help to carry sustainability issues further into the company, for example by including the Investor Relations department.

"Sustainability rating agencies need input from NGOs concerning specific grievances. Without this input, the picture would be narrowed, incomplete" (Oekom Research).

"Companies are information providers for sustainability rating agencies. Moreover, sustainability rating agencies also screen reports of NGOs by examining their degree of reality. An attempt is made to identify objective information which is found in the middle between company information and NGO reports. NGOs tend to exaggerate sometimes, whereas companies rather palliate the reality. We try to find the truth lying somewhere in the middle" (Sustainalytics).

Further essential points mentioned in the interview by all respondents were:

1. None of the agencies believed the state to play an important role regarding the increasing incorporation of sustainability criteria in investments.
2. There are very few connections between rating procedures, their results and methods and consumer organisations, or even with sustainability rating agencies knowing about the considerable impact of consumers on companies.
3. The possible conflict between the rate of return and sustainability has not yet been under discussion. This is interesting considering that the chair persons of companies with a high sustainability standard are already detecting such a conflict (UN Global Campact, 2013: 11ff).

4.3 Reactions of respondents to the results of business inquiry

Towards the end of the interviews the preliminary results were outlined. At that time, half of the interviews had been conducted and none of them mentioned sustainability ratings as the most important incentive for sustainability efforts but it was noted as one among others. Only two companies were competing recognizably in terms of the Best-In-Class approach.

By discussing these results, two assessments stood out and were mentioned by all four agencies. These assessments agreed that companies would not have any provable material advantage in reaching a good score in sustainability ratings and also had just as little material disadvantage due to unsatisfactory ratings. One respondent mentioned as a reason the lack of willingness of many actors in financial markets to face the sustainability subject and to include sincerely sustainability in their investment decisions. Companies' lacked material incentives for greater sustainability and therefore did not have to compete according to the Best-In-Class approach on the basis of investor inquiries.

"The entire financial market is complicated regarding its culture. There, they can only make little use of that subject. It is very difficult to place these new thoughts in such a way that they catch on" (anonymized).

At the same time, the interview partners realized that other factors, such as a scandal directly affecting a company, causes more activity within the company than sustainability rating agencies. On the other hand, they argued that ratings had a broader effect and were therefore less visible. They evaluated the companies as a whole and attempted to make the company generally more sustainable instead of focusing on specific points like the media and NGOs. In general, sustainability ratings, as it was also emphasized in the study of Häßler and Markmiller, did in fact have an impact on companies, but this impact was not as easily verifiable as the effect of particular, outstanding scandals to which companies would promptly respond (Häßler & Markmiller, 2013).

All agencies regarded the considerable increase in inquiries by companies concerning the ratings and their scoring as a clear indication that ratings have quite an impact on many companies. One agency wished that investors would become more involved in business by directly asking the companies about grievances. This would clearly reinforce the impact of ratings. Another agency confirmed that the employees of the sustainability team of a bank pointed out the comparatively strong impact of NGO campaigns. Such campaigns would open spontaneous opportunities for action.

"Companies do not take part in the rating to become part of the DJSI index in the first place, but to learn something about themselves and to know where to improve" (RobecoSAM).

Conclusion: sustainability rating agencies have the main objective of contributing to the increase in investment in accordance with ecological and social criteria. They do not perceive any material pressure on companies, despite the growing amount of sustainable investment. Sustainability ratings are aware of their possible impact on companies but they also realized that this potential needs to be publicly reinforced and that implemented changes are often imperceptible.

5. Results of the interviews with companies

Besides their sectorial affiliation (textile, retail, mining, food), the sample of 37 companies were selected due to their being components of the most significant stock index in their countries. The distribution of the companies within these four industries was relatively equal. Additionally, the number of participating companies with good, middle and bad scoring in sustainability ratings was relatively balanced. Concerning the return, there was one regional particularity: none of the French companies who were contacted participated in the interviews.

The 22 interviews were conducted with CSR representatives and employees of the Investor Relations department of the companies. Specific individual measures of the companies concerning the improvement of the labour and human rights situation were, in none of the cases, due to requests made by sustainability rating agencies. Accordingly, the analysis of the impact of sustainability rating agencies on local changes was not conducted. Two companies, however, reported specific changes regarding the ecological field. One representative referred to a specific example for a modification caused by the engagement of an investor. For this reason, the interviewees focused rather on the significance of ratings with regard to the CSR on the whole activities in comparison to the impact of other shareholder groups, instead of elaborating on concrete modifications. Finally, the respondents were asked how the activities of rating agencies could be improved.

5.1 Experience with sustainability ratings

The more general question concerning their experience with sustainability ratings was answered by providing information about the ratings in which they were incorporated, the effort associated with it, their evaluation regarding the quality of the ratings, and the existence of material reasons for participating in the ratings. Moreover, the answers illustrated the significance of ratings for companies.

Participation in ratings and effort

Companies mentioned in the first place RobecoSAM and their DJSI if they were asked about their experiences with sustainability ratings. Membership in this index was important even to companies which did not regard the investors as their main driving force.

A comparable significance can be found with the FTSE4Good index and the Carbon Disclosure Project. German or French sustainability rating agencies were regarded as secondary.

The answers illustrated that numerous working hours are required to complete the questionnaires. Some companies stated that they reserved 50% or more of the working time of one CSR employee to respond to sustainability rating agencies inquiries. Others tried to manage with less time by responding only to a selection of requests. The collection of data usually extends beyond the head office to production facilities all over the world, consuming further working time there as well. One stated that

> "It must be defined very precisely what data one intends to collect because for each collection of data, you have to think about how it feels to be in Kenya, Vietnam or China and you are asked these questions with English as your second language" (anonymized).

Considering this situation, several companies complained about rating agencies who did not sufficiently utilize the sustainability information already provided online, such as reports in accordance with the guidelines of the Global Reporting Initiative (GRI).[4]

> "What I would find very helpful is if they could align more strongly around the core GRI (Global Reporting Initiative) requirements and only ask questions of companies beyond that. What is frustrating and time consuming for us is completing questionnaires that go over the same ground that has already been publicly reported by the company" (BHP Billiton).
>
> "We are not prepared to collect data which is of no value or no interest to our stakeholders. We don't go and make our businesses, do things and collect and report data unless we can justify that it is really addressing a need for our communities and our stakeholders. So we tend to be selective on the indices we participate in" (BHP Billiton).

Quality of ratings

Companies observed considerable differences in the quality regarding sustainability ratings. The correspondence of the questionnaire with the perception of the sustainability issues of the company is decisive in its evaluation. According to half of the interviewed companies this was increasingly the case. For the other half however, the questions of the agencies did not make sense.

> "The quality of sustainability ratings varies significantly. They can come to very different conclusions depending on what they are measuring." (H&M)

Besides the relevance of the questions, it is very important for the companies to be able to comprehend the valuation. Both good and bad rated companies regarded it as very important to understand how how agencies come up with the intermediary and final scores. The companies complained that such information were often not accessible or were charged expensively.

Material impact

Three companies were referring specifically to the impact of their score of sustainability rating agencies on share prices. All the companies replied in the negative, as can be seen in the statements below:

> "Fourteen days after publishing our quarterly report, our IR Team goes on a road-show for 14 days, meeting some 17-18 key investors. It is extremely seldom that investors actually ask us about our sustainability performance. So that means that we are not really working too strategically on sustainability ratings. In my mind it is much more important to use our sustainability resources to perform better rather than to report and liaise with the sustainability rating agencies. What we experience is that it is not really an important issue for our investors" (anonymized).
>
> "Even if something goes wrong in our company, there is, so far, no impact on our share price. That is still decisive for our investors: How is the share price developing?" (anonymized).

[4] The Global Reporting Initiative develops guidelines for the creation of sustainability reports utilizing a multi- stakeholder procedure.

"I think what we can say is that ethical funds and SRI funds have grown as a percentage of total assets under management in the investment industry but it is still quite small. And it is hard for us to see a lot of evidence of success in this area, *Success that is directly reflected in the share price"* (anonymized).

5.2 Significance of the ratings

An overview of the results is given in the table below.

Sustainability leaders motivated by sustainability ratings

It can be seen that only three of the 22 questioned companies were actively competing for good or top sustainability rates. These companies were referring to their current scores in the DJSI index and had set themselves specific objectives for the next year. Two of the three companies had been ranked in the top positions for years and clearly wanted to maintain their position. Another was engaged in a race to become equal. For two of these three companies, the result of sustainability ratings entered into the calculations of bonus payments to certain employees. These were the only companies declaring that the payment was associated with the score in sustainability ratings.

Significance of sustainability rating agencies	Number	Characteristics of the groups
Sustainability leaders motivated by sustainability ratings	3	Companies know their current score in the DJSI index and have set specific objectives for the next year regarding this index
Intrinsically motivated leaders of sustainability	5	Companies have an ambitious sustainability programme. Ratings are an important driving force among others
Sustainability ratings not the main driving force	12	Sustainability ratings play a subordinate role. Other driving forces such as customers, competitors, NGOs or local communities have a more considerable influence
Laggards	2	No pressure exerted by stakeholder groups; committed investors demand more transparency

"This year, we examined especially the DJSI, which is the deciding factor for our investors, and questioned our standing in the competition in comparison to the entire sector. It should be noted in this regard: we are, I believe, well positioned. We still have a lot of work ahead of us in comparison to other countries, to other competitors and we scored XX in the DJSI while a competitor scored XX and was the best in the sector. Most of the points, they earned by performing well in the social field. That means that this is a field where we still can accelerate the process and generate further points. The management board made clear that we want to be ranked worldwide among the top five, not only financially but also regarding the "Soft Facts" as sustainability because the others as well are competing to gain investors" (anonymized).

Intrinsically motivated leaders of sustainability

Five companies considered ratings as important and valued their motivational effect on their CSR activities. They had an ambitious sustainability agenda, were ranked among the top positions and wanted to be perceived by investors as companies that participated and scored well in ratings.

However, they did not derive their sustainability agenda from the system of sustainability rating agencies to the same extent as the first group. Most of them mentioned that the ratings were only one, albeit an important, driving force among others. The specific score in the ratings did not have a prominent significance for them and they did not derive concrete objectives for their sustainability management from it. They considered good scores to be a confirmation that they were on the right track and not as a result of their alignment with the agenda of sustainability ratings. These companies also coupled the payment of employees to sustainability performances but never to the result of sustainability ratings.

"(Through ratings) we are more aware of some of the expectations of analysts and investors and also it gave us some level of confidence about our code of conduct and policy" (anonymized)

"The worst thing would be to be put off the DJSI because that is a very obvious thing" (anonymized).

"Legislative proposals, high profile NGO campaigns, and robust industry sustainability benchmarks, currently carry far more influence than SRI ratings." (Marks & Spencer)

Sustainability ratings are not the main driving force

For twelve of the 22 companies, sustainability ratings played a subordinate role. They stated that ratings were not the main driving force for their sustainability efforts. Several of them had a quite ambitious sustainability agenda and were rated well or very well in sustainability ratings, while others were rather average. The companies had different reasons not to prioritize ratings.

Seven of the twelve companies considered other actors to be more relevant, such as customers, local communities, workers in supplier firms, media reports or major investors. Consequently, they preferred to invest their resources for sustainable corporate management in more relevant fields. They concluded that doing a good job there would translate into good scoring in the ratings, but the ratings would not determine any priorities.

The time exposure and the necessity to pass confidential company information to the agencies discouraged several companies in this group from ambitiously responding to the questionnaires of sustainability rating agencies.

"We have a very comprehensive corporate programme. And I think in terms of human rights this would be the more significant impact of our operations. So we are dealing very intensively with that we are doing farmer treatment on the ground. We have a supplier code of conduct and so on.

I have seen that. Did you do that because of the investors?

Partly let us say. We do it because we need to do it because it makes sense. There is a wider world of stakeholders out there who are concerned about these topics. Sustainable investors are also concerned about this but I mean that is not the main reason. We cannot say that they are the key driver" (Barry Callebaut).

"Look, we generally do not consider the indices (DJSI and FTSE4good) as the primary driver. The indices are responding to community and stakeholder expectations. I think we probably always see that the indices are just a function of that sort of interest and pressure from communities and stakeholders generally. So I wouldn´t say that we react to the indices as we try to react proactively to our community and stakeholder expectations. Which hopefully then means that we meet the expectations of the rating agencies as well. So generally we would not see them as the primary driver." (BHP Billiton)

The remaining five of these twelve companies had additional general concerns concerning the credibility and method of ratings. They also shrank away from the time exposure and the disclosure of company information. Consequently, ratings were not the driving force for their sustainability management.

"We clearly answer their questions but when we see their report we do not go: 'oh, we should do something as a result of this' " (anonymized).

Laggards

Two companies could not be assigned to one of the three described categories. One company had already undertaken sustainability efforts for reasons of quality assurance and to protect its reputation. It had not yet had to handle any kind of public scandal but wanted to improve its sustainability reporting due to inquiries from engaged investors, with the objective of becoming a member of the DJSI index. The other company rejected sustainability ratings. It found itself constrained to publish more data concerning sustainability subjects due to engaged investors but explained that this would not lead to any changes within the company.

"To be honest: We do not care whether they (the sustainability rating agencies) think we are compliant with their really crazy system of evaluating companies" (anonymized).

General significance beyond the categories

Across the categories described above, half of the questioned companies regarded sustainability ratings as a reference framework which shows them where they stand with their sustainability efforts in comparison to their competitors. They welcome, on principle, the opportunity of comparison but at the same time criticize that this is not given consistently in all rating systems due to their lack of transparency.

5.3 Modifications due to sustainability ratings

Only two interviewees responded to the theme of human rights although the question referred explicitly to changes in the field of human and labour rights. Human rights are, according to them, addressed only to a limited extent by sustainability rating agencies and the effects are correspondingly small.

Sustainability-oriented companies automatically integrated the requirements of the principles of the UN in terms of compliance with human rights in the area of corporate responsibility (Ruggie-Guidelines[5]) in their systems. This happened regardless of the ratings. However, if labour rights are counted as well as human rights, a different picture is obtained. The whole theme of compliance with labour rights in the supply chain will then be taken into account. This subject is weighted distinctively by sustainability rating agencies. None of the companies reported a specific modification in this area.

Most of the answers referred to the general impact of ratings on companies. Two examples of specific modifications in the ecological field were mentioned and recorded here.

Modifications due to sustainability ratings	Number	Type of response
Sustainability rating agencies effect concrete modifications	2	They set themselves more ambitious climate objectives, and buy more considerable amounts of fairly traded goods
Sustainability rating agencies as an incentive mechanism	6	Inquiries and evaluations are an additional motivation to improve sustainability concepts but do not effect concrete modifications
Sustainability rating agencies improve transparency	4	Companies improve their reporting and publish more data regarding social and ecological subjects. This additional publishing does not explicitly affect any modifications
Intrinsically motivated companies	6	Companies do not make any changes due to sustainability ratings but have a sustainability agenda intrinsically motivated
Motivated by other stakeholder groups	4	Responding to NGO campaigns and media reports, rating agencies are, in their opinion, subordinate stakeholders mentioning the same subjects at a later stage

Considerable differences regarding sustainability ratings

An overview of the results is given in the table above.

[5] John Ruggie, UN special envoy on business and human rights, presented in the UN Human Rights Council in Geneva in 2008 a report concerning the human rights responsibility of multi-national companies.

Sustainability rating agencies effect concrete modifications

Two companies mentioned concrete modifications motivated by sustainability ratings. A stock company reorganized its climate objectives and its buying behaviour due to ratings. It set itself more ambitious goals and purchased more sustainably and environmentally friendly produced products.

"The CDP is an example that prompted us to work much more on carbon so we have launched a new work stream on the carbon footprint not only on our direct operation but across our value chain and we intend to develop specific carbon targets linked to that as well." (Barry Callebaut)

Sustainability rating agencies as an incentive mechanism

Six companies reported that requests and evaluations made by sustainability rating agencies constituted an additional motivation to improve sustainability concepts. Four of them added to this statement that NGO campaigns had a significantly higher impact on the company. Two companies believed the impact of stakeholders to be balanced out. The impact of sustainability indices and agencies was considered subtle.

"I think they are not the ones who will initiate what we do who we are as a company and how we are going about our business, but they can accelerate certain things or they can phrase, they can reflect the situation or they are confirmation that we need to do certain things, that kind of stuff. In a way, you can say it is an extra motor but it will never be the reason why we are doing something" (anonymized)

Sustainability rating agencies improve transparency

Four companies saw the need to modify their reporting and to publish more data on social and ecological subjects due to the requests of investors and rating agencies. All four companies additionally declared that this higher level of transparency would not be accompanied by any changes as they were already very well positioned with regard to sustainability. Two of the companies held leading positions in the ratings.

"We did not change our behaviour but we changed our reporting because we already implemented a wide ranged sustainability approach" (Anglo American)

"We ideally do not want to have to respond to a multitude of questionnaires each year from slightly different rating agencies so we certainly respond to those requests by improving the way we publicly report" (BHP Billiton)

"We are thinking of disclosing data that might help tell the story better than we are at the moment. That certainly is a response to incoming ratings but actually changing something due to something that comes in I do not think we have done or will do." (anonymized)

However, one company, feeling motivated by the ratings and therefore assigned to the second group, emphasized that the collection of new data initiated by sustainability rating agencies had led to the perception of sustainability problems on the management level.

"It was one of the problems (precarious working conditions) where we just haven´t had the evidence. We collect data on lots of things you know financial data, but little when it comes to that particular part (working conditions). The data we had was always very local or perhaps regional but we did not have a big global overview so yes that would be a change.

Does this help to make the management more aware of problems?

Definitely, that is what that survey or project looking at labour, in fact in all our factories, does and that had a knock on effect really" (anonymized).

Intrinsically motivated companies

Six companies declared that no changes at all were made owing to sustainability ratings. All of them had a sustainability agenda and some of them even an ambitious one. However, two companies found themselves forced to implement changes due to pressure from their investors.

"We do what we do because we regard it as right and not because sustainability rating agencies force us to. It is a little bit like the question about the chicken and the egg. Which came first: the sustainability ratings or the sustainability efforts of companies? With us the sustainability efforts definitely were there first and thereafter, the requests of rating agencies" (anonymized).

Motivated by other stakeholder groups

Four other companies had responded very firmly to NGO campaigns and media reports in the past. They considered rating agencies as a second stakeholder group which expressed to them the same subjects once again, only at a later stage. Having already responded to the protests, they associated their reactions with the NGOs rather than with sustainability ratings.

"If there is, for instance, a wildcat strike? That would be a warning signal for us to change something and if, at the end of the day, investors say: 'Great, well done, I am interested in that,' then that is an interesting add-on" (anonymized).

5.4 What is not going to change?

In all efforts to achieve a good rating, the respondents indicated that they were not willing to give up or to reorganize entire branches of business, responding to the question whether companies tried to avoid the violation of exclusion criteria. Companies mentioned the following areas in which they could not comply with the requests of investors: companies keep using genetically engineered food in countries where genetic engineering is accepted by customers; they continue selling alcohol; mining companies do not abandon the operation of uranium mines; and the maintenance of a reserved policy towards trade unions remains a component of corporate culture, despite criticisms and requests from investors. Moreover, companies do not seem to revise their decisions concerning the partners they work with on sustainability issues due to the pressure of rating agencies.

Investors Engagement against child labour

In 2003, the Dutch NGO "India Committee of the Netherlands" drew attention to the problem of hundreds of thousands of children working in the cotton fields in the Indian state of Andhra Pradesh. Even in carpet manufacturing, not as many working children were found. The children, mostly girls, were loaned from their parents to the farmers for a certain amount. They worked 12 to 13 hours a day earning a salary often below the minimum wage but always below the wage paid to adult field workers. The girls were regularly exposed to pesticides sprayed on the fields. The farmers explained that they would make losses without the employment of children.

Based on local research, it became clear that several companies, including the Bayer AG represented in India by, *inter alia*, their subsidiaries Bayer Bio Science Pvt Ltd (formerly: Bayer Crop Science Ltd.) were purchasing seeds from these famers. A publication from 2004 stated that in the time between 2000 and 2001 around 2,000 children had been working on fields where cottonseeds were planted for the Bayer AG.. During 2003/2004 the total was 1,650. The results of this study were published and brought into the company by the media and NGOs, yet the reaction of Bayer AG was reserved. First of all, they did not tackle the problem seriously. After several NGOs lodged a complaint against Bayer AG on the basis of the OECD guidelines concerning multinational companies, the company initiated a dialogue with local NGOs and announced several measures but did not show a serious interest in implementing these. In 2005, the Norwegian Pension Fund (NPF) became aware of this situation and contacted the company´s head office and a series of meetings with the management of the company took place. The Fund asked Bayer to address the problem seriously and sent independent teams to India to examine the situation and observe the progress of Bayer´s effort. Dr. Davuluri Venkatesvarlu, the Director of Global Research, stated that "Although Bayer had been aware of the problem since 2003, the company only took serious steps to tackle the problem in 2005. In 2005, sustainability-oriented investors such as the Norwegian Pension Fund became aware of this problem and started to exert pressure on the company. This put the company under enormous pressure and resulted in a considerable effort on the part of the company to tackle the problem."

In the following years, Bayer made considerable efforts to reduce child labour on farms where they collected their seeds. The measures included motivation campaigns, price incentives for farmers not to employ children, black lists of farmers using children for work and separate schools for the rehabilitation of former child workers. These initiatives had a positive effect. As a result the rate of children working on the fields where seeds for Bayer were produced decreased from 53% in 2003/2004 to less than 3% in 2009/2010. The contribution made by the Norwegian Pension Fund was significant.

All these examples originate from very well ranked and ambitious companies. This signifies that exclusion criteria referring to the relinquishing of entire branches of business or parts of corporate culture have led to internal debates in companies but not to the desired changes. Facing these results, a further extension or intensification of such exclusion criteria does not seem to be expedient.

This sobering observation does not necessarily apply to exclusion criteria based on international standards and is accompanied by an engagement process. Hence, the engagement of the NPF was very successful in terms of the reduction of child labour in Indian cotton fields. This engagement was based on the exclusion criteria "Child Labour" of a $700bn fund. If the ethics committee realizes that the criterion is violated, it should first enter into dialogue with the company. Only if there are no significant improvements the management will sell the corresponding shares and publish the decision afterwards.

5.5 Significance of other shareholder groups

An overview of the results is given in the table below.

Significance of other stakeholder groups	Number	Significance of influential factors
State	22	Major influential factor for all companies
Mining companies	**5**	**Major influential factor**
	3	Local communities
	1	Intrinsically motivated
	1	Committed investors/ Exclusion from NPF
Consumer goods/ retail	**13**	**Major influential factor**
	7	Stakeholders have a similar amount of influence
	3	Customers/ NGOs which cooperate to solve specific problems
	2	Customers including also other major enterprises
	1	Workers in supplier firms
Luxury Goods	**4**	**Major influential factor**
	3	Reputation and committed investors
	1	Reputation and NGOs

The most considerable influence on corporate behaviour is exerted by the legislator, as noted unequivocally by all of the companies. Impacts also come from customers, industrial associations, NGOs, the media and investors, all of whom address such subjects.

"I don´t know whether you can compare the influence of an NGO with a SRI rating agency. I don´t think any of those would trump a legal obligation we have" (anonymized)

A relatively clear statement with regard to the potential for change by individual stakeholder groups was made only by the mining companies.

Mining companies

Three of five mining companies considered the local residents living near the mines as their most influential stakeholder group. These residents affected their corporate behaviour the most, significantly more than investors. Numerous protests against new mining projects in developing and emerging countries questioned the legal basis of the business operations of mining companies. These companies were concerned for their future survival and reacted accordingly.

"Possibly if there is one group of stakeholders which in the long term will be more influential than others I would actually say that they are the people living near to our operations. Sorry to say that, when you go to a number of NGOs and people, they will tell you we haven't seen the evidence for that and that is true. We are responding to that" (anonymized)

"One of our major 'clients' is actually the communities, the host communities" (Anglo American)

Consumer goods producers

The responses of consumer goods manufacturers and retailers can be assigned to two groups. The response of manufacturers of luxury goods significantly differed from the answers of producers providing mass products. The latter generally mentioned several influential factors including media, customers, employees, competitors, supplier firms and NGOs. Several did not want to rank them but most of them put their customers first.

"The most influential would probably be the customers because our customers from a purely business perspective are very important stakeholders obviously but also quite advanced in the CSR area. I am sure you are aware of (name of two big businesses which are clients to the interviewee) and the others. They are quite advanced in sustainability so by working with them they also help us to identify where the needs are and we have common programmes to build schools on certifications and so on so they would probably be the most significant stakeholders" (Barry Callebaut).

"The significance of shareholder groups is in this order: consumers, staff, media, civil society and then investors" (anonymized)

One respondent referred to the employees working in the supplier firms as the most important driving force.

"I see the main task of our work in the (CSR) team in serving primarily the workers in the factories and not the investors" (anonymized)

Producers in the high-price segment

Producers of luxury goods see sustainability as an integral part of their quality requirements and their reputation. Moreover, they often did not have to deal with public scandals and saw themselves as more intrinsically motivated than by stakeholder groups. One company in this sector, however, worked together with an NGO and considered this impact as stronger than the impact of investors.

Did you implement any changes as a result of the sustainability rankings?

"No, because I think we take those things very seriously regardless of any external input. Clearly, we are in the business of manufacturing products. There are people in our supply chain who are incredibly important to us. If we react to a sustainability rating we would not be doing our job; that should be part of the supply chain approving system. You should not be forced to react to some external pressure" (anonymized)

Ratings considered a secondary reaction

The statement given in the section above outlines that it would be a bad sign for the corporate sustainability management if they had to react to changes in sustainability ratings, and indeed this was mentioned by five companies in total, completely regardless of the sector involved.

"Companies like ours which are actively engaged with their communities, their governments and stakeholders should really be onto these issues before a rating agency pops up and says: this is important" (BHP Billiton)

"Honestly speaking, the investors and the rating agencies don´t come up with these by themselves so they are prompted by other groups and stakeholders, so if we do our processes, our stakeholder engagement effectively, then we should be a little bit ahead of that" (anonymized)

Industrial standards and media campaigns have a strong influence

Five of the companies with a high engagement regarding sustainability considered industrial standards to be important guidelines for their sustainability efforts, often more important than sustainability ratings.

Companies which were the objective of NGO high media impact campaigns confirmed that these campaigns had significantly faster results and their reactions were more engaged than in the case of sustainability ratings.

> "We have been dealing with this problem (palm oil) for a long time but it is true that having people climbing up the building definitely raises the temperature and forced us to think differently about it. I believe these kinds of NGOs have played a role and I think they have become a lot more focused and a lot more tactically clever in looking to use big companies to advance their causes because they realize that big companies have an ability to respond, which makes them a useful tool if you like and climbing up our building makes us feel very bad (…), that really gets our attention of course and I would say that those kinds of motivations are probably stronger than the DJSI or the FTSE4Good to be straight forward to you" (anonymized)

5.6 Comparison: sustainability ratings – Engagement

All the companies had already been faced with critical questions from sustainable investors. Furthermore, the companies agreed that the number of requests had increased in the recently.

Comparison: Sustainability ratings – Engaged investors	Number
No difference between sustainability ratings and engaged investors	12
Preference for the dialogue with engaged investors	4
Engaged investors have a larger potential for change than ratings	4
Engaged investors are not sufficiently competent to cause effective changes	2

The comparison between the influence of sustainability rating agencies and engaged investors arrived at no clear conclusion. The experiences of all companies with active shareholders had been diverse and they faced very distinctive strategies. Moreover, there was an overlap between sustainability ratings and engaged shareholders with some of the engaged investors demanding participation in ratings or a certain result in a rating.

> "There is one group of shareholders which is very much focused on stakeholder issues and when they talk to us sustainability ratings are important to them to check sustainability. They place reliance on measures such as DJSI. That gives them assurance to be invested in us from that perspective" (anonymized)

No difference between sustainability ratings and engaged investors

For most of these twelve companies, there was no significant difference between sustainability ratings and engaged investors. The questions asked to the companies were similar; the companies reacted with the answers and the data they had already collected for the rating agencies. In business practice, these two approaches to influencing companies with regard to sustainability are perceived as being very similar.

> "Our approach to sustainability ratings and shareholder engagement is broadly similar"(anonymized)

Preference for dialogue with engaged investors

Four companies expressed a clear preference for dialogue with engaged investors compared to communication with sustainability rating agencies. They estimated that these conversations would elaborate more on corporate sustainability issues than it was possible by collecting data using questionnaires. Furthermore, they felt they would be able to explain their approach to certain sustainability subjects instead of reducing these approaches to data form which they considered was sometimes not as relevant.

> "Obviously, direct engagement is stronger, more precise, more detailed and close to the business and so we are better able to react to that. But if the sustainability ratings gave more feedback than it would be able to take those into consideration more" (Barry Callebaut)
>
> "Our preference is to talk to our investors directly." **(**BHP Billiton)

Potential for change of engaged investors

Three companies mentioned changes that had been implemented due to engagement. Another company which was not, at the time of writing, the target of engagement activities pointed out the potential impact of this instrument. Two further respondents reported that the engagement of investors led to participation in ratings or, respectively, to the publication of more sustainability data. The mining company Rio Tinto changed its policy concerning the handling of the tailing of mines after the Norwegian Pension Fund excluded them from investments while another company emphasized the potential influence of investors.

> "We think if they are not coming and asking about problem areas then everything must be alright [….]. They would make a huge impact if they did. The one thing you can definitely say is that given they are not asking lots and lots of questions of our senior management about these issues, but, the day that they did come and say 'before we talk about other things we would like to talk to you about the use of child labour' somewhere or one of the issues that might be on their agenda, that would make a huge impact on our management team that is for sure" (anonymized)

Engaged investors are not sufficiently informed

Two companies perceived engaged investors as not sufficiently informed or critical enough.

> "How do we perceive the way of influencing human rights issues (by engaged investors)? They are important and good in practice but, at least in our view,

they lag far behind the corporate reality. Most of the time, it is about issues that we already have on the table" (H&M)

Another respondent perceived critical investors as not being seriously interested in sustainability subjects.

"They (the sustainability-oriented investors) know that they might get tricky questions about investments in our business. What I have always understood is that they have contacted us to have an arsenal of answers should they ever be questioned. This is the way. They are not saying: 'I want to hear about your CSR effort because I want to understand how I should invest my money' –no. They ask like please tell me what to say if someone scrutinizes my investment in your industry" (anonymized)

5.7 Criticism of, and advice for, sustainability ratings

Sustainability rating agencies and sustainability indices providers were perceived by the companies as participants in the market for sustainability ratings, who were trying to increase their market share and win new customers by launching specific products. They were not considered actors wanting to change something but as agents of investors who want to invest sustainably. One respondent emphasized that they successfully fulfilled their role.

"I think that rating agencies are providing the kind of feedback that investors are requesting. They give scores on different areas: How do you perform on environment, on carbon, how do you perform on this, that and the other and in this sense they are doing a good job. That fits to the investor community; everything is Excel sheets and statistics. They are actually doing it the right way in terms of how the investor´s world works and what investors need. The only problem is that trying to quantify ethics is really difficult. And that is one of the reasons why I am not using too much of my energy on reporting what we are doing, because it is so hard to quantify ethics" (anonymized)

The criticism of companies is comprehensive with regard to this background of acceptance of the agencies' work. They referred to three areas: the communication with the companies, the objectivity of their ratings and the time exposure needed to complete the questionnaires and, related to it, the lack of standardized questions.

Lack of communication

Most of the advice on, and criticism of, sustainability rating agencies and index providers refers to their way of communicating with companies. This was articulated via the following points: lack of transparency, irrelevant questions and lack of personal confrontation. One main criticism was that many ratings were not, or only partly, transparent in terms of the creation of the score. Hence, a comparison with competitors was not possible and there was no possibility of learning from the good practice of others or of improving with respect to the rating. For example, one noted the

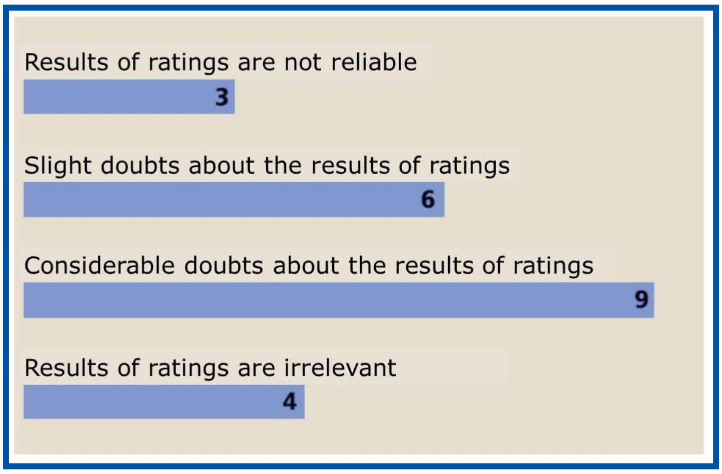
"...need to be more transparent so that we understand the rankings. So: Why did we get that ranking, what about other companies? We do not even know how other companies rank. So we do not know who ranks well and that might be interesting to know who ranks well and ask them what they are doing right, what they are good at and sometimes there can be best practice sharing and that would be very useful" (Barry Callebaut)

Moreover, companies complained that they were still asked irrelevant questions although this had notably diminished, according to the statement of one respondent. Many companies preferred a personal conversation in addition to, or instead of, the questionnaires.

"The CDP is doing a good job. It is very transparent. And when we get the feedback... You see we are sitting with them around a table and we discuss. That goes in the right direction. With other ratings: the results are secret so you do not know where the gaps are. There is a lot of work that is going absolutely nowhere at the end of the day" (Anglo American)

"I do think sometimes an interview on some of these areas might be quicker and easier" (anonymized)

The ratings lack objectivity



A second area of criticism refers to the objectivity of ratings. Only three of the interviewed companies considered the result of sustainability ratings as reliable; six expressed slight doubts and nine even considerable doubts about the results of ratings. At least four companies regarded the results (still) as irrelevant. Two companies reported that ratings were manipulated and that they even had the suspicion that competitors might have done this in the past.

"If I was on the other side of the table I would not think that I would get a true picture of what a company is actually doing" (anonymized)

"We respond to companies engaged in sustainability ratings but we find their methods and reporting very different. This makes it very difficult to engage with them and their conclusions often appear to be biased. Our opinion is therefore that the quality of ratings is poor" (anonymized)

Time exposure and standardization

All companies criticized the rather time consuming questionnaires. Beyond that many companies believed this could lead to contortions of the survey They argued that the scores of ratings depended considerably on the information published or passed on to the rating agency by the company and on the amount of time the company was willing or able to spend on the collection of data. Therefore, it was quite possible that companies performed well with regard to sustainability but would not document it well enough to satisfy the requests of agencies. As a result those companies would score unjustifiably poor on the rankings.

Facing this situation, five companies preferred a greater standardization of ratings.

"I think sometimes the challenge is to make sure that just because something is not publicly available does not mean the company is not doing it. So I think sometimes and I am talking broadly now not only for us –I think sometimes you might have a policy you might not have put up on your website or made available but your mark is down because it is not public" (anonymized)

"What you would not like to happen is that spreadsheet completion becomes the goal, as then of course you have lost the link to real activity and there is always the worry you have that if you make it too much of a hard competition and too detailed, people will start fine-tuning their answers, and not present the reality" (anonymized)

"My feeling is the ratings are way too detailed […]. They are so detailed that it is hard for us to understand what they are getting at. Their questions are really very detailed and they are so detailed in some areas and are not asking questions in other areas at all. I wonder whether they can add value for their clients. So my advice would be to see the bigger picture to see what the main impacts are and focus on the main impacts. […]. So, probably an element of prescreening to work out what the big impacts are and then focus on the big impacts would, I think, in the end enable them to have more impact in their output, that is what I would say" (anonymized)

6. Results of the interviews with NGOs

Experiences of NGOs

All four interviewed organisations know sustainability rating agencies and their functioning and have observed their methods. On the basis of the knowledge of individual ratings, they were able to compare the sustainability ratings of several companies with their own experiences regarding those companies as well. All the NGOs noted that their research was consulted by the agencies in order to rate the companies but only a few agencies contacted them directly and then only sporadically.

Evaluation of sustainability rating agencies

NGOs understand that sustainability ratings look at companies from a different perspective and that they evaluate companies based on a range of aspects. What was criticized was the emphasis on individual aspects within the evaluation of companies. Subjects considered essential by NGOs such as the financing of uranium ammunition, violations of human rights or the payment of living wages did not receive, according to them, adequate significance in the evaluation. Because of this ratings would not yield comprehensible and meaningful results and additionally they would send wrong signals to the companies.

"We experienced that these ratings are not very indicative and, hence, their results do not correspond to the statements of workers, people and trade unionists working in the textile maquilas" (CIR)

Moreover, the questioned NGOs criticized the lack of practical experience of sustainability rating agencies. They felt that the NGOs achieved strange results due to the lack of local information and not conducting sufficient research on the spot. One respondent presumed that such information was not required either and felt that it was more about gathering data to promote the investment in Best-In-Class companies while having a clear conscience.

"The main weakness of sustainability rating agencies is for certain that they do not make own practice tests and, therefore, only partly represent reality" (Urgewald)

NGOs fear, just like some companies, the reallocation of resources away from CSR departments due to sustainability ratings and the measurement of business performance in terms of the successful collection of data for ratings, instead of valuating the actual degree of corporate sustainability.

"We have the impression that the CSR departments in some banks place their main focus on improving their financing practice i.e. they stop financing environmentally destructive activities. Other banks, however, spend a lot of working time on compliance with the requirements of the questionnaires drawn up by sustainability rating agencies. They focus then primarily on success in the ratings at the expense of personal capacity by examining what is going on in practice and what is actually financed." (Urgewald)

The potential of sustainability rating agencies

NGOs see a great potential for investors to enforce a sustainable corporate management in companies. Due to the reasons mentioned above, this potential is not fully exploited. Sustainability rankings do not yet cause the necessary changes in companies. Instead, there is a danger that companies are rated unjustifiably well or that improvements are not implemented, or only with delays, because too much time is spent on filling in ratings.

This point was seen differently by engaged investors. Two NGOs referred here to examples of changes effected by the direct action of shareholders. These are considered, however, as individual cases, and indeed structural changes have so far not arisen from this approach.

Suggestions for improvements

Suggestions for improvement by interviewees were based on processes which had already been successfully implemented on industry level. There are many examples that multistakeholder initiatives face the same tasks as sustainability rating agencies: the selection of criteria, evaluating their significance, reaching an agreement on facts and sources. A multistakeholder initiative which brings investors, rating agencies, companies, trade unions and civil society together in order to develop possible criteria and procedures of company analysis does not yet exist to any extent.

"De facto, it should be implied that we need distinctive criteria for sustainability ratings, that the practice is given more weight and that more transparency has to be guaranteed" (Urgewald)

"In conclusion, the control system should be changed. Critical actors of civil society should be involved equally in the procedure of the creation of criteria, the weighting of criteria and the verification of facts. Only such a process provides the necessary credibility. In other areas, this has already been successfully implemented. If investors want to get a more realistic picture and valuation of companies they invest in, they should demand a transparent multi-stakeholder process to accompany this procedure." (CIR)

7. Best-In-Class – Good enough? Summary of results and a final conclusion

Recapitulation

The starting point of this study was that sustainability ratings are an instrument supporting investors in carrying the moral concepts of society further into companies. The effectiveness of these instruments was reviewed based on the Theory of Change approach. This allowed the study to verify the achievement of social project objectives and to deduce a change of course from the result.

The Theory of Change was constructed in qualitative interviews with four sustainability rating agencies. During these interviews, the objectives of sustainability ratings and the preconditions needed for the achievements of these objectives were finalised. During the interviews with companies and NGOs, it became clear which objectives had been achieved and where alterations had to be made.

Based on this, the first hypotheses concerning the impact of sustainability ratings and suggestions in terms of their further development can be formulated. It is necessary to empirically underpin these hypotheses and to examine which instruments actually cause change in companies. Furthermore, it has to be considered if any other stakeholder group will increase the impact of sustainability rankings as well.

In the following, the objectives of the agencies will be compared with the effects reported by companies and NGOs. Afterwards, the preconditions for the objectives mentioned by agencies will be compared with statements from the companies and NGOs and conclusions will be drawn.

7.1 Objectives of sustainability rating agencies and their implementation

1. More investors continuously invest an increasing amount of capital sustainably

This objective was reached. The amount of sustainably invested capital is continuously increasing. According to Eurosif data, the amount of sustainably invested capital in Europe increased from EUR 340 billion in 2002 to EUR 6,760 trillion in 2011 and thus was approximately twenty-fold over this period (Eurosif, 2012: 63; 2003: 10). Sustainability rating agencies and providers of sustainability indices have oriented themselves successfully on the needs of the investors and reached an increasing number of asset managers.

2. There is a higher level of transparency regarding corporate sustainability performance

This objective was reached with reservations. In the last few years, companies have published significantly more information allowing an evaluation of their sustainability performance. Sustainability rating agencies have contributed significantly to this. However, the three questioned NGOs have considerable doubts about whether sustainability rankings adequately reflect the sustainability performance of companies. Moreover, the companies doubt the validity of the ratings and four of them considered the result to be irrelevant.

3. There is competition between companies for their score in sustainability rankings and the number of participating companies is increasing

This objective was reached to an extent. A minority of three of the 22 interviewed companies were competing for good results in sustainability ratings. The rest of the companies considered other stakeholder groups as equally or more important. The majority of the companies stated that sustainability ratings had an increasing importance. Due to the increasing importance of sustainability ratings, it can reasonably be concluded that the number of competing companies will not decline. There is, however, some concern that too fierce competition for good scores might lead to a situation in which the completion of questionnaires become an end in itself and would not result in changes in corporate reality.

4. Companies perform in an increasingly sustainable manner regarding all relevant points

This objective was reached to an extent. Two of the 22 companies reported in total three specific changes in their sustainability strategy motivated by the participation in sustainability rankings. Specific changes in the practice of compliance with human and labour rights were not mentioned by any company. Further changes attributed to the ratings referred to reporting, which did not explicitly result in changes in practice according to the companies. The interviewed NGOs and organizations setting standards had not observed any changes due to sustainability ratings. Eight companies, however, pointed out the additional motivation gained by sustainability ratings. As all companies referred to other stakeholder groups as an additional or significant driving force in their sustainability agenda, it can be assumed that their sustainability objectives would be achieved more efficiently if all actors were cooperating.

7.2 Preconditions for achieving the objectives of sustainability rating agencies

The following abstract will examine the rating agencies' preconditions necessary for achieving their objectives. If these preconditions are not met, it can hinder the achievement of the set objectives.

1. Sustainability-oriented companies achieve higher profits in the long term and are therefore considered more attractive investments

All questioned companies recognized the existence of this precondition. The material consequences of sustainability were created, according to their perception, by shareholder groups such as customers, communities or the legislator, in terms of risks such as consumer boycotts and loss of the licence to operate due to the society or the state and more stringent laws. According to the companies, sustainable investors have not yet gained a material influence. They do not influence the access to capital nor the share price. Therefore, an essential precondition for the success of sustainability ratings currently depends on the success of other stakeholder groups. Only if they succeed in exerting a material impact on companies investors can successfully argue and gain more sustainably invested capital in order to additionally reinforce this material impact.

2. Sustainability ratings are objective and independent from the influence of companies and NGOs

This precondition was only partly fulfilled. The transparency and traceability of ratings was repeatedly questioned by companies and, further, conscious embellishment by the questioned companies was not excluded. Several companies perceived that sustainability rating agencies reacted very strongly to the reports of NGOs, while the NGOs complained that ratings relied too heavily on corporate data.

These statements are not surprising, considering the public debate in which both these sides are involved. 17 of the 22 interviewed companies and all the interviewed NGOs were in multi-stakeholder dialogues with companies and branches. One part of this dialogue was the clarification of facts, as sustainability rating agencies would be able to provide objective evaluations more easily if they had access to the results of these mostly confidential dialogues. This is because both companies and NGOs have more direct access to relevant information concerning human and labour rights than sustainability rating agencies.

Companies as well as NGOs, estimated that sustainability ratings give an overview of the entire sustainability performance of companies, taking into consideration every company of a branch and, therefore, noted that they do establish a certain comparability. Furthermore, sustainability ratings also include those companies in sustainability reporting which have not yet been affected by campaigns. A great advantage of the agencies is their long-time and continuous confrontation of companies. These three characteristics –the complete presentation of corporate sustainability performances, the addressing of companies not being subject to campaigns and continuity regarding the addressing of companies –are the three essential strengths of ratings.

But the potential created by sustainability rating has scarcely been exploited. The time consuming process of data collection is used to generate company lists which are passed to asset and fund managers. Only a few investors consider the data about the company's performance in detail. At the same time, other influential stakeholder groups such as consumer associations and NGOs rarely have access to these data due to the high costs of these ratings. State agencies do not use that information even though it might be valuable for regulatory projects. Facing the situation illustrated above, stakeholder groups, and, in particular, state actors, have an equally high or higher material impact on companies than investors. It is an essential obstacle to the effectiveness of sustainability ratings that these stakeholders do not have access to the ratings.

Additionally, a stronger focus on the contents of sustainability rankings would allow investors to tackle certain problems and to increase their influence on the company.

3. The subjects the companies are facing in the ratings are present in and supported by the public. The role of the NGOs is to sensitize companies to subjects in the public domain.

This precondition was largely fulfilled. The ratings take up topics which are publicly scandalized by NGOs. If sustainability rating agencies and NGOs could regard each other as being more complementary in their endeavours to increase corporate sustainability, the pressure on companies could clearly be reinforced.

The existing exchange between NGOs and sustainability rating agencies could be intensified and used to incorporate new topics into sustainability ratings.

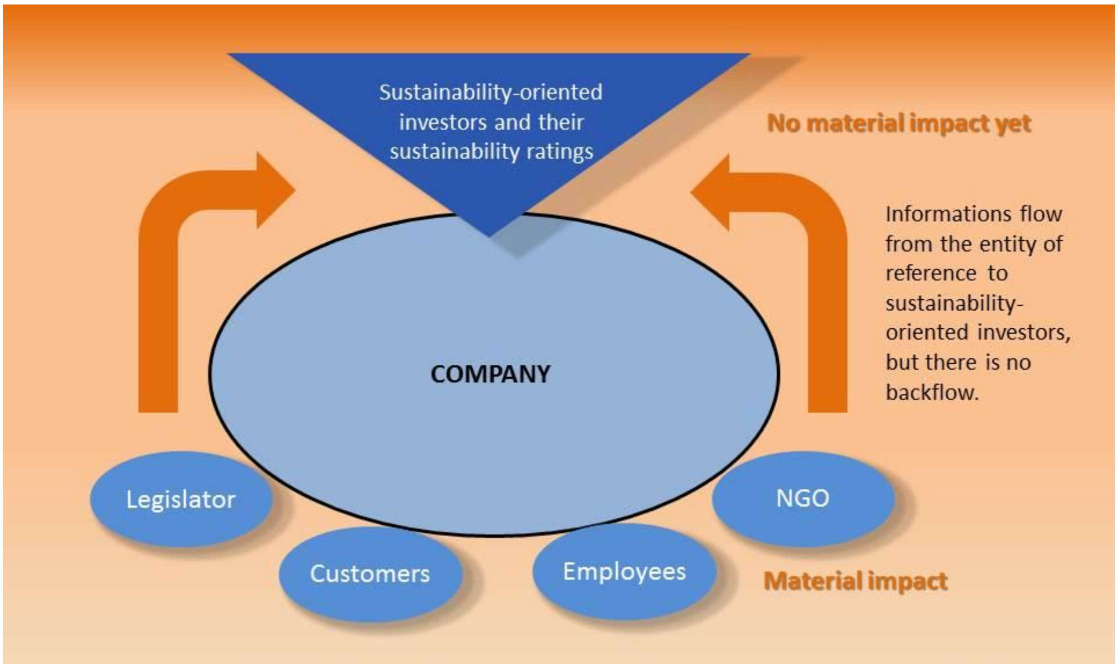
However, inter-connecting also has its limits. Only a limited amount of independent information exists regarding companies which are not the focus of public attention. At this point, NGOs with relevant local contacts could generate information for sustainability ratings. The complex and often dangerous collection of data, for instance on violations of human rights, will only be tackled by NGOs if there are realistic prospects of improving the situation of the people concerned. The example of child labour in cotton fields shows that this is possible.

4. Conclusion

To sum up sustainability rating agencies and engaged shareholders have a great potential to promote social and ecological improvements in companies and indeed they are already doing it. The confrontation of the objectives of sustainability rating agencies and the statements of companies and NGOs makes clear that this process is not yet working optimally Reasons for this being:

- Sustainability rating agencies should provide a good overview of corporate sustainability performances, bring sustainability subjects to all actors of a branch and have a high degree of continuity regarding the requirements for companies. These strengths are not sufficiently utilized by all stakeholder groups including many investors, using only the positive lists of agencies. It is particularly striking that state agencies have not yet shown an interest in the information of sustainability ratings, although they could gain important information out of it with regard to regulations.
- Sustainability rating agencies and investors so far have hardly any material impact on companies. The material impact is derived from other actors such as consumers, communities or legislators. Only if the influence of these actors affects the company in terms of boycotts, higher costs caused by new legislation, the risk of losing the licence to operate of the company due to the society or the state the argument for a material impact exists for investors. Given the considerable relevance of these actors, sustainability rating agencies should be more embedded in the networks of these actors.
- The legitimacy of demands on companies is increasingly established in stakeholder dialogues. In the long run sustainability rating agencies will be measured by these standards and their criteria will be established in cooperation with further stakeholder groups such as customers, trade unions and NGOs during stakeholder dialogues.
- Sustainability rating agencies underline the objectivity of their data and evaluations. At the same time, they receive all information from secondary sources. Companies have several local employees and NGOs watching the performance in cooperation with local partners. Sustainability rating agencies do not have the possibility to directly verify the facts in the same way. With regard to certain subjects such as the area of compliance with human and labour rights, the credibility of ratings suffers.
- For companies which have developed a momentum of their own in terms of their sustainability efforts, direct dialogue with shareholder groups as NGOs, consumer associations, communities and industrial associations is often more important than the consideration of investors. Sustainability rating agencies should take this development into account by informing

themselves about existing dialogues with shareholder groups and their subjects.
- This generally inefficient situation is largely detached from state regulation although this, according to all actors, has the most significant influence and could counteract existing inefficiencies by determining certain legislation with regard to, for instance, the publication of sustainability data.



This situation leads to asymmetries and inefficiencies. On the one hand, the sustainability rating agencies set standards without including other stakeholders in an appropriate form. On the other hand, there exist, irrespectively of that, dialogues and processes which go further and are more effective than those standards.

What can investors do?

Sustainability-oriented investors who pay for this process with their contributions to ratings have a greater interest in improving this process. They also have a considerable interest in "their" companies not being occupied by gathering data whose relevance for the corporate sustainability is questionable.

It is therefore an advantage if investors are aware of the preceding process of investment lists and the relevance of sustainability for a company. They should be able to comprehend the method of data acquisition. Moreover, they should know which actors the agencies are in contact with and insist that they join existing stakeholder dialogues in order to intermesh the investor's concern more closely to the interests of other material stakeholder groups.

A better networking as well as a wider knowledge about the formation of ratings could help investors finding new topics for an active engagement. Additionally, it could be beneficial for identifying actors which are consulted for putting critical stakeholder dialogues into practice. With this direct engagement, many problems currently attached to ratings can be avoided. The given example of the critical stakeholder dialogue with the Bayer AG has demonstrated the possible success a company can have by consorting investors and well-informed NGOs This will improve the flexibility of investors and will allow them to ally with further stakeholder groups. As a result they will have a better access to specific data in order to prepare for approaching companies. This could serve as a model for the further development of sustainability ratings.

Appendix

List of Interview partners

Sustainability rating agencies	Interview partners
Imug	Silke Stremlau (General Partner, Head of Sustainable Investments)
Oekom Research	Robert Haßler (Chairman) Matthias Bönning (Board Member, Head of Research)
RobecoSAM	Dr. Daniel Wild (Member of the Executive Board, Head of SI Research & Development) Stefan Peller (Head of Institutional Clients)
Sustainlytics	Claudia Volk (Researcher) Arne Philipp Klug (Associate Analyst)

Companies	Interview partners	Branch
Adidas AG	Frank Henke (Head of Global CSR)	Clothing
Anglo American plc	Jan Klawitter (Government Relations Manager) Georgia Dempsey (Communications and Engagement Manager) Hermien Botes (Safety & Sustainable Development Reporting Manager)	Mining
Barry Callebaut AG	Jens Rupp (CSR Communications)	Food/ Semi-luxuries
BHP Billiton plc	Ian Wood (Community Relations)	Mining
Boliden AB	Frans Benson (Director, Group Investor Relations)	Mining
Burberry Group plc	Charlotte Cowley (Investor Relations Manager)	Clothing
Delhaize Group SA	Frederic van Daele (Head of Investor Relations)	Retail
H&M AB	Hendrik Alpen (Sustainability Reporting Manager)	Clothing
Hugo Boss AG	Dennis Weber (Head of Investor Relations)	Clothing
Inditex Group SA	James O'Shaughnessy (Investor Relations Manager)	Clothing
Lindt & Sprüngli AG	Dr. Dieter Weisskopf (Group CFO)	Food/ Semi-luxuries
Marks & Spencer	Rowland Hill (CSR Team)	Retail
Metro Group AG	Hans-Jürgen Matern (Head of CSR)	Retail
Nestlé, SA	Achim Drewes (Public Affairs Manager Corporate Communication Nestlé, Deutschland)	Food/ Semi-luxuries

	Ferhat Soygenis (Senior Corporate Affairs Manager) John Bee (Public Affairs Manager)	
Next plc	David Keens (Group Finance Director)	Retail
Pandora AB	Claus Teilmann Petersen (Vice President, Group CSR)	Jewellery
Puma AG	Dr. Reiner Hengstmann (Globaler Direktor für den Bereich Umwelt-und Sozialstandards) Kerstin Neuber (Head of Corporate Communications)	Clothing
Rio Tinto plc	David Ovington (Investor Relations)	Mining
J Sainsbury plc	Kellie Herman (Investor Relations Team)	Retail
Tods S.p.A.	Cinzia Oglio (Investor Relations)	Clothing
Unilever N.V.	Helen Keep (SRI Engagement Manager) Roger Seabrook (Vice President Investor Relations)	Food/ Semi-luxuries
Vedanta Resources plc	Mark Eadie (Chief Sustainability Officer)	Mining

Non-governmental Organisations	**Interview partners**
Christliche Initiative Romero (CIR)	Maik Pflaum
SOMO	Myriam Vander Stichele
Urgewald	Barbara Happe

Standard-setting Organisations	**Interview partners**
Press office D/A/CH of Rainforest Alliance c/o: relations Gesellschaft für Kommunikation	Sascha Tischer

Conversation guidelines

Initiator of the study

SÜDWIND is a church related Non-governmental organisation which works on global economic justice. The department "socially responsible investment" counsels church investors and integrates development related criteria in sustainable investment products and strategies.

Background of the Study

For 15 years sustainable investors employ the Best-In-Class approach to find suitable companies for their investment. This approach analyses the sustainability performance of companies from the same industry sector and ranks them according to their achievements. The interview tries to find out which impact this approach has on the sustainability performance of companies. The focus of this study lies on human right issues in the mining, food, textile and retail sector.

The study is not at all concerned with the sustainability performance of single companies or how a company scores in sustainability ratings. It rather seeks an answer to the question in how far the Best-In-Class approach makes a suitable tool to promote the sustainability of companies.

The study is financially supported by the Union Investment Foundation. Union Investment is the investment company of the German cooperative banks. With about 200 billion assets under management it is the third biggest investment company in Germany. It is also supported by the foundation for the environment and development of the German state North Rhine Westphalia and the private Foundation „Apfelbaum".

The study will be published at the end of 2013. All interviewees will receive a printed copy of it.

The Interviewees and their organisations will be mentioned in the study. The interview will be recorded; however, the content will be confidential. Statements of the interview partner will be subsumed in the text anonymously. Quotations will not be printed unless authorized by the interviewee.

The interview will take about one hour.

Interview Guideline for Rating Agencies

1. How do you define the success of sustainability ratings in general and regarding the Best-In-Class Approach?
2. What mechanisms lead to success?
3. What preconditions are necessary for the functioning of such mechanisms?
4. How are such preconditions precipitated?
5. What indicators describe the success of sustainability rankings or the Best-In-Class Approach?
6. What role does a rating agency play in this system?
7. Has your agency already realized a success analysis as described above?
8. If yes, what were the results?

Interview Guideline for Companies

The impact of sustainability ratings on companies

1. Which experiences did the company make with sustainability ratings?

2. In how far do sustainability ratings which lead to a ranking of companies motivate your company to improve the sustainability management especially in the area of human rights?

3. Which actions did the company take up to improve its performance in the area of human rights to fulfil the expectations of sustainable investors?

4. How does the company measure the effects of the actions which have been initiated in reaction to sustainability ratings?

5. How does the company ensure that there is a feedback from local people and their organisations to measure the effect of its human rights engagement?

6. Please compare the companies reaction on sustainability ratings to its reaction on shareholder engagement

7. Please compare the impact of sustainability ratings to the impact the media, studies from NGOs, and legislative proposals have on the company

8. If possible please give an example for the impact of sustainability ratings and shareholder engagement on the company.

9. Which advice would you give to sustainability rating agencies?

Further information

- Who answers to questions from sustainability ratings? What is his or her position?
- Who else is informed about the rating?
- Does the company strive for a concrete result in sustainability ratings like being among the three best companies in its sector?
- Does the company seek a certain status in sustainability ratings like being a component of the Dow Jones sustainability index or attaining the prime status of oekom research?
- Does the company seek to avoid to be excluded from the Norwegian Pension fund?
- Does the company seek to meet the exclusion criteria of other sustainable investors on human rights?
- Does the remuneration of some employees depend on the grade in a sustainability rating?

Interview Guideline for NGOs

1. Which information do you have on sustainability ratings and shareholder engagement?
2. Have you been contacted by sustainability rating agencies or active shareholders like EIRIS, F&C or SAM and if so which experiences have you made with them?
3. Which experiences have you made with active shareholders?

4. Which potential do sustainability ratings and shareholder activism have to improve the human rights situation in the mining industry?
5. Which changes did you observe which are due to shareholder activism or sustainability ratings?
6. In how far do sustainability ratings agencies or active shareholders contribute to solve special problems which your NGO addresses?
    a. Can you give an example which illustrates the potential of sustainability ratings or active shareholder?
7. Do you notice that there is a competition among companies for good marks in sustainability ratings?
8. Which changes would contribute to make better use of the potential of sustainability ratings and active shareholders? In which area changes would be most worthwhile:
9. Which improvements would you expect from an intensified cooperation with investors?
10. Are your partners in developing countries informed on sustainability ratings agencies and their potential and if so how do they make use of it