Rate the Raters Phase Five

The Company Perspective

October 2012

SustainAbility

Overview

Throughout the first four phases of Rate the Raters, we heard perspectives from a number of companies on sustainability ratings, and included some of these in our reports. We certainly heard a lot about the things ratings should do better (greater transparency, more feedback, etc.). Yet, we completed phase four lacking a systematic view on how ratings are being used by, and creating value for, companies. We thus set out in phase five to better understand how companies are using and getting value from ratings, and interviewed nearly 30 companies in the process.[1]

We spoke with individuals responsible for managing the ratings process within these companies and asked them the following questions:

— Which ratings, rankings and indices do you prioritize and why?
— How has your approach to managing ratings evolved over last five years?
— How do you use ratings in your work?
— How do you get value from ratings?
— What and how do you communicate about ratings to your non-sustainability colleagues?
— How could ratings create more value for your work?

We present the highlights of our conversations in this paper.

1 See the end of this paper for the companies we interviewed.

Making Sense of the Madness: How Companies Are Priortizing Ratings

In response to our question about the ratings they prioritize, our interviewees cited the usual suspects – Carbon Disclosure Project, Dow Jones Sustainability Indices, FTSE4Good, etc. Their responses are generally aligned with the ratings deemed most credible in our expert survey, the results of which we published in September 2012.

In explaining why these make the cut, the companies most often mentioned the traits that we've discussed throughout our Rate the Raters research:

— Profile
— Credibility
— Transparency of methodology and results
— Management buy-in or recognition of the rating (or the brand behind the rating)
— Quality of approach and methodology
— Relevance of approach and criteria to a company's sector and context

As we probed deeper into the above traits, several themes emerged.

Don't Fall Off the Treadmill

"Is this really about changing our business or just gathering and arranging the information?"

A number of companies expressed the view that there is more attention from doing poorly or being dropped from a rating / index than there is for doing well or being added to such rating / index. Thus, once a company makes a list like the Dow Jones Sustainability Index, they must run hard to remain on the treadmill, lest they drop off and garner unwelcome attention from colleagues or the media. Several interviewees confided that it would be better to not do well on certain rankings in the first place, as this just creates the expectation amongst colleagues to do as well or better going forward. Lastly, a number of interviewees posed sincere questions about the substantial time, resources and management attention they invest to do well on ratings, and how these could be better spent implementing sustainability initiatives. As one interviewee questioned, "is this really about changing our business or just gathering and arranging the information?"

Held Hostage by Ratings

On a related point, many interviewees expressed a desire to further prioritize ratings and to decline rater requests for information or to review profile reports. Yet, they find it difficult to ignore reports or information compiled by raters – sometimes with inaccuracies or incomplete information – that may find its way into the hands of important stakeholders. As one interviewee put it, "unfortunately there are so many ratings and indices, and if you don't review what they will publish, misinformation will spread to key constituencies." Several stated that peer pressure drives their responses to certain ratings, and that if their competitors stopped responding (and caring), so would they.

Evolving to a More Strategic Approach

Most companies with whom we spoke are thinking more critically about ratings than they were several years ago. Some are using the sort of criteria listed above (profile, credibility, etc.) to focus their time and attention, and most see their sustainability reports as key to meeting the information demands of raters going forward (and also lament that reports are not utilized as much as they could be by stakeholders, including raters).

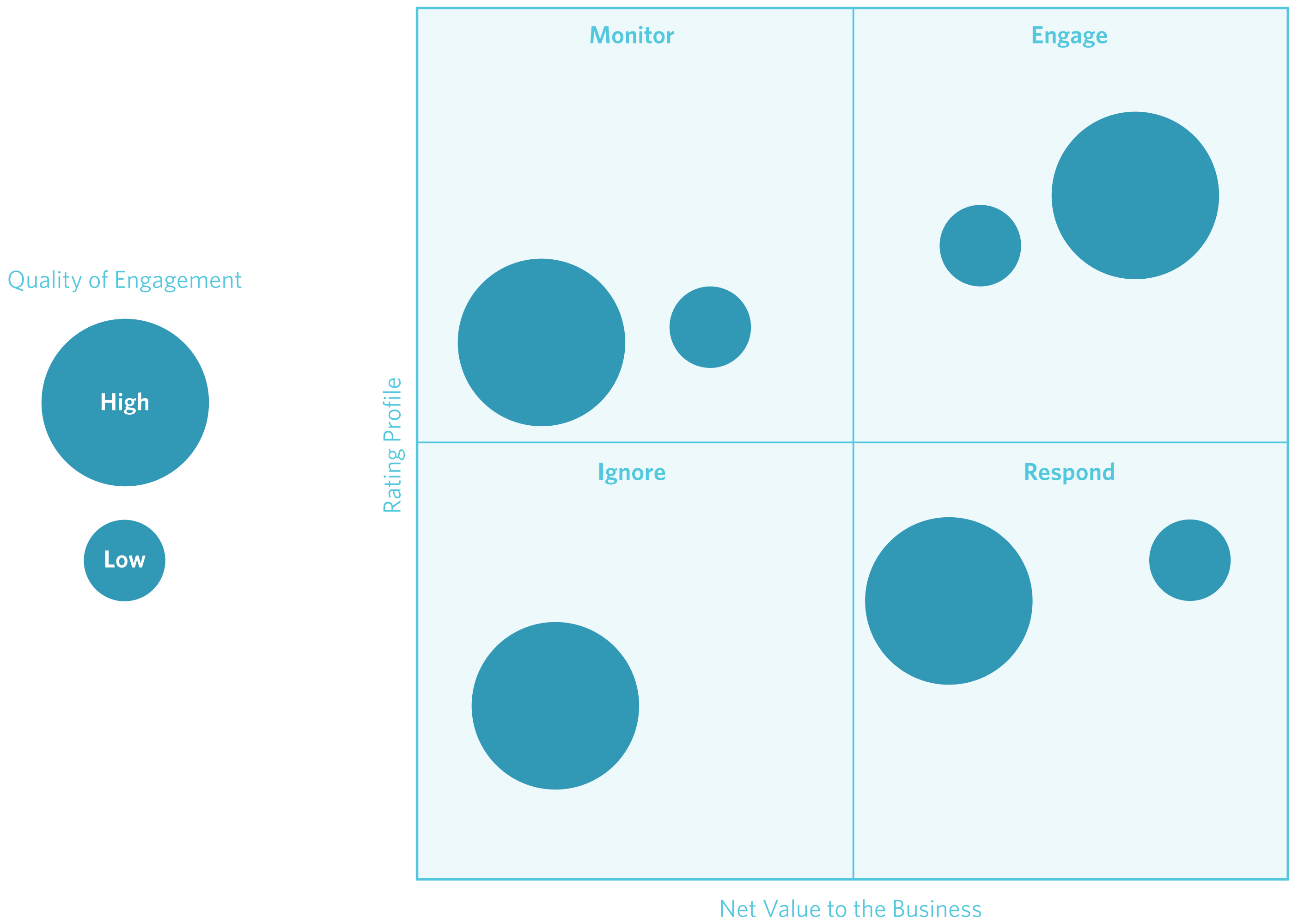
However, even as they strive to be more strategic in their approach, companies find it difficult to say no to raters, and they are not yet realizing the benefits of prioritization in terms of time and resource efficiency.

A Framework for Prioritizing Ratings

Based on our experience and interviews, we offer the following framework that may help companies to better prioritize and manage ratings.[2]

Figure 1

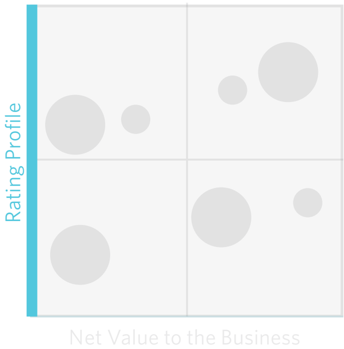
Ratings Prioritization Framework



On the following pages we define each of these variables.

2 We offer thanks in particular to the interviewees from The Walt Disney Company, whose perspective helped shape this framework.

Rating Profile

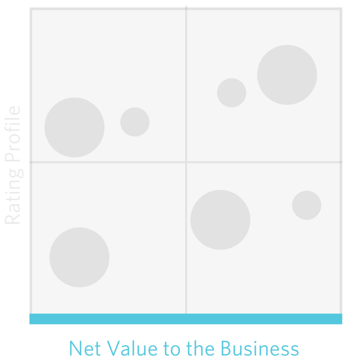


Companies may define profile in various ways, but we recommend they answer the following simple questions (with responses of High, Medium or Low):

— What is the profile of the rating within the sustainability field?
  — Many sustainability professionals have a good sense for this from their interactions with peers; they can also leverage research such as SustainAbility's expert survey or the recent GreenBiz poll on surveys.
— What is the profile of the rating with a company's key stakeholders?
  — Certain ratings have more clout and credibility with senior management, NGOs, customers, investors, etc.
  — The investor survey results SustainAbility will release later this fall will be one resource for companies; otherwise, we recommend they engage key stakeholders on this topic
— How much media coverage / public attention does the rating get?
  — A Google or Factiva search of news and blogs will shed light on the prominence of a rating. In phase two of Rate the Raters, SustainAbility leveraged web search tools to measure aspects such as website visits, external web links (to a rating's home page) and blog mentions.
  — In our view, it is important to distinguish between media coverage from third parties (e.g. newspapers, magazines, blogs) versus company-issued press releases, the latter of which comprise the majority of media hits for ratings

Companies can make this as scientific as they choose, though we suggest they keep it simple. For example, a company could assign 2 points for each High response, 1 point for Medium and 0 for low, thus creating a range of 0 to 6 points on the Y-axis. And, importantly, we recommend that companies focus on judging the relative profile of different ratings, rather than assessing each in absolute terms.

Net Benefit to the Business



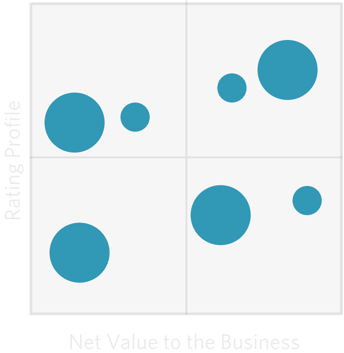
For net benefit to the business, we offer the following questions (also with High, Medium or Low responses):

— How relevant are the methodology and criteria to the company? Is this rater assessing the issues that are most material?
— To what degree do the rating's process and results drive improvements in company disclosure and/or performance?
— To what degree are key constituencies using the rating to make decisions?

If companies use the same 0 to 6 point scale and answer key for the above, they could also subtract points for the time and resources needed to respond to / engage with the rating (High = 2, Medium = 1, Low = 0) to arrive at the net benefit.

Quality of Engagement

Companies may want to add a third dimension in their evaluation, which would be indicated by the size of the circles in the chart. For example, companies could assess the quality of the rater's work, the time spent by the rater with them, the degree of transparency, openness to constructive feedback, etc.



In our illustrative example, we include quality of engagement, for which companies could evaluate the quality of their experience with raters, for example is a particular rater willing to spend time explaining their methodology and results? Are they open to feedback? Etc.

Based on the questions above, a company can sort ratings into four quadrants by priority:

— **Engage:** Companies should place top priority on these ratings, investing the necessary time and resources to manage the process, engage with the ratings team and comprehend / leverage the results. With this investment, companies should feel a sense of ownership in the quality and future success of the ratings. Sustainability professionals should prioritize these ratings in their communications to senior management and boards. Ideally, there should be only a few ratings in this quadrant.

— **Respond:** For these ratings with medium to high benefit to companies but a lower profile, companies should invest a moderate amount of time and resources, including completing surveys or validating draft profile reports. As with Engage, there should only be a handful of ratings in Respond.

— **Monitor:** With a medium to high profile and low net benefit, companies should be judicious about investing time and resources into these ratings. For highly prominent ratings, companies might take the time to complete a survey or review a report. Otherwise, we recommend that companies pay attention to the results of these ratings for insights and not invest much time in responding.

— **Ignore:** With low profile and low benefit, companies should not devote time or attention to these ratings. Rather, companies should refer the raters to public information (e.g. sustainability reports).

In assigning ratings to these quadrants, we recognize that companies will need to make difficult judgment calls, and that they will feel compelled by various forces to prioritize too many ratings. Yet, they must focus in order to be able to go deeper on the most important ratings and to reduce the burden of responding to or minding so many others.

Getting Value From Ratings

When asked how they use and get value from sustainability ratings, our interviewees shared the following perspectives.

Benchmarking and Validating Performance, to a Point

Nearly all of the interviewees mentioned the role that ratings play in helping to identify strengths and areas for improvement, as well as their utility in benchmarking performance against that of peers. This resonates strongly with how our surveyed experts use ratings – 64% use ratings at least once every few months to gain intelligence on sustainability strategy / performance, while 57% use ratings to benchmark against peers over the same time frame. Most interviewees cited the value that third-party validation brings.

Related to this, a number of companies opined that ratings can help put emerging sustainability issues on their radar screens, and also serve to reemphasize the importance of known issues. For example, a number of interviewees cited human rights, supply chain and compensation practices as examples of topics that raters have raised for some time. These are areas in which the better raters continue to go deeper, for example assessing companies on performance and not just on existence of policy or on disclosure.

This said, there are diminishing returns to ratings as companies advance in their sustainability efforts, as more experienced companies are not likely to be surprised by issues raised by raters, nor do they need an external nudge to go deeper in their management and disclosure of issues. For these companies, raters must bring unique perspectives and insights on "known" topics or deliver valuable intelligence on emerging issues (points we raised in phase four).

A Lever for Internal Engagement

A fair number of interviewees cited the role that ratings play in helping to engage their colleagues outside of sustainability functions. The headline aspect of ratings that can drive companies batty also serves to get the attention of colleagues who don't normally think about sustainability. Their competitive juices flowing, these colleagues aim to best their peers, in turn helping sustainability teams get additional management time, attention and resources. As one interviewee put it, "ratings create a tension that we can leverage to drive change in how we manage and report on our sustainability efforts."

However, there are downsides to getting colleagues hooked on ratings. For example, management come to expect to do well on a ranking year after year, and, if performance dips, they may turn the heat on teams responsible for responding to the ranking without having the time to get into the details of why their score changed, how the ranking methodology might have evolved, etc. As discussed above, companies find themselves on the ratings treadmill, with management's finger on the "go" button without asking why.

"Ratings create a tension that we can leverage to drive change in how we manage and report on our sustainability efforts"

Goals, Evaluation and Compensation

In previous phases of *Rate the Raters*, we discussed the problems associated with using external sustainability ratings to set goals and to evaluate and compensate employees. In particular, the fact that ratings can be fluid year-over-year in terms of their methodologies and staff, company scores can fluctuate for reasons other than changes in actual performance or disclosure. Companies are better off basing goals and evaluation / compensation criteria on their own defined metrics rather than on external rankings.

Our interviews with companies suggest that many are heeding this advice: only a few had formal objectives to do well on external ratings, with more tying rating performance to employees' evaluation and compensation. On the latter point, this is generally done for individuals responsible for the topic areas evaluated in the ratings.

Little Attention From Employees, Investors and Suppliers

While the above points are important, not one interviewee asserted that their performance on ratings had an influence with key stakeholders such as employees, investors, suppliers and other business partners. According to one interviewee, "management won't pay attention to sustainability ratings until they impact sales – as do ratings from Consumer Reports and J.D. Power and Associates."

This is the crux of the challenge facing both companies and ratings: until we see ratings driving decisions amongst these critical stakeholders, the uptake and impact of ratings will be limited.

"Management won't pay attention to sustainability ratings until they impact sales – as do ratings from Consumer Reports and J.D. Power and Associates."

Attention Raters: How to Deliver More Value to Companies

We asked companies how they would get more value from the process and results of ratings. Our interviewees raised the expected points about ratings: greater transparency, the need to standardize and streamline questions and criteria, higher quality, better disclosure of sources, etc. Probing deeper, we heard the following points and recommendations to raters throughout our conversations.

You Need Us, We Need You

As discussed above, companies and ratings depend on each other in a variety of ways, and thus should work together to address the challenges raised throughout our *Rate the Raters* research. Sustainability professionals within companies use ratings to drive change and engage their business colleagues, and thus it is vital that they understand how and why their companies are being judged, and that the processes and outputs of ratings are of high quality. A number of our interviewees stressed that they too often can't explain to their colleagues why certain questions are asked or how the rater will use the resulting information, and thus the rating and, worse, the sustainability professional, is discounted. One interviewee lamented the point that her team made a considerable effort to do well on a certain rating, but couldn't celebrate once the desired result was achieved because she couldn't explain it sufficiently.

"A few years ago, supply chain management was not a concern. We raised it, but our colleagues didn't listen. When DJSI rated us poorly however, they woke up."

Get to Know My Business

A good number of our interviewees expressed a desire to be challenged by raters, albeit on the right (i.e. the most material) issues. In this respect, they view ratings as they do well-regarded NGOs, which bring constructive challenge and ideas. One interviewee from a bank opined that he would prefer to be judged on the bank's lending practices (quality, transparency, equity, etc.), rather than on supply chain standards (which he views as less material for the sector). An interviewee from an automotive manufacturer asked to be pushed on sustainable mobility, which he believes will define the future of the sector.

A number of interviewees asserted that raters often pose questions that don't make sense given how their companies are structured and managed. A prime example raised here is the topic of "sustainable innovation," as a number of raters strive to assess how companies address environmental and social considerations in their R&D processes and deliver products and solutions to sustainability challenges.

Yet, the metrics currently being used – percentage of R&D invested in sustainability, percentage of products with sustainability benefits, etc. – don't mesh with how companies think about their products, nor how they track R&D spending. The raters' approach also sends a signal that sustainability is somehow distinct, rather than an attribute that should be integrated across a company. Our interviewees suggested that raters should spend time with them to understand how issues are considered and managed within their companies, as this will result in more targeted questions.

Show Us the Value

As discussed above, as well as in the expert survey, companies have sincere questions about the value of participating in and responding to many ratings, particularly as they invest an increasing amount of time, resources and management attention to them. Our interviewees want to know who specifically is using the ratings and how. This understanding will not only help justify their participation and engage their business colleagues, it will also allow them to better respond to the questions.

One interviewee offered that her company has a team of 40-plus people that get engaged in various degrees in a particular rating's process each year, and they need to see that their time is having an impact (and that the resulting rating is being used) in order to keep them involved going forward. Another interviewee stressed the importance of rater engagement with and constructive challenge of her company – that these are more valuable than the rating results.

"We're facing diminishing returns from engaging with ratings. We need to see value beyond the promotion of good disclosure."

Show Us the Big Picture

Lastly, in phase four we called for raters to focus more on analysis rather than data collection, and to spend more time assessing the future prospects of companies. To these points, our interviewees want raters to better articulate the key trends affecting industries, as well as leading practices. Several opined that raters have at their disposal an enormous trove of data, and that they should use it to educate and engage companies. This should not be a stretch for some raters, who do this sort of trend analysis for clients. And, if raters offered high quality and novel perspectives, companies may be more willing to pay for such information.

"We get value when raters shed a light on our performance relative to our competitors, and when they call out key sector trends."

Next Steps for *Rate the Raters*

This paper represents the second of two deliverables from *Rate the Raters* phase five, the first being the expert survey. In the coming weeks, we will release the findings of our survey of and interviews with mainstream investors on sustainability. We will also make public raters' responses to our questionnaire, along with our view on how ratings have evolved since our last engagement in early 2011.

If you have questions or comments about our research, or if you represent a company and would like to share additional perspectives on the topics addressed in this paper, please contact Michael Sadowski at sadowski@sustainability.com.

SustainAbility

SustainAbility is a think tank and strategic advisory firm working to catalyze business leadership on sustainability. Established in 1987, SustainAbility delivers illuminating foresight and actionable insight on sustainable development trends and issues. The company operates globally and has offices in Europe, North America and India. For more information, visit www.sustainability.com

Participating Companies in our Interviews

We wish to thank the sustainability professionals responsible for ratings at the following companies for sharing their perspectives:

Abbott Laboratories Limited
Advanced Micro Devices, Inc.
Autodesk, Inc.
The Bank of New York Mellon
Barrick Gold Corporation
BASF SE
Bayer plc
BMO Financial Group
Campbell's Soup Company
Cisco Systems Inc.
Coca-Cola Enterprises Ltd
Deutsche Bank AG
Ford Motor Company
General Motors Company
GlaxoSmithKline plc
Hewlett Packard Company
NIKE, Inc.
Novartis International AG
PepsiCo Inc.
PG&E Corporation
Schlumberger Limited
Scotiabank
The Walt Disney Company
UBS AG
Volkswagen AG