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Investing in tomorrow's company

Improving sustainability communications between property and construction companies and the investment community

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sharing knowledge ■ building best practice

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Summary

Environmental and social performance is of increasing importance to both SRI and mainstream/traditional investors, as they realise that these issues can influence economic performance and commercial risk. This trend to wider reporting of risks and their economic impacts is mirrored in tightening regulation such as the Turnbull Guidance and the Draft Regulations on the Operating and Financial Review.

It is in the best interest of both property (real estate) and construction companies, and the investment community they address, to reach a common understanding of the most relevant social, ethical, economic and environmental (or sustainability) risks and opportunities faced by companies in these sectors. Such risks and opportunities can differ significantly according to the company's activities across these industry sectors. It is up to companies to identify and prioritise and effectively manage the most relevant issues that could impact on their financial performance, using a systematic, comprehensive and transparent process.

This guide provides a walk through of the key steps of such a process for companies in the property and construction sectors, including guidance on how to:

- understand how investors might make decisions and how providing sustainability information might influence this process
- identify and prioritise the key sustainability issues that are most relevant to their business, considering:
    - the stage of the property development, construction and investment process in which they are involved
    - the company's key characteristics and external context (policy issues and stakeholder concerns)
- link sustainability performance with financial performance in all communications with investors
- measure, monitor and manage the key sustainability issues effectively
- develop a sustainability communications strategy appropriate for investors, considering both non-financial reporting requirements and other communication media.

Understanding how sustainability issues might affect the performance of companies in the property and construction sectors should assist SRI and mainstream investors to make better informed investment decisions.

It is believed that if both companies and investors work to the principles explained in this guide, it will assist the evolution of an industry-wide conceptual framework for reporting.

Investing in tomorrow's company.

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Reader interest	**Classification**	
(Listed) real estate and construction companies: executive and non-executive directors, sustainability/CSR managers, investor relations and corporate communications officers. Investment community: buy and sell side analysts, fund managers, pension fund trustees, financial analysts, corporate financiers/ investment bankers.	AVAILABILITY	Unrestricted
	CONTENT	Advice/guidance
	STATUS	Committee-guided
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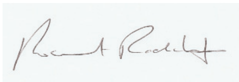
Foreword

Improved corporate reporting is a key business issue today. Its importance is reflected in initiatives from government, such as the proposal to introduce a mandatory Operating and Financial Review for all quoted companies, but also in the increasing realisation on the part of investors that the value of their investment is, potentially, affected by a very wide range of factors, many of which have not been adequately reflected in conventional, financially based company reports. Investors recognise that decisions by all kinds of stakeholders – employees, customers, suppliers, society more widely – will affect long-term shareholder value, and companies in many sectors are, as a consequence, recognising that they need to communicate much more effectively about the ethical, social, economic and environmental risks and opportunities that they face. In this way improved reporting is not just a response to regulatory pressure from government but a tool to enhance business competitiveness.

Many companies also recognise that they have some way to go in improving their own understanding of these "sustainability" issues and deciding how best to report on them. That is why the publication of this Guide is particularly to be welcomed. It provides a clear and concise map for companies in the property (real estate) and construction sectors that will enable them to improve their understanding of investor perceptions, to identify the key risks and opportunities most relevant to their business, and to decide how best to report on performance. In my view the principles set out in the Guide have the potential to help companies significantly to improve not only their reporting but also their understanding of the factors driving performance in their own business.

As we look ahead to the introduction of the mandatory OFR, the focus of directors will increasingly need to be on how to ensure that their OFR meets the requirements of the Regulations, and in particular meets the OFR objective of providing the information that will enable members to assess the company's strategies and their potential to succeed. This Guide will give directors an excellent start in deciding how to exercise these responsibilities. But for those who follow where the guidance leads, it will also, potentially, be a trigger for improved business performance, and for competitive advantage in the market for investment funds.



Rosemary Radcliffe, January 2005

Rosemary Radcliffe CBE is an economist and business consultant. She served on the steering group for the Review of Company Law that recommended the introduction of a mandatory OFR and she chaired the independent working group set up by the DTI to develop practical guidance on the OFR for directors.

1 Introduction

This chapter establishes the background and purpose of the guide, identifies the target audiences, and contains instructions as to its use.

Throughout the guide, the term *sustainability* refers to the triple bottom line of economic, social and environmental performance. Corporate social responsibility (CSR) is the business community's response to the challenges presented by sustainability.

1.1 WHY USE THIS GUIDE

Socially responsible investment (SRI) is one of the fastest growing investment approaches as pension fund trustees recognise their responsibilities as shareholders, and personal investors seek to invest in line with their moral values or risk assessments. Social, ethical or environmental (SEE) factors are increasingly being accepted as having the potential to affect financial performance, and SRI is gradually moving away from negative screening towards proactive engagement over sustainability performance. More information about SRI can be obtained from the UK Social Investment Forum, <www.uksif.org.uk>.

Few investors, however, have developed methods for incorporating a measure of performance into financial analysis of industry sectors, such as property (real estate) or construction.

There are signs that the mainstream investment community is taking greater interest in the emerging evidence linking sustainability performance to long-term financial performance.

Katherine Garrett-Cox, chief investment officer of Morley Fund Management, says:

> *In our view, companies that combine good governance and corporate responsibility are better positioned for long-term success, so it is in our interests to use our influence as shareholders to promote good practice among the companies in which we are invested…. While only a small proportion of our funds are run on SRI criteria we believe we should use the insights gained from SRI research to engage constructively with all the companies whose shares we own.*

Indeed, listed companies are required to disclose information about the risks and opportunities they face, including future liabilities arising from changing operating conditions. Examples of recent developments include:

- Corporate governance – revisions to the Combined Code on Corporate Governance 27 (July 2003), which incorporates principles from:
  - Smith Guidance on Audit Committees (January 2003)
  - Higgs Report (January 2003)
  - Turnbull Guidance on Internal Control (September 1999)
- Company Law Review – Modernising Company Law (White Paper, July 2002); which led to the draft Regulations on the Operating and Financial Review and Directors' Report [36] (May 2004).

A growing number of companies across all sectors are responding by producing separate detailed reports on their environmental and/or social performance. However, they are being criticised for failing to integrate the key messages in their standard communications with (mainly mainstream) investors, who need to know which sustainability issues are most relevant to their businesses and why (both mainstream and SRI investors).

Background research conducted into the reporting practices of the property and construction industries, undertaken to inform the drafting of this guide suggests that, while companies in these industries are mirroring the general trend of issuing sustainability reports, they are not being transparent about the process by which they have identified the issues to report against and what impact these issues could have on their bottom line.

There also appear to be significant disparities between the sustainability issues that individual property and construction companies are reporting against and those that certain investors are asking questions about. Appendix 1 provides the key facts about corporate social, ethical and environmental performance, reporting and SRI.

There is therefore a need for sector-specific guidance to identify those sustainability issues that are most relevant to property and construction, and to illustrate how the issues might differ according to the particular characteristics of the sub-sector and the individual company.

This guide will inform:

- property and construction companies about the processes they can employ to identify sustainability issues that are most relevant to their businesses, and to communicate them effectively to the financial community
- mainstream and SRI investors in their investigations of sustainability performance among property and construction companies, and provide a standard against which to evaluate non-financial disclosure of such companies.

1.2 WHO SHOULD USE THIS GUIDE

Investing in tomorrow's company is specifically targeted at:

- companies in the property (real estate) and construction industries*; commercial property developers and investors, house-builders and all companies involved in construction activities
- investment companies – both mainstream investors and those involved in SRI.

* including the FTSE categorisation for the Real Estate and the Construction and Building Materials industrial sectors.

Within these organisations, the guidance will benefit the following:

- property and construction companies:
  - executive and non-executive directors
  - sustainability/CSR managers
  - investor relations and corporate communications officers
- investment community:
  - buy and sell side analysts
  - fund managers
  - pension fund trustees
  - corporate financiers/investment bankers.

This guidance has been developed with specific reference to the UK policy context but it should also be useful to companies operating in other countries.

1.3 HOW TO USE THIS GUIDE

Instructions on how to use the guide are included in each chapter, and distinctions drawn between the two target audiences.

The guidance is not intended to be prescriptive, so all users should use the concepts and ideas to help them refine their sustainability communications. *Investing in tomorrow's company* complements the use of other guidelines such as the OFR *Practical guidance to directors* [36]. It may be useful to property and construction companies in identifying which information is relevant for inclusion in their OFRs.

Table 1 *Comparison between* Investing in tomorrow's company *and the* OFR Practical guidance for directors

CIRIA C636 *Investing in tomorrow's company*	***Operating and financial review – practical guidance for directors***
Case studies and examples from the property and construction sectors	Spans across all industries
Focused on sustainability (ie environmental, social and economic performance)	Includes a very broad spectrum of information, only some of which will relate to social or environmental performance
Covers the wide spectrum of communications between property and construction companies and the investment community (mainstream and SRI)	Limited to preparation of the OFR
Targeted at both companies and the investment community, and could be applied by a much broader spectrum of employees	Targeted specifically at company directors