Indexing The Good The Bad and The Ugly

The JSE Securities Exchange recently launched its Socially Responsible Investment (SRI) Index. The **Labour Bulletin** looks at what this index is and why unions should be taking note of this development.

The SRI Index is the first of its kind in an emerging market and the first in the world to be launched by a stock exchange. It joins the ranks of similar international indices, such as FTSE4Good and the Dow Jones Sustainability Group Index. Dual-listed South African companies are already represented in the latter, but this time they had to meet criteria constructed to reflect South African sustainability priorities.

The criteria for the Index were developed by the JSE Securities Exchange in partnership with Sustainability Research & Intelligence (SR &I) (Pty) Ltd, its data provider, in a stakeholder engagement process during 2003. The index criteria were based on the triple bottom line approach, seeking a balance between environmental, social and economic sustainability issues. Embedded in all of these is a fourth – corporate governance. The SRI Index, which started trading in May, provides a scorecard for the three elements of the triple bottom-line. The index scores companies' level of compliance in three areas for each triple bottom-line aspect: policy and strategy, management systems and performance, and reporting and consultation. To be included in the index, a company had to score a minimum number of points in each category and meet several compulsory criteria.

All the companies (~160) in the FTSE/JSE All Share Index were invited to participate in the index by responding to a questionnaire sent out by the JSE Securities Exchange late last year. SR&I processed the questionnaires and supporting documentation that were returned. Initially, 100 companies responded, but ultimately only 74 listed companies made a full submission. Of these, 51 companies met the criteria and thus qualified for the index.

'It's not about hugging bunnies, it's about managing non-financial risk and demonstrating management through disclosure.' That's SR&I director Markus Reichardt's assessment of the index criteria. An interesting trend here is that in general South African companies have demonstrated that they can take non-financial issues - such as HIV/AIDS and corporate governance – seriously. However, the picture is much more mixed when it comes to the environment. Although South Africa has good environmental laws, enforcement is poor. As a result, companies have become complacent about environmental issues. In addition, there has been a decline of interest since the Johannesburg World Summit on Sustainable Development last year.

'We were surprised how mixed awareness and disclosure of environmental issues was among South African companies of all sectors and sizes,' says Dan Sonnenberg, a director at SR&I. Having said that, it wasn't 'high impact' companies, such as mines and resources concerns, that performed badly. As a generalisation, the small and medium companies came short in reporting on the environmental impact side for the SRI. Many still haven't chosen to report that they are aware of the impact and have systems to manage the effect. Many companies don't understand that it's not only mining and oil companies that need to report on their environmental impact.

Reichardt stresses that the index is as much about disclosure as it is about performance. Those companies that met the criteria *inter alia* were those that did not take communication with their stakeholders for granted. They've made explicit statements about how they're dealing with issues that affect their communities, suppliers and regulators. Many companies report by exception from a regulatory, shareholder and stakeholder point of view. But the companies included in the SRI Index have generally shown that on-going stakeholder engagement is on the radar screen and is being managed.

Companies that were included in the index either had good disclosure in their existing materials – annual reports and websites – or made up for it by engaging with SR&I to make the information accessible. Reichardt says there won't be too many direct benefits flowing from being part of the index initially.

For South African institutional investors the index offers a benchmark of better practice and this should prove useful for example trustees of union pension funds in making their investment decision. In fact, any investor who wants invest according to values now has a way of screening for those companies that operate in accordance with these values. LB