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Sustainable Development Goals: two years since the release

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Governance and Active Ownership

- The private sector embraces the Sustainable Development Goals
- Focus should be on the most material issues for an organization
- Active ownership provides an opportunity for contribution

Two years ago, in the fall of 2015, the UN released the Sustainable Development Goals (SDGs), with the explicit invitation to the private sector to contribute as well. Since then, the private sector has embraced this invitation, by setting goals and drawing plans for contribution. On behalf of clients, Robeco contributes to the achievement of the SDGs through active ownership and ESG integration in investment decisions.

The 'Agenda for Sustainable Development' was adopted by 193 countries, which together agreed to contribute to the realization of 17 SDGs by 2030. The 17 goals range from ensuring the availability of water and sanitation for all, food security, achieving gender equality, to access to affordable and sustainable energy within 15 years.

The private sector can back many SDGs directly, for example in relation to infrastructure, by investing in power generation, renewable energy, transport, water and sanitation projects. It can also contribute to more abstract concepts such as sustainable economic growth and sustainable production and consumption. Other SDGs such as education and the promotion of peaceful societies are more systemic in nature, and thus more difficult to operationalize for the private sector. Therefore, we expect that these goals will be mainly addressed by the public sector.

'Joint action that benefits society'

The SDGs set an agenda until 2030, and progress made towards the goals will be published in the Global Sustainable Development Report, to be published in 2019. This report will be the first of a quadrennial series that will inform the high-level global reviews of the 2030 Agenda at the United Nations in those years.

In the two years that have passed since the presentation of the SDGs, we have seen multiple publications by companies on how they expect to contribute to the SDGs. Midway towards the first Global Sustainable Development Report, we see how a common language is being developed, which helps us as investors to compare companies and select the winners in the market. On the other hand, progress can be made on the relevance and accuracy of disclosures.

Figure 1 | The 17 Sustainable Development Goals

Materiality

Following the paper of Khan, Serafeim and Yoon (2016)[1], we know that it is important to distinguish between material and immaterial sustainability issues. Khan et al. found that companies with good performance on material sustainability issues significantly outperform firms with poor performance on these issues. For immaterial sustainability issues, no such link was found. For an investor seeking outperformance, the relevance and accuracy of disclosures is a concern.

In the last two years, during the initial adoption of the SDGs, we have observed a variety of ways in which companies' activities are being linked to a contribution to the SDGs. Where some companies focus on SDGs that are linked to their core activities – and therefore to those activities where they have the most material impact – others report on many different objectives or link their contribution to the SDGs mainly to their corporate philanthropy

[1] Khan, Mozaffar and Serafeim, George and Yoon, Aaron S., "Corporate Sustainability: First Evidence on Materiality" (November 9, 2016). The Accounting Review, Vol. 91, No. 6, pp. 1697-1724

programs. Notwithstanding the contribution these programs can have, they are not highly material to a company's performance.

Robeco regards the SDGs as a business opportunity for listed and non-listed companies, which in turn leads to investment opportunities for asset managers and asset owners. A study of PwC[2], published in the first year after the release of the SDGs, estimated that the SDGs 8 'Decent work and economic growth', 13 'Climate action' and 9 'Innovation and infrastructure' would be the most actionable and practicable goals for the private sector to tackle. These goals especially represent opportunities for companies to make an economic profit from solving social or environmental problems while at the same time creating positive and social environmental change. Also in the autumn of 2015, the Paris agreements on climate change were reached, calling for action related to SDG 13, 'Climate action'.

Robeco's own action towards SDGs

As a sustainability investor, Robeco integrates Environmental, Social and Governance (ESG) factors into its investment processes in order to make better informed investment decisions and improve the risk/return profile of its investments. From a risk perspective, companies that align their business strategies with the SDGs will be more likely to anticipate future regulation and market developments and therefore avoid risk of losing their license to operate or facing high costs of adjusting to structural changes too late. On the upside, innovation, business model adaptation and a sound strategy towards sustainability that aligns with the SDGs, place a company in a favorable position to achieve better financial returns in the long term.

Next to ESG integration, active ownership is especially effective in contributing to the SDGs.

Active ownership

Robeco's Active Ownership team contributes to the achievement of the SDGs in two different ways. First, companies are encouraged to take action on the SDGs through a constructive dialogue (engagement). Second, the team votes at over 4,000 shareholder meetings on environmental, social and governance proposals.

Engagement

Through our value engagements, we address a variety of themes related to environmental, social or governance issues, in specific sectors. We have mapped these themes and their relation to the SDGs. This is illustrated in figure 2.

[2] PwC (2016). "Make it your business: engaging with the Sustainable Development Goals."

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Figure 2 | Engagement themes and Sustainable Development Goals

	Engagement themes (2017)	SDG 1: No Poverty	SDG 2: Zero Hunger	SDG 3: Good Health and Well-being	SDG 4: Quality Education	SDG 5: Gender Equality	SDG 6: Clean Water and Sanitation	SDG 7: Affordable and Clean Energy	SDG 8: Decent Work and Economic Growth	SDG 9: Industry, Innovation and Infrastructure	SDG 10: Reduced Inequalities	SDG 11: Sustainable Cities and Communities	SDG 12: Responsible Consumption and Production	SDG 13: Climate Action	SDG 14: Life below Water	SDG 15: Life on Land	SDG 16: Peace, Justice and Strong Institutions	SDG 17: Partnerships for the Goals
ENVIRONMENTAL	Climate change and well-being in the office real estate sector											■		■				
ENVIRONMENTAL	Sound environmental management												■	■				
ENVIRONMENTAL	ESG challenges in the auto industry									■		■						
ENVIRONMENTAL	Env. challenges in the European electric utilities sector							■						■				
ENVIRONMENTAL	Environmental challenges in the oil & gas sector									■				■				
SOCIAL	Social risks of sugar		■	■														
SOCIAL	Data privacy																■	
SOCIAL	Social issues in the food & agri supply chain												■			■		
SOCIAL	ESG risks and opportunities in the biopharmaceutical industry			■						■								
SOCIAL	Sound social management								■	■								
SOCIAL	Sustainability of the meat supply chain												■		■			
GOVERNANCE	Board quality					■											■	
GOVERNANCE	Corporate governance in Japan																■	
GOVERNANCE	Tax accountability										■		■					
GOVERNANCE	Good governance					■											■	
GOVERNANCE	Corporate governance standards in Asia																■	
GOVERNANCE	Culture and risk oversight in the banking industry[3]																	

[3] The theme "Culture and risk oversight in the banking industry" will be launched in the fourth quarter of 2017. Currently, research is still pending on the exact focus, including the relevant SDGs.

In the engagement theme 'Environmental challenges in the European electric utilities sector', for example, electric utilities are encouraged to implement ambitious environmental strategies and, independently of their historical energy mix, focus on de-carbonization: moving from coal to gas to renewables and using meaningful internal carbon prices in their planning. By encouraging utilities to shift from coal to gas to renewables, a contribution is realized to SDG 7 'Affordable and clean energy' and SDG 13 'Climate action'. During our engagement so far we have already seen substantial changes taking place in the sector. Several utilities have drastically adjusted their business models in order to focus on renewable energy.

For our engagement theme 'ESG risks and opportunities in the biopharmaceutical industry' we have encouraged companies to report on their specific contribution to SDG 3 'Good health and well-being'. We note that the first companies have now started to include concrete showcases in their sustainability reports and have created internal working groups to find ways to report quantitative impact in the future.

In September 2016, we hosted a break-out session at the RobecoSAM Forum in Switzerland, which many of the companies in our engagement peer group attended. This session provided a platform for a roundtable discussion on their ambition to report their contribution to SDG 3 in particular, next to the broader set of SDGs. We provided our assessment of the most relevant SDGs to focus on and the level of reporting we want the companies to develop in the coming years.

Regarding governance, the 'Board Quality' and 'Good Governance' engagement themes contribute to SDG 5 'Gender Equality'. In these engagement programs companies are encouraged to create well balanced boards in terms of gender, age and skills.

Voting

For all shareholder proposals on environmental and social issues, we seek to balance the merits of the proposal, the company's present performance on the issue, and the long-term impact adoption of the proposal would have on shareholder value. Our voting instruction always includes at least the following three components: a detailed assessment of the company's current performance and disclosure on the issue in question; the extent to which the proposal is likely to enhance or protect long-term shareholder value; and whether the proposal's underlying objective falls within the scope of the company management's influence and control.

In recent years, the number of shareholder proposals on environmental and social topics filed at companies' shareholder meetings has risen exponentially, with a few topics reoccurring frequently, and gaining ever greater levels of investor support. We would like to highlight two topics on which we see an increasing number of shareholder proposals, and that have a clear relation to the SDGs.

First, the number of shareholder proposals requesting reports on companies' gender equality and gender pay equity has increased. Typically, these proposals request reporting on the company's policies and goals to reduce the gender pay gap, to enable shareholders to review the company's strategy and performance on this issue.

The materiality of such requests is reinforced by a number of studies. For instance, Robeco's own studies[4] indicate that companies with more diverse boards are better positioned to outperform, while research by Morgan Stanley[5] found that the stocks of American companies with the highest scores on diversity beat those that scored the lowest by 2.3% on an annualized monthly basis over the last five years. Earlier, McKinsey & Company[6] had found that companies with highly diverse executive teams boasted higher returns on equity, earnings performance, and stock price growth. We therefore believe that when considering overall board and workforce composition, assessing gender diversity is important, and subsequently that any potential gender pay gap would represent a sizable barrier to achieving overall gender diversity at organizations.

'SDG 5, Gender Equality, proves to be financially material'

This is an example of how the SDG 'Gender equality' relates to a financially material sustainability issue, and we will therefore support these proposals, unless the company already offers reporting and disclosure on the issue, such as pay data demonstrating that no such gap exists. Furthermore, using the IT sector as an example, a 2016 Glassdoor study[7] found that a 5.9% gender pay gap existed after statistical controls. Therefore, we believe that when such trends are observed at sector level, it is pertinent for companies in the sector to increase disclosure on such issues.

Second, after the Paris agreements of 2015, we have seen a number of proposals related to 2°C scenario planning, which aim to address material risks around high greenhouse gas emissions, stranded assets, and business strategies that are unequipped to cope with a low-carbon economy. Most proposals request that the company makes an analysis of the impacts climate change will have on corporate operations, or conducts a robust assessment of strategic changes that can facilitate a transition to a low-carbon future.

Robeco believes that the transition to a low-carbon economy is a major global challenge that requires assertive corporate action. We therefore wish to see strategies that adapt their

[4] Robeco (2015). "Do companies with diversified boards have higher stock returns?"
[5] Morgan Stanley (2016)"Putting Gender Diversity to Work: Better Fundamentals, Less Volatility"
[6] McKinsey (2007). "Women matter: Gender diversity, a corporate performance driver" McKinsy & Company, Inc.
[7] Glassdoor (2016). "Demystifying the Gender Pay Gap, evidence from glassdoor salary data"

business models and strategies to prepare themselves for a net-zero carbon energy system. This is an example of a contribution to SDG 13 'Climate action' and in general we are supportive of such proposals when we believe the company's current strategy is deficient in regard to climate change, and when the proposal's underlying objective falls within the scope of the company management's influence and control.

Conclusion

In the two years since the release of the SDGs, we have seen business embracing them. Many organizations have published statements or reports voicing their support towards obtaining the SDGs. The quality and relevance of the information provided, however, differ significantly.

The financial industry has a special role to play in contributing to the SDGs, because the sector has the ability to direct capital towards sectors that offer the largest opportunities to contribute to the SDGs. The SDGs set clear goals for 2030, and as an active investor with a long-term focus, we are particularly interested in the strategy companies are developing regarding their most material issues. Public disclosure on areas where companies expect to face a risk, or in areas where the contribution to the SDGs is negative, is still only available to a limited extent.

Through active ownership, especially with our engagement programs, we challenge companies on issues related to SDGs for which we think their contribution is material to increase their positive and mitigate their negative impact. This active dialogue provides the investment teams with additional information which leads to better informed investment decisions, and leads to increased awareness among companies, ultimately invoking change that benefits society.