

Ethical Indices

This Briefing provides an overview of the plethora of 'ethical indices' that have emerged over the last decade. A 2010 study by SustainAbility recognised 108 such tools¹ and a 2013 report by Corporate Citizenship identified "a database of over 250 global and local schemes"².

Which are the most important? What are they for? And what are their limitations?

Ethical Investment Indices

Ethical Investment Indices were evolved to facilitate financial investment in ethical companies, as defined according to the indices' criteria. They include companies already listed on a specified financial index and use their own methodology to select companies which also meet predefined environmental, social and governance (ESG) criteria.

The two most well known ethical investment indices for UK companies are **FTSE4Good** and the **Dow Jones Sustainability Index (DJSI)**. These are deemed to have the highest profile, be the most credible and provide the most materiality to the companies themselves³.

FTSE launched their **4Good** series in 2001. This was in response to the growth in demand for Socially Responsible Investment (SRI) as investors recognised that non-financial factors, such as good CSR practice, were significant in risk mitigation and enhanced bottom line performance⁴. The FTSE4Good index is a family of indices which measures the financial performance of groups of companies meeting globally recognised social responsibility standards. It applies a 'negative screen' to organisations listed on the FTSE All-Share Index, meaning that companies from the tobacco, nuclear power and arms industries are excluded. Remaining organisations have their performance assessed against ESG criteria including human rights, labour standards and countering bribery⁵.

The **DJSI**, launched in September 1999, is also a family of indices. It tracks the sustainability performance of the largest 2,500 companies listed on the Dow Jones

¹ SustainAbility (2010), Rate the Raters Phase 2. Available <http://www.sustainability.com/library/rate-the-raters-phase-two#.Uc1yXzs3scw>. Accessed 28/06/2013.

² Corporate Citizenship (2013), Rankings, standards and awards. Available <http://www.corporate-citizenship.com/wp-content/uploads/Corporate-Citizenship-Rankings-Standards-and-Awards.pdf>. Accessed 30/08/2013

³ From IBE research 2013

⁴ http://www.ftse.co.uk/About_Us/FTSE_Corporate_Responsibility/FTSE4Good.jsp

⁵ See http://www.ftse.co.uk/Indices/FTSE4Good_Index_Series/Downloads/FTSE4Good_Inclusion_Criteria.pdf

Global Total Stock Market Index and is the longest running global sustainability benchmark. It assesses corporate performance around a number of economic, environmental and social criteria. These include aspects of compliance, codes of conduct, corruption, bribery and marketing practices⁶. In addition to general performance measures, a company's response to ethical issues which may arise during the course of their operations, such as corruption, fraud, human rights abuses, etc., is also considered. The result of this media and stakeholder analysis has the power to affect a company's total sustainability score (TSS) significantly and their subsequent inclusion in the DJSI⁷.

As opposed to the negative screen approach adopted by FTSE4Good in the calculation of their index, Dow Jones adopts a 'best in class' approach which enables the selection of sustainability leaders from across all sectors, with no discrimination against organisations from certain industries.

Interest in ethical investment indices continues to rise, with RobecoSAM (which offers investment services and products) reporting an increased participation rate in 2012 for their Corporate Sustainability Assessment, which is used as the basis for inclusion in the DJSI:

*"The participation rate for this year's Corporate Sustainability Assessment was 8.4% higher than last year. We see this as a strong signal of the increasing recognition that integrating sustainability into corporate strategies is essential to the bottom line"*⁸.

FTSE4Good and the DJSI are not the only examples of ethical investment indices. Stock Exchanges around the world also offer SRI options. For example, in South Africa the Johannesburg Stock Exchange offers a Socially Responsible Investment Index (JSE SRI Index), in Turkey there is the Istanbul Stock Exchange Sustainability Index (ISESI) and in Brazil there is the Corporate Sustainability Index (ISE).

Inclusion and deletion from Investment Indices

Inclusion: Both the FTSE4Good and DJSI adopt a two stage approach to creating a range of indices for investors in which they may trade.

At the first stage, both assess the performance of companies according to particular ethical and sustainability criteria and those which meet them are included in the FTSE4Good or DJSI 'benchmark' index. Currently, for the FTSE4Good benchmark index 35%⁹ of companies listed on the FTSE All-Share Index meet the '*challenging yet achievable*'¹⁰ inclusion criteria.

For the DJSI, companies are selected for inclusion if their total sustainability score puts them in the top 10% of most sustainable companies in their sector. The score is calculated using the RobecoSAM Corporate Sustainability Assessment (CSA) and consists of an industry-specific questionnaire focused on financially relevant economic, environmental and social dimensions as well as a media and stakeholder analysis¹¹.

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⁶ See http://www.sustainability-indices.com/images/CSA_methodology_en_tcm1071-338252.pdf

⁷ BP were ejected for this reason after the Deepwater Horizon oil spill in the Gulf of Mexico in 2010

⁸ S&P Dow Jones Indices, Press Release 13 September 2012: <http://press.djindexes.com/index.php/results-announced-for-2012-dow-jones-sustainability-indexes-review/>. Accessed 23/07/2013

⁹ March 2013, 721 of 2034 organisations listed on the FTSE Developed Index met the selection criteria and were included in the FTSE4Good Benchmark index

¹⁰ See http://www.ftse.co.uk/Indices/FTSE4Good_Index_Series/Downloads/F4G_Criteria.pdf. Accessed 16/07/2013

¹¹ http://www.sustainability-indices.com/images/120913-djsi-review-2012-e-vdef_tcm1071-343064.pdf. Accessed 16/07/2013

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As a second stage, tradable indices are created by selecting the largest companies by market capitalisation. For example, the FTSE4Good Global Benchmark Index is tradable as the FTSE4Good Global 100 Index and the DJSI World Benchmark Index is tradable as the DJSI World 80 Index.

Deletion: As both FTSE4Good and the DJSI indices aim to serve the purpose of raising the bar of sustainability performance¹², organisations are required to enhance and refresh their sustainability initiatives continually in order to ensure they remain included. Those which fail to stay on top of the changes can be deleted from either index. FTSE4Good releases more information into the public domain than the DJSI and publishes a semi-annual review each March and September, in which all additions and deletions to the index are named. In the September 2013, update thirty companies were added to the index whilst no companies were removed¹³.

The DJSI is reviewed annually with the largest additions and deletions outlined each September. In 2013, the largest companies deleted from the index were Johnson & Johnson, HSBC and Vodafone¹⁴. Complete reports are disseminated to licensees only.

Other Ethical Indices

Other ethical indices include ratings, rankings and benchmarks established by a variety of organisations. Examples include the **Business in the Community (BITC) CR Index**, the **EIRIS Sustainability Rankings**, **Carbon Disclosure Project (CDP) Leadership Indices**, the **United Nations Global Compact** and **Ethisphere's World's Most Ethical Companies**. These indices seek to measure and quantify the sustainability performance of organisations and rank companies as a result of their ethical/corporate responsibility performance.

The purposes of these indices are not said to be primarily for promoting investment in the included companies. For example, the BITC CR Index was created "*as a robust tool to help companies systematically measure, manage and integrate responsible business practice*"¹⁵, and Ethisphere's World's Most Ethical Companies "*recognizes companies that truly go beyond making statements about doing business "ethically" and translate those words into action*"¹⁶.

Of course, there are a multitude of standards which companies also use to improve and prove their ethical performance (such as ISO 14000, the AA1000 Framework, the UN Global Compact and Global Reporting Initiative (GRI) Guidelines), but achieving such standards does not necessarily lead to listing in a published index.

¹² Slager (2012) The FTSE4Good index: engagement and impact. Available <http://www.nottingham.ac.uk/business/ICCSR/briefings.php?action=single&id=11>. Accessed 24/07/2013

¹³ Available http://www.ftse.co.uk/Indices/FTSE4Good_Index_Series/Downloads/FTSE4Good_Sept_2013_Review.pdf. Accessed 16/09/2013

¹⁴ Available http://www.sustainability-indices.com/images/130912-djsi-review-2013-en-vdef_tcm1071-372482.pdf. Accessed 16/09/2013

¹⁵ See more at <http://www.BITC.org.uk/our-services/benchmarking/cr-index>

¹⁶ See more at: <http://m1.ethisphere.com/wme2013/index.html>

Relevance

Ethical indices of all types can fulfil a number of roles for the organisations they encompass. Inclusion in, or a 'high score' on, these indices has become important to businesses for several reasons and omission or deletion from them is often taken seriously.

Internally, inclusion can provide a **benchmark and assurance** about how well ethical values and sustainability are embedded in corporate practice¹⁷. Research from SustainAbility¹⁸ suggests that companies use ethical 'ratings' to gauge the sustainability performance of their organisation and IBE research has suggested that companies use the findings as a **valuable gap analysis tool**¹⁹. For example, following deletion from the DJSI in 2012, GSK chose to review their sustainability performance against the DJSI inclusion criteria to ensure they regained their position for 2013²⁰.

Some companies **link executive compensation to inclusion** in one or more of these indices. Akzo Nobel link 50% of their long term bonus scheme for 600 of their top managers to the company's position in the Dow Jones Sustainability Index for chemicals companies²¹. Eni include "*maintenance of Eni's presence in the FTSE4Good index and the Dow Jones Sustainability Index*" as one of the objectives related to annual variable incentives of the CEO and General Manager²².

Inclusion may also be regarded as **external recognition** of good performance; a positive PR opportunity or reputation risk management tool and consequently quoted in Corporate Responsibility reports and promoted on the company website; for example Diageo, Sainsbury's and Anglo-American.

Additionally, **investors** who wish to align their investment strategies with their values use these indices to provide additional insights into the quality of a company's management and performance potential. This enables them to make better informed investment decisions. In return, by being included in ethical indices businesses can benefit from **exposure to a more diverse list of investors**²³.

The aforementioned SustainAbility research further suggests that increasingly, **consumers** are looking to these indices for '*actionable information regarding purchasing decisions*'.

Limitations of Ethical Indices

Ethical indices are not without their critics. One view is that they are not sufficiently transparent around why some companies are included and others are not. For example, in September 2010 both AOL and Chubb Corp were simultaneously deleted from the DJSI and added to the FTSE4Good index. FTSE's Head of Responsible Investment acknowledged at the time that "*many sustainability indices do have a pretty opaque methodology*"²⁴. The confusion related to this lack of correlation between the

¹⁷ See <http://www.sustainability.com/projects/rate-the-raters#projitab-6>

¹⁸ ibid

¹⁹ From IBE research 2013

²⁰ See page 7 of the 2012 GSK Corporate Responsibility Report. Available <http://www.gsk.com/content/dam/gsk/globals/documents/pdf/corporateresponsibility/cr-report-2012/gsk-cr-2012-report.pdf>. Accessed 22/07/2013

²¹ WBCSD *People Matter Reward: linking sustainability to pay*. Available http://oldwww.wbcsd.org/DocRoot/fXxvKXV3CbppJvboQgG3/WBCSD_People%20Matter%20Reward.pdf. Accessed 23/07/2013

²² Eni Remuneration Report 2013. Available http://www.eni.com/en_IT/attachments/governance/shareholder-meeting/2013/Remuneration-Report-2013.pdf. Accessed 24/07/2013

²³ From IBE research 2013

indices gives the opinion that there is no clear consensus on what best practice may be²⁵.

Others feel that the methodologies involved in some indices are designed for companies with a specific internal structure. This leaves some organisations which do not conform to the 'one size fits all' approach limited in the position they can achieve within the ranking²⁶.

The value of these ethical indices in meeting their self-prescribed aims has also been questioned. In 2010, BP were included in the DJSI and the FTSE4Good indices; however, they were promptly ejected from both in the wake of the Gulf of Mexico oil spill. This incident cast doubt over the merit of the indices as proxies for future sustainability performance.

Another issue is that, although these indices are often intended to assist organisations in tracking their CR progress over time²⁷ the questions posed can change annually making year on year comparisons challenging. Also, there is a feeling that feedback on entry submissions is limited, leaving companies guessing as to how they could improve²⁸.

Even though many indices verify the disclosures submitted by companies, they are still subject to the criticism that they are exposed to corporate bias²⁹. It has been suggested that indices reward the companies with the greatest capacity to respond to the questionnaires rather than those with the best socially responsible practices³⁰ and that they are more of a reflection of successful marketing than proven sustainability performance³¹.

Although these indices have a variety of uses for different interested parties, it is frustrations such as these noted which help to explain why they can suffer low levels of trust from businesses, as reported in SustainAbility's Rate the Raters survey³².

This and other Business Ethics Briefings are available to download free of charge from the IBE website: <http://www.ibe.org.uk/index.asp?upid=51&msid=8>

At L'ORÉAL, we have been working with the IBE for many years. We have always found their advice pragmatic and practical as well as, in many instances, inspiring. They help us and challenge us at the same time."

Emmanuel Lulin, Group Director of Ethics, L'ORÉAL

²⁴ Reuters (2010). Available <http://www.reuters.com/article/2010/09/16/us-indexes-transparency-analysis-idUSTRE68F56420100916>. Accessed 29/07/2013

²⁵ From IBE research 2013

²⁶ ibid

²⁷ From BiTC CR Index website <http://www.bitc.org.uk/our-services/benchmarking/cr-index>

²⁸ From IBE research 2013

²⁹ Holt et al. (2004). Measuring Sustainability. Available <https://extranet.kenan-flagler.unc.edu/kicse/ORIG%20Shared%20Documents/Measuring%20Sustainability.pdf>. Accessed 20/07/2013

³⁰ Bendell, J. (2010). World Review, *Journal of Corporate Citizenship*, Winter 2010. Available <http://www.greenleaf-publishing.com/content/pdfs/jcc39worldreview.pdf>. Accessed 18/07/2013

³¹ Peter Knight, Letter from the mid-Atlantic – Same old names, same old games? Ethical Corporation. Available <http://www.ethicalcorp.com/business-strategy/letter-mid-atlantic-%E2%80%93-same-old-names-same-old-games>. Accessed 19/07/2013

³² A survey of over 1,000 sustainability professionals from over 80 countries in 2010 revealed that only 48% of respondents considered the DJSI to have a high credibility, and 34% for FTSE4Good



The IBE was established in 1986 to encourage high standards of business behaviour based on ethical values.

Our vision is to lead the dissemination of knowledge and good practice in business ethics.

We raise public awareness of the importance of doing business ethically, and collaborate with other UK and international organisations with interests and expertise in business ethics.

We help organisations to strengthen their ethics culture through effective and relevant ethics programmes.

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