FINANCE FOR THE FUTURE AWARDS

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ACCOUNTING FOR SUSTAINABILITY

ICAEW

2013 WINNER CASE STUDY

LESSONS IN DRIVING BUSINESS SUSTAINABILITY

RECOGNISING EFFICIENCY THROUGH OSMOSIS

An investment management partnership demonstrates that investing on the basis of sustainability measurement delivers returns

THE BUSINESS

Osmosis Investment Management is a small partnership, launched in 2009, to identify sustainable behaviour in large, publicly-listed companies and invest on the basis of that behaviour. It is based on one simple belief; that companies which take a proactive approach to managing the constraints of world resources deliver greater shareholder value. Greater resource efficiency, Osmosis believes, is a characteristic of well-managed, forward-thinking businesses.

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This fundamental is underpinned by a cultural understanding that the transition to a more sustainable, less carbon-intensive economy has been underway for decades. Corporates have been reflecting the transition in their behaviour for years through better, more efficient energy consumption and water usage, for example. The Osmosis process identifies resource efficient companies by collecting and objectively analysing audited, publicly disclosed corporate information. The team running Osmosis is drawn from a variety of backgrounds in the financial markets and believes that the capital markets are a crucial and significant key to the sustained changes that the environment and society require.

THE IDEA

People have invested 'ethically' for a long time and there have been many ethical investment funds over the years, but the partners of Osmosis think such funds have been coming from the wrong direction. 'Historically, the sector has used its funds negatively', says Ben Dear, one of the Founding Partners. 'They screened the results and would not invest in companies that they deemed to be "bad" because of oil products, or alcohol products, for example'. Osmosis takes the view that it is sustainability demonstrated through resource efficiency that drives better rewards, not whether companies are producing "bad" products. 'We can identify resource efficiency in all sectors', says Dear, 'and all companies doing better from a sustainability perspective should be rewarded'. 'We are not environmentalists or activists', says another Founding Partner, Gerrit Heyns. 'We don't tell a company what they should be doing, or how they should be doing it. We are investment managers and our objective is to identify and capture investment returns'.

Gerrit Heyns, Founding Partner

'It is in the measuring where we have taken a unique approach', says Dear. 'We take an objective approach. Resource efficiency is the result of management behaviour and it requires a corporate culture that understands the link between resource efficiency and shareholder value'.

THE INNOVATION

They developed their model of resource efficiency (MoRE) as an objective methodology to identify forward-looking public companies that are more resource efficient. It took several years to develop and it deals with the world's top 3,000 companies by market capitalisation. The model allows Osmosis to assess information that is widely accepted as material to investment, but that they felt was largely ignored by the investment community. They collect, collate, standardise and analyse observed amounts of water used and fossil fuel consumed by a company together with the total amount of waste it creates. From those three information sources, Osmosis identifies companies that are simply better at turning resources into revenue and the portfolios are based on those companies. Osmosis finds that these portfolios tend to outperform the benchmark of choice by a meaningful margin.

'Our objective', say the partners, 'is to understand the intensity of each of these three major factors with respect to the revenue a company generates. For example, we can determine how many litres of water are required to generate a unit of revenue in a company. This is a measure of both water intensity and inversely, water efficiency in a company'.

'Companies disclose this information on an annual basis', says Dear. 'But there is not a Generally Accepted Accounting Principles (GAAP) style of accounting for this information'. In other words, it is not kept uniform or comparable by a global or national set of standards. 'There are different bases of disclosure', says Dear. 'It makes it difficult to use it in the investment process, but we have collected it since 2005 and standardised it so that you can compare apples with apples, and oranges with oranges'.

We can demonstrate a definite link between resource efficiency and investment performance.

And they stick with the sustainability information and do not mix it up with any other information. 'We only use this data', 'says Dear. 'We are deliberately not using traditional financial information, except for revenue, and, from the data we collect, we can demonstrate a definite link between resource efficiency and investment performance'.

Resource efficiency, insist the partners at Osmosis, does indicate greater shareholder value. Even more astonishing, they say, is that the process does not include subjective analysis or traditional financial ratios. It is derived purely from observed environmental data, yet it yields results that financial ratio-based investors struggle to achieve on a consistent basis. Osmosis also points to the fact that the multitude of corporate sustainability reports that sit on the desks of most fund managers and analysts are far more useful, relevant and beneficial than any have given them credit for. The information is there, but no one has figured out how to make it work for them.

FINANCE FUNCTION LEADERSHIP

Osmosis is governed and driven by finance issues so financial leadership is implicit. In particular, it highlights how CFOs at the larger companies, who have been creating sustainability reports for a long time, have been frustrated for years by the lack of interest in the material that these reports produce.

POSITIVE LONG-TERM IMPACT

Osmosis believes that the investment community has a great deal of responsibility in balancing the needs of the current generation without compromising the ability of future generations to meet their own needs. They feel that the core of that responsibility is to embrace sustainability as an economic rather than an emotive imperative. As the sustainability trend grows, ideas like the analysis, upon which Osmosis bases its investment strategy, will become common tools in the investment decision-making process.

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LESSONS FROM THE CASE STUDY

The first lesson that Ben Dear would point to is that sustainability is much more embedded in companies than most people think. 'Companies are much further ahead than the markets would lead you to believe', he says. 'Companies have been doing this for a long time'.

The lesson that leads on from that, suggests Dear, is that the traditional investor market is facing an unseen risk through not taking sustainability on as a major constituent of their analysis and portfolios. 'They are taking slightly longer to understand some of the risks their portfolios face', he says.

But that is the nature of investment markets. People should not expect a rapid change in culture. 'Markets move slowly', says Dear. 'New investment ideas, though positively encouraged by the market, take a while to be implemented. We have learned to be quite patient'.