

THE WAY FORWARD FOR THE UNGC LOCAL NETWORK

Intervention made at the occasion of the

UNGC Annual members meeting

19 March 2013

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1. Context

- The global economic conditions we are faced with today are in turmoil because it is indicative of the way we manage ourselves. The way in which we run our corporates and the way in which we run our economies, which to a large extent has been short-termist.
- We are in this financial meltdown today not because the financial meltdown was going to happen – no we are in this situation because of the manner in which we have been managing our institutions and our economies. If we have been much more focussed on the long term we wouldn't be facing the issues we are facing today.
- Asset managers seem to be playing a huge role in sustainability but asset owners should start to contribute as well –the owners of capital should get involved.
- To what extent do they make the right decisions, to what extent do they send the right signals to the people who manage this capital on their behalf to ensure that they manage it in a sustainable manner. We need to think about the role of asset managers who have a double-edged sword in the manner in which they make investment decisions.
- We need to conscientiously decide to take a long-term view on every decision and every investment that we make. Our outlook should be a minimum of ten years. The NDP extends this to a horizon of 20-25 years. The AU has just set it out 50 years.
- Another issue is the role of the consumer. Can the consumers of the world vote with their feet? When corporates are behaving badly, can the consumer be able to withdraw their demand from those commodities such that the suppliers of these

goods and services would change their behaviour and act in a much more responsible and sustainable fashion? I think it is important that they do. This also gives a very important pointer for the participants on the Local Network

- What is the role of analysts? To what extent are we going to get analysis from the financial markets that will incorporate sustainability and will not only be driven by just the bottom-line which is purely financial.

2. Input of the PIC in the change of behaviour and thinking

- PIC fully appreciates the importance of transparency, accountability and sustainability. On the back of that condition we put out a sustainability matrix, an exercise which we have been running for the fifth year now.
- The matrix is a very important part of our assessment of the companies in which we are invested. The PIC accounts for about 11% of the Johannesburg stock exchange. It is the largest asset manager on the African continent.
- What we do is, we assess and evaluate in detail the behaviour of the companies we are invested in - whether on or off the stock exchange. It is important for us that the companies we are investing in behave in a particular fashion. Why it is important for us, is because we see the concept of sustainability as being at the heart of what we do. We manage funds, predominantly pension funds, which have a life of 30 to 40 years and that means we cannot be short term in the way in which we think. It also means that those companies we invest in, the partners that we identify, are partners that we need to ensure that they are managing those companies very well, in a sustainable manner and those companies are going to be in business in at least the next generation. If we do not see the good behaviour, unlike a lot of other investors, we do not have the luxury of voting with our feet. We do not pull our resources, instead we entrench ourselves deeper in the operations and ensure that we change these from within, particularly with regards to their South African operations.
- Given the PIC and GEPIF's active role in addressing matters of governance and ethics within corporate South Africa and as the largest institutional investor and pension fund on the African Continent it was fundamental that the PIC ensured that

its investment decisions moved beyond the mere financial performance of companies.

- The challenge for the PIC is to delve into the core of a company's controls, its sustainability strategy, its social responsibility intent and ultimately its commitment to all stakeholders.
- Constraint with rating matrices is the ability to measure "true" performance based on a company's reporting of compliance. Many specialists believe that companies that have subscribed, voluntarily or not, to the various governance codes merely perform a tick-box exercise to appease stakeholders.
- Must get companies to move away from tick box mentality
- No clear link found between good corporate governance and companies that outperformance in terms of financial results. In fact in many instances it was found that some of the best performing companies had the worst corporate governance practices. However, there is an argument that this will only be in the short term and not the long term as it would not be sustainable.
- Business leaders and asset managers and asset owners must move away from short-termism.

3. Structure of the Matrix

- Unlike others, the PIC Matrix tries to achieve a balanced focus on both compliance/conformance and performance issues. While it rewards disclosure it also tries to ascertain the level of actual conformance or performance. In other words, if a company discloses poor performance it will be rewarded for disclosure but not for performance.
- Although it could be argued that true performance is more important than disclosure, from a stakeholder engagement perspective, disclosure remains critical. Otherwise there is no basis or channel for engagement. In some of the indices, disclosure in itself will constitute compliance yet in others a more comprehensive assessment is required.
- Given the PIC's motivation to encourage the full disclosure of relevant information by all companies in South Africa, it was decided that the matrix be completed with the use of publicly available information only.

- Where possible, indices within the matrix attempt to measure true performance by searching for disclosure of actual progression around identified strategic projects as opposed to a mere listing of their intentions *vis-à-vis* an apparent tick-box approach to their governance and sustainability reporting. In order to reduce the effects of subjectivity, regular discussions are held between the analysts responsible for the scoring, the Corporate Governance Division of the PIC as well as the PIC's Equity Analysts.
- Except for annual reports, sustainability reports and integrated reports, publicly available information are also sourced from the internet especially where it relates to news reports around environmental and social issues as well as corporate behavior towards consumers and communities.

4. Scoring Methodology:

- Each of the core indicators are scored for disclosure, conformance and performance.
- **Disclosure Score:** The purpose is to purely ascertain whether the required information is disclosed or not. This being irrespective of the actual conformance / performance or the depth of the information provided. All print and online media formats need to be reviewed for the disclosure as long as it is in the public domain. In addition to the score allocated for disclosure the indices would thereafter receive either a score for conformance or performance.
- **Conformance Score:** A conformance score applies where the indicator purely relates to a company's compliance with a regulatory or voluntary standard *e.g.* the inclusion of an unqualified audit report. This is typically a binary assessment with the assessment being either a Yes or No answer for the specific indicator. The maximum score that can be allocated for such an indicator would be 75 *i.e.* 50 for disclosure and 25 for conformance.
- **Performance Score:** A performance score relates to information that allows for quality assessment and the ability to distinguish and rank companies on their levels of performance. In addition, these indices allow for best practice assessment and the awarding of additional bonus points.
- **Final Aggregate Score:** The assessment of an individual company will therefore result in the allocation of a final score out of 100%. This final score is comprised of

weighted scores per individual category (environmental, social and governance), which are in turn comprised of an average of scores per indicator within the relevant category. Scores per indicator will vary between a minimum of 0 where there is no disclosure and 100 where there is disclosure and recognized best practice. Scores per category will vary between 0 and 100 and will comprise the average of all indicators within that category. The final score will be the aggregate of all weighted scores per category.

- The three categories social, environmental and governance are equally weighted.
- The table below displays the sub-categories for each main category:

Governance	Social	Environmental
Board	UN Global Compact	Energy
Individual Directors	Human Rights	Water
Executive Management	Transformation	Waste
Remuneration	Health and Safety	Emissions
Shareholder Treatment	Corporate Responsibility	Paper
Auditing and Accounting	Disabled Employees	Spills
Disclosure and Reporting		
Corporate Behaviour		
Corporate Culture		
Sustainability Reporting		

5. Some Observations:

- For the first time in 2013 there will be no changes in the metrics that will be used, so the 2012 and 2013 results will be the first set that can be used to measure whether a company has progressed in terms of its score. This year's data will, therefore, be analysed in more detail by the ESG Working Committee as well as PIC Equity Analysts. There are, however, some key observations:

- Companies in the financial sector as well as dual listed companies tend to perform better. The reason for this might be the regulatory environment as well as better disclosure.
- Companies with a strong family influence tend to perform badly, although Altron and Altech are exceptions.
- Media companies, holding companies and listed property companies are also bad performers.
- Board and executive management transformation in terms of gender is a serious concern.
- Certain sectors such as the retail sector lag behind in terms of transformation.
- As we go about undertaking this analysis we do it with a long term objective in mind. The view and message we would like to leave this forum with is, as we advance the initiatives that we are pursuing, it is important that we make these intermediations work sustainably for our people because if they do not work they may be viewed as meaningless.
- Concluding message will be one of integrity. The way I am defining integrity, in this respect, is ensuring that whatever institution you run is an institution that matches its objectives or what it does with the long term interests of its shareholders and other stakeholders. I think a story is very important here. In my previous life, which is not long ago, I sat around a table with a dozen CEO's of the top 100 companies listed on the Johannesburg Stock Exchange. We were trying to introduce the concept of long term planning and sustainability and why it is important for a business and for a CEO to concern themselves with the economic case before they worry about the business case. The response that I got from all the people around the table was frightening. They said to me, Elias don't bother us with a ten or twenty year outlook, we are on three or five year contracts and that is all that we are interested in. What happens beyond the five years is none of our business. That was quite a telling response and it was very concerning. This was at a time where the Government of SA was moving to a multi-year budgeting system which set a stage for a 10-20 year national development plan. That said to me there was no consistency in thinking between the people that ran our businesses and the stakeholders in the country.

- Needless to say, this is in the past. That is why we have a vibrant Local network today.
- Do business with integrity - avoid doing business with entities that have no integrity. Where you are already involved in such, intervene in a very activist fashion, to change that attitude.

6. What are the challenges for the Local Network?

- **The need for quality and scale on sustainability**

South Africa needs to build a body of best practice on sustainability through increased efforts by companies to implement SD in their strategies and operations. More companies need to buy into the practice, influenced by learning from companies that are already ahead. We need scale and impact for SA to be counted in the league of countries that embrace responsible business practice for a sustainable society.

- **Urgent need for sustainability leadership by business leaders**

The voices of business leaders, especially CEO's and Boards of Companies are critical in making the efforts of business visible on SD. A number of companies are already doing good work on certain issues and this needs to be communicated. Business leadership is necessary both for internal sustainability processes to take shape but also in influencing the value chain and broader business community. Contributing to society through responsible business practice is also critical in building a stronger relationship with government and with citizens and consumers.

As a Local Network, we are working to establish a CEO Roundtable for Sustainability, that will be used as a strategic and policy platform on SD.

- **Sustainability interventions in the supply chain**

We cannot forget the role that supply chains play on trade, growth and employment. Supply chains are also important due to their potential for bearing the highest sustainability risks. In this respect, gains on sustainability will only show if supply chains are recognised as critical sustainability leverage points. South African

companies need to find ways to enable supply chains to integrate sustainability for more widespread impact.

- **Need to grow and fund the Local Network**

South Africa's Local Network has the potential for growth. Currently standing at 74 entities, there is still scope for hundreds more companies to join the UNGC and grow this community of progressive companies. As signatories, we need to think of our role as influencing our peers, clients, suppliers etc. to also commit to good corporate citizenship. I urge you to spread the word, the learning and the benefits drawing from your own experiences.

It is also our responsibility to ensure that collectively, we are able to keep the Local Network resourced, active and delivering on our agreed plans. Our current activities are funded from the NBI core yet not all UNGC signatories are NBI members and vice versa. We need to agree on a viable funding model that is able to support our programmes in the medium term. The UNGC Business Plan circulated to all of you gives a sense of the resources we need to accomplish our plans for the next two years. I would recommend further engagement around the issue.

Thirdly, the UNGC New York did contemplate and approach signatories for mandatory contributions. The Advisory Committee of the Local Network has discussed this and developed the response letter available in front of you.

- **A focus on sustainability beyond domestic borders into the wider continent**

South Africa is an important player in the African continent. There is significant potential for more trade in the continent. But the sustainability of the continent is closely tied to ours and vice versa. Our Multi-National Companies in particular already have a role cut out for them as potential ambassadors for responsible business in the continent.

- **The role of investors on SD- PIC & JSE?**

As a CEO of an Investment Company, we are also aware of our responsibility to integrate sustainability considerations into the investment decisions that we make. This is an influencing role that sends a strong message to the companies where we invest. We need to tap onto different available ways that can support and motivate responsible business behaviour in our country.

As a group of companies that have publicly committed to the UNGC 10 Principles, it is our duty to lead by example.

- **Extending the participation to Government, NGO's and labour unions**

I invite you to engage on these observations and find ways of endogenising them in our day to day business.

I thank you.