Dow Jones Sustainability Group Index: A Global Benchmark for Corporate Sustainability

Ivo Knoepfel

Increasingly investors are diversifying their portfolios by investing in companies committed to the concept of corporate sustainability. Investors are attracted to this new investment style because it promises to create long-term shareholder value by embracing opportunities and managing risks deriving from ongoing economic, environmental and social developments. It focuses on future challenges and is capable of capturing qualitative non-financial information for criteria such as quality of management, corporate governance structures, reputational risks, human capital management, stakeholder relations, corporate social responsibility.

Here we present the framework used by the Dow Jones Sustainability Group Index (DJSGI) for identifying and ranking companies according to their corporate sustainability performance. In a yearly review the 10% leading sustainability companies in each of the 64 industry groups are selected for inclusion in the DJSGI. Throughout the year the companies are continuously monitored and, if necessary, downrated or excluded from the Index. A variety of sources is used for the assessment and for cross-checking of information, including company questionnaires, company documents, publicly available information, stakeholder relations, media screening and company interviews. The selection process is externally verified and the methodology is reviewed yearly to capture the increasing knowledge and standardisation of sustainability issues and to align it with ongoing initiatives such as the Global Reporting Initiative.

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The past years have seen a rapidly increasing interest from the financial community in the broad area of sustainability and ethical investments with growth rates in Europe and North America of up to 70% per year. Estimates for ethically screened funds in the UK are in the range between £50bn and over £100bn. In the U.S. socially screened funds
are estimated at around USD 2 trillion. A large portion of these assets is screened according to simple negative screens, such as avoidance of companies with sales in tobacco and alcohol.

Increasingly, institutional investors such as pension funds have started to shift towards adopting environmental and social investment policies. In the UK, the July 2000 amendment to the Pensions and Investments Act calling for pension fund trustees to disclose in their annual statements “the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments” is supporting this trend.

The more professional institutional investors are entering this market, the bigger is the need for active screening of portfolios and for consistent rating and benchmarking tools to assess the environmental, social and economic bottom line (triple bottom line) of companies and the implications for value creation for investors. This has prompted Dow Jones Indexes and SAM Sustainability Group to launch the first global sustainability equity index in September 1999: The Dow Jones Sustainability Group Index (DJSGI)\(^2\). Already more than 20 financial institutions are using the DJSGI for a variety of products ranging from index funds, certificates and equity linked notes totalling assets under management of approximately 1.5 USD billion. Moreover, because the companies included in the Index are publicly announced, the wider social investment community is increasingly using the DJSGI as a benchmark.

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The DJSGI focus on the concept of corporate sustainability and in its first year of operation has already shown that this concept leads to a favourable risk/return profile for investors (Figures 1 and 2). An in-depth comparison between the components of the DJSGI and those of its benchmark, the Dow Jones Global Index (DJGI), shows better average returns on equity, on investments and on assets for the sustainability companies (Figure 3).

In the long-term sustainability companies deliver more predictable results, which means fewer negative surprises. Therefore, investors will seek out leading sustainability companies not for outsized performance, which always is temporary, but for above-average growth on which they can rely.

\[\text{DJSGI}\text{DJGI (USD):} \]
\begin{align*}
\text{Correlation:} & \quad 0.9493 \\
\text{Tracking Error:} & \quad 3.08\% \\
\text{DJSGI Volatility:} & \quad 14.55\% \\
\text{DJGI Volatility:} & \quad 13.25\% \\
\end{align*}

**Figure 1 Dow Jones Sustainability Group Index World (December 1993–October 2000, USD, Price Index)**
Increasingly, investors use corporate sustainability as a proxy for enlightened and disciplined management — which is one of the most important factors that investors consider in buying a stock.

**Concept of corporate sustainability**

Corporate sustainability leaders achieve their business goals by gearing their strategies and management to harness the market’s potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks. It is this pursuit and related management capabilities that creates long-term shareholder value. Sustainability opportunities and risks are directly related to a company’s commitment to five key corporate sustainability performance principles:

**Innovation:** Investing in product and service innovations leading to a more efficient, effective and economic use of financial, natural and social resources over the long-term.

**Governance:** Setting the highest standards of corporate governance, including management quality and responsibility, organizational capability and corporate culture.

**Shareholders:** Meeting shareholders’ demands for sound financial returns, long-term economic growth, long-term productivity increases, sharpened global
competitiveness and contributions to intellectual capital. **Leadership:** Leading the industry toward sustainability by setting standards for best practice and maintaining superior performance. **Society:** Encouraging long lasting social well being in local and global communities, interacting with different stakeholders (e.g. clients, suppliers, employees, government, local communities and NGOs) and responding to their specific and evolving needs thereby securing a long term “license to operate” and superior customer and employee loyalty.

The Corporate Sustainability Assessment methodology — developed by the SAM Sustainability Group — is structured along these lines and covers the three major dimensions of corporate sustainability: the economic, the social and the environmental dimension.

**Structure of the DJSGI**
The Dow Jones Sustainability Group Indexes (DJSGI) cover the leading sustainability companies in the Dow Jones Global Index universe. Included in the DJSGI universe are the 2000 largest capitalised companies in the world. The top 10% of companies with the best sustainability performance in each of the 64 industry groups is selected for inclusion in the DJSGI (“best in industry” approach) (Figure 4).

The DJSGI index family consists of the following global, regional and specialised indexes:

**Regional Indexes**
- DJSGI World index
- DJSGI Europe index
- DJSGI North America index
- DJSGI Asia Pacific index
- DJSGI USA index

The DJSGI Europe, DJSGI North America, DJSGI Asia Pacific and DJSGI USA indexes are derived from and are, therefore, subsets of the DJSGI World index.
Specialised Indexes

- DJSGI excluding Alcohol indexes
- DJSGI excluding Gambling indexes
- DJSGI excluding Tobacco indexes
- DJSGI excluding All indexes (i.e. excluding alcohol, gambling and tobacco)

Each specialised index is derived from and is, therefore, a subset of the relevant regional index.

Corporate Sustainability Assessment

The annual DJSGI component selection process reassesses the companies in the Dow Jones Global Index for their corporate sustainability performances. This reassessment consists of the Corporate Sustainability Assessment, Corporate Sustainability Monitoring and component ranking and selection. Once the components are selected, they are continuously monitored throughout the year (Figure 5).

The Corporate Sustainability Assessment methodology identifies the leading sustainability companies from the DJSGI investable stocks universe for each industry group. The methodology is based on the application of specific criteria to assess the opportunities and risks deriving from economic, environmental and social dimensions of each of the eligible companies in the DJSGI investable stocks universe. These criteria consist of both general criteria applicable to all industries and criteria applicable to companies in a specific industry group.

For each company, the input sources of information for the corporate sustainability assessment consist of the responses to the corporate sustainability assessment questionnaire, submitted documentation, policies and reports, and publicly available information.

Monitoring media and stakeholder information assesses a company’s ongoing involvement in critical social, economic and environmental issues and its management of these situations. For example, the four categories of Corporate Sustainability monitoring are:

- Illegal commercial practices e.g. tax fraud, money laundering, antitrust, balance sheet fraud, and corruption cases;
- Human rights issues e.g. cases involving discrimination, forced resettlements, child labor and discrimination of indigenous people;
- Workforce conflicts e.g. extensive layoffs and strikes; and,
- Large disasters or accidents e.g. fatalities, accidents, workplace safety, technical fail-
dures such as crosschecking of information sources, are used to monitor and maintain the accuracy of the input data, assessment procedures and results.

Assessment Criteria
Through the assessment of economic, environmental and societal driving forces and trends, generally applicable corporate sustainability criteria are identified and defined. They are based on widely accepted standards, best practices and audit procedures and are applied to all industries, identically and without exception.

Companies that score poorly in the ongoing Corporate Sustainability Monitoring are excluded

In addition, industry specific criteria covering each dimension are identified for every industry group. The industry group specific criteria reflect the economic, environmental and social, political and technological forces driv-
ing the sustainability performance of a particular industry group. They are based on extensive input from industry specialists and consultants.

In a second step, both the general and industry specific criteria are then equally defined in terms of sustainability opportunities and risks. An additional classification of the criteria is introduced according to their strategic, management and industry specific character.

Table 1 gives an overview of all criteria used and their classification. The table also shows the weighting structure used. Additionally, in each dimension a 30% weight is assigned to strategic, a 40% weight to management and a 30% weight to industry specific criteria. Based on these criteria, a total of 500 companies has been analysed by SAM in 1999 and a total of 600 companies in 2000.

Results
For each company assessed the total sustainability score can be shown on a scale from 0% to 100% and compared to the industry average score. Additionally, sub-scores for the economic, environmental and social dimensions or for the quality of opportunities and risks management can be shown. Every year, companies that have participated in the DJSGI assessment receive a rating report showing their scores compared to the industry average and qualitative sustainability performance information.

Figure 6 shows results for Procter and Gamble, the leading company in the consumer non-cyclical market sector according to the year 2000 reassessment of DJSGI. The leading companies in each of the ten market sectors in the DJSGI are as follows:

2. Consumer cyclical: Bayerische Motoren Werke AG, Volkswagen AG, Daimler Chrysler AG
3. Energy: BG Group Plc
5. Financial: UBS Group
6. Telecommunication: Deutsche Telecom Group
7. Basic Materials: Doosan Inc.
8. Technology: Fujitsu Ltd.
9. Industrial: ITT Industries
10. Utilities: Anglian Water Plc., Transalta Corp

Another way of presenting the results is by means of the SAM Sustainability Rating, which provides a rating for both sustainability opportunities and risks.

It is interesting to compare the spread of results for different dimensions. Figure 7 shows the comparison of the spread of economic sub-scores and of environmental sub-scores of 600 companies analysed in the year 2000 (33% is the maximum score for each dimension). The differences between companies are much bigger for the environmental dimension as compared to the economic dimension. The main reason for this is the still strongly differing perception of the importance of environmental issues in different companies and industries. Economic scores are bundled around a surprisingly low score of 14%. The main reason for this is the still relatively low average performance on issues such as human capital management, quality management, and corporate governance standards.

Outlook
The DJSGI provide the investment community with the first global benchmark for sustainability that is published daily and is based on well-defined, externally reviewed rules and on a high quality of information (b).

The methodology developed by SAM Sustainability Group for the DJSGI provides...
Table 1 Assessment Criteria and their Classification

<table>
<thead>
<tr>
<th>Opportunities (50% weight)</th>
<th>Risks (50% weight)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic (33% weight)</td>
<td>Corporate governance</td>
</tr>
<tr>
<td>Strategic</td>
<td>Strategic planning</td>
</tr>
<tr>
<td></td>
<td>Organisational development</td>
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<tr>
<td>Management</td>
<td>Intellectual capital management</td>
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<td>IT management</td>
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<td></td>
<td>Quality management</td>
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<tr>
<td>Industry Specific (for example)</td>
<td>R&amp;D spending</td>
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<tr>
<td>Environmental (33% weight)</td>
<td>Internet security</td>
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<tr>
<td>Strategic</td>
<td>Environmental charters</td>
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<td></td>
<td>Environmental policy</td>
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<td></td>
<td>Responsibility for environmental issues</td>
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<tr>
<td>Management</td>
<td>Environmental reporting</td>
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<td></td>
<td>Environmental audits and management systems</td>
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<td></td>
<td>Environmental profit and loss accounting</td>
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<td></td>
<td>Environmental performance</td>
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<tr>
<td>Industry Specific (for example)</td>
<td>Eco-design of products</td>
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<td></td>
<td>Product labelling</td>
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<td></td>
<td>Environmental liabilities</td>
</tr>
<tr>
<td>Social (33% weight)</td>
<td>Corporate governance</td>
</tr>
<tr>
<td>Strategic</td>
<td>Stakeholder involvement</td>
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<tr>
<td></td>
<td>Social policy</td>
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<tr>
<td></td>
<td>Responsibility for social issues</td>
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<tr>
<td>Management</td>
<td>Social reporting</td>
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<td></td>
<td>Child labour</td>
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<td>Conflict resolution</td>
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<td>Equal rights and non-discrimination</td>
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<td>Occupational Health and Safety</td>
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<td>Layoffs/freedom of association</td>
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<td></td>
<td>Standards for suppliers</td>
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<tr>
<td>Industry Specific (for example)</td>
<td>Community programs</td>
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<td></td>
<td>Resettlements</td>
</tr>
</tbody>
</table>

investors with a consistent framework for the financial quantification of corporate sustainability performance. The structure of the assessment methodology allows benchmarking companies on all relevant dimensions of sustainability: economic, social and environmental. In addition, company benchmarks for opportunities and risk categories, and for strategic, managerial and industry-specific criteria are possible. The methodology will be further developed in the future to reflect our increasing knowledge about the linkages between corporate sustainability performance and long-term shareholder value creation.

The DJSGI provides not only investors but also companies with strategic sustainability information. SAM Sustainability Group is planning to provide companies with more detailed rating and benchmarking services as a basis for their continuous improvement efforts. In future, all information exchange between companies and SAM will be supported by an internet-based information management platform.
**Figure 6** Sustainability Scores of Procter & Gamble

**Figure 7** Spread of total economic and environmental scores of 600 analysed companies
Sustainability leading companies included in the DJSGI will directly benefit from the growing demand for sustainability related investments. In addition, being included among the leaders in the DJSGI will enhance a company’s image in the eyes of its stakeholders and the public at large.

**Endnotes**

1. For more information on the SAM Sustainability Rating please refer to www.sam-group.com.
2. For additional information about the DJSGI and the described corporate sustainability assessment please refer to www.sustainability-index.com.