

Wednesday 21 December 2022

# focus



## ESG: How New Zealand companies measure up

Forsyth Barr has published its inaugural Carbon and Environmental, Social and Governance (CESG) ratings for New Zealand companies. The ratings help to build confidence in companies' long-term outlooks and to identify areas of risk beyond traditional financial analysis that warrant further investigation.

## Fonterra and farmers risk not being able to get debt funding from banks if they don't meet sustainability expectations •

Is Kathmandu greenwashing? 'Biodegradable' jacket ad pulled after complaint

## ...Those that don't evolve away from unsustainable business practices face the risk of sharp consumer and regulatory responses...

Court Bans Import Of Fish From Certain New Zealand Fisheries To Protect The Critically Endangered Māui Dolphin

Lessons from a backlash over a CEO's sexist comments

NZ King Salmon cuts forecast after warm seas lift fish mortality rates

Electricity sector has reached peak coal use, Genesis shareholders told

Historically, investors largely focussed on a company's financial performance — how much profit it made. This is changing. There are greater and greater demands on companies to be good corporate citizens and operate in a more sustainable way. The drivers of this change are many and varied, including, but not limited to, our rapidly changing climate, a need to transition away from fossil fuels, pressures on global food supply chains, greater inequity in society, and increasing levels of pollution, all backed by growing societal awareness and changing consumer demands.

The risks to businesses from this changing environment are more than reputational. Those that don't evolve away from unsustainable business practices face the risk of sharp consumer and regulatory responses. The pricing of greenhouse gas emissions or the ban on plastic bags are recent examples of once wide spread practices that are now frowned upon. Some of these changes can have a rapid and material impact on a company's financial performance, valuation, and reputation.

### Basic tools have evolved to help investors, but...

In response to investor demands to better understand Carbon and ESG risks and opportunities a new industry has emerged — third party suppliers of ESG company data and ratings. Often these ratings providers tally up how a company manages all the different ESG factors it faces into a single score, with the idea it

provides you an immediate snapshot of how well (or not) each company is doing.

Unfortunately, however, in our view the ratings provided are typically oversimplified. ESG issues are complex and nuanced. They require detailed knowledge of companies, sectors, and operating jurisdictions. And to be useful, they need to be regularly updated with the most current information. We have found that the ratings currently undertaken on New Zealand companies do not give us the insights we need. There is not enough detail or appropriate geographical nuance for the local market. The data is predominantly backward-looking, whereas we need a focus on the future. Furthermore, existing ratings do not cover an adequate range of New Zealand companies.

### Forsyth Barr steps in to fill the gap

Our response to the challenge of addressing important questions with imperfect tools has been to develop our own Carbon and ESG ratings. Our inaugural ratings enable an assessment of how companies are adhering to best practice and how they are navigating CESG risks and opportunities. They provide insights on how companies are positioning for a low-carbon, more sustainability-focussed future, and how they are thinking about their impact on the environment and society. It also enables an assessment of how companies are adapting to ever increasing demands from different stakeholders.



...New Zealand corporates are moving on the sustainability agenda and it is a quickly evolving space...

FIGURE 1: OUR CESG EXPECTATIONS OF NEW ZEALAND CORPORATES

<b>Carbon</b>	<ul style="list-style-type: none"> <li>Have a good understanding and be proactively managing any physical and transition risks associated with climate change</li> <li>Understand how its business model might be affected by changing consumer preferences</li> <li>Be preparing to meet upcoming climate disclosure standards</li> </ul>
<b>Environment</b>	<ul style="list-style-type: none"> <li>Have minimal negative impact on the environment as a result of operations</li> <li>Minimise the use of natural resources and also work to reverse the degeneration of ecosystems</li> <li>Be measuring and monitoring the consumption of water, waste that goes to landfill, and recycling efforts</li> <li>Have good policies in place to help measure and monitor resource use</li> </ul>
<b>Social</b>	<ul style="list-style-type: none"> <li>Have a positive impact on the communities that surround company operations/support surrounding communities to thrive</li> <li>Maintain and build on trusted relationships with clients, communities and other stakeholders</li> <li>Ensuring committed and proud employees</li> <li>Be measuring and monitoring health and safety incidents, risk of modern slavery</li> <li>Be aware of and managing potential ESG issues in supply chains</li> <li>Have good policies in place to help measure and monitor impact</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>Be adhering to best practice corporate governance standards and acting with integrity at all times</li> <li>Ensuring sustainability is linked into the heart of business models</li> <li>Proactively managing issues around, for example, data security, privacy and responsible tax governance</li> </ul>

Source: Forsyth Barr analysis

### Creating our ratings

After deciding on the CESG information we wanted to collect and assess for the 57 New Zealand companies we research, we undertook a year-long investigation, capturing more than 6,500 pieces of data. We converted the data into an overall score that classifies companies as a *Leader*, *Fast Follower*, *Explorer*, or *Beginner*. Our [methodology](#) is available as are the scorecards of all 57 companies we assessed.

A significant difference in our methodology versus external data providers is we have

split Carbon metrics out from the broader Environmental category. We have found that, typically, carbon-related metrics dominate an Environmental rating. We did not want to lose sight of other important Environmental matters, while also giving appropriate weight to the crucial transition to a low-carbon future.

### Our findings

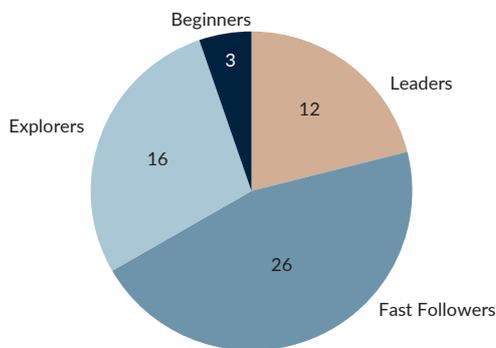
Our findings highlight that New Zealand corporates are moving on the sustainability agenda and it is a quickly evolving space —

**...almost all companies have a sustainability strategy in place or under development...**



but there is a lot more work to do. There is a significant gap between the *Leaders* and *Beginners* while the majority of companies fall into the *Fast Follower* and *Explorer* categories. And for those delayed in getting underway, there is increasing urgency to take meaningful action.

**CESG LEADERS, FAST FOLLOWERS, EXPLORERS AND BEGINNERS**



Source: Forsyth Barr analysis

**The things *Leaders* are doing which are great...**

Have sustainability strategies that have been in full operation for multiple years and are integrated into business strategies

Are generally collecting and reporting on a wide range of CESG metrics

Recognise and managing key CESG risks and opportunities

Are well versed on stakeholder demands and how they are evolving

Are already well prepared to meet upcoming climate disclosure standards

Are beginning to discuss the positive and negative impacts of business operations on the environment, economy, and people

**...while there are some archetypical characteristics of the *Beginners***

Despite being early in their journeys almost all companies have a sustainability strategy in place or under development

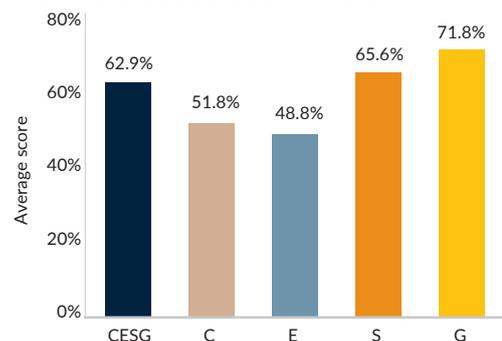
Are typically smaller market capitalisation (under \$1.5b)

Some are recently listed on the NZX so they have not previously been asked for CESG data

Others are outside the NZX50 and have not been rated by external ESG providers before

A portion have not had a commercial or regulatory imperative to report on ESG information until now

**AVERAGE CESG SCORES BY CATEGORY**



Source: Forsyth Barr analysis



**...We are encouraged  
by the response from  
companies thus far...**

#### **Where to from here?**

This first iteration of our ratings helps us to understand where companies are currently at on their CESG journey and acts as a baseline from which we can measure progress. The information provides a framework for us to discuss companies' strategies and initiatives. As the data gets better and our insights deeper, we plan to evolve the framework and methodology, and raise the bar year-on-year, finding ways to better assess the quality of responses.

We are encouraged by the response from companies thus far and look forward with keen interest as to how CESG scores improve in our future Carbon and ESG reports, and broader positive progress made by New Zealand businesses.

If you wish to read the full report [click here](#), the full [methodology](#) and individual company [scorecards](#) are also available.



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**If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.**

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