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# management *ethics*

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## **Sustainable Development's Time Has Come**

*By Dr. Blair Feltmate*

Many Canadian companies, spanning industry sectors from mining to banking, have committed themselves to minimizing environmental impacts that result from their activities, while also working to contribute to the social and economic well-being of the communities in which they operate. This commitment is described as *sustainable development*, a term coined by the Brundtland Commission in the publication *Our Common Future*, about 13 years ago.

The advocacy of sustainable development has been assumed by many prominent corporate executives. Notable among them is Senator J. Trevor Eyton, Senior Chair EdperBrascan Corporation, who unreservedly states that "our corporate group, including the directors and senior officers of Noranda, have concluded that sustainable development is an inevitability. The sooner a corporation reaches that conclusion, the greater its advantage in the future." Placer Dome Inc. Chairman John Willson affirms that "coming to terms with sustainable development will be key to our long-term business success."

But why are so many corporate leaders – and companies like Dofasco Inc., Falconbridge Ltd., Loblaw Companies Ltd., Nortel Networks, Royal Bank of Canada, TransAlta Utilities Corp. and Westcoast Energy Inc. – committing themselves to sustainable development with such strong conviction?

A partial answer lies in anecdotal evidence that sustainable development is simply good business.

For example, benefits are realized by sustainable development companies through increases in sales to discriminating customers who prefer what have come to be known as *green* products. Further benefits accrue to sustainable development practitioners as they strive to

increase operational efficiency and minimize the production of waste, which is good for both the environment and the bottom line. For example, as Ford Motor Company produces more output (cars) per unit of resource consumed (electricity), this pleases both shareholders and environmentalists.

Relative to risk, sustainable development companies are generally viewed by banks as well managed. In response, these companies realize greater success in securing loans, and the cost of borrowed capital is often adjusted downward in response to perceived low risk. As John Gray, Senior Manager, Environmental Risk, the Royal Bank explains, "The Royal Bank integrates a comprehensive environmental review process when assessing applications for financial

assistance. Occasionally we approve projects when a [poor performer] has an appropriate corrective action program that can be put into effect, but typically companies that do not have a solid track record in environmental management are much less likely to

receive approval than those able to demonstrate sound environmental

performance.” Within the context of sustainable development, similar reasoning applies to risk adjusted corporate insurance premiums.

For companies opening new facilities, either within Canada or abroad, a reputation for adhering to sustainable

development can have a substantial pay-off. Falconbridge Ltd. is a good example of a nickel mining company that has realized the benefits of sustainable development with its mine in Raglan, northern Quebec, where local residents turned out early on as enthusiastic supporters. Conversely, other mining companies, perceived as less committed to sustainable development, have realized very costly delays in reference to project start-ups.

Quite clearly, the anecdotal evidence in support of sustainable development contributing to the creation of shareholder value is compelling. But what about harder evidence?

Over a period of four years Toronto-based YMG Capital Management Inc. engaged research to assess whether a portfolio of large Canadian companies, that were practitioners of sustainable development, would realize share price appreciation in excess of the benchmark TSE 300. YMG used their proprietary Sustainable Development Index (SDI™) to identify companies that were meaningful practitioners of sustainable development. The SDI™ focused on 80-160 quantifiable, industry-specific measures of environmental, economic and social performance.

Industry specificity was necessary due to idiosyncratic differences between the operations of banks, mining companies, hotel chains, utilities, etc.

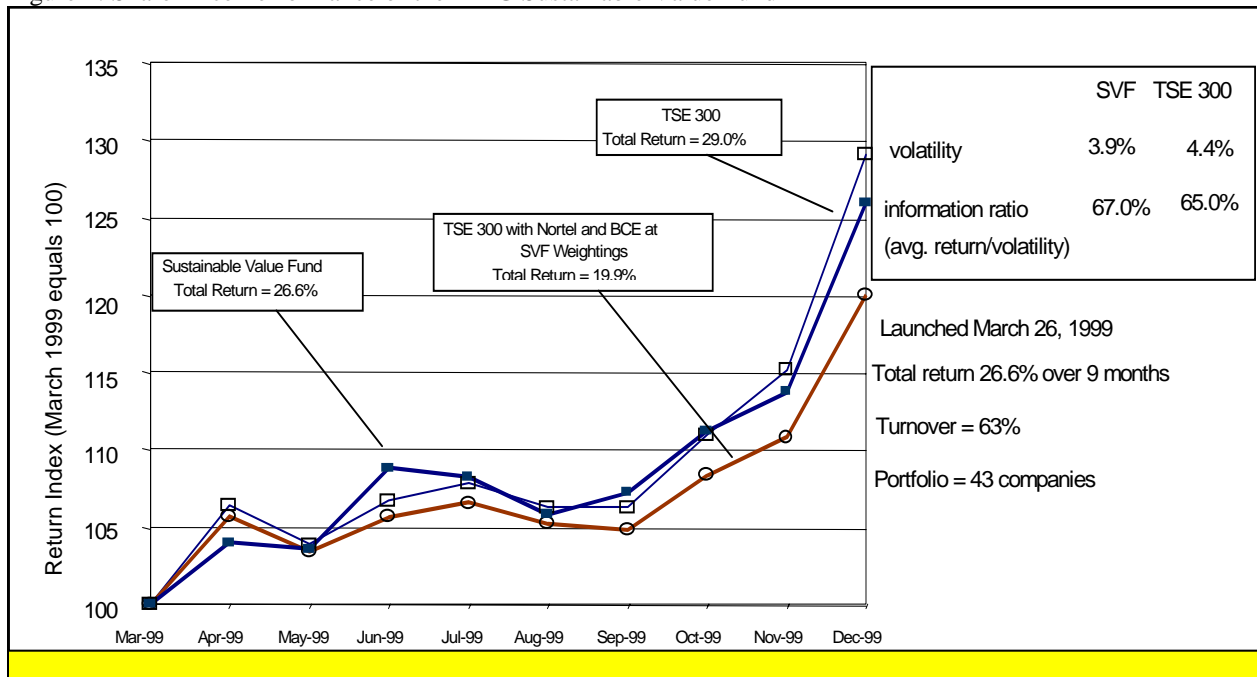
Research indicated that “sustainable development” companies, identified using SDI™ analysis, realized share

price appreciation in excess of market performance. Recognizing sustainable development as a value driver, YMG launched “sustainable development” screened pension and mutual funds in March and June, 1999, respectively. The performance of the Sustainable Value Pension Fund (i.e., the longer running of the two funds) is presented in Figure 1.

The return of the TSE 300, between March-December 1999, was 29.0%. This return was driven largely by substantial increases in the share prices of Nortel Utilities and BCE Inc., which collectively constituted approximately 28% of the TSE 300 during this period. For the YMG Sustainable Value Fund, industry restrictions determined that Nortel and BCE could constitute no more than 20% of the portfolio, thus the returns of the fund were necessarily lower, at 26.6%, than those of the TSE 300. However, when the weightings of Nortel and BCE were equally balanced between the TSE 300 and the YMG Sustainable Value Fund, as indicated in Figure 1 the YMG Sustainable Value Fund outperformed the adjusted TSE 300 by an impressive 6.7% (note that this figure reflects “live money under management”, and not a study based on back-tested data).

In addition to the direct impact sustainable development has on share price appreciation (discussed above), correlative factors pertaining to “superior quality of management” must also be considered. Specifically, companies committed to sustainable development tend to think “ahead of the curve”, and it is therefore reasonable to postulate that these companies probably make good decisions regarding such issues as production efficiency, innovation, new market opportunities, financing and other value added initiatives. (*continued page 4*)

Figure 1: Share Price Performance of the YMG Sustainable Value Fund



## Ethics Terminology

By W. Morley Lemon, PhD, FCA

There is often confusion about terms used in discussions about ethics. This section of *Management ethics* will attempt, on an irregular basis, to shed some light on the words used in such discussion by providing some commonly accepted definitions. The following discussion is based on the *Oxford Dictionary of Philosophy* (Simon Blackburn, Oxford University Press, 1960) and *The Cambridge Dictionary of Philosophy* (Robert Audi, editor, Cambridge University Press, 1995)

**Ethics** – the philosophical study of morality. Ethics is one of the main branches of philosophy and is more strictly described as *moral philosophy*. Ethics can be divided as follows “...the general study of goodness and the general study of right action ... constitute the main business of ethics. ...its principal substantive questions are what ends we ought, as fully rational human beings, to choose and pursue and what moral principles should govern our choices and pursuits.”(Audi, p. 244)

As rational human beings we should follow some moral principle or system when facing a moral dilemma. We should not make our decision in a vacuum. Examples of moral principals include:

**Utilitarianism** (Jeremy Bentham, John Stuart Mill and others) – an action (decision) is good or right if it produces more total happiness than total unhappiness. Another description is the greatest good for the greatest number.

**Duty** (Immanuel Kant) – an action or decision is right if performed by an individual’s desire to do his or her duty (i.e. do the right thing). In summary, when faced with an ethical dilemma, we, desiring to behave in an ethical way, as rational persons should follow some moral principle in making a choice as to how we will resolve the dilemma. For example, when I examine my bill in a restaurant and find the waitperson has not charged me for one of the items I ordered and consumed, I face an ethical dilemma; I could pay what I was charged or draw the cashier’s attention to the oversight. My choice, as a rational human, should be

governed by a moral principle such as duty and I should forgo my happiness at paying less and inform the cashier. My practice has been to inform the cashier. Similarly, when an organization faces an ethical dilemma, the decision-makers in the organization should follow some moral principle in making a choice as to how they would resolve the dilemma. For example, when the management at Tim Hortons recently found that when the handles on several of the coffee pots (of the thousands they had sold through their stores) broke they faced an ethical dilemma. They could ignore the situation, and probably no one would be burned by spilled coffee, or they could recall the pots, at some expense, and replace them with safe pots. Their choice, as rational humans, was governed by the moral principle of duty. They issued a recall through newspaper ads promising to replace the potentially unsafe coffee pots with new safe pots, and they offered a \$5.00 bonus to anyone turning their pot in as an incentive to purchasers to do so.

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## "Only what gets measured . . .

*Editorial by David Selley*

has value" appears to be a modern day business mantra. While intending no support whatsoever for this outrageous concept, increased interest in measurement is at least an indication that people are paying attention to it. It is hoped that this is true of measurement of ethical performance of corporations. It is certainly true that there has been an explosion of measurement of ethical performance of one kind or another.

Several organizations have developed and published, or are attempting to develop, criteria for ethical or social responsibility performance (1). Fund managers and other bodies in the securities industry have developed criteria for ethical, social and environmental performance and compare the performance of companies that meet the specified criteria with the market in general. One example is

described in the article in this issue by Dr. Blair Feltmate. His firm has developed a proprietary and complex set of measures as one filter for investments (the others being economic performance and timing). So far, over an admittedly short period of time, their investments have outperformed the market.

While one might argue that corporations should be ethical because it is right to be ethical, even a purist would presumably admit that being ethical because on balance it increases profits, or stock price, is at least a good second best. It is dangerous, though, for those who promote increased attention to the ethical dimension of corporate decision-making, to place too much faith in the positive effect of stock market-related measures that have mostly

operated in a period of feel good economics and a charging bull market. Ethics will be even more important when the current euphoria (and market prices) subside. If ethical companies generally outperform the market during a downturn, then that will surely be a good thing since it will further reinforce the trend towards ethical awareness by companies and investors.

Of course, the many performance criteria differ, and have different objectives. Some ethical funds and indexes, for example, exclude from their portfolios resource based companies on the grounds that they are by definition non-sustainable. Many, including this writer, believe this is a counter-productive approach, because resources are needed and it is especially appropriate that such companies act ethically because any unethical conduct will likely have a worse environmental impact than that of, say, a law firm. Resource companies that act with ethical awareness and care are to be prized in their own right, since they can make the biggest difference. Recognizing this, a few resource companies have been in the forefront of developing environmental and other social and ethical performance measures and reporting. Most indexes and fund managers do not exclude them.

What is most important about all this activity relating to ethical performance is that it is becoming much more difficult to push ethics to the sidelines. The present lack of consistency of ethical performance criteria, and the competition among fund managers to find the best criteria,

create some confusion and difficulty for business and for those interested in corporate ethics alike. But the subject is in its infancy, and the confusion is likely inevitable. In future, though, life will be simpler if at least the major NGOs and other international organizations that are working on criteria attempt to reach a consensus so that we eventually have no more than one or two internationally recognized sets of ethical principles (and reporting standards for ethical and social responsibility performance) for corporations. Fund managers can continue to play a role in searching for measures of their own to provide competitive advantage to their clients. The danger, though, is if ever the fund managers eventually conclude that shares of ethical corporations are under-performing the market, investors will lose interest in ethical performance. It is, therefore, inappropriate to rely solely on investors to champion ethical performance.

1 The Global Reporting Initiative, The Caux Principles, SA8000, and the Canadian Principles for International Business have all been referred to in previous editions. There are several others, such as "AccountAbility 1000", a foundation standard that comprises principles and process standards that are underpinned by the principle of accountability to stakeholders (see [www.AccountAbility.org.uk](http://www.AccountAbility.org.uk)). EthicScan, through its publication, The Corporate Ethics Monitor, has for many years rated selected corporations' social responsibility against a set of criteria it has developed based on a survey of many stakeholders (see [www.csrindicators.com](http://www.csrindicators.com))

## Sustainable Development's Time Has Come...

*(continued from page 2)* Accordingly, sustainable development correlates with sound management practices that would have a positive impact on share price. Frank Popoff, former Chairman of Dow Chemical, goes so far as to suggest that "sustainable development is actually one of the

signs that a company is well managed."

In sum, sustainable development began as a rather poorly understood initiative 13 years ago, and it has since emerged as a major force linking corporate social responsibility with the creation of shareholder value. Recognizing this linkage, the

challenge corporations now face is their continued ability to correctly identify and act upon key sustainability issues.

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