

Sustainability Ratings: A Social Responsibility Investment Perspective on Listed Airline Companies in Australia

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Abstract:

Sustainability ratings are prepared for a number of purposes, including the provision of information to assist investors with the assessment of environmental, social and financial business risk of corporations. A number of ratings agencies provide corporate sustainability information, particularly for ethical investors and for directors examining where their companies are seen to be weak or vulnerable to their own mistakes or to corporate competitors. It seems anomalous that ratings agencies provide scant information about sustainability ratings for the airline industry as it faces a number of important sustainability issues. This paper outlines the notions of sustainability, corporate sustainability and corporate sustainability ratings, before providing information about key aspects of three corporate sustainability ratings systems - the Dow Jones Sustainability Index, FTSE4Good Index and RepuTex Index. The potential importance of sustainability ratings for investors in the airline industry is then reviewed. It then considers sustainability ratings for listed airline companies in Australia, followed by a comparison of sustainability ratings for two listed airline companies in Australia - Qantas and Virgin Blue. Conclusions are drawn about the potential of such sustainability ratings in the Australian airline industry

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1 Introduction

Sustainability ratings for listed companies in the airline industry in Australia are examined in this paper in the context of socially responsible investment (SRI) by and in corporations. Three institutional situations arise in practice. First, sustainability ratings are produced by organisations external to the company being rated. Specific agencies provide ratings for a number of companies, industries and sectors. These ratings include, for example, the Dow Jones Sustainability Index (DJSI), the FTSE4Good Index and, in Australia the RepuTex Index. Second, funds themselves sometimes directly rate companies to include in their share portfolios for others to invest in. Information about such internal ratings processes is often confidential and is hard to obtain, but is often based on pre-specified negative or positive screening criteria. Negative screening excludes companies or sectors because their fundamental activities are not congruent with the aims of the fund. Positive screening leads to selection of companies based on the acceptability of their approach to addressing environmental, social or ethical issues of concern to the fund. Finally, some organisations provide data sets direct to investment funds, about social, ethical, environmental, etc. impacts of companies which might be included in investment portfolios. The fund then chooses those critical criteria from the set which will determine whether a company is included or excluded in their investment portfolios. Once again, information about such data selection is competitively sensitive, but subject to general screening criteria adopted by the fund managers. In consequence, the focus in this paper is on the first type of external ratings provided to the general market.

A major purpose of sustainability ratings is to encourage company management to control non-financial business risks, increase productivity and improve business opportunities in areas such as governance, environmental and social impact, and workplace practices (RepuTex 2005). Awareness and proactive management of these non-financial risks provide opportunities for the organisation to build a positive social responsibility reputation, reduce costs and future liabilities, and increase revenues (see RepuTex 2006). External sustainability ratings provide an independent assessment of a number of dimensions of company activity. Such dimensions depend upon the way in which each index is constructed. Marquez and Fombrun (2005) argue that sustainability ratings are of particular use in the growing social investment fund sector. In this sector, investors continue to look for a greater transparency in relation to company performance (Bauer et al, 2003; Gompers et al, 2003; Harrison & Freeman, 1999). This suggests that although financial performance remains at the heart of corporate disclosure, investors today place value on information about environmental and social aspect of companies and companies will react to investor responses to such non-financial disclosure and external assessments.

Australia only has a small presence in the international airline industry, with two listed companies quoted on the Australian Stock Exchange - Qantas and Virgin Blue. Yet, as seen in section 5, the industry has important environmental and social impacts. The two companies differ in size, in target markets, and in their strategies for securing customers. Qantas, founded in 1920 in Queensland, is the first airline company in Australia. The Qantas Group operates a diverse portfolio of airline related activities. The Qantas Group's Flying businesses include Qantas, Jetstar, Regional Airlines and

Australian Airlines. In the year ended 30 June 2005, Qantas recorded a profit before tax of A\$ 1027.2 million, up 6.5% on the previous year (Qantas 2005). Qantas is included in the ASX 300 largest companies in Australia. Virgin Blue, which started operations in August 2001, is known as a low cost carrier. Virgin Blue's passenger share of the total domestic market is around 30% (Virgin Blue 2005). Although Virgin Blue operates mainly in the domestic market, it recently launched international flights through a subsidiary, Pacific Blue. For the financial year ending 2005, Virgin Blue recorded a net profit of A\$ 238.5 million. It is not included in the ASX 300 largest companies.

The Qantas Group states that it recognises the importance of the environment and society in its daily operations and promotes continuous improvement in this area (Qantas 2005). The company has a Sustainable Future Programme designed to help it achieve savings through improvement in operational efficiency (Gregg 2005). Qantas also has the vision of achieving world class environmental performance, and has set a Group Environment Policy. It does not, however, publish a sustainability report. The absence of information regarding Virgin Blue's environmental and social practices makes it hard to assess the company's sustainability profile. It too does not publish a sustainability report.

Given this contextual information provided above it is now appropriate to address the research question considered here - 'To what extent are external sustainability ratings used by Australian ethical fund managers in deciding whether to include Australian airline companies in their investment portfolios?'

Given the social and environmental impacts of the airline industry, and associated business risks and opportunities for improvement, sustainability ratings should be of particular relevance for investors in the two airline companies.

The following sections briefly outline the notion of corporate sustainability and explore the reasons for its critical role in the airline industry. This is followed by examination of sustainability ratings and sustainability issues in the airline industry, discussion of the research methods adopted, data analysis undertaken, results of the analysis and conclusions of this study.

2 Corporate Sustainability

Corporate sustainability can be seen as a business approach to sustainability that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments Dow Jones (2003c). The U.N Conference on Trade and Development (UNCTAD) took a narrower view and defined a sustainable business as "one that leaves the environment no worse off at the end of each accounting period than it was at the beginning of that accounting period" (UNCTAD 1995).

Academics argue that sustainability is an ill-defined concept because it can mean different things to different stakeholders (Arlow & Gannon, 1982; Phillis and Andriantiatsaholiniaina, 2001; Schaltegger and Burritt, 2005). Also, terms such as Corporate Social Responsibility (CSR) and sustainability are often used interchangeably (Finch 2004). Such vagueness and ambiguity makes it confusing for those wishing to operationalize the concept, such as those concerned with the potential link between corporations and sustainability (Schaltegger and Burritt, 2005, p. 187). Given that sustainability is not well defined, it would be unrealistic to expect

the notion of corporate sustainability to be clear. In practice it is widely understood as being embodied in the multi-criteria triple bottom line perspective (Elkington 1998). Note that sustainability addresses economic as well as social and environmental performance. The view has been put forward that directors of a corporation only have one goal, the maximisation of shareholder wealth, with social responsibilities being the preserve of government who were elected to assume this purpose (Australian Government, 2005, p. 4). But this view has long been challenged. For example, in the USA most states retain 'corporate constituency' statutes to permit directors to broaden the constituencies or stakeholder groups that they may take into account in decision making, especially where the market for corporate control is concerned. Likewise, in Australia companies listed on the Australian Stock Exchange (ASX) are required to comply with the principles of good corporate governance which recognise the legal and other obligations of companies to non-shareholder stakeholders. In addition, the ASX comments that 'there is a growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital (ASX 2003). Current terms such as the *social contract* and the corporation's *social licence to operate* highlight the potential importance of the relationship between business and society, within a commercial framework that looks towards an increase in corporate benefits and reduction of risks faced by the corporation; suggesting that investors who incorporate social considerations in their investment process can receive higher returns (Clikeman 2004; Bruyn, 1987, p. 12).

There is a growing body of literature suggesting that sustainability is something with which corporations should be concerned (Schaltegger and Burritt 2005; Garz, Volk and Gilles 2002; Clikeman, 2004). However, little empirical evidence about these benefits has been gathered because it is not an easy process to integrate all dimensions of sustainability. Indeed, analysis of empirical studies reveals that no specific relationship between sustainability and corporate value has prevailed (Wagner et al. 2001). Instead, the literature suggests a number of possible interrelated explanatory factors. These include: (1) competitive advantage, where potential environmental and social regulations can be anticipated and new products and services developed (Porter and van der Linde 1995); (2) the link between corporate sustainability and reputation, caused for example, by people who would like to belong to a company that has a corporate image that they can feel good about (Reeves-Ellington 1998); (3) business and personal risk management, as surprise is removed from potential environmental and social liabilities (Burritt 2005); and (4) increasing shareholder value by reducing operational, investment and financing costs while increasing profits (Schaltegger and Figge 1998).

A further issue relates to the type of information of relevance to investors. There is a need to disclose the monetary repercussions on the corporation of its actual and potential environmental and social impacts (Schaltegger and Burritt 2005). However, of equal importance is physical information about the direct and indirect impacts of the company on the environment and society, as well as the qualitative considerations that form a critical part of any investment decision (Schaltegger and Burritt 2005; Finch 2005). Sustainability, or triple bottom line, accounting has been developed as an enabler of dialogue between stakeholders and the corporation based on such information.

The importance of companies disclosing environmental and social information is summarised by Moody-Stuart (2003):

"The escalating demands for information on environmental and social business risks from analysts, rating groups, benchmark organizations and

advocacy groups show no sign of abating. Business must choose whether to lead on reporting, or be led. ...non-financial reporting can be a powerful management tool. As it has evolved, great deal about past performance, but it is unable to reveal fully a company's intangible assets or the various risks and opportunities it faces in the market environment in which it operates."

3 Corporate Sustainability Ratings

A rating is an assessment or measure; a grade, category or standing (Simpson and Weiner 1989). Ratings facilitate comparison; they provide consistency between data and the basis for a common language to discuss risk and performance and to broadcast the performance to the market (Schmidheiny and Zorraquin 1996). Finch (2005, p.3) states that "sustainability ratings rank organisations' effectiveness at meeting the expectations of stakeholders while maintaining sustainable financial, environmental and social performance". Van den Brink and Van der Woerd (2004, p.11), suggest that a good sustainability rating is one that is compatible with financial accounting criteria, being quantifiable where possible and providing information that is meaningful to both the reporting company and its stakeholders. Schmidheiny and Zorraquin (1996, p.157) feels that sustainability ratings are based on facts and informed judgments about the company's approach to sustainability. According to Van den Brink and Van Der Woerd (2004), agencies rate the sustainability of companies to help ascertain whether they are operating in the interests of their current or future stakeholders both over time and in comparison with competitors. It is in a company's interest to have a good sustainability rating because this brings awards, applause, sales and reputation, while a bad one increases the likelihood of "churn", where various stakeholders turn against the company (Marquez and Fombrun 2005). From a financial accounting point of view sustainability ratings draw attention to the potential impact of environmental and social risks to a company's financial performance and financial position. For example, in the context of environmental risks, sources of financial exposure can include tort liability for such matters as personal injury, property damage, and penalties for failure to comply with environmental laws or remediation obligations (Zuber and Berry 1992). Under International Financial Reporting Standard (IFRS) 37 these risks should be treated as contingent financial liabilities when there is:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability

Hence, such information is already recognised as being of relevance to investors. Similar recognition exists with FAS #5 (Accounting for Contingencies) in the USA (Zuber and Berry 1992) and European Commission. Sustainability raters formalise and extend this recognition. There are many providers of ratings, but in this paper the focus is limited to the three sustainability ratings systems examined in the next section. However, it should be noted that, as Hooper and Greenall (2002) points out, any assessment of the sustainability of the airline sector is fraught with difficulties.

Variations of the exact definitions of the indicators used and the suite of functions embraced by the term “airline” are identified as fundamental obstacles to effective sector benchmarking (Hooper and Greenall 2002).

4 Corporate Sustainability Ratings Systems

A brief description of three sustainability ratings systems follows. Two of these are global in their outlook. The final system, RepuTex, has a distinctly Australian focus.

4.1 Dow Jones Sustainability World Index

The Dow Jones Sustainability World Index (DJSI World) provides investors with an index for global sustainability portfolios. It consists of around 300 companies – the leading 10% in terms of sustainability from the 2500 companies listed on the Dow Jones Global Index (Dow Jones 2003a). The DJSI rating takes into consideration the economic, environmental and social dimensions of a particular company in general or of an industry, by utilising sources such as company questionnaires, company documentation, media and stakeholders and direct contact with companies (Dow Jones, 2003b). The criteria considered and their respective weights are shown in Table 2. The Index score is then calculated using the following formula:

$$TS = \sum (ANS * CRW * QUW)$$

Where: TS = Total Score

CRW= Criteria Weight

QUW= Question Weight

ANS= Answer Score

4.2 FTSE4Good Index

The FTSE4Good Indices measure the performance of companies that meet globally recognised corporate responsibility standards (FTSE 2005a). Launched in 2001, the criteria are regularly revised and updated to ensure that they reflect developments in corporate responsibility thinking and trends in socially responsible investment as they evolve (FTSE 2005a). First, the companies should be in one of the following starting populations: the FTSE-All Share Index (UK), or the FTSE All-World Developed Index (Global) (FTSE 2005b). Next, companies in some industries (tobacco, nuclear weapons and nuclear power stations) are removed from the eligible universe. Companies are then screened according to the main criteria covering environmental sustainability, social and stakeholder and human rights. Classified as high, medium or low impact, companies are then assessed against appropriate indicators for each class (eg high impact must meet 5 core indicators). The FTSE considers Air Transport, the industry considered here, to be under the high impact sector classification.

4.3 RepuTex

In Australia, RepuTex is an independent CSR ratings and research agency, engaged in CSR performance appraisal and reputation risk analysis (Reputex 2006). RepuTex independently appraises performance and distinguishes between companies on the basis of their social responsibility commitment. RepuTex offers services to all types of organisations: listed and private companies, government bodies and not-for-profit organisations. In August 2005, Reputex launched the first Australia’s Socially

Responsible Investment (SRI) Index. To be eligible for inclusion in the RepuTex SRI Index listed companies in Australia must meet two criteria, as follows:

- They must be listed on the Australian Stock Exchange and be a constituent company included in the S&P/ASX300 Index; and
- They must demonstrate a required minimum level of socially responsible performance and risk management by being assigned a RepuTex Rating of "A" (satisfactory) or higher.

For the Reputex index, organisations are rated on a scale AAA to D. The main criteria on which they are assessed are: Corporate Governance, Environmental Impact, Social Impact and Workplace Practices.

In 2005, Qantas was the only Australian airline company in the RepuTex index. It has a rating of "A" which is considered as "Satisfactory". Table 1, which is adapted from the Qantas RepuTex report illustrates the ratings which the company has in the different sub-categories:

	Overall Rating	Corporate Governance	Environmental Impact	Social Impact	Workplace Practices
Outstanding	AAA	G1	E1	S1	W1
High	AA	G2	E2	S2	W2
Satisfactory	A	G3	E3	S3	W3
Low	B	G4	E4	S4	W4
Very Low	C	G5	E5	S5	W5
Inadequate	D	G6	E6	S6	W6

Table 1: RepuTex Score for Qantas in 2005 (in bold) (Reputex 2005).

As Table 1 suggests, according to its RepuTex score, Qantas still has considerable scope for improvement to achieve excellence in its environmental and social performance.

Because Virgin Blue is not in the ASX 300, it is not considered for inclusion in the RepuTex SRI index. As comparable data with the Qantas RepuTex SRI rating is not available, separate calculations would need to be made by any ethical fund wishing to consider Virgin Blue for inclusion in its investment portfolios.

In summary, one clear fact emerges, the DJSI includes all three triple bottom line criteria in its sustainability ratings, but the other two ratings omit economic criteria, thereby leaving a gap in any one stop analysis of sustainability.

Table 2: List of sustainability criteria included by three ratings agencies.

Dimension	Criteria	DJSI		FTSE4Good		RepuTex	
		Included	Weight (%)	Included	Weight (%)	Included	Weight (%)
Economic	Codes of Conduct/Compliance	✓	4.8		NA		
	Corporate Governance	✓	4.8				
	Customer Relationship Management	✓	4.2				
	Investor Relations	✓	4.2				
	Risk & Crisis Management	✓	4.8				
Environment	Environmental Policy / Management	✓	4.8	✓		✓	
	Environmental Performance	✓	6.0				
	Environmental Reporting	✓	2.4			✓	
	Voluntary Codes			✓			
	Product Stewardship and Life cycle Assessment			✓			
	Commitment to ecologically sustainable development			✓			
Social	Corporate Citizenship/ Philanthropy	✓	3.0	✓		✓	
	Stakeholders Engagement	✓	4.2	✓			
	Labor Practice Indicators	✓	4.8				
	Human Capital Development	✓	4.8				
	Social Reporting	✓	2.4	✓			
	Talent Attraction & Retention	✓	4.8				
	Human Rights			✓		✓	
	Consumer Rights, Access and Empowerment			✓			
Corporate Governance	Ethical Business Conduct			✓		✓	
	Ownership of Organisation			✓			
	Organisational Structure and Management			✓			
	Risk and Financial Management			✓			
	Audit Compliance			✓			
	Shareholder Relations and Reporting			✓			
Workplace practice	Employee Development and Training			✓		✓	
	Workplace Relations and Remuneration			✓		✓	
	Organisational Culture and Diversity			✓			
	Occupational Health and Safety			✓		✓	

Legend: NA = Not Applicable

Source: Adapted from DJSI (2003d), RepuTex (2006).

5 Corporate Sustainability and the Global Airline Industry

With the on-going debate on sustainable development, the airline industry is becoming a focal point.

5.1 Economic Performance of air transport

Air transport is one of the largest industries with a global economic impact of approximately US \$2,960 billion, equivalent to 8% of world Gross Domestic Product (GDP) and employing 29 million people (ATAG 2005). Aviation provides the only worldwide transportation network and has an indispensable role in global business and tourism. Over recent years the airline industry has been consistently growing - passenger numbers have increased by 45% over the last decade and have more than doubled since the mid 1980, the world fleet has more than tripled in size over the last 25 years (ATAG 2005). The main factors contributing towards growth have been increasing disposable income, reduced air travel cost due to deregulation and globalisation. Also, the industry generates wide indirect benefits: air transport facilitates world trade, helps boost productivity across the global economy, improves the efficiency of the supply chain, and acts as a spur to innovation and investment (ATAG 2005). In short, aviation plays a very important role in the world economy which is striving towards a "sustainable society". However, recent economic setbacks faced by the airline industry, are related to terrorism threats, regional wars, Severe Acute Respiratory Syndrome (SARS) and a surge in oil prices, and are some of the reasons behind recent financial losses recorded by the industry (Bisignani 2005).

5.2 Social Performance of Air Transport

Air Transport improves quality of life and standard of living by broadening people's leisure and cultural experiences (ATAG 2005). Trade and services liberalization has seen many new routes opening up, connecting some of the most remote areas in the world. Thus, air transport has a social function in improving the access to remote and regional areas. However, it presents a number of social problems.

Safety and Security

Safety and security are a high priority. Air transport security has been the subject of continual improvement and, in spite of the traffic increase, per passenger-kilometre air transport remains 25 times safer than road travel (ATAG, 2002, p.27). However, in the wake of the tragic 9/11 terrorist attacks, air travel has been through a disruption the effects of which are still being felt. In its pursuit of safety and security goals, the International Air Transport Authority (IATA) has developed a strategic direction called the IATA Six-point Safety Programme (IATA 2004a).

Congestion and Delays

Following deregulation of the airline industry around the world, the number of airline companies and travellers has increased tremendously while airport infrastructure has not kept pace (ATAG, 2002, p.29). As a result, congestion in the air and on the ground is having a severe impact on the quality of service provided, with side effects on fuel consumption as aircrafts have to use longer routes to bypass congested area, or carry additional fuel when holding delays are anticipated.

5.3 Environmental Performance of Air Transport

IATA has been consistently applying efforts within the industry to improve environmental performance. The main categories of environmental impact include noise pollution, air pollution and energy efficiency.

Noise pollution

Aircraft are claimed to be 75%, or 30 dB, quieter, than typical jets flying in the 1970's (IATA 2004e; ATAG 2005). According to (ATAG, 2002, p.47), air transport has a lower noise impact in comparison with other modes of transport; air transport on average affect less than a 5m² area, followed by coach (8m²), intercity train (29m²) and passenger car (approximately 37m²). Although noise levels have been declining at many airports, disturbance from aircraft noise continues to be perceived as critical, especially in high income countries. The International Civil Aviation Organisation (ICAO), in a partnership with the IATA, has been working on a *Balanced Approach* to address local noise problems in the most cost effective manner. The Balanced Approach consists of identifying the noise problem at an airport and then analysing the various measures available to reduce noise using four principal elements, namely: reduction at source, land-use planning and management, noise abatement operational procedures and aircraft operating restrictions (IATA 2004b).

Air pollution

Because of growing air traffic volume, total air pollution emissions have grown. However, today's aircraft emit five times less carbon monoxide and 20 percent less nitrogen oxides than engines certified before 1976 (ATAG, 2002, p.47). At present carbon dioxide emissions from aviation are thought to represent around 2% of total carbon dioxides emissions arising from the burning of fossil fuels. In comparison with other transport modes, emissions of nitrogen oxide per passenger kilometre on long haul trips are comparable with those of a modern passenger car but it is not as good on short-haul flights where high Landing Take off (LTO) emissions lead to high emissions per passenger kilometre (ATAG, 2002, p.41).

In the direct vicinity of airports, emissions of nitrogen oxides, unburned hydrocarbons, carbon monoxide and visible smoke contribute to local air quality concerns (IATA 2004d). Balancing society's growing demand for air transport and the need to mitigate the impacts associated with engine emissions poses a fundamental challenge. The 'low hanging fruit' for improving technological and operational standards within the air transport industry have already been gathered, making additional improvements increasingly difficult and costly to achieve.

In summary, the airline industry faces a range of environmental and social problems which make it a less than clean and socially desirable industry in all respects. The question is can its standing, as far as movements towards sustainability are concerned, be assessed?

The best estimate of aviation's share in climate change is about 3.5% of the total contribution brought about by human activity (IATA 2004c). This share is expected to grow to 5% by 2050 because of the high level of demand for aviation services and the fact that technological solutions are limited. To reduce its impact on climate change, the airline industry plans to optimise its use of energy, as well as consider other fuel options (ATAG, 2002, p.29). Aircraft also help deplete the ozone layer in the stratosphere, contributing to the problems associated with its thinning.

Energy efficiency

Today's world fleet consumes on average 4.8 litres of fuel for every passenger carried over 100 kilometres. For the period 1990-2012, IATA member airlines are aiming for a 26% increase in fuel efficiency (IATA 2001). At a worldwide average level, energy consumption per passenger kilometre of scheduled air traffic is comparable with that of a passenger car. On average both modes of transport consume around 2.7 Mj per passenger kilometre. Further improvements in energy efficiency are expected in the future through engine, aircraft design and operation improvement. The IPCC (1999)

report suggests that the average aircraft will consume 25% less energy per passenger kilometre by 2015 and 40% less by 2050 than in 1990 (ATAG, 2002, p43).

6 Socially Responsible Investment in Australia

The main motives to invest are maximizing return and minimizing risks. However investment can have some other facets. Many investors today want their investment holdings to reflect their values, and support companies that behave “responsibly” making Socially Responsible Investment (SRI) the next wave (ASX 2005). In the Australian context, SRI is seen as being the placement of money in managed funds, share portfolios, or other investment securities portfolios screened to reflect environmental, social, labour relations or other ethical considerations (EIA 2005). Growth of SRI was initially slow in Australia. Investors were reluctant to adopt the SRI approach for a number of reasons, including the dominance of the mining and energy sectors in the domestic share market, also the belief was held among investors that returns in SR investments would be lower. Finally, it was believed that there were insufficient high quality socially responsible investments available in Australia. However with the emergence of concepts like CSR, sustainability investment, etc, there an increase awareness and interest in SR investment has arisen. As a result SRI Managed Portfolios grew by 70% during the 2005 financial year, from \$4.5 billion to \$7.67 billion (EIA 2005). The main factors contributing to this growth were: large superannuation companies adopting SRI policies for existing portfolios (\$1720m), strong investment performance (\$785), capital raised by new SRI funds (\$153m) and net flows to established SRI funds (\$512).

In a survey carried out by CPA Australia from a sample of 700 people drawn from the public, shareholders and professionals, 54 percent disagreed with the statement that financial performance is more important than social and environmental concerns (CPA, 2005a). In the same survey 62 percent of those surveyed said that if a company has an unfavourable environmental reputation, it would considerably discourage them from investing in the company. Only 8 % of the sample said that they would not be discouraged at all, while the remaining 30% responded that they will be discouraged a little. In the same survey the preference to invest in a socially responsible fund was revealed. 83 percent of the sample agreed that if they were looking to invest in a business that adopted socially and environmentally responsible practices they would choose a socially responsible fund (CPA 2005a). This study confirmed how much Australian investors today value the environmental and social aspects of a company in their investment decisions. Table 3 identifies the level of reliance on the different sources of social and environmental investment information available.

Table 3: Reliance on Sources of Social and Environmental Investment Information (sample of 700 = 100%).

	Own Research	Annual Report	Sustainability Report	Financial Advisor	Investor Briefings	Rating Agencies	Website	Investor Newsletters	Media Reports
	%	%	%	%	%	%	%	%	%
A lot	71	43	42	50	26	37	18	15	14
A little	27	51	50	37	58	47	63	63	64
Total (N)	100	100	99	99	84	99	99	99	99
Positive	98	94	92	87	84	84	81	78	78
Not at all	2	6	7	12	NA	15	18	21	21
Total (N)	100	100	99	99	84	99	99	99	99

Source: CPA (2005b).

The results show that the most widespread form of SRI investment information is gathered from in-house research. Ratings agencies are a popular source, along with annual and sustainability reports and financial advisors. Watmore and Bradley (2001) suggest that with the present level of interest, ethical investing is undoubtedly going to become an accepted and major part of the Australian investment landscape in the near future. Such optimism is backed by recent research commissioned by CPA Australia (CPA 2005a), which reveals that companies that adopt a sustainability approach to reporting have superior financial performance, gearing, debt servicing and valuation multiples. The same research concluded that funds structured towards socially responsible investments tend to perform below the market in the short to medium term, but that this gap narrows over long periods. At the same time, socially responsible investments are seen to exhibit lower volatility of returns than all the major market benchmarks.

7 Research Method

The lack of past research evidence on the use of sustainability ratings makes an interactive phone interview an appropriate medium for gathering preliminary evidence. Phone surveys provide an interactive environment where issues could be clarified and additional insights and follow-up obtained. Although Dillman (2000) highlights certain deficiencies and problems, phone surveys are used extensively in market and academic research because of their speed and ease with which a sample can be contacted in a cost effective way (Ticehurst and Veal 2000; Weitz 1990). Another advantage of this method includes the observation that respondents feel

anonymous and therefore, may be more forthcoming in their opinions (Ticehurst and Veal 2000).

Ethical clearance was received before the interview process commenced. Each interviewee was phoned and asked if they were willing to spare a few minutes of their time to answer three questions. Once consent was given, their answers (and any other opinions) on the subject matter were recorded. These responses were then analysed.

8 Results of analysis

Results from the telephone interviews are summarised in Table 4.

Ethical Fund	Qantas included	Virgin Blue included	Use of sustainability ratings	Importance of external ratings (Scale 1 to 10)
A	Yes	No	No	2
B	Yes	No	Yes	5
C	Yes	No	Yes	N/A
D	No	No	No	0
E	No	No	No	0
F	No	No	No	2
G	No	No	No	3
H	No	No	No	10
I	No	No	No	N/A

Table 4: Sustainability ratings telephone survey of nine ethical investment funds in Australia.

Nine managers of major ethical investment funds were contacted. The funds represented more than 80% of the SRI funds under management in Australia. Managers were asked whether their fund used sustainability ratings in selecting companies to include in their ethical investment portfolios. Twenty two percent said that they did use the Reputex sustainability ratings in selecting companies for their portfolios.

Managers were then asked whether they included either Qantas or Virgin Blue in their SRI funds. One third of the major fund managers advised that they included Qantas in their ethical fund portfolios. In contrast, Virgin Blue was not included in any of the ethical fund investment portfolios. Reasons suggested for the exclusion of Qantas and Virgin Blue included: negative screening meant that the airline industry as a whole was not included because it has significant environmental and social impacts; positive screening means that the airline industry is not considered to make a positive contribution to the environment; one of the two listed companies was cited as being associated with military and alcohol related activity.

Finally, managers were asked to rank the importance of external sustainability ratings on their decision to include a company in their ethical funds. On a scale of 1 to 10, where 10 represents 'very important', on average the fund managers rated the importance of external ratings at a relatively low figure of 2.2. The figure suggests that ethical fund managers in Australia do not consider external ratings to be highly influential in their portfolio decisions. Two of the nine companies in the sample did not wish to assess the importance of external ratings because they were of the opinion

that it is was not possible give a score given the fact that external ratings are only one of the set of criteria they use.

8.1 Limitations

Conclusions from the paper are limited by: the small sample of managers interviewed, even though they represented a large proportion of the SRI industry in Australia; the focus on sustainability ratings in a single industry, the airline industry, which is at present underrepresented in sector sustainability ratings; the examination of only three well known ratings services - the DJSE, FTSE4Good and Reputex; the limited time and scope of interviews conducted by telephone for this exploratory research.

9 Conclusions and Summary

The paper set out to seek an answer to the question “To what extent are external sustainability ratings used by Australian ethical fund managers in deciding whether to include Australian airline companies in their investment portfolios?” In addressing this question the paper initially examines the concepts of sustainability and corporate sustainability. It concludes that these are ill defined. Sustainability ratings can be criticised on the same grounds. Sustainability ratings are also much criticized because they tend to look at separate individual factors related to environmental, social and economic performance. However, sustainability is more about the integration of these factors, and so far, sustainability ratings seem to overlook this issue, more in accord with the triple, and separate, bottom lines concept. There is what might be described as a “sustainability gap” which ignores the interaction component. Furthermore, although SRI is becoming an increasingly popular type of investment, as noted by the survey carried out by CPA Australia (CPA 2005b), there is a lack of ratings in Australia which benchmark sustainable investment. As a result, Australian companies remain relatively immature in their rating and disclosure about sustainability (see Finch, 2004, p101).

Included in this study are some new exploratory insights into the emerging field of the relationship between corporate sustainability and ratings.

First, the airline industry is often seen to having negative environmental impacts, thus pitching the industry into the forefront of the sustainability debate. The evidence gathered here indicates that fund managers adopting positive screening tend to omit airline companies from their portfolios.

Second, SRI fund managers suggest that sustainability ratings are of low significance to their portfolio investment decisions. However, air transport is a major sector of the world economy, hence, categorizing all airline companies in the sector as “unsustainable”, as is the case with some ethical investors, requires re-examination. Perhaps the shortage of sustainability ratings for airlines reinforces the perception that sustainability and the airline industry do not mix. British Airways for instance is regarded by some as one of the world’s top 100 sustainable companies (Innovest 2005). Furthermore, industry organizations such as the IATA and the ATAG are set on changing this perception, being committed to maximizing the social, environmental and economic benefits of the industry. Such indirect support for improving movement of the industry towards sustainability provides potential demand for the development airline industry-specific ratings.

Third, integration, the key component of sustainability is missing from sustainability ratings. Further, of the three ratings systems examined two treated social and environmental performance as separate silos, divorced from economic performance,

something with which investors, companies, industry associations and those concerned about a full picture of sustainability and necessary trade-offs, will not easily identify. One area of future research relates to the formulation of new indicators which look more closely at the interaction between all components of the triple bottom line, such as eco-effectiveness and socio-effectiveness, with at worst a view towards long term maintenance of environmental, social and economic capital.

Fourth, the paper examined whether ethical funds in Australia use external ratings such as Reputex to construct their portfolios. However, what it found is that sustainability is only one of the many things fund managers look for. Perhaps, future research could explore all the factors which ethical fund managers take into consideration when choosing their portfolio. The importance of sustainability ratings for fund managers was gleaned from a telephone survey and linked with empirical evidence from previous research. However, because of the exploratory nature of the research, the interviews were limited to the major SRI fund managers in Australia. Given further time and resources, the interviews could be carried out in such a way as to explore the perceptions of a greater number of participants, thereby eliminating any possible bias towards the views of managers of large funds.

Although the findings of CPA Australia (CPA 2005b) reveal that approximately 98% of a sample of 700 people considers environmentally and socially responsible practices in investment decision making, the current study shows that external ratings of these practices are not in wide use by ethical funds. Rather, the emphasis appears to be on the provision of information by internal (management) sustainability accounting systems and choice of relevant indicators from available data sets. Clear scope for future research into these systems exists.

10. References

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