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"What is Your Water Footprint"

21/10/2009

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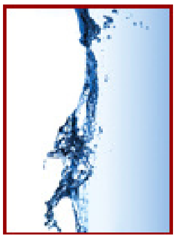
WATER MANAGEMENT: What is your water footprint?

The Norwegian sovereign wealth fund is monitoring how companies manage their water supplies. *Angele Spiteri Paris* investigates...



Water is a commodity taken for granted by many companies, particularly in the developed world. But businesses in water-dependent sectors may have to stand up and take notice if shareholders put pressure on them to manage water resources and stop profitability from draining away.

Water as a thematic investment has been around for a number of years. But water-related investment to some investors means checking for sustainabile supplies of the liquid, which can save companies millions of euros each day.

Norway's sovereign wealth fund, the Government Pension Fund – Global, which has NOK2.47 trillion (€289bn) of assets, highlighted the importance of water management in its latest set of results. The fund is making water management a new area of corporate governance and is due to publish its expectations of how companies should manager their water resources.

Anne Kvam, global head of corporate governance at Norges Bank Investment Management, which manages the majority of the sovereign fund's assets, says: "Poor water management may result in operational and physical disruptions – or operational risks – but also increased water-related regulatory risks and in brand damage with huge potential financial costs for companies.

"Consequently, investors need adequate and transparent information regarding water-related risks to better assess the risk of their investment."

Numerous sectors are water-dependent – and not just the most obvious ones like agriculture, paper and pulp and mining. General retail businesses, transport companies and even the leisure sector all have a level of water exposure that could influence their operations and, ultimately, their profitability.

Denis Schmidli, senior product specialist within Pictet Asset Management's water fund, says: "A micro chip-making business, for example, needs roughly 400,000 liters of water per hour. This is not tap water either. It needs to be highly purified. Poor water quality would put the whole business at risk. In other words, they need to make sure that this essential resource is available in the quantities required."

According to Envirowise, a UK government-funded programme working to increase awareness about sustainable use of resources, UK businesses alone are missing out on cost savings of around £10m (€10.9m) per day. That's over £3.5bn per year.

A survey of UK businesses revealed that almost two-thirds of respondents do not currently measure or monitor their water use at all, and a huge 85% do not have any water reduction targets in place.

Claire Sweeney, Envirowise water specialist, says: "With more than 9.8bn cubic metres being used nationally each year, there is significant potential for businesses to save money and reduce their environmental impact by taking action on water efficiency."

Paolo Sardi, CEO of ECPI, a research, rating and index provider focused on sustainability, says: "Currently only a minority of companies mention water risk in their corporate reporting. Within this group only a few address external water-landscape and supply-chain issues in evaluating risk."

An obvious means to make corporates pay attention to the issue is to put a price on water.

Market's the way

Neil Eckert, CEO of Climate Exchange (CE), says: "One way to make [companies] care about water is to trade it and provide the profit or loss incentive. That is what happened with carbon and as a result carbon trading is now so high profile."

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Climate Exchange is principally engaged in owning, operating and developing exchanges to facilitate trading in environmental financial instruments. Eckert explains that active water markets can provide incentives for companies to make water a top priority. He believes it will take a few years and a number of different initiatives before this becomes a reality.

Eckert says: "Currently there are a few water markets in infant stages. For example, Australia is one place where there's water markets trading. We are involved with various pilot schemes in America and are also looking at potential for trading water in China. So there are markets starting."

So water markets can potentially redress the balance of water usage - and offer another route for investing in the commodity too.

Dennis Wichelns, an agricultural economist with the International Water Management Institute (IWMI), says: "Already large cities in the US are buying their water rights from farmers and moving their water to cities. We'll see companies doing similar things.

"Companies don't necessarily need a lot of water to do what they do. The water they use has relatively high value per unit so if a company purchases even five or ten per cent of a farmer's water supply, then that company can often accomplish its goals and leave the farmer with 90-95% of his or her water supply. So both parties win and that's why water markets can make so much sense."

But the creation of such markets is not that straightforward. This is mainly because water and accessibility to it is very localised.

Wichelns explains the difference between the nascent water markets and the now more mature carbon markets. "We can't ship water from Australia to Europe. But with carbon, we all contribute to the global pool of CO_2 in the atmosphere. Therefore reducing carbon from any region or country is beneficial to the common good because anybody anywhere can trade carbon credits. Water is going to be a little more limited but it can be very powerful to have effective water markets within dry areas."

Carrot and stick
Ultimately, having an actively traded market for water should help reach environmental goals as well as boost company profitability. Similar to what happened in the carbon market, water could become an expensive commodity and according to Eckert: "The more expensive something is, the better you tend to look after it."

Robert Glennon, author of Unquenchable: America's Water Crisis and What To Do About It, says: "If the price of water rose, people would carefully examine how they use water, for what purposes and in what quantity."

Although water can be sometimes tricky to price, Schmidli, of Pictet, says: "In some countries water is actually rather expensive. In Copenhagen, Denmark, the price for a cubic meter of water is close to US$9 [€6]."

According to Eckert, on some level, consumers have already started to attach a higher value to water. He gives the example of people paying good money for bottled water in restaurants: "They're actually spending more on bottled water than they do on a litre of petrol. It's hard to rationalise, but subconsciously people are starting to recognise the value of clean, guaranteed water."

The question is whether this consciousness has been trickling into the corporate world.

Jim Brezack, project director at ICF Jones & Stokes, an environmental consultancy, says: "It's the old metaphor of the carrot and the stick. In my line of work I've always seen agencies and companies do things for one of two reasons: either they're regulated and fined, so they must comply; or they see an opportunity for either bottom-line increases or a grant opportunity which they need to use to meet their cost of compliance."

So it's all about incentives, both positive and negative.

Crime and punishment
Authorities have the power to dole out hefty fines to firms that do not comply with certain restrictions on water consumption and wastewater discharge.

But Brezack notes that this may not be sufficient. He says: "You get poor water management because it's cheaper than good water management. So this will occur unless there are punitive measures that make good management cheaper."

He says that in some sectors companies absorb any fines as part of the cost of doing business. So although fines are already being enforced, they may not be meeting their aim of making companies more water conscious.

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But what they need to realise is that taking care of their water supply is ultimately to their benefit as well as to the benefit of the environment. And in some cases, the message is getting through.

Wichelns, of IWMI says: "At the micro level companies are endeavoring to show that they are doing and what they can do to reduce their water use, to reduce their 'water footprint'."

He says this was one of the hot topics at World Water Week, held in Stockholm in August this year. At the event, company CEOs and presidents addressed the rising significance of water as a strategic business concern.

Björn Stigson, president of the World Business Council for Sustainable Development, says: "Business is dealing with this uncertainty [brought about by climate change] by getting more energy out of each drop of water and more water out of each unit of energy, but there is an urgent need for clear policies and principles for sustainable water management."

Wichelns says the reduction of a company's water footprint is "done for good public relations and also to see whether they can generate some cost savings in some areas. As water becomes scarce companies know that they could be paying more for water once those scarcity values are priced in".

Sectors that care
Certain sectors of the industry are more sensitive to the water issue than others, particularly those in the food arena.

Wichelns says: "Large international firms like Nestle and PepsiCo and Coca Cola and some others are getting together and forming consortia to look at this issue of water resources on the planet. They're concerned that water sources generally could become a very binding constraint on production and consumption activities in the next 20-30 years."

So there are sectors that realise water is an important part of their business. The Environment Agency in the UK held the Water Efficiency Awards in July this year, to commend businesses that have made an effort to manage their water.

The overall winner was Lafarge Cement UK. The company reduced its water use by 95% and is now saving £14,000 a year in associate electricity costs at one of its sites.

This is evidence that companies can take action and savings can be made from water management that - hopefully - will be passed on to investors.

But not all sectors are aware that water management is vital to their bottom line.

Although most people spoken to were hesitant about pinpointing specific sectors, areas like silicone chip manufacturing and cooling were mentioned.

But getting these sectors to be proactive about sorting out their water management is not a simple task, but shareholders can play a role.

Shareholder importance
Together, agriculture and industry use 92% of the global water supply and therefore having water-aware companies in these sectors can make all the difference.

But how does one make large firms care about a resource that has been considered practically free for centuries?

Shareholders are one of the most important players when it comes to putting pressure on companies to sort out their water management.

Jean Ryan, investment specialist at KBC Asset Management, says: "Clearly the move by the Norwegian fund is reflective of the fact that there probably hasn't been enough of a focus on reporting or transparency in that whole area. What has always happened is that capital markets investors and analysts would have been proving these issues with companies because of the impact on profitability and results.

"But what is happening slightly differently now is that investors are coming at it from a sustainability angle. They see it as an investment risk, but also [as a] sustainability issue and that is something that is increasingly important."

So pressure from influential investors such as the Norwegian fund can lead to companies taking the water issue more seriously, since they risk losing those investors' support if they don't.

Ryan adds: "We would see it very much as an area that's going to involve increased focus and investment over the years ahead… the absence of a reliable source of sufficiently clean water can literally be a show stopper."

According to Therese Niklasson, head of governance and responsible investment at Threadneedle: "Water is now

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regarded in line with energy as a key resource input to business, showing greater numbers under operational costs on the P&L, but unlike energy, the global water problem is widely regarded as not one of fundamental resource scarcity, but one of management and governance failure.”

The management and governance failure Niklasson speaks of could indicate that shareholder pressure may not be enough to force companies to manage their water more appropriately.

The challenge is to retrain the corporate brain to accept that water is a precious commodity.

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