White paper

Greenwashing risk indicator

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Covalence SA
Antoine Mach and Marc Rochat, co-founders

1 Avenue Industrielle
1227 Geneva, Switzerland
+41 (0)22 800 08 55
http://www.covalence.ch
contact@covalence.ch

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Introduction

Covalence's ESG rating system has been enriched with a greenwashing risk indicator highlighting discrepancies between companies' promises and action regarding sustainability. Like a **sincerity detector**, this new indicator gives a more realistic picture of their ESG credentials while enabling to assess the credibility of sustainability commitments, analyze ESG risks, identify future leaders and spot companies showing most progress.

As of April 30, nearly 1,200 companies out of the more than 13,000 monitored (9%) present a risk of greenwashing on at least one of the three pillars Environment, Social, Governance.

The greenwashing risk indicator is obtained by comparing forward-looking and backward-looking news sentiment. Forward-looking news data covers companies' sustainability commitments and aspirational statements, while backward-looking data reflects how stakeholders perceive their achievements and past actions.

Rationale

Why did we develop a greenwashing risk indicator? While sustainable investment represents 37% of assets under management worldwide[1], there are increasing claims and fears of greenwashing in finance, be it from asset owners, finance professionals, academics, international organizations, market supervision authorities, and NGOs. In the broader public, the very idea of sustainable investments is often being challenged or depicted in negative, even cynical terms. Hence, it is important that these claims and fears of greenwashing are addressed seriously.

Our actual and potential customers - mostly investment professionals - are increasingly calling for forward-looking ESG data. Several of them are not fully satisfied with ESG ratings currently offered by major providers, as these are mostly backward-looking and are quite uncorrelated one from another. Forward-looking ESG data is believed to provide information not yet integrated by market players.

In Covalence's existing rating system, certain companies register a high ESG score and a low level of current controversy thereby obtaining a high score and a risk considered as "mitigated". By comparing forward-looking and backward-looking data, discrepancies and incoherencies between companies' commitments and realizations can be identified and integrated into the risk assessment.

[1] According to the Global Sustainable Investment Alliance

Methodology

Covalence's ESG ratings are based on two types of data: quantitative indicators, which draw upon data disclosed annually by companies, and used to calculate a disclosure score; and news-based data, which takes positive and negative news published by the media and other stakeholders to calculate a reputation score following sentiment analysis.

The greenwashing risk indicator is calculated using news-based data. As a first step, the news data is tagged with forward-looking elements: prospective keywords such as "net-zero", "commitment" or "target", future dates, quantities, and units of measurement. This tagging allows to split the news data into two groups: forward-looking data and backward-looking data.

The former describes companies' commitments, targets, and ambitions in terms of sustainability, while the latter covers companies' achievements, legacies and past controversies.

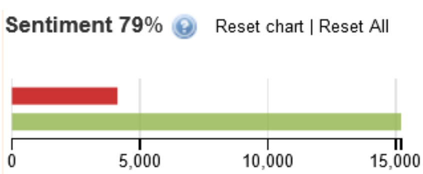
Headlines found in forward-looking news data

- *3M plans to reduce use of virgin fossil-based plastic by 56,700 tons by 2025*
- *Ericsson to provide one million children, youth access to digital learning skills by 2025*
- *Ryanair s'engage à 12,5% de carburant durable d'ici 2030*
- *Glencore commits to net zero emissions by 2050*
- *Phillips 66 to cut 30% greenhouse gas emissions by 2030*

Headlines found in backward-looking news data

- *Boohoo agrees to preliminary terms in U.S. class action lawsuit*
- *Feds responding to reports of oil, chemical spills after Ida*
- *Investigates Story Leads to Larger Fines for Eversource*
- *2021 a 'Landmark' for Corporate Human Rights Litigation*
- *First rehabilitated birds released after being oiled at Phillips 66's Alliance refinery*

A sentiment, or reputation score, is calculated for both data sets, forward-looking and backward-looking. The basic metrics used are quantities of news items gathered on the web that can be coded as having a positive or negative polarity towards named companies.



Positive news articles are called "endorsements", while articles with negative polarity are "controversies".

A historical erosion factor is applied to the quantities of positive and negative news with recent articles weighting more than older ones. The sentiment, or reputation score, is given by the share of positive news over the total of positive and negative news.

The following scores are calculated for each of the E, S, and G dimensions:

Forward-looking sentiment: reputation score based on forward-looking news data, reflecting sustainability commitments, targets, and ambitions

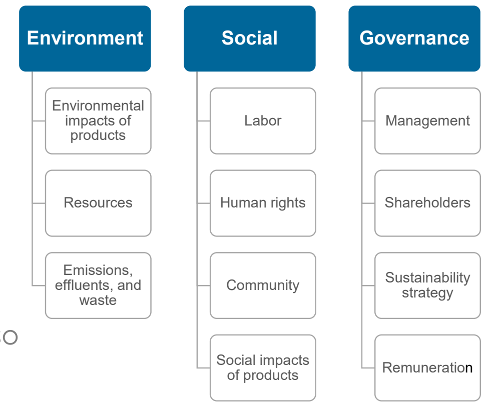
Backward-looking sentiment: reputation score based on backward-looking news data, reflecting achievements, legacies, and past controversies

Greenwashing risk indicator: difference between backward-looking sentiment and forward-looking sentiment (based on standard deviation from the mean value)

Sentiment analysis applied to ESG news data			Greenwashing risk indicator
Forward-looking sentiment Reflecting commitments, targets, and ambitions	>	**Backward-looking sentiment** Reflecting achievements, legacies, and past controversies	Medium or high greenwashing risk
	≈		Low greenwashing risk
	<		Green muting risk

When both sentiment scores are similar, the greenwashing risk is considered as **low**, and commitments as **credible**, in line with data describing the past. Such similarity does not inform on the absolute strength and ambition of commitments, but rather on their coherence with what companies have achieved so far, in relative terms. Companies are believed to '**walk the talk**'. This situation is represented with a white color.

When the forward-looking sentiment is superior to the backward-looking sentiment, a medium or high **greenwashing risk** is identified, signaling potential discrepancies between companies' announcements and their actual practices. The credibility and trustworthiness of corporate commitments are challenged by past wrongdoings and controversies. Companies are thus suspected of 'not walking the talk'. Such cases are indicated in red. When the forward-looking score is inferior to the backward-looking score, the greenwashing risk is negative: we rather face a **green muting[2] risk,** indicating a lack of commitments due to missing sustainability strategy, to a hiding posture (**voluntary green muting**); this situation could also be due to commitments made inaudible as being frequently or systematically associated with controversies (**forced green muting**). Such cases are also indicated in red.



The greenwashing risk indicator is calculated with the ESG news database run by Covalence since 2002. The data is first classified according to 50 criteria inspired by the Global Reporting Initiative (GRI). It is then recoded with hundreds of topics and sub-topics and classified into 11 dimensions and 3 categories: Environment, Social, Governance.

[2] The concept of "green muting" has been defined by Bob Langert https://www.greenbiz.com/article/how-tell-your-sustainability-story-0

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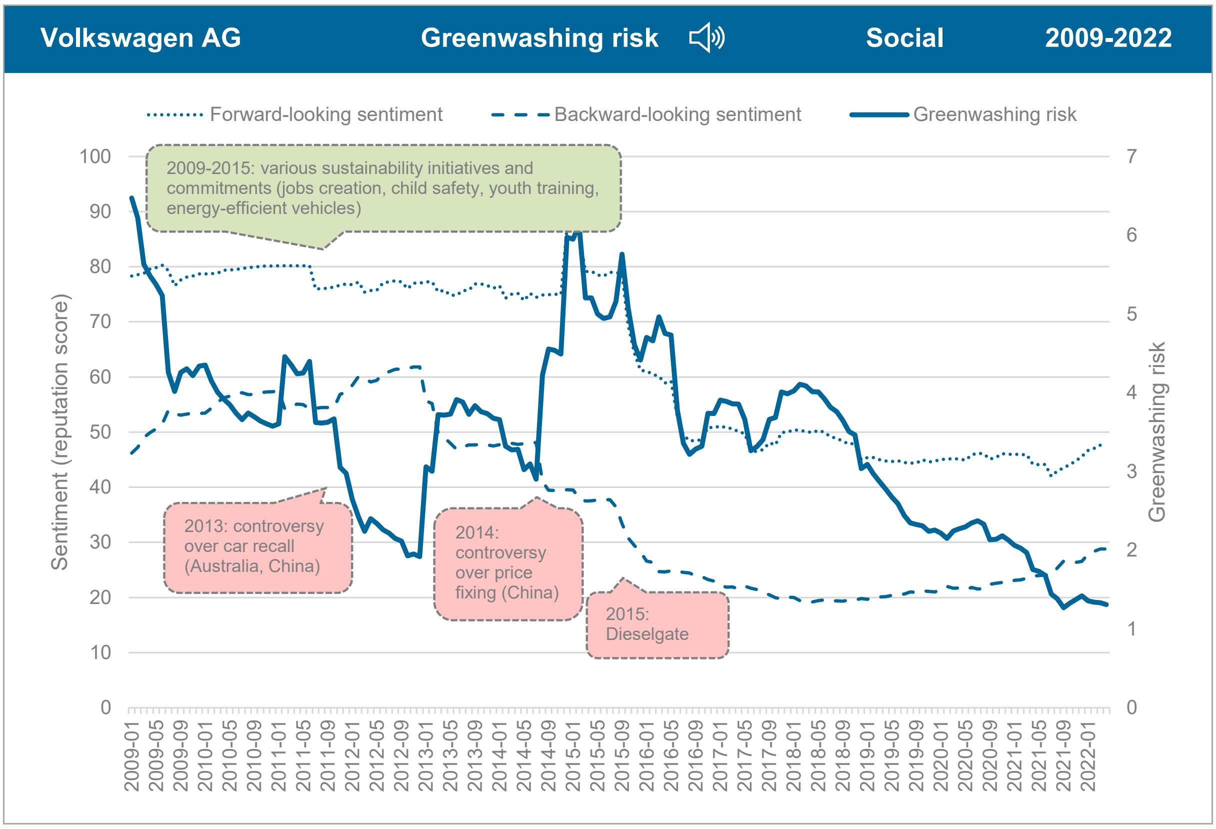
Case studies

To understand how this greenwashing risk indicator works, let's consider various case studies.

Case Study 1: Volkswagen



Prior to 2015, Volkswagen was widely considered as an industry leader, a best-in-class automobile company in terms of sustainability, announcing various commitments and initiatives such as jobs creation, child safety, youth training, and energy-efficient vehicle. This translated in a high forward-looking sentiment, indicating ambitious ESG commitments and policies.

During the pre-2015 period, however, the company had been involved in several controversies, notably the 2013 car recalls in Australia and China and the price fixing scandal in 2014. Such controversies have resulted in the decline of backward-looking sentiment for that period. Subsequently, the gap between the two scores (forward-looking and backward-looking) widened, indicating a high greenwashing risk in the company's Social dimension. **Such risk could have been taken into consideration by investors to reduce exposure to Volkswagen in 2013 or 2014, prior to the company's Dieselgate emission scandal (September 2015).**

This case study demonstrates how the greenwashing risk indicator applied to the E, S, and G dimensions is useful for analyzing potential **offsetting** of sustainability credentials; a company may appear as a leader in one dimension (E), while facing controversies in another (S). It is therefore important to analyze a company's performance separately in the E, S, and G dimensions.

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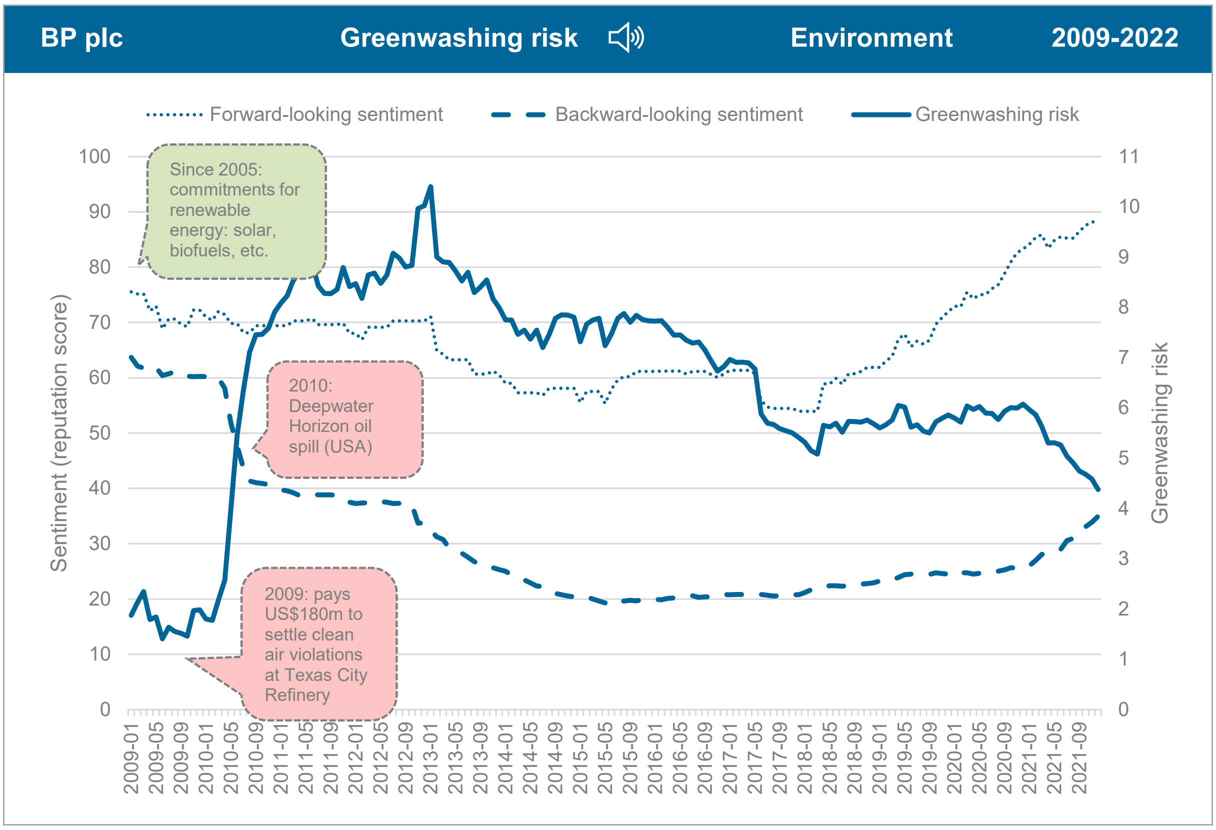
Case Study 2: BP



Since 2005 BP made several commitments relating to renewable energy projects (solar, biofuels, etc.), hence achieving a relatively high forward-looking sentiment. Meanwhile, BP has been involved in several controversies, such as that in 2009 where the company paid US$180m to settle clean air violations at Texas City Refinery.

Such controversies have caused the backward-looking sentiment to decline, and also cause the gap to widen with the forward-looking sentiment. As such, **a medium greenwashing risk was identified in the 2009-March 2010 period, before the Deepwater Ocean oil spill occurred. This indicator could have been useful for reducing investment exposure to BP.**

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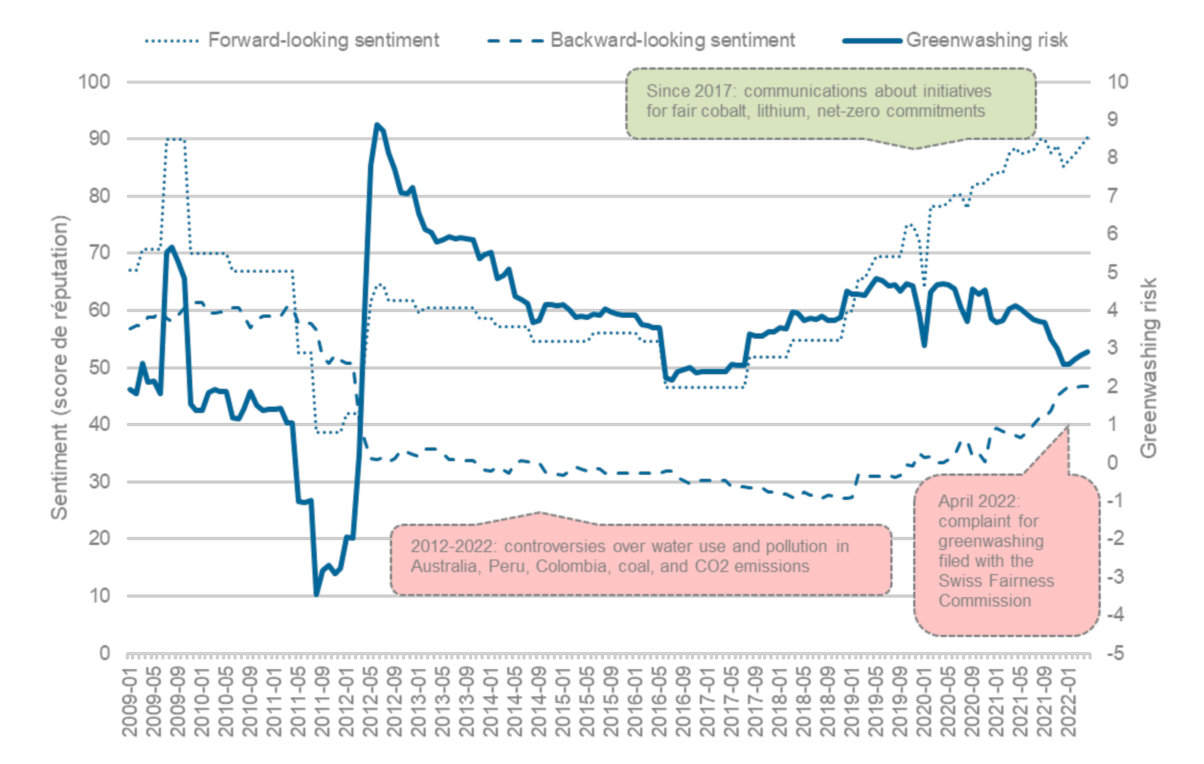
Case Study 3: Glencore

Glencore plc	Greenwashing risk	Environment	2012-2022



Since 2019-2020, Glencore has been actively communicating about its commitments for fair sourcing of cobalt and lithium and its net-zero emissions plans. This increased the forward-looking sentiment.

However, during that time the backward-looking sentiment remained below average, because of persisting allegations and controversies over issues such as water use and pollution in Peru, Australia, and Colombia (Cerrejon mine).

Due to the gap between both scores, **2017 Glencore continued to carry a high greenwashing risk in the Environment dimension**. Such analysis may be justified in view of **the recent complaint filed with the Swiss Fairness Commission in April 2022** by the Coalition for Responsible Multinationals, **accusing Glencore of greenwashing**.

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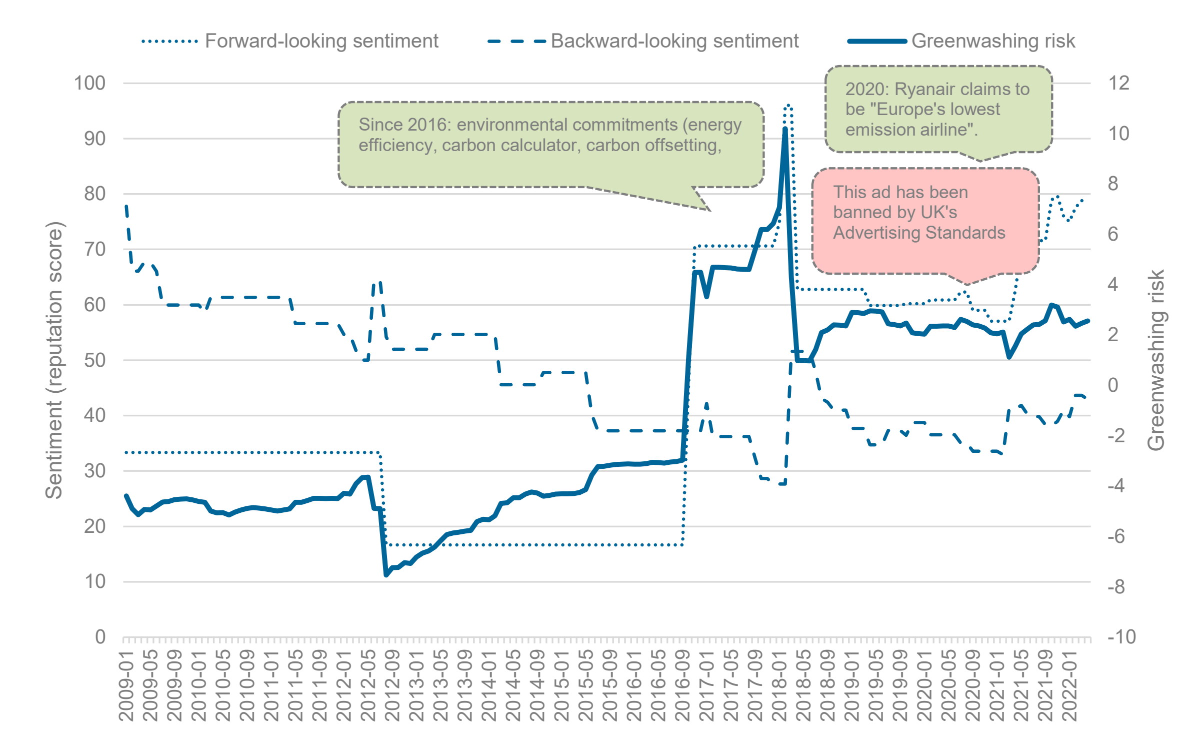
Case Study 4: Ryanair

Ryanair Holdings plc | Greenwashing risk | Environment | 2016-2022



From 2009 to 2016 Ryanair registered very little positive news about their environmental commitments. The company seem to have chosen a low profile (voluntary green muting). Ryanair started communicating its green ambitions from 2016 and included matters such as energy efficiency, carbon calculator, carbon offsetting, or sustainable fuel. **In 2020, Ryanair even claimed to be "Europe's lowest emission airline".**

Such announcements made the company's forward-looking reputation score go up. In the meantime, the backward-looking reputation score remained relatively low due to controversies over carbon offsetting and their 2020 advertisement being banned by UK's Advertising Standards Agency. **Ryanair's greenwashing risk remains high**.

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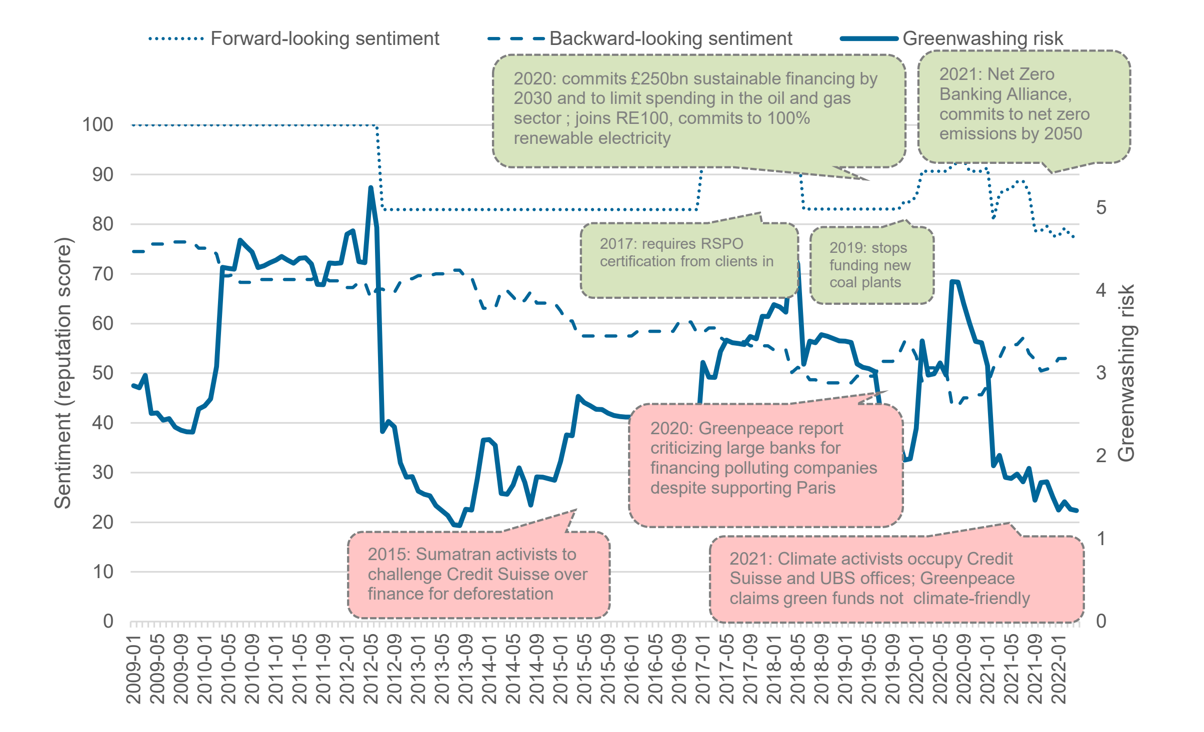
Case Study 5: Credit Suisse Group

Credit Suisse Group | **Greenwashing risk** | **Environment** | **2015-2022**



Over the entire period (2009-2021) the forward-looking sentiment calculated for Credit Suisse remained at a high level (above 80). This reflects several of the company's sustainability commitments including: committing £250bn for sustainable financing by 2030 and to limit spending in the oil and gas sector; joining RE100 and committing to 100% renewable electricity (2020); and, Net Zero Banking Alliance, committing to net zero emissions by 2050 (2021).

Conversely, the backward-looking sentiment score has followed a negative trend since 2015. Controversies over the bank's financing activities linked to deforestation and pollution, as well as a Greenpeace report, which found that Credit Suisse's green funds were not in fact climate-friendly, may have been attributable to this finding.

Due to the widened gap between forward-looking and backward-looking sentiments, a high or medium greenwashing risk has been identified for Credit Suisse since 2015.

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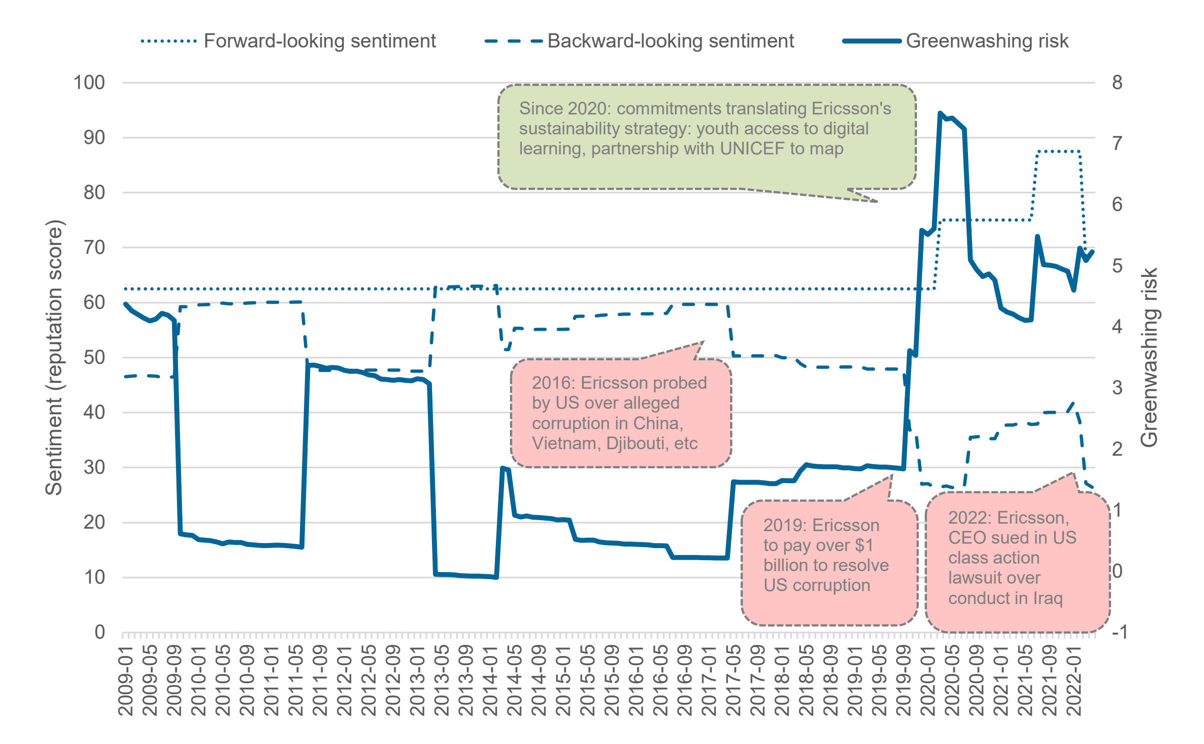
Case Study 6: Ericsson

Ericsson	Greenwashing risk	Governance	2016-2022

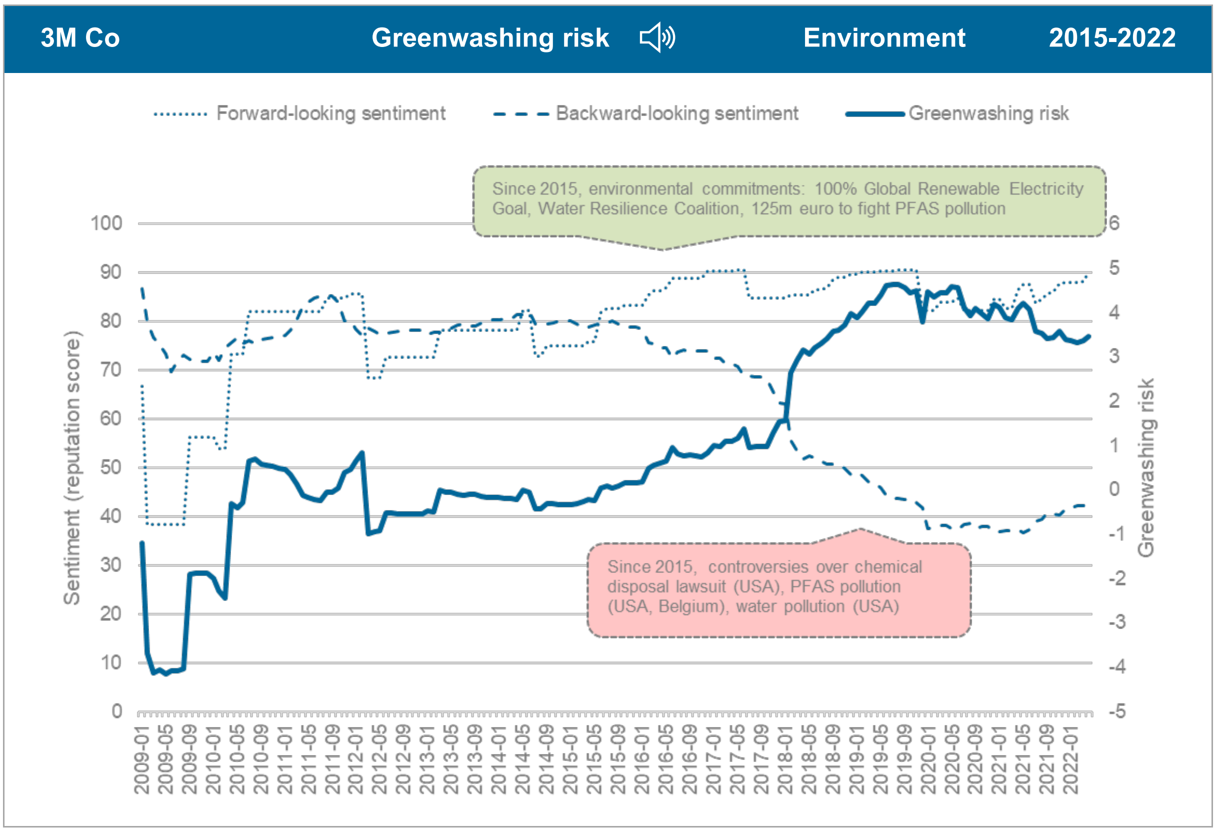


Since 2020, Ericsson has been communicating various initiatives and commitments regarding their sustainability strategy: youth access to digital learning, partnership with UNICEF to map schools internet access, and green digital initiative. Subsequently, their **forward-looking reputation score increased.**

Contrastingly, **Ericsson's backward-looking sentiment declined from 2016 onwards. This downwards trend was due to alleged corruption cases** in China, Vietnam, Djibouti and other countries (probe in 2016, settlement in 2019). **Due to the widened gap between forward-looking and backward-looking sentiments, a high greenwashing risk has been identified for the company since 2019**.

Echoing this assessment, in March 2022 Ericsson, its CEO and its CFO have been sued in a US class action lawsuit over the company's past conduct in Iraq.

Case Study 7: 3M



Since 2015, 3M has been announcing several environmental commitments including 100% Global Renewable Electricity Goal, Water Resilience Coalition, and 125 million euros fund dedicated to fighting pollution caused by toxic compounds such as Perfluoroalkyl and Polyfluoroalkyl Substances (PFAS). Such commitments translated in a high (> 80) forward-looking sentiment.

However, during that period, **the sentiment of 3M in the backward-looking data indicated that their ESG achievements and legacies suffered due to controversies over chemical disposal lawsuit (USA), PFAS pollution (USA, Belgium), or water pollution (USA).**

Therefore, an increasing high greenwashing risk has been identified for 3M in the Environment dimension.

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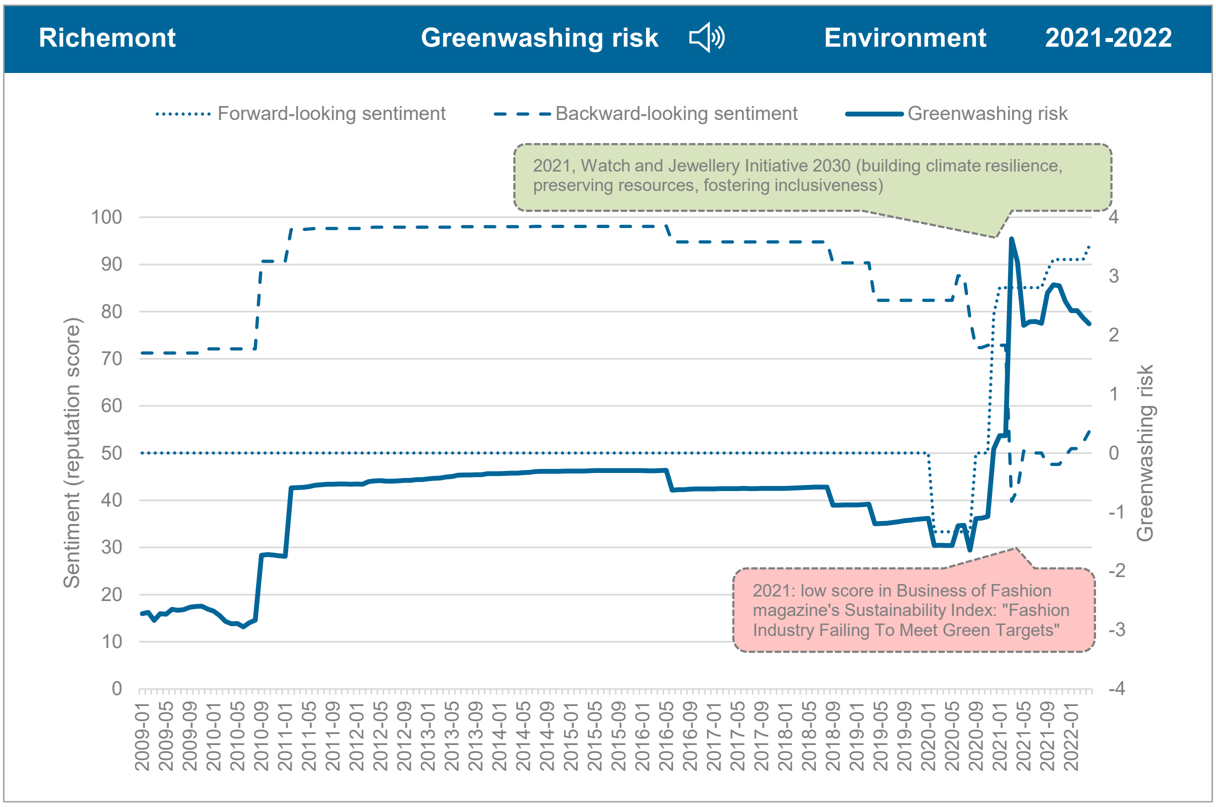
Case Study 8: Richemont



In 2021, Cartier, an affiliate of luxury group Richemont, co-founded the Watch & Jewellery Initiative 2030 together with Kering.

The Watch & Jewellery Initiative 2030 is a global initiative open to all Watch and Jewellery players committed to a common core of key sustainability goals in three areas: building climate resilience, preserving resources, and fostering inclusiveness.

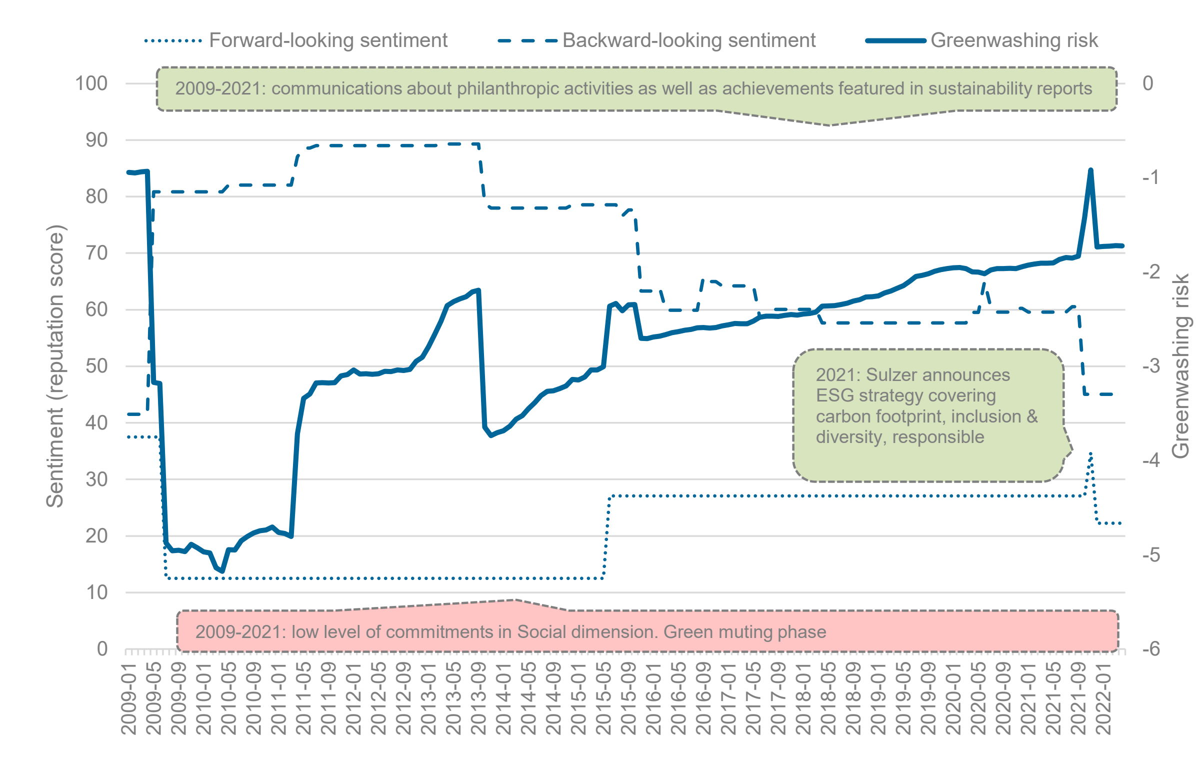
This initiative has been commented positively by various media and stakeholders and has made the forward-looking sentiment of Richemont rise.

Also in 2021, Business of Fashion magazine published their **Sustainability Index**. While no company was found on top of the table ("**Fashion Industry Failing To Meet Green Targets**"), **Richemont appeared at the bottom**, just ahead of Under Armor (15 companies were ranked).

This story generated **negative media coverage** for Cartier and Richemont, causing their backward-looking sentiment to fall, widen the gap with their forward-looking sentiment. Consequently, this signals a **high greenwashing risk** for Richemont.

Case Study 9: Sulzer

Sulzer AG	Green muting risk	Social	2009-2022



From 2009 to 2021, little information could be found in Sulzer's forward-looking data for the Social dimension, and it included some negative comments relating to job cuts. As a result, its **forward-looking sentiment remained below average**.

In the meantime, Sulzer achieved an above-average backward-looking sentiment, reflecting various philanthropic activities and achievements featured in sustainability reports.

As their backward-looking score is superior to the forward-looking score, **a green muting risk was identified**. It seems that for an extended period of time, the company adopted a cautious, discrete position, and a reluctance to define and communicate an ambitious ESG strategy. This started to change in 2021, when Sulzer announced an ESG strategy that covered carbon footprint, inclusion & diversity, and responsible sourcing.

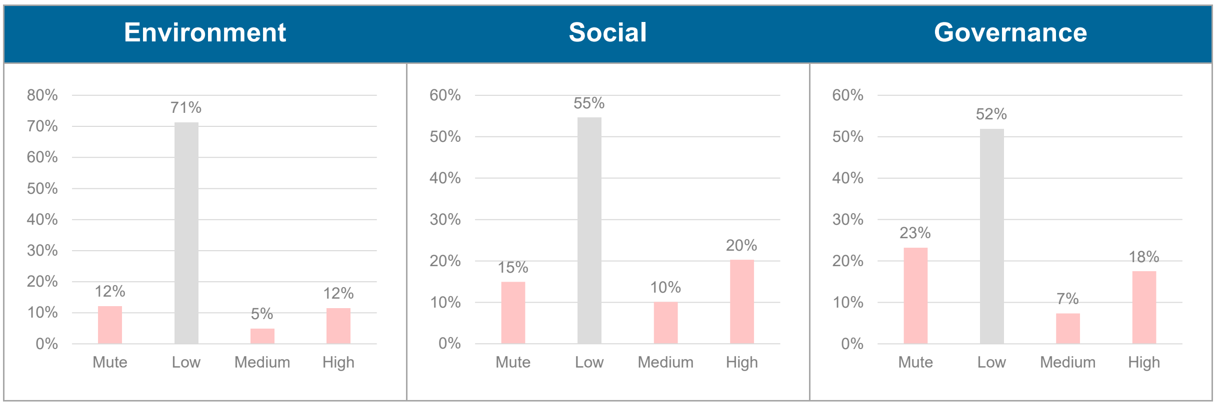
Aggregated results

The next few pages present aggregated results of the greenwashing risk indicator at industry groups, sub-industry and country level.

Distribution

Four situations are considered: low, medium, and high greenwashing risk, as well as mute (green muting risk). The chart below shows how the greenwashing risk indicator is distributed among the four situations in the 2009-2022 (April) period. Percentages indicate the share of months with high, medium, low, or negative (green muting) greenwashing risk.

Distribution of greenwashing risk indicator in 2009-2022 (April) period:



It is in the Social dimension that the most instances of medium or high greenwashing risk are found (30%), followed by Governance (25%) and Environment (17%).

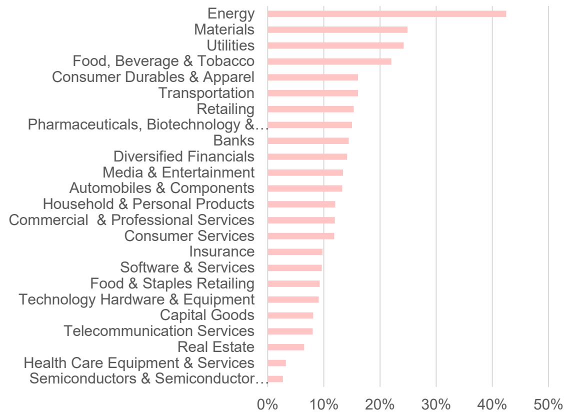
Considering green muting risk (negative greenwashing risk), Governance shows the most cases (23%), followed by Social (15%), and Environment (12%).

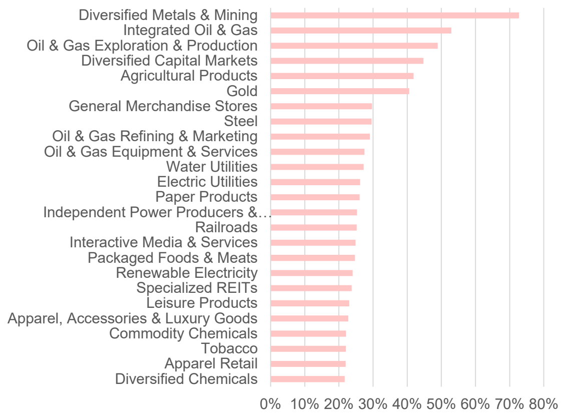
Industry groups and sub-industries

This section looks at differences found among industry groups and sub-industries (GICS) in terms of greenwashing and green muting risks in the E, S and G dimensions. It reflects the share of months registering a medium or high greenwashing risk, or a green muting risk, though the 2009-2022 (April) period.

Environment

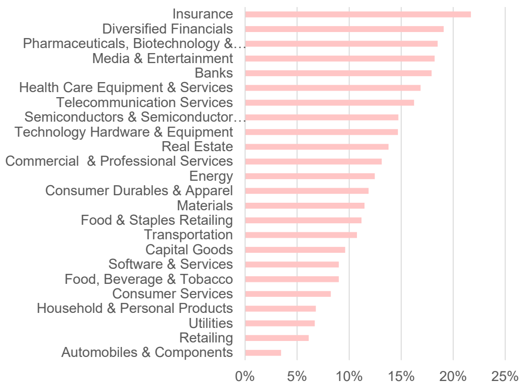
Industry groups — **Greenwashing risk** — **Subindustries**

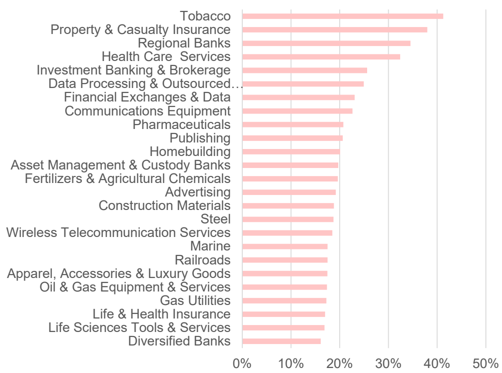




The most frequent situations of greenwashing risk are found with Energy (Integrated Oil & Gas, Oil & Gas Exploration & Production) and Materials (Diversified Metals & Mining, Gold, Steel). Oil & Gas and mining companies have historically been involved in many controversies covering themes such pollution, health & safety, or climate change. Such controversies negatively affect their backward-looking sentiment. At the same time, they actively promote their sustainability initiatives, commitments, and objectives, which enable them to register higher forward-looking reputation scores. Hence, the important gap between both scores signals a high greenwashing risk.

Industry groups — **Green muting risk** — **Subindustries**





Next, we consider green muting risks. The most exposed Industry groups are Insurance, Diversified Financials, and Pharmaceuticals, Biotechnology & Life Sciences. Within sub-industries, Tobacco has the highest green muting risk. Tobacco companies' environmental commitments are often associated with negative comments, particularly in regard to the impact of their products, which has the effect of stifling their commitments rendering them inaudible (forced green muting). Property & Casualty Insurance, Regional Banks and Health Care Services also show high levels of green muting risk, although in these apparently less impactful industries, the green muting attitude is likely to be elective rather than imposed (voluntary green muting).

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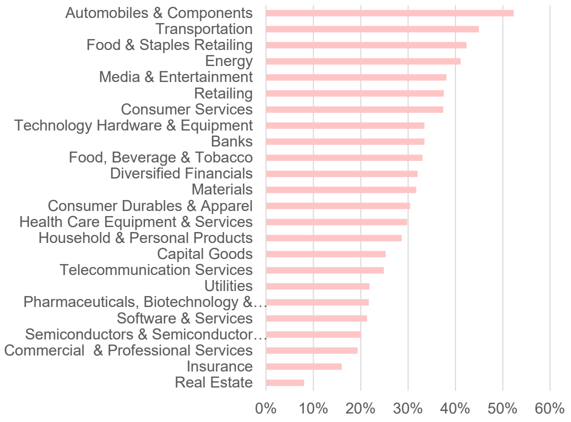
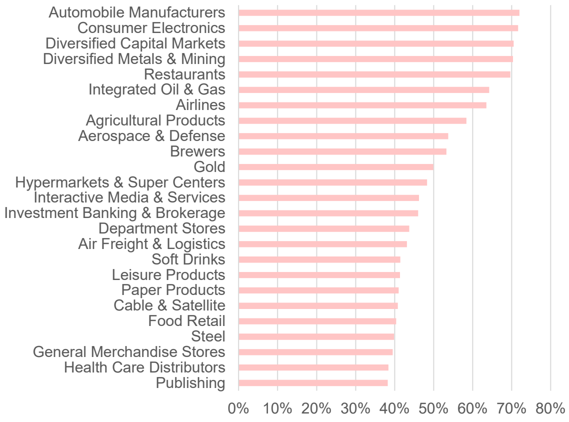
Social

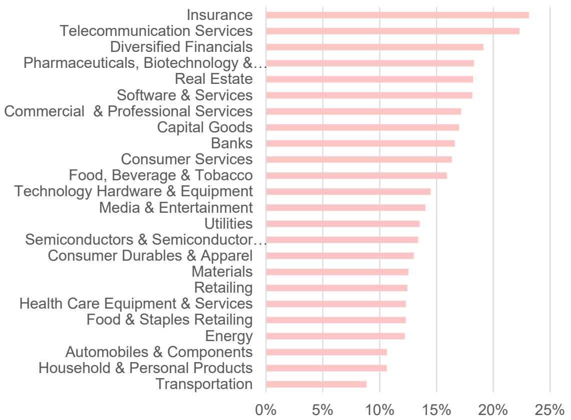
Industry groups — Greenwashing risk — Subindustries

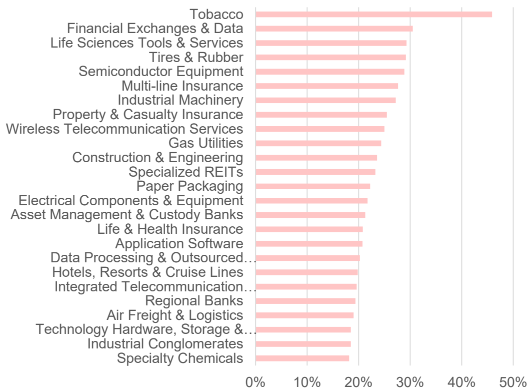




In the Social dimension, industry groups showing the most cases of greenwashing risk are Automobiles & Components (Automobile Manufacturers, see Volkswagen case above), Transportation (Airlines, Air Freight & Logistics, Marine), and Food & Staples Retailing (Hypermarkets & Super Centers, Food Retail). Among sub-industries Consumer Electronics and Diversified Capital Markets also register high levels of greenwashing risk.

Industry groups — Green muting risk — Subindustries



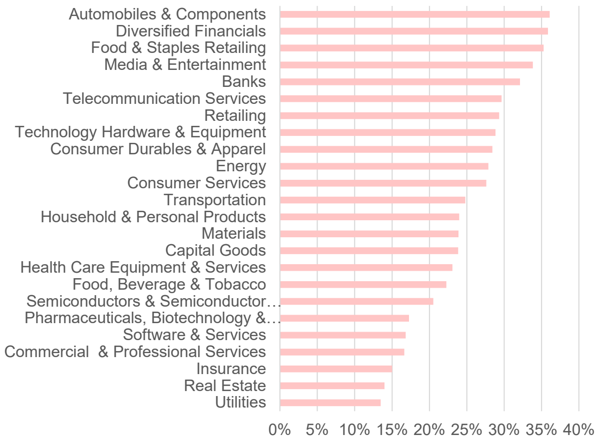


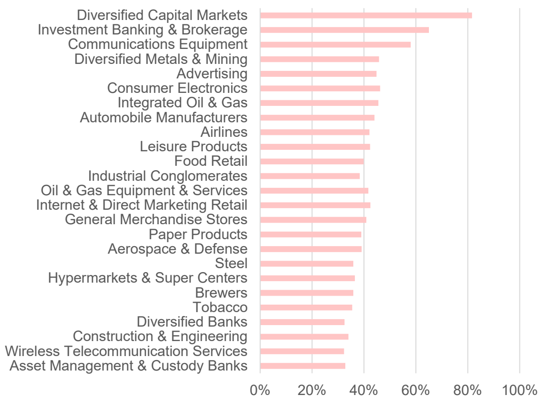
As in the Environment dimension, Insurance tops the list for green muting risk in the Social dimension (especially within Multi-line Insurance and Property & Casualty Insurance). A possible interpretation of these results may be that Insurance, Telecommunication Services and Diversified Financials (Financial Exchanges & Data, Asset Management & Custody Banks) view themselves as less exposed to ESG risks and as "low footprint" companies. Hence, they remain cautious and discrete with their sustainability commitments.

With respect to subindustries, again, tobacco received the highest level of green muting risk. Companies' commitments in the social domain (e-cigarette, heated tobacco, responsible marketing, etc.) are in most cases commented with a negative tone and therefore, maintain a low level in forward-looking sentiment.

Governance

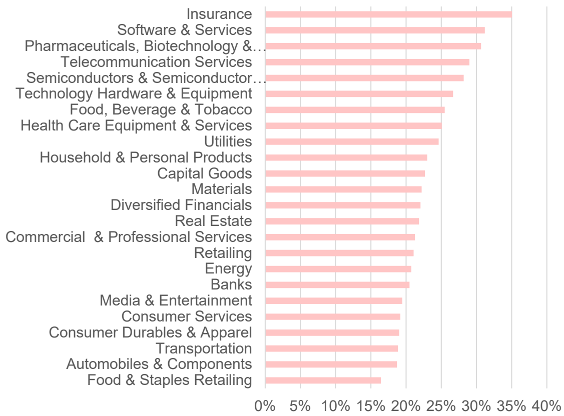
Industry groups — Greenwashing risk — Subindustries

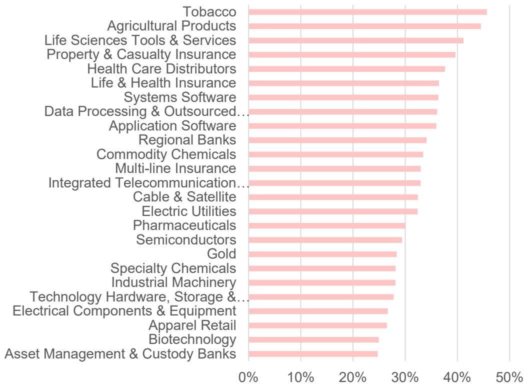




Industries showing the most occurrences of greenwashing risk in the Governance dimension are Automobiles & Components, Diversified Financials (Diversified Capital Markets, Investment Banking & Brokerage), and Food & Staples Retailing (Food Retail, Hypermarkets & Super Centers). Among sub-industries Investment Banking & Brokerage and Communications Equipment come second and third.

Industry groups — Green muting risk — Subindustries





Industries with the most cases of green muting risks found in the Governance dimension are Insurance (Life & Health Insurance, Property & Casualty Insurance), Pharmaceuticals, Biotechnology & Life Sciences (Life Sciences Tools & Services, Pharmaceuticals) and Software & Services (Systems Software, Application Software).

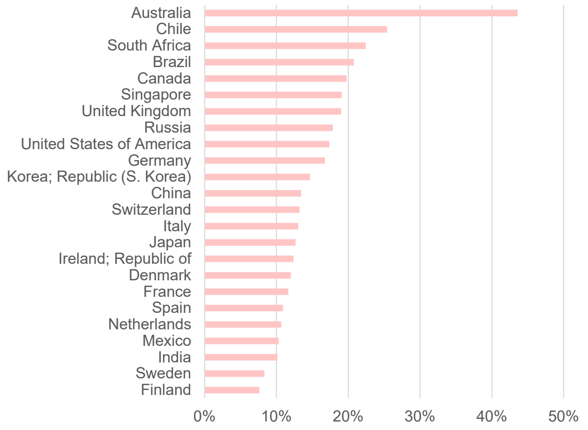
At sub-industry level, Tobacco again registers by far the highest level of green muting risk. Next come Agricultural Products and Life Sciences Tools & Services. For companies active in these subindustries, the forward-looking sentiment is often inferior to the backward-looking sentiment, meaning their ESG commitments are inaudible, either because they are not communicated or because they are systematically challenged.

Companies' home countries

Finally, let us consider differences between companies' home countries in terms of greenwashing and green muting risks in the E, S and G dimensions. Again, charts below represent the share of months registering a medium or high greenwashing risk, or a green muting risk, through the 2009-2022 (April) period.

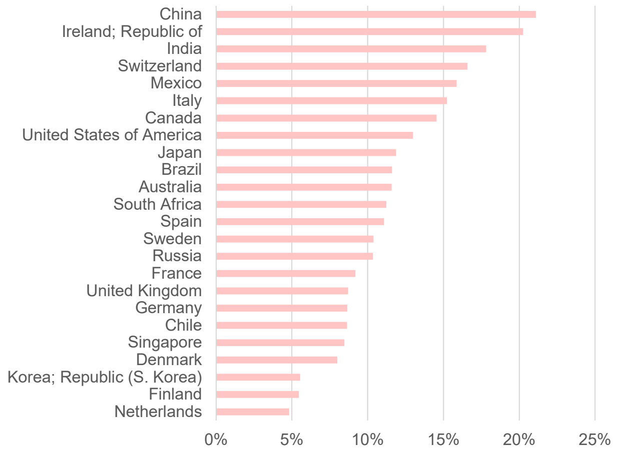
Environment

Greenwashing risk



Companies based in Australia show the most occurrences of greenwashing risk in the Environment dimension. These companies are mostly active in the following industry groups: Banks, Materials, Energy, and Utilities. Chile comes second (Utilities, Materials), South Africa third (Materials, Banks, Energy, Transportation, Food & Staples Retailing), and Brazil fourth (Materials, Energy, Food, Beverage & Tobacco, Utilities).

Green muting risk



When considering the share of months flagged with green muting risks, China came first (with companies mostly active in Technology Hardware & Equipment, Energy, and Materials). Ireland comes second (Transportation, Materials, Software & Services, and Capital Goods), India third (Software & Services, Materials, Energy), and Switzerland fourth (Commercial & Professional Services, Diversified Financials, Banks, Insurance).

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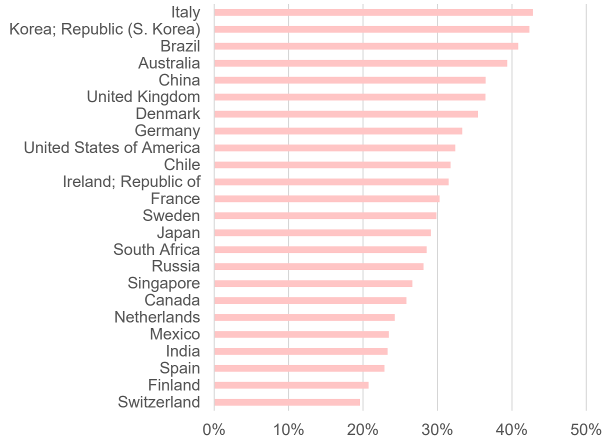
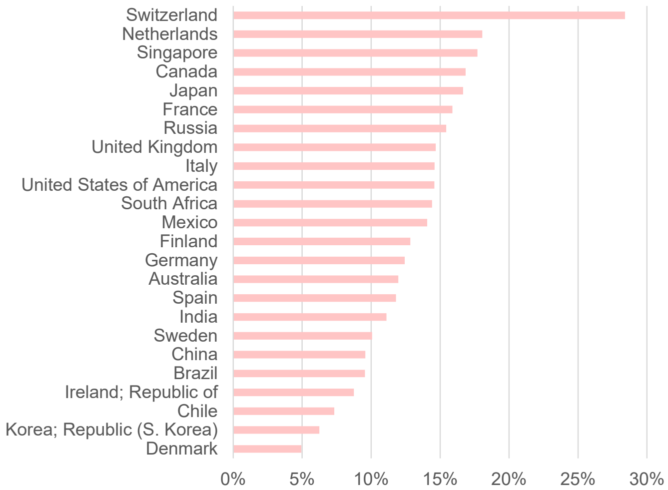
Social

Greenwashing risk



In the Social dimension Italy registers the most situations of greenwashing risk, with companies mostly active in Automobiles & Components, Energy, Utilities, Banks, and Capital Goods. South Korea came second (Technology Hardware & Equipment, Materials, Automobiles & Components, Capital Goods), Brazil third (Materials, Food, Beverage & Tobacco, Utilities), and Australia fourth (Transportation, Energy, Utilities, Banks, Materials).

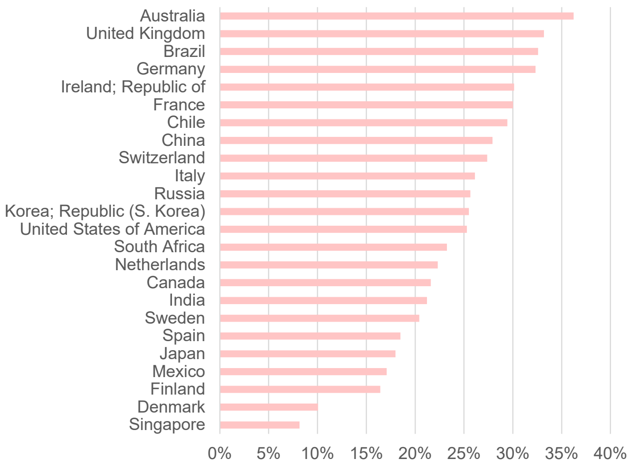
Green muting risk



Switzerland registers the most situations of green muting risk in the Social dimension. Various industries are involved in this phenomenon: Banks, Capital Goods, Commercial & Professional Services, Diversified Financials, Food, Beverage & Tobacco, Insurance, Materials, Pharmaceuticals, Biotechnology & Life Sciences, Semiconductors & Semiconductor Equipment. The Swiss green muting is voluntary rather than forced. Two potential explanatory factors: politically, Switzerland tends to focus on the environmental and economic pillars of sustainability compared to the social one; and culturally, certain traits of the Swiss identity, like pragmatism, cautiousness, discretion, and modesty, do not favor the expression of ambitious commitments and targets.

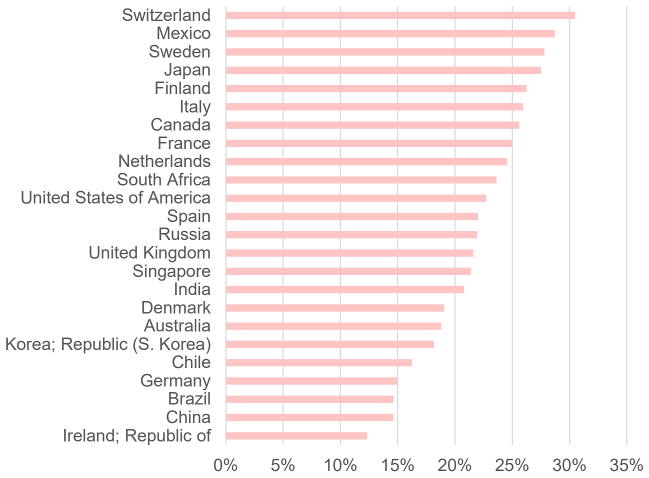
Governance

Greenwashing risk



The following countries register the most cases of greenwashing risk in the Governance dimension: Australia (Banks, Diversified Financials, Energy, Materials), UK (Banks, Capital Goods, Consumer Durables & Apparel, Consumer Services, Materials), Brazil (Food, Beverage & Tobacco, Utilities, Materials), and Germany (Banks, Capital Goods, Consumer Durables & Apparel, Materials, Semiconductors & Semiconductor Equipment, Transportation, Utilities).

Green muting risk



As with the Social dimension, Switzerland comes on top of the list for green muting risk in the Governance dimension. Again, companies from various industries are involved. An important component of the Governance dimension is sustainability strategy. The aforementioned political and cultural reasons may also be drawn upon here to explain why Swiss companies seem to be reluctant to openly communicate their sustainability commitments, targets and objectives. Mexico, Sweden, and Japan come next.

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Use cases

Asset owners and asset managers

Portfolio risk analysis and reporting

The greenwashing risk indicator provides a useful tool for assessing the credibility of a portfolio's ESG credentials and the associated risks. It is relevant to both conventional and ESG fund managers for internal and external reporting purposes.

Institutional reputation management

Institutions investing in, or managing, ESG funds need to ensure their internal processes and external communications do not conflict with reality. Offering a transparent assessment of the credibility of portfolio holdings' sustainability commitments, the greenwashing risk indicator helps financial institutions protect their reputation.

Portfolio management

As a complement to scores calculated for ESG factors collectively, E, S, G factors individually, and 11 underlying categories, the greenwashing risk indicator is an additional tool utilized to filter out underweight companies that are flagged for significant greenwashing risks or green muting risks, and to strengthen a portfolio's ESG credentials.

ESG integration

The greenwashing risk indicator informs on the precision, transparency, and credibility of companies' sustainability commitments. It allows the assessment of the coherence of their sustainability trajectory, enhance ESG risk analysis, identification of future leaders and spotlight firms showing the most progress.

Shareholder engagement

Shareholder engagement requires accurate and up to date ESG information. Covalence's greenwashing risk indicator can help identify companies with exaggerated ESG announcements relative to their observed practices. It is also useful to spot companies lacking a proper ESG strategy and corresponding commitments, or those whose commitments are made inaudible due to past controversies (green muting risk).

Corporates

The greenwashing risk indicator helps companies assess whether their sustainability commitments are endorsed and deemed as credible by their stakeholders and the media.

Authorities

Market supervisory authorities are increasingly adopting anti-greenwashing policies and programs. The greenwashing risk indicator can help them establish priorities and gather relevant input data.

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Greenwashing and stock market performance

Greenwashing is penalized by long-term markets

Over short periods, however, companies at risk of greenwashing do better than others.[3]

Do companies with a high risk of greenwashing perform better or worse than those with a low risk? This is the question this article tries to answer, focusing on environmental issues (the E of ESG).

The rating agency Covalence has recently developed a greenwashing risk indicator that aims to measure the gaps between companies' promises and practices on sustainability issues. This indicator is obtained by comparing a sentiment score based on forward-looking media data (reflecting commitments for the future, e.g. in terms of reducing CO2 emissions), and a sentiment score based on backward-looking data (reflecting past actions).

Starting from a universe of 2'500 internationally listed companies, two groups were constituted: companies with a low risk of greenwashing, and companies with a medium or high risk. Each group represents a fictitious equally weighted portfolio. The average performance of the two portfolios was calculated over several periods: 10, 5, 3 and 1 year, without buy and hold.

Over a 10-year period (May 2012 - April 2022), companies with a low risk of greenwashing outperform by 12% (140% vs. 128% for the group of medium and high risk companies). This outperformance is mainly observed in the following sectors: utilities (e.g. Acciona and American Water Works); materials (UPM-Kymmene, Givaudan); information technology (Advanced Micro Devices, STMicroelectronics); and energy (Neste, Lundin Energy). Geographically, the companies contributing to this outperformance are based in countries such as Germany (Encavis, Merck KGaA), Great Britain (London Stock Exchange Group, Intercontinental Hotels Group), Japan (Sony, Yamaha), the United States (Netflix, T-Mobile US) and Canada (Canadian Solar, Thomson Reuters).

On the other hand, over 5 years, companies with a medium or high risk of greenwashing do better than the others (39% vs. 29%). The same is true over 3 years (35% vs. 25%). Over the past 3 years, in order to favor companies that are reliable and credible in terms of sustainability while maintaining investment performance, it was worth considering these sectors first: industrial (e.g. FuelCell Energy, BioteQ Environmental Technologies), consumer discretionary (AutoNation, Sony), and utilities (Boralex, Encavis).

The phenomenon is even more pronounced over one year (May 2021 - April 2022). Over the last 12 months, the outperformance of stocks marked by a significant risk of greenwashing (15% vs. -3%) is mainly observed in these sectors: utilities, materials, energy; and in these countries: USA, Canada, Great Britain, and Japan.

By definition, sustainability is analyzed over a long period of time. The investments made by companies that walk the talk represent, in the short term, significant costs. The return on

[3] This text appeared in allnews on June 22, 2022 https://www.allnews.ch/content/points-de-vue/le-greenwashing-est-p%C3%A9nalis%C3%A9-par-les-march%C3%A9s-%C3%A0-long-terme

investment comes only after several years (think of customer loyalty, employee motivation and, more broadly, stakeholder relationship management).

Companies that practice greenwashing, i.e. those that spend more on communication than on concrete actions for sustainability, make short-term savings that can be valued by the markets. In times of geopolitical instability, this phenomenon is probably accentuated. We look forward to seeing you soon for similar analyses on the social and governance dimensions.

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On social issues, sincerity pays off in the long run

Over the past twelve months, however, cynicism has prevailed in most areas [4]

Do companies with a high risk of greenwashing perform better or worse than those with a low risk? This is the question this article tries to answer, this time focusing on social issues (the S of ESG).

The rating agency Covalence has recently developed a greenwashing risk indicator measuring the gaps between companies' promises and practices on sustainability issues. This indicator is obtained by comparing a sentiment score based on prospective data (reflecting commitments for the future), and a sentiment score based on retrospective data (reflecting past actions).

Starting from a universe of 2,500 internationally listed companies, two groups were created: companies with a low risk of greenwashing, and companies with a medium or high risk. Each group represents a fictitious equally weighted portfolio. The average performance of the two portfolios was calculated over several periods: 10, 5, 3 and 1 year, without buy and hold.

Over 10 years (May 2012 - April 2022), the low-risk companies outperform by 3.6% (139.9% vs. 136.2% for the medium- or high-risk group). This outperformance is mainly observed in the following sectors: industrial (e.g. Vestas, Plug Power and Kardex); consumer discretionary (Yamaha, Lowe's, Lululemon Athletica); consumer staples (Constellation Brands, Keurig Dr Pepper, Kesko); and finance (SVB Financial, London Stock Exchange, Moody's).

The companies contributing to this outperformance are based in countries such as Switzerland (Lonza, Bachem, Sika), Germany (Encavis, Merck KGaA, Deutsche Boerse), Great Britain (Rentokil Initial, Persimmon) or Canada (Canadian Solar, Ballard Power Systems, Alimentation Couche-Tard)

On the other hand, over 5 years, companies with a medium or high risk of greenwashing do better than the others (34.1% vs. 28.5%). This is also the case over 3 years, but to a lesser extent (26.6% vs 25.9%). In order to favor companies that are reliable and credible in terms of sustainability, while taking care of the performance of its investments, it was necessary to consider these sectors in priority: industry and utilities.

Over the last 12 months (May 2021 - April 2022), we also calculate an outperformance of stocks marked by a significant risk of greenwashing (-0.25% vs -2.1%). In only three sectors do low-risk companies do better, even if their average performance is negative: telecommunications, consumer discretionary, and technology.

On the other hand, Industrials, Consumer Staples, Health Care, and Materials show a positive 1-year average stock performance. In each of these sectors, companies with a high risk of greenwashing produce this positive performance, while companies with a low risk show a negative result.

[4] This text appeared in allnews on July 18, 2022 https://www.allnews.ch/content/points-de-vue/sur-le-social-la-sinc%C3%A9rit%C3%A9-paie-%C3%A0-long-terme

In utilities and energy, we have a similar but more nuanced view, because while companies marked by a risk of greenwashing are doing better overall than the others, they are also posting a positive performance. Among utilities, this is the case of Acciona, and in energy, of Equinor.

The current period, marked by the war in Ukraine, generating uncertainty and anxiety, seems to favor cynical behavior and to sanction sincere commitments. It is upsetting the ESG criteria and taxonomies (coal, oil, nuclear, arms, for example). So when will the next cycle begin, one that is optimistic rather than cynical, one that favors long-term sustainability rather than short-term opportunism?

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Credible governance is promoted in the short term

Over 1 year, companies with a low risk of greenwashing in governance show an outperformance[5]

Do companies with a high risk of greenwashing perform better or worse than those with a low risk? This is the question this article tries to answer, focusing on governance issues (the G of ESG) after covering environmental and social issues.

The rating agency Covalence has recently developed a greenwashing risk indicator measuring the gaps between companies' promises and practices on sustainability issues. This indicator is obtained by comparing a sentiment score based on prospective data (reflecting commitments for the future), and a sentiment score based on retrospective data (reflecting past actions).

Starting from a universe of 2,500 internationally listed companies, two groups were created: companies with a low risk of greenwashing, and companies with a medium or high risk. Each group represents a fictitious equally weighted portfolio. The average performance of the two portfolios was calculated over several periods: 10, 5, 3 and 1 year, without buy and hold.

On environmental and social issues, companies with a low risk of greenwashing, i.e. those whose commitments to sustainability are deemed credible and in line with observed practices, outperform over the long term (10 years) but underperform over the short term (1, 3 years). The opposite is observed with governance: companies with a low risk of greenwashing outperform in the short term and underperform in the long term.

Over 1 year, companies with a low risk of greenwashing (-1.4%) are indeed 2.5% better than risky companies (-3.9%). Over 3 years, credible companies show an even greater advantage, outperforming by 11.7% (27.3% vs 15.7%). This outperformance is particularly evident in the following sectors: Industrials (e.g. FuelCell Energy Inc, Plug Power Inc, AP Moeller - Maersk A/S), Consumer Discretionary (AutoNation, Sony Corporation, Office Depot), Information Technology (Shinko Electric Industries Co, Ltd, Renewable Energy Corporation ASA, Advanced Micro Devices), and Energy (Obsidian Energy Ltd, Antero Resources, Range Resources Corporation).

Over 3 years, it is only in the health care (e.g. McKesson Corporation, Unitedhealth Group Inc, CVS Health Corp) and materials (Freeport-McMoRan Copper & Gold Inc, Alcoa Inc, Vale SA) sectors that companies at risk of greenwashing show a better performance.

Over 5 years, there is no difference in performance between companies at risk of greenwashing and the others. On the other hand, over 10 years, risky companies (147.6%) do 9.3% better than low risk companies (138.2%). This outperformance can be observed in particular in healthcare (UnitedHealth Group Inc, Eli Lilly and Co, Anthem Inc), information technology (Applied Materials Inc, Microsoft Corp, STMicroelectronics NV) and finance (S&P Global Inc, Morgan Stanley, Bank of America Corp).

Over 10 years, to generate performance with companies at low risk of greenwashing in governance, it was necessary to focus on communication services (Netflix Inc, T-Mobile US Inc,

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[5] This text appeared in allnews on August 15, 2022 https://www.allnews.ch/content/points-de-vue/une-gouvernance-cr%C3%A9dible-est-favoris%C3%A9e-%C3%A0-court-terme

Alphabet Inc), materials (Svenska Cellulosa SCA AB, Sika AG, Sherwin-Williams Co) and energy (Neste Oyj, Cheniere Energy Inc, Valero Energy Corp).

As seen above, the current period seems to favor cynical behavior and to sanction sincere commitments in the social and environmental fields. On the other hand, on governance issues, credible sustainability profiles with low risk of greenwashing are favored by the markets. This can be seen as a premium for companies with a strong sustainability strategy and governance, an advantage in terms of resilience and ability to bounce back.