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Preface

The High Meadows Institute, through our Future of Capital Markets project, is working with investment industry leaders to explore their role in building a more sustainable capital market system. A key focus of this work is on how consideration of sustainability or ESG factors can be introduced and integrated into mainstream asset management. In 2016, HMI convened an ESG Path to Value Forum of investment management professionals to help identify key challenges in ESG integration and discuss strategies to overcome them. As background for the work of the forum, and to disseminate the forum's findings, the Institute has commissioned a series of working papers that look at specific issues and solutions.

In this report, under the guidance of Institute board member and Harvard Business School Professor George Serafeim, we examine how sell side analysts currently consider ESG factors in the valuation of companies and how consideration of these factors can be encouraged. This report, prepared by KKS Advisors, includes a survey of 365 sell-side analysts and detailed follow-up interviews into the inputs analysts currently use in their decisions and the incentives that influence these decisions. From a review of this analysis by Forum members, the report then identifies strategies that may be helpful in encouraging sell side analysts to consider ESG factors in their investment thesis and valuation models.

We hope you find these insights useful and welcome your feedback on our findings. For further information on our Future of Capital Markets project, and other reports in this series on ESG integration, please visit www.highmeadowsinstitute.org.

This report, prepared by KKS Advisors, includes a survey of 365 sell-side analysts and detailed follow-up interviews into the inputs analysts currently use in their decisions and the incentives that influence these decisions.
The goal of the research presented in this report is to understand what incentives and information are needed to encourage sell side analysts to integrate ESG factors into their valuation and pricing models. Sell side analysts have a large influence over valuation and pricing for companies that in turn impact the willingness of those companies to take on projects that don't meet analysts expectations. Research shows that over half of businesses would forego projects with positive net present value if they conflict with their planning around meeting analyst expectations.

Our research included both quantitative and qualitative research into the behavior of sell side analysts, the incentives that drive them and their attitudes, and current practices in terms of ESG. In terms of incentives, our research shows that recognition and size of portfolio are key drivers for sell side analysts. There is no evidence that compensation is related to earnings forecast accuracy, but rather compensation programs are designed to reward actions that increase brokerage and investment banking revenues.

When it comes to ESG, our desk research and a survey of 570 sell side analyst quarterly calls showed that:

- ESG integration is still in its infancy for most analysts, with less than 3.8% of analysts in our sample asking questions specifically linked to ESG factors.
- 80% of ESG-related questions asked by sell side analysts in our sample were concentrated within just five sectors. Predictably, these sectors can be deemed traditionally ‘ESG heavy’. They include Services, Energy and Resources, Consumption, Health Care, and Financials.
- In terms of institutional players, sell side analysts for Barclays, Bank of America Merrill Lynch, and Morgan Stanley asked the most ESG or long-term value related questions.

Looking forward, there were number of approaches and challenges identified by the research regarding strengthening ESG integration by sell side analysts. These include:

1. Direct engagement: A direct engagement approach (analyst-to-analyst), despite being resource intensive, could ultimately be most effective in influencing practices. Organizations that aim to bring change need to be equipped with enough information to convince analysts in these engagements that a series of ESG related events have damaged shareholder value and are yet to be flagged by analysts.

2. Analyst events: Direct engagement requires access to analysts through industry events and collegial bodies. Potential avenues include the top investment bank conferences, company conferences, analyst days hosted by top companies, and industry-focused events such as Morgan Stanley's global telecoms conference, company roadshows, and CFA events.

3. Data: It is critical for analysts to
have a good data infrastructure, with data integrated with current work flows and the ability for it to be easily manipulated and downloaded.

4. Rankings: There is no existing ranking that accounts for sell side analysts’ ESG practices published by a mainstream institution. Building this ranking could be highly influential given the significant role of rankings in influencing analysts’ compensation and practices.

5. Client demand: If analysts’ clients are asking about ESG issues then that would definitely prompt action. Starting with the asset owner and moving to the investment manager, if the investment manager is considering ESG then the sell side will need to change its practices and do the same. Although this is a recognized chain of influence, the reverse of this chain can also be true. The critical factor is how the message on ESG is articulated.

We would like to acknowledge the limitations of our research approach. Quarterly earnings calls are only a small part of the engagement activity between investors and companies and not a comprehensive representation of what sell-side analysts consider when making decisions. At the same time, these calls are the only publicly available data that give us the opportunity to explore what analysts believe is important enough to be asked during such calls with the management. Our detailed methodology can be found in the Appendix.
Sell side analysts are one of the major players in capital markets. They usually specialize in a particular sector and provide equity recommendations and investment research to buy-side asset management firms and their fund managers.\footnote{1}

Analysts can guide investor behavior by interpreting information about industry trends, company strategy, corporate finance and profit potential. Analysts make summary judgements in the form of earnings forecasts and stock recommendations, of which the latter is considered the more important output.\footnote{2}

A sell side analyst report will typically cover financial performance, earnings growth, equity value and highlight specific risks relevant to the company and its business sector based on a variety of sources such as analyst briefings, press releases, preliminary results and annual reports.

Sell side research can significantly affect market perceptions of particular stocks. This influential research is tracked by companies who scrutinize analyst statements and recommendations and react to their content. Reports can have a negative impact on a company’s prospects and thus companies’ determination to meet analysts’ earnings expectations has created a bias towards short-term strategies.

Research suggests that over half of businesses would forego projects with a positive net present value if they conflict with their planning around meeting analyst expectations.\footnote{3}

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Research suggests that over half of businesses would forego projects with a positive net present value if they conflict with their planning around meeting analyst expectations.\footnote{3}
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In a typical semi-annual performance-evaluation period, the average analyst: 4
• Supplies 80 research notes and 3 reports
• Spends around 1 week brokering meetings between client investors and corporate managers
• Holds approximately 750 private calls and 45 one-on-one meetings with client investors

What drives sell side analyst compensation at high-status investment banks? 5
• “All-Star” recognition
• Investment banking contributions
• Size of analysts’ portfolios
• Whether an analyst is identified as a top stock picker by the Wall Street Journal

There is no evidence that compensation is related to earnings forecast accuracy. Compensation is designed to reward actions that increase brokerage and investment-banking revenues.

Recent research (a survey of 365 sell side analysts and detailed follow-up interviews) into the inputs analysts use in their decisions and the incentives that influence these decisions has shown that: 2
• Industry knowledge is the most important determinant of analysts’ compensation and the most important input into both their earnings forecasts and stock recommendations;
• Client demand for information was the most important determinant of analysts’ coverage decision;
• Private phone calls are the most useful type of direct contact with management for the purpose of generating both earnings forecasts and stock recommendations, even more useful than earnings conference calls;
• Analysts use P/E and PEG valuation models rather than more sophisticated models, such as residual income models;
• Accurate earnings forecasts and profitable stock recommendations have relatively little impact on their compensation; and
• Broker or client votes are very important for analysts’ compensation, more than the Institutional Investor surveys.

Sell Side Analysts and ESG

Views on ESG Integration

A steady stream of evidence links environmental, social and governance performance with long-term business value. How are analysts responding to these trends? Are quotes like the one by Colin Monk, right, being backed up by actions?

A 2004 study by WBCSD and UNEPFI examined an anticipated generational shift that could drive systematic change. Young professionals across industries have been catalysts for raising the profile of ESG issues within their own companies, and analysts could potentially play the same role; The results of this research showed that this change is not taking place in the financial sector.

Interviewed analysts tended to be:
- Uninformed of many ESG issues, and cynical about their materiality;
- Unconvinced that their clients would value ESG research and doubtful that their companies would reward them sufficiently for doing so;
- Unsure how ESG integration could practically be achieved.

The emergence of ESG

A notable moment of change arrived in 2006, when Citi’s Head of Research Bruce Rolph published a research paper together with an external consultant named Elaine Prior, titled ‘Climate Change and the ASX100: An Assessment of Risks and Opportunities.’ At the time the report came out, the Australian government was considering carbon trading, but the investment community initially lagged behind. Meanwhile, the media started linking the Australian drought to climate change, the Al Gore movie ‘An Inconvenient Truth’ and Stern Review came out, and the setting was right for Australian investors to begin addressing the issue.

“It is becoming clear that sustainable development will be one of the major drivers of industrial change over the next fifty years and there is a growing demand from both companies and institutional investors to understand its financial impacts. It follows therefore that the successful brokers will be those that anticipate this demand, respond to it with robust financially-relevant research and thereby differentiate themselves in an increasingly crowded marketplace.”

- Colin Monks, Head of European Equity Research, HSBC

6. WBCSD and UNEPFI, 2004 ‘Generation lost: young financial analysts and environmental, social and governance issues’
Elaine was offered a full-time role and became the world’s first ESG analyst.7

Since then, the appetite for ESG research has grown. Many equity research teams have produced relevant work. Some examples of sell side ESG research reports and work are the following:

- Goldman Sachs (GS Sustain) report ‘The Low Carbon Economy’
- Bank of America Merrill Lynch’s report ‘Globesity – The Global Fight Against Obesity’
- UBS with their ESG Analyser, mapping which ESG issues are material in the context of a typical investment portfolio
- Morgan Stanley’s (Sustainable and Responsible Equity Research Group) report ‘Embedding Sustainability into Valuation’, describing their global framework to analyze 29 different equity market sectors around ESG issues and their value for analysts and fund managers.

One of the key ways in which sell side analysts interact with companies is through quarterly earning calls. To gain greater insight into how ESG is currently integrated in sell side analysis we surveyed 51 top ranked sell side analysts’ questions on quarterly calls. Some of the key questions our research addressed included:

- Are top sell side analysts asking questions around ESG issues or long-term value creation?
- How frequently do these questions come up?
- Are specific sectors more likely to attract attention on these issues?
- Does in-house ESG research influence the behavior of analysts?
- How do analysts’ questions compare with existing frameworks?

By analyzing the questions asked by 51 leading analysts over 571 calls, we find the ESG integration practices of sell side analysts are at a relatively early stage.

The full report from this research can be found in the appendix.

ESG integration in its infancy

The questions put to company management by sell side analysts during quarterly earnings calls constitute a narrow view of their overall activities and approach to conducting equity analysis. Nevertheless, by analyzing the questions asked by 51 leading analysts over 571 calls, we find that the ESG integration practices of sell side analysts are at a relatively early stage.

In 30% of quarterly earnings calls

analysts asked either an ESG related question or a long term value relevant question. Long term value relevant questions arguably can be considered more traditional and thus typical of these calls. Taking ESG related questions alone we find that only 3.8% of total calls explicitly reference ESG.

**Sector analysis**
80% of ESG related questions asked by sell side analysts in our sample were concentrated within five sectors. Predictably these sectors can be deemed traditionally ‘ESG heavy’. They include Services, Energy and Resources, Consumption, Health Care, and Financials. This finding is evidence that for high exposure sectors, sell side analysts perceive ESG to be relatively important. However, factoring in ESG issues is comparatively rare amongst top analysts for the majority of sectors.

**Investment banks**
The investment banks whose analysts asked the most ESG or long term value relevant questions were Barclays, Bank of America Merrill Lynch, and Morgan Stanley. It should be noted that most of these questions were not explicitly ESG focused. Rather the vast majority were recorded as long term value relevant. Further investigation of the three investment banks revealed that each has recently developed in-house sustainability initiatives, perhaps the reason for the relatively high frequency of ESG and long term value relevant questions asked.

**Alignment with existing frameworks**
Comparing the relevant questions identified to the SASB and Delphi frameworks allowed us to verify whether analysts’ thinking on material issues aligned with existing frameworks. It appears that analysts’ thinking around materiality most closely matches the Delphi framework, with 24% of the relevant questions asked covered in the framework. It is important to note that the Delphi framework extends materiality beyond mere ESG issues, as opposed to SASB’s stricter definition.
Deepening ESG Integration

Research Findings

To further our research into the ESG integration practices of sell side analysts we collected field data through interviews. Some of the key findings are summarized below.

To what extent are the questions asked by sell side analysts in quarterly earnings calls a representative data set to reflect analysts’ engagement with ESG issues and long term value creation?

• Quarterly earnings calls are moderated by an operator and typically allow analysts to ask only 2-5 questions, limiting the room for very detailed conversations.
• The main objective for analysts is to get more qualitative information around certain key issues.
• Analysts also use the calls to promote their personal brand and reputation and understand what peers are thinking about the issues they are covering.

To what extent do sell side analysts consider ESG topics, or long term value creation beyond quarterly earnings?

• The prevalence of ESG issues in analysts’ research will vary dependent on the industry covered (e.g. corporate governance and executive pay in the financials sector).
• The topics covered are in part influenced by compensation mechanisms. A key factor to analyst compensation is their rankings (e.g. Institutional Investor ranking).

Analysts could be motivated to integrate ESG issues in their analysis if there is a perceived opportunity for differentiation and to offer a new perspective that can bring value.

• Rankings might be influenced by the differentiation of an analyst’s approach, new ideas, access to company management, etc.
• Analysts could be motivated to integrate ESG issues in their analysis if there is a perceived opportunity for differentiation and to offer a new perspective that can bring value.
• The incentive for
differentiation is a key leverage point for engaging the sell side. If ESG information is yet to be fully priced in, and it can help unlock value for companies, you want to be one of the first people talking about some of these issues.

Who are the key people whose influence would help generate the buy-in necessary to change practices across industries?

- Research directors and leading analysts tend to be quite influential. Research directors can drive companies’ thinking and push for more in depth consideration of ESG issues. With leading analysts it is more complicated since the questions from lead analysts will prompt others to take a closer look at certain issues, but analysts will try to avoid herding behavior and as a result the opinions on ESG issues might end up being less favorable.

As we seek to change ESG integration practices, should analysts working in industries with high ESG exposures be the primary targets?

- Analysts covering industries such as extractives and utilities could be considered ‘low hanging fruit’ but many such analysts are already covering certain ESG topics in their dialogues with companies.
- It is important to go beyond industries with high ESG exposure and a reactive approach of discussions on risks that have already materialized (e.g., discussing health and safety after a mining catastrophe has taken place).
- A conversation needs to take place that looks into potential ESG risks and opportunities before they arise. There is already increasing demand for forward-looking information (e.g., the TCFD recommendations on climate-related disclosures).
- To ensure real change, a wider shift in thinking is required, beyond industry specifics. The opportunity for analysts is to distinguish their product by moving from a reactive to a proactive approach, one that remains highly relevant to value creation.

Have practices evolved towards a better integration of ESG issues in the sell side analysis?

- Integration of ESG issues in the practices of sell side analysts is still at the early stages.
- There is lack of education on the significance of ESG issues in the sell side.
- Despite analysts’ attempts to distinguish their product and avoid appearing like part of a herd, making bold strides on ESG integration is still something approached with caution.

The inertia in ESG integration is a key challenge for the High Meadows Institute and other parties concerned with enhancing ESG integration practices on the sell side. What could be the most impactful approach or the key levers to affect change?

Five themes were identified in our interviews:
1. Direct engagement: A direct engagement approach (analyst-to-analyst), despite being resource intensive, could ultimately be most effective in influencing practices. Organizations that aim to bring change need to be equipped with enough information to convince analysts in these engagements that a series of ESG related events have damaged shareholder value and are yet to be flagged by analysts.

2. Analyst events: Direct engagement requires access to analysts through industry events and collegial bodies. Potential avenues could be the top investment bank conferences, company conferences, analyst days hosted by top companies, and industry-focused events such as Morgan Stanley’s global telecoms conference, company roadshows and CFA events.

3. Data: It is critical for analysts to have a good data infrastructure, with data integrated with current work flows and the ability for it to be easily manipulated and downloaded.

4. Rankings: There is no existing ranking that accounts for sell side analysts’ ESG practices published by a mainstream institution. Building this ranking could be highly influential given the significant role of rankings in influencing analysts’ compensation and practices.

5. Client demand: If analyst’s clients are asking about ESG issues then that would definitely prompt action. Starting with the asset owner and moving to the investment manager, if the investment manager is considering ESG then the sell side will need to change its practices and do the same. Although this is a recognized chain of influence the reverse of this chain can also be true. The critical factor is how the message on ESG is articulated.
ESG INTEGRATION PRACTICES OF SELL SIDE ANALYSTS

Quarterly Call Sell Side Analysts

Research Results I

High Level Results: ESG Integration

51 top analysts selected with the Institutional Investor 2015 ranking

571 quarterly earnings calls analyzed to get a picture of the questions asked during those calls

30% of the calls had a question classified either as ESG or as focusing on long-term value creation.

High Level Results: ESG Integration
Results for Barclays, BofAML, and Morgan Stanley

Barclays: 4 Analysts
Bank of America Merrill Lynch: 5 Analysts
Morgan Stanley: 3 Analysts

While the majority of questions identified tend to be long-term value relevant questions rather than strictly ESG, we further explored in-house sustainability initiatives for the three organizations above:

• In 2013, Morgan Stanley launched its Institute for Sustainable Investing to advance market-solutions to ESG challenges. It aims to bring sustainable investments to significant scale, produce informative research and support strategic partnerships that train and develop the next generation of sustainable investing leaders.

• In 2016, the Barclays Social Innovation Facility launched an Impact Series designed to explore the social impact of economic, demographic, and disruptive changes affecting markets, sectors, and society at large. The first report identified the positive effect that ESG investing can have on bond portfolio performance.

• In 2015, BAML provided 14,000 financial advisors detailed reports about the ESG characteristics of its new sustainable impact multi-asset class portfolios and their constituent funds. In 2016, the institution re-chartered its Global Corporate Social Responsibility Committee as the Global ESG Committee.
Sector Analysis

80% of the ESG questions asked are concentrated on 5 sectors.

The five sectors with the highest proportion of ESG questions on quarterly earnings calls are: Services, Energy and Resources, Consumption, Health Care, and Financials.

It is important to underscore that the number of ESG questions asked is not always correlated with the overall number of relevant questions (ESG and long-term). For instance, we identified that 26% of the questions in the Services industry were relevant, of which 11% were ESG. Conversely, 40% of the questions asked in the Resource Transformation sector were relevant, with only 2% classified as strictly ESG.

Framework comparison: are analysts’ questions deemed material?

Of the 169 ESG or long-term orientated questions asked by analysts, 10% cover factors that align with SASB’s materiality framework for the given industry. 24% align with factors included in Delphi’s framework for the respective sector.

24% of the 51 analysts asked at least one question on a topic deemed material by SASB and 51% asked at least one question covering factors in the Delphi framework. 11% of analysts asked only questions deemed material by SASB, whilst 31% asked only questions covering factors deemed material by Delphi.
Appendix
Aims and objectives

The aim of this research is to examine the practices of the top sell-side analysts around ESG integration. Some of the key questions this research is trying to address include:

- Are top sell-side analysts asking questions around ESG issues or long-term value creation?
- How frequently do these questions come up?
- Are specific sectors more likely to attract attention on these issues?
- Does in house ESG research influence the behavior of analysts?
- How do analysts’ questions compare with existing frameworks?

Research approach

1. Identification of top sell side analysts

To identify top sell side analysts for our research we used the rankings provided by Institutional Investor for the top sell-side analysts in 2015. This is an important sample given the reputation these analysts have in the investment community.

The Institutional Investor list contains 57 analysts from 15 different organizations. These include: Bank of America Merrill Lynch, Barclays, Citi, Cornerstone Macro, Credit Suisse, Deutsche Bank Securities, Evercore ISI, Goldman Sachs, JP Morgan, Keefe Bruyette and Woods, Morgan Stanley, Rennaissance Macro Research, Sanford C. Bernstein, Wells Fargo Securities and Wolfe Research.

We collected data for 51 analysts. Analysts from the Institutional Investor list were excluded where there was no available data showing their attendance on quarterly earnings calls.

A limitation to our data collection is its restriction to publicly available information in the form of quarterly earnings calls and sustainability reports. At the time of this report we had no access to sell side reports for the companies covered.

2. Data collection and analysis

For each of the analysts that we have researched up to the time of writing this report, we selected 2-3 companies covered. The selection of the companies was done to ensure that:

- There is a diverse representation of sectors. The sectors in our sample include: Health Care, Financials, Technology and Communications, Energy and Resources, Transportation, Services, Resource Transformation, Consumption, and Infrastructure.
- The analyst has provided an updated recommendation on the company relatively recently (within the last 2 years).

All companies at this stage are US headquartered, apart from TransCanada, Valeant Pharma, Talisman Energy (Canada), Steel Dynamics (UK), SeaSpan (Hong Kong), Mobileye (Israel), BP (UK), and Alibaba (China).

For each company, transcripts of quarterly earnings calls that took
place between Q1 2014 and Q1 2016 were analyzed for questions asked by the analysts in the sample. The range of quarters was selected so that enough questions could potentially be gathered per analyst. The analysts in our sample asked questions in 571 of the quarterly calls we have researched.

The content of these questions was evaluated to identify cases where the analyst asked about ESG integration and / or aspects of long-term value creation. Whenever a question was identified as involving ESG / long-term value, it was coded and assigned a category relevant to the content of the question asked. We took an agnostic approach towards the categories emerging as a result of the coding and these were subsequently refined as the data sample increased (i.e. if a question focused on GHG emissions then an environmental category was created accordingly).

The five overarching categories identified are Business Model, Governance & Risk Management, Human, Social, and Environmental. After coding the questions, we then calculated the rate of occurrence of each ESG / long term value relevant questions. Further analysis of the sample was used to ascertain which institutions asked these questions most frequently.

Finally, for the questions identified as ESG or long-term value related we compared them with:
• Material issues according to SASB (Sustainability Accounting Standards Board) for the sector in which each company operates; and
• Material issues according to the Delphi framework.

The rationale of such a comparison was to:
• Evaluate how important this type of information is considered to be within the context of quarterly earnings calls; and
• Examine if analysts’ thinking is aligned with current frameworks.
Quarterly Call Sell Side Analysis

Research Results III: Example Classifications of Analysts’ Questions

What is an example of an ESG-related question?
Sector: Infrastructure
Analyst question: How are you thinking about the retention policy for key management or people in place on the CPGX (acquisition)?
Our classification: Employee recruitment and retention

What is an example of a question focused on long-term value creation?
Sector: Services
Analyst question: When you scenario plan out HBO over the long term, do you ever think about what a significant increase in content investment would do globally to the business? Is there a business model where you go big, global, more direct to consumer? Given how rapidly the world is changing, do you ever think about what HBO could do if there’s an opportunity to just get much more aggressive on the content side to build the long-term value of the business?
Our classification: Strategic management

What is an example of a question that corresponds to existing frameworks?
Sector: Financials
Analyst question: One question on the regulatory front, really looking at FSOC and SIFIs, is how is the conversation evolving with regulators on systemic risk today? To what extent is the conversation still moving for the corporate risk to the product risk? How effectively do you think the asset management industry is at kind of regulator education, and is it really effectively making its case?
Our classification: Systemic risk management
SASB’s classification: Systemic risk management
Delphi framework: Risk processes

What is an example of a question that is reactive to an ESG event?
Sector: Energy and Resources
Analyst question: Could you just remind us where things stand on recovery for the coal ash remediation investments, and just when will we know kind of the recovery plan for that?
Our classification: Environmental impact

Sector: Energy and Resources
Analyst question: My question is on Groningen, there’s been a lot of commentary about the issue surrounding seismic conditions and property in the area. My question is whether or not we could kind of get a little bit more color on the situation. It sounds like when you answered Ed’s questions a few minutes ago that the implication for production maybe negligible. But I just want to make sure I heard that correctly. And then also, there are talks of some financial penalties too. So any commentary you could provide that would help us sort this out would be appreciated.
Our classification: Environmental impact
Reactive or Proactive? Reactive. Question follows reported damage to residential homes in Groningen due to ExxonMobil’s natural gas extraction in the area.
Case Study

The Enhanced Analytics Initiative

The Enhanced Analytics Initiative (EAI) formed in 2004 to promote a longer-term investment perspective that provided advocacy and resources for analysts’ research into extra-financial issues. Such research was incentivized using both reputational rewards and financial returns based on “a commitment from EAI members to direct a minimum of 5% of their brokerage commissions or research budgets to the providers that performed best in evaluations of the published research.”

A united effort from buy side firms and asset owners, the ultimate goal of the EAI was to see material non-financial drivers such as ESG integrated in sell side research.

Between 2004 and 2008, the initiative grew from 4 members to 30. It included both asset owners and managers, representing more than €2 trillion in assets. The membership was predominantly European (over 85%).

By 2008, members were allocating more than double the original research funding commitments, at an average of 11%, solely based on EAI evaluations. Numerous institutions were influenced by these incentives to change their research practices, from sell side (non)brokers to investment banks and regional research providers. EAI research grew particularly strongly in France, with some positive response in Canada and Australia. However, the EAI had comparatively little impact in the USA and Japan.

As the initiative grew in influence, its research evaluations became more stringent, requiring an increase in the quality of extra-financial analysis in order to warrant commission. With standards improving, a significant gap emerged between the leading research firms and other competitors, perhaps due to the degree of strategic specialization that took place. After four years, the EAI merged with the UNPRI with the explicit purpose of extending its influence to the extensive list of PRI signatories.

Lessons learned

On its terms, the EAI was an innovative and relatively successful project running between 2004 and 2008. However, the outcomes serve to highlight important insights into the challenges associated with integrating ESG issues into sell-side research.

• The relatively low rate of engagement in some key economies embodies a major barrier to achieving the ultimate goal of mainstreaming ESG integration. Poor uptake in USA was a concern considering most major corporations are listed or cross listed in US stock exchanges.

• The majority of research generated took a thematic approach, comprising standalone reports on a small number of mainstream issues. This trend means only a paucity of ESG issues were integrated into company- or sector-specific analyses that hold greater market impact.

• Recognizing the abundance of buy side firms that did not sign up as EAI members, there is reluctance to financially commit to rewarding ESG research despite the consensus around its pertinence to market health in the long-term. There is thus a lack in quality of ESG research, which in turn reduces the funding available to resolve this issue.

• A perceived first-mover disadvantage restricts many mainstream asset owners from seeking progress in the integration of ESG issues.

• The concept of materiality was rarely adequately applied in research. Instead, easily quantifiable environmental issues were commonly researched, whilst social issues received relatively little coverage.

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About the Authors

**KKS Advisors** is a leading advisory firm specializing in strategy and research, formed with the vision to reshape markets. Our goal is to enable clients to create long-term value through the integrated management of economic, environmental, social and governance factors. KKS works with companies, investors, NGOs and policy-makers to drive systemic change, across a range of service offerings including - strategy, corporate governance and reporting, sustainable investing, sustainable development and branding. KKS provides thought leadership by regularly publishing research that inspires decision makers to drive market transformation.

The **High Meadows Institute** is focused on the role of business leadership in society. Our mission is to ensure sustainable economic and social progress in a global economy and society. The High Meadows Institute was founded in 2013 by a small group of senior business leaders with deep experience in the private and non-profit sectors. The Institute works in close partnership with other leading think tanks and academic and business organizations to advance its mission.

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**KKS Advisors** is a leading advisory firm specializing in strategy and research, formed with the vision to reshape markets. Our goal is to enable clients to create long-term value through the integrated management of economic, environmental, social and governance factors. KKS works with companies, investors, NGOs and policy-makers to drive systemic change, across a range of service offerings including - strategy, corporate governance and reporting, sustainable investing, sustainable development and branding. KKS provides thought leadership by regularly publishing research that inspires decision makers to drive market transformation.

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