

INVESTING IN THE ENVIRONMENT

‘The wise man lays up an inheritance for his children.’ There is no denying that this quote speaks volumes with regard to the economic and social prosperity of the future generations. But what is the wise man to do when he sees this intended inheritance being eroded? Since the enforcement of the regulation that Pension Funds should not hold more than 50% of their total assets in equities, Stockbrokers have complained that trading volumes have plummeted and continue to be evasive of previous levels enjoyed. Share price multiples also declined sharply as they succumbed to the negative pressures exerted upon them by the laws of demand and supply.

What this has done however is to create opportunities in the market for both the long term investor and the speculator. The long term investor would likely concern himself about the intrinsic value of the share and recognize price bargains while the speculative investor seeks to take advantage of any share price volatility that may exist at the lower prices. Both types of investors rely on available information to make decisions about which shares can help them achieve their goals.

I am by no means trying to suggest an efficient or inefficient market hypothesis at this point, but rather, I am only recognizing the use of information in decision making.

So.., what should investors make of the recent announcement by Trinidad Cement Limited (TCL) that it has acquired the International Organization for Standardization’s certification - ISO 14001?

Those aware of the Standard would acknowledge that the company is taking a very positive and responsible step in the management of those aspects of the environment over which it has control and can be expected to have an influence. Although the Standard does not state the criteria for the organization’s specific environmental performance, it does stipulate the requirements for an environmental management system (EMS).

Two very important issues surface when considering this step taken by TCL. Why would a company be concerned about environmental performance when it is in business to make profits for its shareholders? and why should shareholders and investors be concerned about the company achieving this certification?

To answer the first question – management of the firm’s environmental performance is closely related with the management of a number of associated risks. Environmental performance has become a major factor for business relationships worldwide with stakeholders from customers to regulators having amplified interests in how the organization’s operations affect the environment.

As these stakeholders become more environmentally aware, they impose their ‘sense of nature’ on the organization in various ways, for example:

Customers demand for the company's product or service can be affected either positively or negatively dependent on which end of the spectrum the company finds itself.

Suppliers are becoming more sensitive about the preservation of brand names. The association of brands with contentious world issues may cause suppliers to be quite selective in their management of business relationships.

Communities may strongly oppose the presence of operating plants by firms with negative environmental reputations. This can lead to bad publicity for those firms.

Regulators set standards for environmental performance and may impose fines on organizations that negatively impact the environment.

Conversely, a positive environmental reputation may attract customer and suppliers wishing to be associated with 'green' companies. They may even be encouraged by communities to establish business and can also be recipient of some leniency from regulators. For TCL, it may well have been an unavoidable decision as one of the main objectives identified in the National Environmental Policy developed by the Environmental Management Authority is ensuring all industries install certified EMS.

Nonetheless, these are but a few of the risks that pertain to environmental performance and business relationships that managers must consider. Each of these risk factors has some impact on how the firm carries on its operations and ultimately affects profits.

There are also several benefits that a firm can derive from being environmentally friendly including more efficient use of resources and enhanced competitiveness. These can translate into greater profitability for the organization.

One case drawn from myriad reports of increased profitability due to the business being environmentally friendly is that of a small pizza establishment in the United States. The company used produce from the local community in order to reduce the amount of pollutants emitted into the air from transporting the produce. Needless to say this resulted in big savings in transportation costs. Special fuel efficient ovens were installed and cleaner burning fuel than natural gas used to cook the pizza. Also the heat from cooking the pizza was trapped in special ducts to avoid direct release into the atmosphere; it was instead used to heat the watering system. This of course reduced energy consumption and saved on costs. Additionally, to deliver the pizzas the company introduced small vehicles powered by bio-fuel, which burns cleaner than petrol. This attracted new customers and was a favorite with existing customers who specifically requested that the pizzas be delivered in those vehicles.

To answer to the second question, increased profitability enhances shareholder value.

Although I am not suggesting that an efficient market exists in Trinidad and Tobago, to some degree, the principle still applies i.e. according to the efficient market hypothesis; markets are very efficient at interpreting data and arriving at equilibrium share prices. Therein lays the significance to TCL's announcement to the shareholders and investors.

The information is interpreted by investors and is then reflected in the higher prices for shares of 'green' companies.

Some research findings show that capital markets may have short-term reactions to news about environmental impacts; however, the affected business relationships can create a more lasting influence on the sustainability of the business operations. For a firm like TCL to receive the ISO 14001 certification means that they have implemented an EMS that is acceptable on the global scale and has therefore opened itself to broader opportunities.

This may well be of interest to the longer term investor who is not easily swayed by the price-volatility that occurs due to short term market conditions.