

How Government initiatives help steer SRI investment



By Seb Beloe, Head of SRI Research at Henderson Global Investors

'Don't drink and drive' was the way that many tabloid headline writers summarised Alistair Darling's March 2008 budget. The Chancellor, sandwiched between recessionary fears and climbing inflation, chose to focus most of his attention on yet further tax increases for alcohol and cars, both now it seems joining cigarettes as perennial features of budgets focused on discouraging 'social ills'. At the same time, though with fewer headlines, the Chancellor also launched some more modest initiatives aimed at making homes 'greener' and reducing child poverty.

As a sustainable and responsible investor (SRI) these initiatives and their predecessors have proved critical in helping to kick-start and then maintain investor interest in social and environmental investment themes. In particular, Government support for clean energy has played a key role in increase the volume of power generated from wind, solar and biomass technologies. In the UK for example, the Renewables Obligation has been essential in ensuring adequate returns for investors in wind power, while similar schemes in Germany, Spain and the US have ensured rapid growth in their own domestic renewable energy portfolios.

Government regulation can also drive the development of key themes in less direct ways. Progressively higher standards for example on health, safety and environmental issues – areas in which Henderson's Industries of the Future fund actively invests – have been instrumental in the development of new industries focused on providing solutions to these issues. For example, companies focused on selling products and services that increase safety are expected to benefit from the Corporate Manslaughter Act, which came into force last month and is intended to raise safety standards within business by holding companies more directly accountable for workplace accidents. Companies like **Halma**, a manufacturer of accident prevention and safety equipment, are expected to benefit from the new legislation.

Ever-stricter environmental standards aimed at further limiting pollution can also drive growth in companies like **Johnson Mathey**, another UK company that manufactures catalysts aimed at reducing polluting emissions from vehicles. They also help to underpin a flourishing environmental consulting including companies like **RPS** and **WSP**, which advise companies on how best to meet – or exceed – tightening environment, health and safety standards.

While such regulatory drivers are welcome, Governments are famously fickle and their involvement does also introduce risks for investors – including the risk that support for particular sectors or technologies will be withdrawn further down the line. In Germany for example, support for biofuels that previously came through tax exemptions was removed in 2007, resulting in a dramatic slump in demand and leaving investment in new biofuel production capacity and refining effectively stranded.

However, for a growing set of renewable energy technologies these risks are receding as these technologies become competitive without the assistance of direct government support. Geo-thermal sources of energy and heat-pumps manufactured for example by firms such as **Waterfurnace International** are already cost competitive – spurred in particular by the high price of hydrocarbons – with running costs that are typically 70% below those of conventional alternatives. In addition, according to Citigroup research, on-shore wind can now generate electricity at just over €60/MWh, a price which is comparable with traditional coal and gas power. In fact, several US commentators bemoaned delays in decision-making regarding the future of US government support for wind power, not because of concerns over the level of support, but because it simply postponed the approval process for investments that are already cost-competitive.

Technologies that focus on increasing the efficient use of energy and other resources are perhaps best-placed to benefit from higher energy prices, and developers of everything from software that improves the energy efficiency of computers through to manufacturers of loft-insulation such as **Sheffield Insulation Group** are seeing real growth in demand for their products as a source of significant cost savings. We expect these trends to strengthen as the cost-benefit ratios of these →

technologies become more widely understood and appreciated. While the oil price has helped to lessen regulatory risk in these sectors, it is not the only trend to reduce the significance of government support. We are also finding that demand for clean technologies is drawn from the growing use of 'private law' being developed by companies through their supply-chain relationships. As early as 2005 more than fifty of the 250 largest businesses in the UK had already developed programmes focused on improving the social and environmental performance of suppliers. Efforts by businesses for example to reduce greenhouse gas emissions in their supply chains (and extract greater efficiencies) have led retailers such as **Sainsbury's** to convert parts of their logistics chain to zero emission vehicles – a trend benefiting companies such as **Tanfield** which manufactures electric vehicles. These trends are largely separate from legislation and are proving enormously powerful.

While these developments in private law, as well as wider changes in the economic landscape, are helping to drive the development of new 'green' industries, it is clearly essential for

the government to remain supportive of their further development. For example, in still emerging technologies such as carbon capture and storage (CCS) and wave and tidal energy, direct support is still vital.

Perhaps though of almost greater importance is the 'indirect' support that government also provides to business to invest in these areas. Enabling legislation that provides information to consumers and investors – for example on the relative safety of different types of car, or on the carbon emissions from different businesses – is crucial in assisting these groups to make informed decisions. Equally, providing a predictable regulatory environment that enables businesses and investors to make long-term decisions is also essential in facilitating the development and implementation of promising new technologies and approaches.

Ultimately, in the absence of headline-grabbing budget reports, it may well be that these wider forms of support will be the most important in enabling businesses and investors to respond effectively to pressing social and environmental issues.

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