ESG Ratings for the Maritime Industry: a Review

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Summary

The maritime industry needs to speed up the integration of ESG factors in its operations. Any instrument or initiative that positively contributes to this is to be supported and encouraged. Webber research has created an ESG Scorecard with which it aims to assess and classify publicly listed companies in the maritime sector based on their ability to adequately integrate ESG in their operations. This research note offers a high level assessment of this scorecard and finds that there are significant differences between the findings of the Webber ESG Scorecard and those offered by a different rating agency, namely Sustainalytics' ESG Risk Ratings. This white paper reviews these differences and offers possible reasons for this divergence as well as some suggestions for further work on ESG assessments in the maritime space.

1. Introduction

PROW Capital was founded with the ambition to provide capital in order to speed up the decarbonization of the shipping industry. When looking at possible transactions we not only look at underlying asset–the vessel(s) to be financed–but also the profile of the company we are financing. The latter is of equal importance. We only want to assist those companies committed to decarbonization in the way that we are. In addition, the companies we finance are showing that sustainability is broader than the mere environmental performance of their vessels and that their performance on social and governance issues is likewise in play.

Given our holistic view on ESG we are always interested in initiatives that share our concerns and aim to improve the sustainability or indeed ESG performance of the maritime sector. A couple of weeks ago the US based research firm Webber Research published their "2022 ESG Scorecard" which aims to provide an assessment or rating on how companies in the maritime sector perform on various non-financial metrics (Wasikowski *et al*, 2022), the topic of this research paper.

What are ESG Ratings?

ESG ratings are a simple (and some would argue *simplified*) way of assessing how a company performs on specific Environmental, Social and Governance issues. There are many different rating initiatives out in the market but arguably the leading initiatives include those by Sustainalytics, MSCI, and S&P.

Each rating agency has its own (proprietary) rating methodology which can, and indeed does, result in the same company having a very good rating by one agency while having a very poor rating with another agency. The existence of different assessments on the same company highlights that these ratings are a means for those who want to integrate ESG concerns in their capital allocation rather than an end in themselves.

The origin of the different assessments can lie with the focus on different topics and/or the application of different weights in coming to a final rating. Some agencies are more focused on commitments (e.g. by way of policies) and others place greater value on actual outcomes. Also the relative importance of the various components differ among rating agencies, with some placing a greater importance on environmental topics and others on social or indeed governance issues.

In this paper the focus is on the Webber ESG Scorecard, which aims to introduce ESG assessments specifically to the maritime sector. The remainder of this paper is structured as follows: the next section looks at the Webber ESG scorecard itself, its underlying methodology and outcomes; the subsequent section compares the outcomes of the ESG scorecard with those of another agency, section 4 discusses possible explanations for the differences identified. The last section (5) offers some concluding remarks and recommendations.

2. The Webber ESG Scorecard

In 2016 Webber research launched its Corporate Governance Benchmark which it has since then rebranded as the Webber ESG Scorecard. The aim of this ESG scorecard is to create "<..> comparable quantitative and qualitative corporate governance ranking across the Marine universe." (see Webber *et al*, 2021, p. 11)

Methodology

The underlying methodology of the ESG scorecard–which was not altered in 2022 compared to 2021–is built around nine (mostly binary) different inputs. The score that arises from this analysis are subsequently used to classify each company into quartile rankings. The rated universe of the Webber Research ESG Scorecard consists of 52 publicly listed companies.

The idea of the scorecard is that a low score causing a company to be classified in the lowest quartile signals that investors should be aware that this might impact their returns: "<..> if a Marine stock scores poorly (Quartile 4), we believe the corporate governance profile of that name should probably receive extra scrutiny. Thus, an investor would need to price this lower degree of corporate governance (and associated risk) appropriately (i.e., pay a lower price/valuation). In contrast, we believe Quartile 1 Marine names are more likely to fetch a relative valuation premium based on higher underlying quality indicated by our scorecard."

In other words the application of the ESG Scorecard is a tool to help investors in pricing in ESG related risks. Alternatively one could also use the outcomes as a way to engage with companies on the status and possible improvement on their ESG performance as measured by this approach.

Table 1 below provides an overview of the nine factors that constitute Webber's ESG Scorecard. Each factor has its own weight with the "Carbon Factor" amounting to 20% of the final ESG Scorecard and factors 1 to 4 the lowest weight of 8.75% each.

Table 1 Webber Research's ESG Scorecard factors

Factor	Description	Weight
Factor #1	Related Party Commercial Management	8.75%
Factor #2	Related Party Technical Management	8.75%
Factor #3	Sale And Purchase Fees	8.75%
Factor #4	Related Party Transactions	8.75%
Factor #5	Board Independence	12.50%
Factor #6	Board Composition	10.00%
Factor #7	Board Policy	10.00%
Factor #8	Carbon Factor	20.00%
Factor #9	Subjective	12.50%
		100%

Source: Webber *et al* (2021, p. 13)

The overview of the different factors accentuates the fact that this enterprise started out as a benchmark for corporate governance, indeed seven of the nine factors are directly linked to precisely that topic. The recently added factor covering Carbon deals with the question whether or not there is disclosure of relevant carbon data.

With the exception of factor #9, the various components are pretty straightforward and, as indicated before, mostly binary in nature. The ninth factor is a subjective factor, which is included in order "<..> to capture dynamics, context, or risks that are missed by the inherently binary aspect of some of our metrics." (Webber *et al*, 2021, p. 11).

One final remark on the ESG Scoreboard developed by Webber Research relates to the question as to how the universe (i.e. the selection of companies) that is subjected to the scorecard was created. Unfortunately, Webber doesn't discuss why it only looks at 52 companies or indeed what the basis is for this particular selection. What is clear is that all are publicly listed and predominantly so in the USA and to a lesser extend in Norway.

Impact

Regardless of the pros and cons of the methodology (some of which are discussed below) it should be pointed out that the endeavour of creating such an ESG Scorecard has merit in and of itself. If anything, it helps with the ongoing conversation on the integration of ESG factors in the way companies operate. The media attention given to the publication of the Webber Research ESG Scorecard highlights again the necessity to also look more broadly in assessing how companies are doing. The fact that companies take pride in their ESG scores is also testament to this. It should however be stressed that any ESG analysis is only the start of a conversation and not the end.

Results

Given the approach of creating quartiles and applying this to a universe consisting of 52 companies, this means that each quartile consists of 13 companies. Apart from offering insights as to how each company performs against its peers, the benchmark also offers the opportunity to see what if any changes occur over time.

Comparing the results of 2021 with those of 2022 (see Table 2 below) the most striking result is that nearly all (92%) of those companies that were in the first quartile, stayed in that quartile. This stands in contrast with those companies of the second quartile of which only 7 of the 13 companies remained in that category with one improving in its position, two sliding to the third quartile and three companies disappearing from the rated universe because the corporate entity as such, ceased to be. The companies that make up the lowest quartile and thus perform the least on the Webber ESG Scorecard are also fairly solid with little movement:

Table 2 The Webber ESG Risk Score Quartiles for 2021 and 2022

2022 / 2021	1st Quartile	2nd Quartile	3rd Quartile	4th Quartile	Exit	Total
1st Quartile	12 (92%)	1				13
2nd Quartile	1	7 (54%)	2 (15%)		3 (23%)	13
3rd Quartile		3 (23%)	8 (62%)	1	1	13
4th Quartile			1	11 (85%)	1	13
New		2	2	1		5
Total	13	13	13	13	5	52

Source: Wasikowski *et al* (2022)/ Webber *et al* (2021)/ PROW Capital analysis/ Note that five new entities were added in 2022

The next section takes a closer look at the outcomes of the Webber ESG Scorecard by comparing these with the work done by the ESG rating agency Sustainalytics.

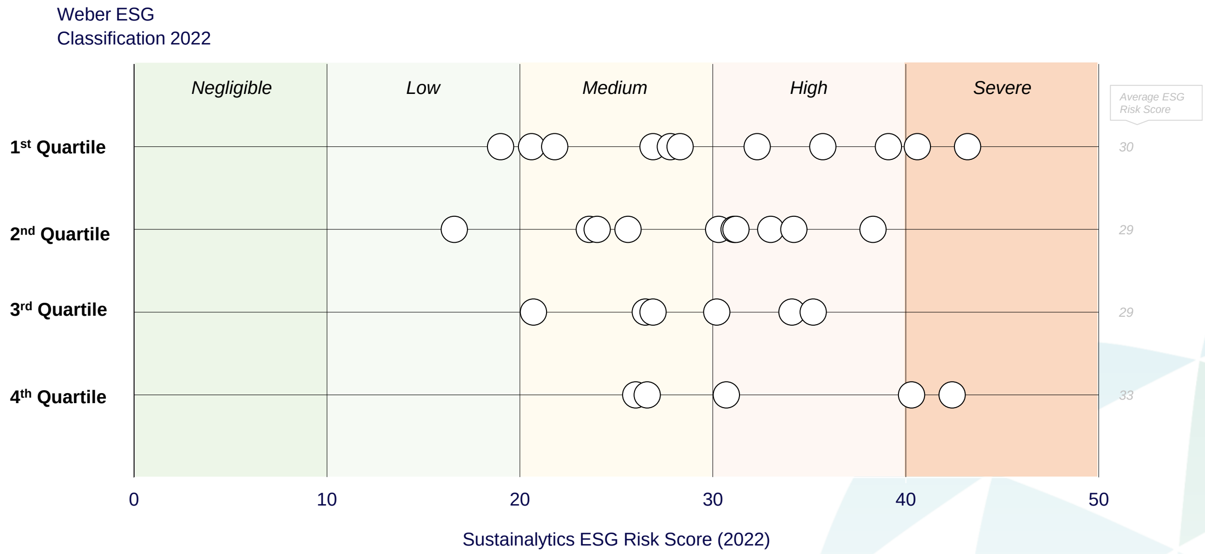
3. Comparing the Webber ESG Scorecard with the Sustainalytics ESG Risk Score

As noted above, there can be a wide divergence in the outcomes of ESG assessments done by different rating agencies on the same company. Comparing the outcomes of different ESG appraisals is itself part of the ongoing conversation on ESG and should not be seen as a way to prefer the one over the other as such. Indeed, comparisons can lead to identifying possible areas for improvement in the activity of assessing the ESG performance of companies.

In this section the outcomes of the Webber ESG Scorecard are compared to those of Sustainalytics. Using the latter's publicly available ESG Risk Scores (see Sustainalytics, 2022) we match these with the quartile assessment of Webber Research. The ESG Risk Scores that Sustainalytics produces are a number ranging from 0 to 50 indicating an assessment ranging from "Negligible Risk" to "Severe Risk" respectively. The scale also includes intermediate steps signifying different levels of ESG Risk, Low (a score from 10 to 20), Medium (20 to 30) and High Risk (30 to 40). The Sustainalytics' ESG Risk Score is created in such a way that it provides an assessment of a company against the entirety of its universe, meaning that it compares a company against every other company regardless of sector or industry.

In the graph below the different Sustainalytics' ESG Risk Scores are shown for each of the quartiles identified by Webber Research for 2022. In other words, each marker on the line "1st Quartile" denotes a company which is classified as being in the top quartile by Webber Research while its place on the (horizontal) axes is determined by that company's own Sustainalytics ESG Risk Score.

Graph 1 Sustainalytics' ESG Risk Scores (and categories) per Webber ESG quartile (2022)



Source: PROW Capital analysis

The most striking outcome of comparing the assessments of Webber Research and Sustainalytics is that no less than two companies, classified by Webber Research as being in the vanguard compared to their peers are given the label of Severe High ESG risk by Sustainalytics. Apart from this, the comparison shows that there is no clear connection between the two approaches as such. This indicates that these two approaches are measuring different things when doing their ESG assessment.

There are various possible explanations on why these differences occur, for instance: The analysis of Webber might capture characteristics that are not included in the analysis of Sustainalytics resulting in the latter incorrectly assessing the companies; the reverse might be true or a combination of both.

The most obvious difference between the two approaches is the factors included in the analysis. Whereas Sustainalytics utilizes a comprehensive questionnaire covering E, S and the G in great detail, the approach taken by Webber Research is more limited, focussing on only a select number of factors, the majority of which are linked with Corporate Governance.

Although governance issues are of great importance and possibly even more so for the investor community, the material ESG issues for the maritime sector cover a much broader array of topics. With the recent inclusion of a factor directed at Carbon Emissions, Webber Research acknowledges as much. At the same time the ESG Scoreboard is very silent on the Social dimension which in light of the very dire consequences for people at sea during the height of the Covid-19 pandemic (e.g. unable to set foot ashore for months on end) is not a topic that can be overlooked in any ESG assessment of any company in the Maritime sector.

The Sustainability Accounting Standards Board already noted eight years ago that working conditions (Health and Safety) are part and parcel of the material sustainability issues in the Marine Transportation industry (SASB, 2014). Likewise, are the environmental topics deemed material well beyond the mere scope of carbon emissions (e.g. waste water treatment). These omissions in the Webber Research methodology are noteworthy regardless of the question–if such a question is even meaningful–which of the approaches might be better positioned to identify the level of ESG integration at a company.

The average Sustainalytics' ESG Risk Score per Webber Research Quartile shows little connection between the two assessment types. The average scores are 30, 29, 29 and 33 for Q1, Q2, Q3 and Q4 respectively. This analysis should be treated with some caution as not all companies that are included in the assessment of Webber Research also have a Sustainalytics rating.

Table 2 provides an overview of the outcomes per category and quartile while also highlighting the comparatively large number of companies that are *unrated* by Sustainalytics: twenty in total, nearly halve of these are of the 4th quartile. This observation warrants a closer look as to why this is the case, which is the topic of the next section.

Table 2 The Sustainalytics ESG Risk Scores (and categories) per Quartile of the Webber ESG Score (2022)

Sustainalytics ESG Risk Categories / *Webber Quantiles of ESG Scores*	Negligible	Low Risk	Medium	High Risk	Severe	Unrated	Grand Total
1st Quantile	-	1	5	3	2	2	**13**
2nd Quantile	-	1	3	6	-	3	**13**
3rd Quantile	-	-	3	3	-	7	**13**
4th Quantile	-	-	2	1	2	8	**13**
Grand Total	-	**2**	**13**	**13**	**4**	**20**	**52**

Source: PROW Capital analysis

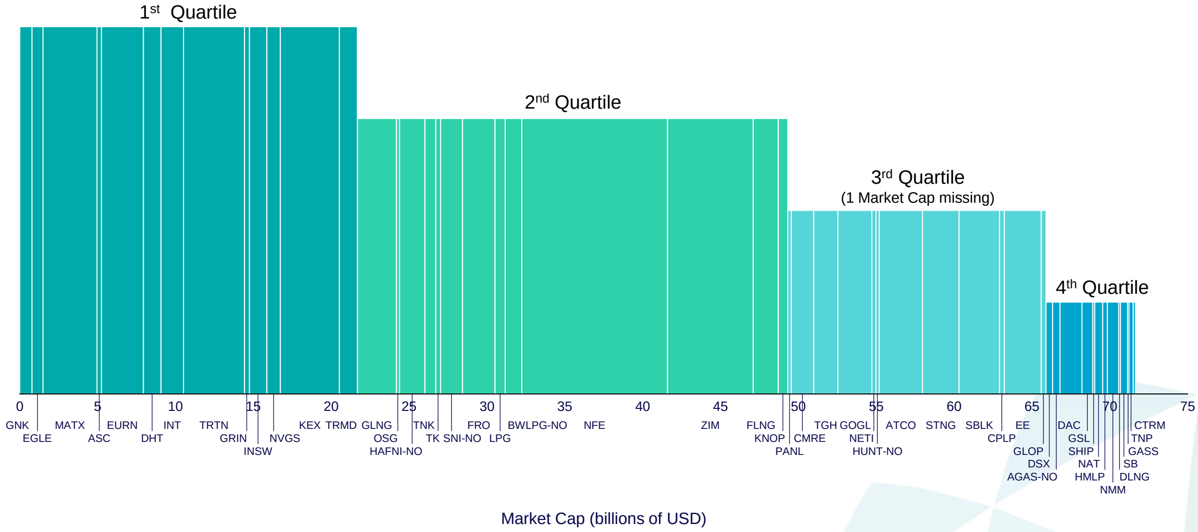
4. Possible explanations for the unequal coverage of Webber and Sustainalytics

Many–if not most–of the ESG rating agencies operate a subscription model, meaning that investors subscribe to their services to obtain access to their catalogue of ratings. This means that the 'rated universe' of these agencies consists of companies that are of interested to their subscribers. Overall, this results in the fact that many of these ratings tend to be on publicly listed companies that have a certain size and/or a minimum level of liquidity.

From this observation the inference can be made that when a company doesn't have a rating of one of the leading ESG rating agencies (such as Sustainalytics), this company is (as yet) not of interest for the core subscribers to these agencies, which given the cost of subscriptions tend to be the larger asset managers. This type of investor (which includes the larger institutional investors) are (for their public equity portfolios) generally very keen on stocks having a certain amount of liquidity (meaning lots of buyers and sellers are active so that they are able to sell their shares at very short notice) and size.

In order to test the hypothesis that a lack of ratings for a significant number of companies in the Webber Universe might be due to underlying characteristics (that make the companies less interesting for the larger asset managers and hence less likely to have an ESG Risk Rating from Sustainalytics) the market cap for each of the companies was reviewed. In graph below, the various 'members' of each quartile are included whereby the width of the bar indicates the size/ market cap of each company. The height of each bar indicates merely in which quartile the company is included with the highest for the 1st quartile. For one company it was not possible to obtain the information on the market cap.

Graph 2 Market Cap per Webber ESG Score Quartiles (2022)



Source: PROW Capital analysis/ Data from Yahoo! Finance for 26/07/2022

The graph shows that the largest individual companies in the Webber Universe are to be found in the second quartile. On an aggregate level, the second quartile is also the largest (27.7 billion USD) followed by the first (21.7 billion USD) and third (16.6 billion USD) and lastly the fourth quartile with an aggregate of 5.8 billion USD. The latter is by far the smallest of the four indicative of the presence of a larger number of smaller companies.

Table 3 below takes a closer look at the size of the companies in each quartile. Companies in the 4th Quartile tend to be significantly smaller than those in the other quartiles. Whereas the average size for a company in the first quartile is 1.7 billion USD and 2.1 billion USD in the second quartile, the average for the fourth quartile stands at 0.4 billion USD. When looking at the median size for each quartile its noteworthy that in each subsequent quartile it increases, from 1.1 in the first to 1.4 and 1.5 billion USD in the second and third quartiles respectively with 'only' 0.4 billion USD for the last quartile.

When the focus is on only the unrated companies the differences are striking. With the exception of the second quartile, both the average size as well as the median tend to be a lot lower for unrated companies compared to the overall numbers.

Table 3 Summary statistics on Market Cap per Webber ESG score Quartiles (2022)

Billions of USD	1st Quartile	2nd Quartile	3rd Quartile	4th Quartile	Overall
			All companies		
Average	1.7	2.1	1.4	0.4	1.4
Median	1.1	1.4	1.5	0.4	0.8
			Non-rated companies		
Average	0.3	2.4	1.0	0.3	0.9
Median	0.3	1.6	0.3	0.3	0.3

Source: PROW Capital analysis

In short there are notable differences between rated and unrated companies in terms of size. This is in line with the hypothesis whereby investors that tend to subscribe to Sustainalytics and signal that there is a demand for an ESG ratings, are less interested in these companies due to a lack of size (and assuming lack of liquidity)

5. Conclusion

Today it's more important than ever that companies acknowledge the impact they have on society and on the environment, whether good or bad. Initiatives that help with identifying this impact and enable companies but also their employees, investors and other stakeholders to steer on those impacts are to be welcomed. For maritime companies there is a large gap in the availability of such information in the form of ESG ratings. Webber Research with its ESG Scorecard has attempted to fill this gap, which is to be welcomed and supported. At the same time, it should be acknowledged that these undertakings are a moving target in and of themselves and should always be subject to reviews insofar as to improve their quality and effectiveness. This isn't just applicable for Webber Research but for all who are taking up this important task.

That said, this review of Webber Research' ESG Scorecard finds that the applied methodology is somewhat one-sided and too much focussed on corporate governance, which given that this scorecard started out as a corporate governance scorecard is not surprising. This would suggest that this scorecard is thereby possibly missing out on other relevant ESG related issues that would provide a more comprehensive approach to the integration of non-financial factors in the assessment of corporates and ones that may even influence the profitability of a company and/ or its share price.

Regardless of the direct financial impact of the above issues, PROW Capital sees these as topics that any responsible investor should have a look at under any case. They contribute to prudent investment management while also identifying those companies that have a clearer view on how they are going to operate in this changing world. Precisely these topics are of increasing concern. This high-level review suggests that Webber Research should expand the scope of its analysis and incorporate more environmental and social topics in its analysis.

With regard to the environmental dimension, it should be noted that the disclosure of relevant carbon data is (or rapidly becoming) a legal requirement in many jurisdictions. This would therefore entail that any measure that is just focussed on the actuality of disclosure is in fact measuring whether or not a company abides by the law, which thus only yields a meaningful result if it is found to be negative. In our view, abiding by the law should not be counted as a clear commitment with regard to a meaningful integration of ESG in a company's operations.

Lastly, there is another reason why we would like to encourage Webber Research to expand the scope of its methodology. The suggestion of an "ESG Scorecard" implies a greater width of topics than is currently covered by its methodology. Such an expansion would also insulate the scorecard against any complaints of greenwashing; after all, the suggestion is that it is an ESG rating and not a Governance rating.

The fact that many companies in the Webber Universe do not have an alternative ESG rating might very well be the result of a lack of investors willing to invest in precisely those companies. This might be because these companies are comparatively small and may therefore not be of interest to the larger investors which are also looking for enough liquidity when making their investment decisions. At the same time, it could also be that the poor ESG scores might deter investors to enter in those companies and improving the ESG score might therefore possible to attract new investors. This is certainly a topic for further research. In any case, it should be noted that regardless of whether or not the investment community 'rewards' better ESG scores, it will definitely support financial institutions to include in their assessment of their clients the non-financial metrics that are becoming ever more important.

PROW Capital believes that the degree in which companies integrate non-financial concerns in their operations, and thus how well they manage their ESG issues, will increasingly influence their access to capital. Especially the banking sector is increasingly taking steps to integrate these issues in their risk models. These developments are further promoted by regulators (e.g. the ECB but also the Federal Reserve) that are increasingly integrating sustainability concerns in their regulatory oversight activities, such as through the application of the recommendations of the Taskforce on Climate related Financial Disclosures (TCFD).

In short, access to capital will increasingly be influenced by non-financial–ESG–issues. Companies in the maritime sector need to understand that they are in competition with other companies that are looking for capital. Only comparing against peers in the same sector is a helpful tool to get a better picture of where a company stands within the industry. At the same time we are talking about issues and concerns that go well beyond any mere industry or sector; just comparing it to the peers in the same sector can create a false sense of accomplishment as the sector in its entirety might be performing badly compared to other industries and sectors.

6. Literature

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Colophon

The PROW Capital white papers aim to contribute to the debate on advancing the decarbonisation of the economy and furthering the integration of non-financial factors in the way companies operate. This white paper was prepared by Maarten Biermans and Deniz Ilhan Önal (both PROW Capital), August 2022, Amsterdam

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