Chapter 11
Corporate Social Responsibility: The Investor's Perspective

Céline Louche

The cynic knows the price of everything and the value of nothing.

Oscar Wilde

Abstract Investors are increasingly realising that a proactive approach to the management of a firm's social and environmental risks can result in considerable opportunities in both financial and sustainable value creation. This trend is being reflected in a significant increase in the number of corporations that are involved in what is called 'Responsible Investment' (RI) – that is approaches which integrate environmental, social, governance and ethical factors into investment processes.

This chapter explores the investor's perspective of the field of corporate social responsibility and more specifically on the practice of Responsible Investment (RI). The aim is threefold: firstly to provide a general background on Responsible Investment – definition, history, actors and trends, secondly, to give an overview of the existing practices of responsible investment and its key characteristics and finally to discuss some critical issues that may shape the future of RI.

RI is still a developing and changing activity which is expected to keep growing in the future. But responsible investors can play a major role in transforming the concept of investing by integrating social and environmental dimensions whilst simultaneously pushing up the issue in a company's CSR agenda.

11.1 Introduction

Investors like any other members of society have not remained indifferent to the concept of Corporate Social Responsibility (CSR). According to the Economist Intelligence Unit 2005 survey 85% of the investors consider CSR as a 'central' or 'important' consideration in investment decision (Economist Intelligence Unit,

---

C. Louche (✉)
Vlerick Leuven Gent Management School, Gent, Belgium

S.O. Idowu, W.L. Filho (eds.), *Professionals' Perspectives of Corporate Social Responsibility*, DOI 10.1007/978-3-642-02630-0_12,
© Springer-Verlag Berlin Heidelberg 2009

2005); a number which has almost doubled in five year (44% in 2000). This trend has been confirmed by other surveys that show that fund managers and financial analysts do not only believe in the relevance of CSR to assess companies' potential viability but also effectively use CSR related information in valuing firms (Taylor Nelson Sofres, 2003; Ambachtsheer, 2005; Guyatt, 2005; PLEON, 2005; Jaworski, 2007). Indeed CSR related information is believed to help to better manage investment risks and bolster long-term shareholder value as well as investment returns (CSR Europe, Deloitte et al., 2003; Jaworski, 2007).

As a result investment vehicles with specific CSR objectives have emerged. One of such prominent vehicles is Responsible Investment (RI). Responsible investment combines investment strategies to bring together the three dimensions of CSR, namely social, environmental and economic responsibilities. RI does not only seek to maximize financial returns but also to contribute to social betterment.

This paper provides insights into investors' perspective on and practices of corporate social responsibility and more importantly, it y focuses on the activity of Responsible Investment.

The paper is structured as follows. The first part provides background information on the history and development of the responsible investment it also gives an overview of the current trends and the actors involved in the field of RI. The second part focuses on the implementation of responsible investment. It introduces the three dimensions of RI, namely materiality focus, long term orientation and stakeholder perspective and then moves on to the consider different strategies and tools used in the RI industry. And finally, the last two parts present some discussion points and conclusions.

11.2 Introducing Responsible Investment

11.2.1 Investors and CSR

Investors constitute one of the core stakeholder groups that can affect companies' (Donaldson and Preston, 1995; Freeman, 1984; Freeman et al., 2007; Mitchell et al., 1997). As such they can play a major role in encouraging companies to engage in CSR. Nonetheless CSR concerns and adoption have been a neglected area of inquiry within the investment community. But changes have been taking place over last decade and a number of signs suggest a growing interest and implementation of CSR among members of the investment industry:

- Some investment management firms are presenting the CSR argument as a tool of competitive advantage. For example Generation IM believes that sustainability research integrated into a rigorous traditional investment process can strengthen fundamental investment analysis and deliver superior long term results (Generation IM, 2009).

- Studies are suggesting that worldwide, money managers are convinced that the adoption of RI practices and strategies will become a commonplace (Taylor Nelson Sofres, 2003; Ambachtsheer, 2005; Jaworski, 2007).
- Launch of several initiatives promoting responsible investment within the investment community. One of the most prominent initiatives is the Principles for Responsible Investment (PRI) launched in 2006, the PRI is a coalition of more than 400 institutional investors and asset managers with some $15 trillion dollars under management (Hobbs, 2008).
- An increasing number of studies on the link between corporate social performance (CSP) – and – corporate financial performance (CFP) have emerged (see for example (Pava and Krausz, 1996; Preston and O'Bannon, 1997; McWilliams and Siegel, 2000; Orlitzky et al., 2003). Margolis and Walsh (2003) counted 127 studies devoted to exploring the relationship between CSP-CFP in the period 1972–2002 (Margolis and Walsh, 2003).
- A large number of academic research has looked at the impacts of social and environmental aspects on stock valuation (see for example (Klassen and McLaughlin, 1996; Jones and Murrel, 2001; Bauer et al., 2002, 2007)

In December 2008, Günter Verheugen, Vice President of the European Commission, emphasised the importance of investors in boosting CSR during his speech at the CSR Alliance event. He also stated that 'there is indeed no other powerful incentive to consider the strategic role of corporate responsibility than an investor being able to value the role that it plays for the future prosperity and sustainability of a business' (Verheugen, 2008).

11.3 Defining Responsible Investment

Responsible Investment (RI) can be described as an investment strategy which seeks to generate both financial and sustainable value. It consists of a set of investment approaches that integrate environmental, social and governance (ESG) and ethical issues into financial analysis and decision-making (Hutton et al., 1998; Cowton, 1999; Eurosif, 2003; 2006; Mercer and UNEP Financial Initiative, 2007). The 2005 World Economic Forum's report specifies that it takes 'into account the impact of investments on wider society and the natural environment, both today and in the future' (World Economic Forum, 2005).

Over the past four decades, Responsible Investment has mainly focused on the equities market, where it has been variously described. Names such as ethical investing, socially responsible investing, sustainability investing, triple-bottom-line investing and best-of-class investing have been used. However, as we will discuss in the last part, RI can be implemented in different investment asset classes.

RI is a product and a practice. It is a product in the sense that investors acquire, hold or dispose of company's shares that are estimated to be sustainable. It is a practice in the sense that RI is a way to identify the best performing, sustainable and responsible companies (Boxenbaum and Gond, 2005). Based on ESG and financial criteria fund managers evaluate and judge the corporate sustainability performance of firms.

11.4 History

The definition and practices of RI have evolved and changed over time. Three main periods can be identified, each of them showing an increasing complexity in the methods used to practice RI, and a change in terms of actors involved.

The first period, relatively long period and deeply anchored in the United States, dates back to the eighteenth Century (Domini, 2001). The first embryonic forms of RI were dominated by the use of negative exclusion criteria. For hundreds of years, many religious investors whose traditions embrace peace and non-violence have actively avoided investing in certain kinds of enterprises, the so-called 'sin' stocks – alcohol, tobacco, weapons and gambling. Church groups like the Methodists and Society of Friends (Quakers) have long imposed certain social screening of their investment activity. However this form of RI attracted limited attention.

The *second period* can be traced back to the 1970s. It marks the beginnings of contemporary RI with new issues and new actors driving the movement but also the start of RI in Europe. It grew in large part from political roots and the major protest movements. The Vietnam War and apartheid in South Africa are examples of such issues fuelled by the RI community especially in the US. A number of investors refused to support the war and such a regime. Other citizen movements such as the civil rights movement, women's right and environmental protestors joined RI to lobby against industrial activities seen as non ethical (Louche and Lydenberg, 2006). RI reached a major milestone in 1970 when the US consumer advocate and environmentalist; Ralph Nader succeeded in getting two socially-based resolutions on the General Motors annual meeting proxy ballot. The first so-called RI fund was launched in 1971 in the US, the Pax World Fund.

In the 1980s, RI started to develop also in Europe. The first UK RI fund was launched in 1984 by Friends Provident Stewardship Unit Trust. It began to develop more broadly in Europe towards the end of the 1980s and early 1990s with a clear emphasise on environmental issues. Many RI funds were based on a positive and restrictive approach which encourage investing only in very specific sectors usually linked to the environment; such as renewable energy. It is also called the 'green funds'.

During the second period, RI spread in an impassioned political climate and was transformed from a clerical activity (attempts to use ethical principles in the construction of investment portfolios) into a public awareness of 'ethical' investment (the self-conscious phenomena of RI) (Sparkes, 2001). RI was used as a vehicle to coerce corporations to change their strategy towards responsible and ethical practices.

The beginning of the twenty first century heralded a turning point for RI both in terms of approach and growth. The *third period* has been characterised by the mainstreaming of the activity on RI. As a result of its embracement by major financial institutions, RI has shifted its image away from activism to becoming a commercial project (Déjean et al., 2004; Louche, 2004). As a consequence, not only did the name used for this activity change but there was also a resurgent of a new approach to RI. 'Responsible Investment', as used in this chapter, is a recent phenomenon. During the previous periods, the activity was referred as 'ethical', 'mission based' or 'socially responsible' investment. The new RI approach is based on a more diversified, positive and quantified approach. One of the key developments in terms of methodology is the best in class approach. It consists of benchmarking companies in terms of their corporate sustainability performance. Companies are not excluded or included on the basis of pure involvement in certain activities or sectors (the negative and positive approach) but on the basis of their performance. Companies from the same sector are compared and only the best performing ones are selected for the investment universe. The objective of RI products is not only to promote certain principles and values but also to create value. Although the exclusion approach is still in use today, often in combination with the best in class, the tendency is to reduce or even eliminate negative screens.

11.5 Trends

RI has grown dramatically especially since the 2000s. A number of factors can be used to explain this dramatic growth from both the supply and demand side of the financial markets – e.g. legislative imperatives and requirements of funds, market opportunities, personal preferences and believes of investors (Cullis and Lewis, 1992; Michelson et al., 2004).

Although RI has diffused and spread worldwide (see Fig. 11.1), its growth is best illustrated in the US and European contexts. In the U.S., the first RI fund was launched in 1971 by 2007; it had expanded to the extent of reaching a target of more than 260 RI funds. In 2007, RI assets under management were of \$2.71 trillion, representing an increase of 324% since 1995. It means that one out of every nine dollars under professional management is using a RI Strategy, – 11% of the \$25.1 trillion in total assets under management (US SIF, 2008). According to the US SIF, RI is growing at a much faster pace than the broader universe of all investment assets under professional management: an increase of 18% against 3% between 2005 and 2007.

In Europe, the first RI fund was created in 1984 in the UK. At the end of 2007, there were 447 RI funds available (Lipper FERI, 2008). Between 2002 and 2007, the number of RI funds has increased by 150%. Eurosif has valued the RI market[1] at €2.665 trillion as at December 31, 2007, an increase by 102% between 2005 and

[1] This estimation include the broad and core RI as defined by Eurosif (2008).

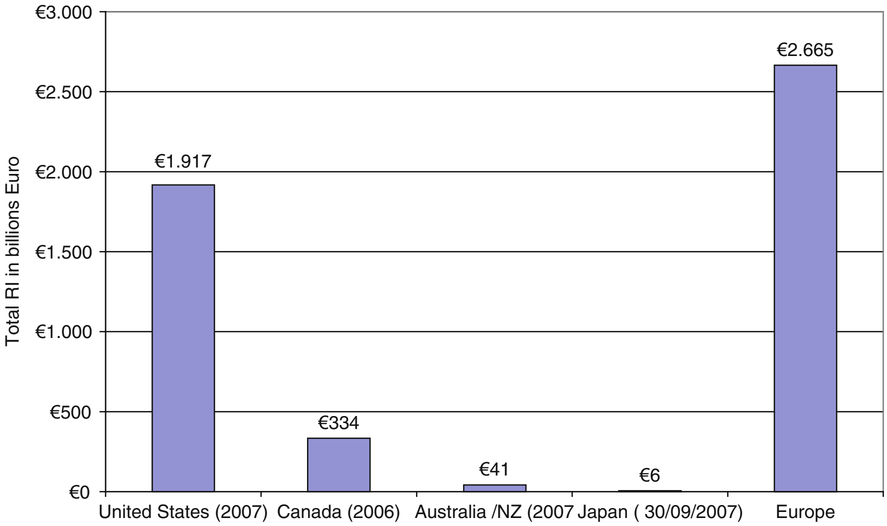

Fig. 11.1 Global RI data (source Eurosif, 2008)

2007 (Eurosif, 2008). Institutional investors represent a very significant part of the RI market as they hold 94% of RI assets under management. The Core RI represents a total of €511.7 billion and €2.154 trillion for Broad RI.[2] RI accounts for 17.6% of total European funds under management (Eurosif, 2008). Although there is a general growing trend towards RI in Europe, the leading countries are by far UK and the Netherlands (Eurosif, 2008). But the most proactive countries for new RI funds launched in 2007 were Belgium, France and the UK (Lipper FERI, 2008). It is also interesting to note that in Norway, the UK and Netherlands, the State Pension Funds are clearly taking the lead in RI.

The recent trend in the RI market is the development of the thematic funds. Thematic funds focus either on sectors or issues such as energy efficiency, climate change, renewable energy, water or health and nutrition. Thematic funds have multiplied over the last couple of years. According to Lipper FERI, 13 out of 20 top RI funds in Europe by estimated net sales were thematic funds. The top 10 thematic funds represented a total of €22 billion in March 2008.

[2]Eurosif defines Core RI as all funds that include either ethical exclusions (more than two negative criteria applied), positive screening, including Best-in-Class and RI, Theme Funds, or a combination of ethical exclusion and positive screening. Broad RI consists of all funds including simple screening, including norms-based screening (up to two negative criteria), engagement, or integration.

11.6 Actors Involved in RI

Actors involved in the Responsible Investment field can be classified into three categories:

– Investors: this group refers to the different types of investors investing in responsible investment funds.
– Rators: this group refers to rating organisations and Responsible Investment indices.
– Connectors: it refers to initiatives and platforms related to responsible investment that bring together actors of the field (all or some of them) in new combinations and venues.

11.6.1 Investors' Type

There are two main groups of investors: retail and institutional investors. Retail investors are individuals who purchase small amounts of equities for him/herself, as opposed to institutional investors who are corporate entities that invest large amounts, such as investment companies, mutual funds, brokerages, insurance companies, pension funds, investment banks and endowment funds.

The US and Japan RI markets are dominated by retail investors while the dominant type of investors in Europe are institutional (Louche and Lydenberg, 2006; Sakuma and Louche, 2008). Historically, isolated individuals within the world of finance and small institutions have been the most involved in the RI field. Institutional investors represent 11% of the total assets in all RI funds in 2007 (US SIF, 2008). Compared to Europe, the government has not played an active role in promoting RI. In several European countries, law and regulations have been enacted requiring especially pension funds to publicly state the degree to which they take into consideration social and environmental aspects in their investment decisions. The precursor legislation was the U.K. Pension Act issued in 1999 and implemented in 2000. Since then regulations have flourished in a number of other European countries: Sweden (2001), Germany (2001), Belgium (2004), Italy (2004), Austria (2002), Netherlands (2001), France (2001), and Spain (2003). Those legislations have been significant drivers in the growth of RI in Europe (Solomon et al., 2002) and explain the importance of institutional investors in the European RI landscape (for more detailed information see Eurosif (2003)).

11.6.2 Rators

Reliable information on social, environmental and governance performance is an important prerequisite for investment decisions in line with RI principles. That explains why raters are such important actors in the RI field. Two main groups can be distinguished among the raters: the rating organisations and the Responsible Investment indices.

Rating organisations play a very central role in the RI field. They are rating agencies that screen companies using social, environmental, corporate governance and ethical criteria. They act as providers of information services (e.g. company profiles, ranking, sector analysis, etc). Information is used mainly for investment decisions or shareholder engagement activities. While there are commonly applied standards for financial reporting, non financial information like ESG information is rather inconsistent among companies making the evaluation of the CSR performance of companies a difficult task and requiring some expertise. In 2003, ORSE counted 33 rating organisations (ORSE, 2003).

Responsible Investment indices are stock market indices to measure and benchmark companies' performance on ESG indicators. Many of the major stock markets have established RI indices. There are more than 30 RI indices around the world but the most popular are the Domini Social 400 (US) created in 1990, the Jones Sustainability Index (DJSI) launched in 1999 and the FTSE4Good Index (UK) launched in 2001.

11.6.3 Connectors

Connectors are all type of venues facilitating networking, meeting, and exchange. They are very important as they enable actors to connect, share and develop knowledge, and build an identity. The platforms and initiatives bring together professionals, academics or a mix of the two. Two of the earliest actors in this group are the US based organisation the Council on Economic Priorities (CEP) and Interface Centre in Corporate Responsibility (ICCR) both created in the early 1970s. In 1991 the first Social Investment Forum was set up in the US. As at December 2007, twelve SIFs were in existence throughout the world including one European SIF, the Eurosif. Those membership associations are dedicated to advancing the concept, practice, and growth of responsible investing. SIF's membership includes more than 500 social investment practitioners and institutions, including financial professionals, analysts, portfolio managers, banks, mutual funds, researchers, foundations, community development organizations, and public educators. Those initiatives are both national and international. The most prominent and influential initiative that has been set in 2006 is the Principle for Responsible Investment (Section 11.2 above). In relation to RI, there are also, a range of new organisations that have emerged which have been described as part of an emerging 'Civil Economy'. Those organisations seek to influence investors and the ultimate owners of the funds to factor in the externalities of business and seek the integration of ESG factors. These include organisation like Enhanced Analytics Initiatives and others like Carbon Disclosure Project, and Fair pensions.

Next to the more professional platforms, are a number of academic RI initiatives that have been created. Just to mention a few: the Moskowitz award, an initiative created in the United States in 1996, the Sustainable Investment Research Platform, initiated in 2006 in Sweden, and the European Center for Corporate Engagement (ECCE) based in the Netherlands and was officially launched in 2007 (Table 11.1).

Table 11.1 Classification of the actors involved in responsible investment

Actors' category	Description	Examples
Investors	• Retail investors • Institutional investors	*Pension Funds with RI strategies*: ABP (NL), AP2 (SE), ARIA (AU), Caisse de dépôt et placement du Québec (CA), CalPERS (US), CIA (CH), The Environment Agency Pension Fund (UK), ERAFP (FR), Fonds de Réserve pour les Retraites (FR), Government Pension Fund (TH), Metallrente (DE), Norges Bank (for Government Pension Fund) (NO), PGGM (NL), PREVI (BR), TIAA-CREF (US) (*Source: Insight Investment*)
Raters	• Social rating agencies • Responsible Investment indices	• *Rating agencies*: Vigeo (FR); KLD (US); EIRIS (UK); Innovest (US); Good Bankers (JP); Jantzi Research (CA), Centre Info (CH), DSR (NL), SAM (CH), Trucost (UK), Scoris (DE), SIRIS (AU) • *Indices*: FTS4Good, Domini 400 Social Index, Dow Jones Sustainability Index Family, MS-SRI, ASPI, DAXglobal Sarasin Sustainability, Ethibel Sustainability Index, ECPI Index Family, HSBC Global Climate Change Benchmark Index
Connectors	• Responsible Investment initiatives & Platforms	• *Practitioner platforms & initiatives*: Social Investment Forum (SIF), Principles for Responsible Investment (PRI), Enhanced Analytics Initiative (EAI), Carbon Disclosure Project (CDP), Fair Pensions, Pharma Futures • *Research platforms*: European Centre for Corporate Engagement (ECCE), Moskowitz award, Sustainable Investment Research Platform

11.7 Implementing Responsible Investment

11.7.1 Key Dimensions

There are three main aspects which characterise RI, namely the focus on materiality, the long term orientation and the stakeholder perspective. They are all three participants playing an important role in shaping the implementation of RI. Although there is a variation in the understanding and translation of these three aspects, they are definitively at the core of RI.

11.7.2 Materiality Focus

Investors have a very specific approach to CSR in the sense that they focus on factors that generate value. There is an increasing believe among investors that responsible corporate behaviour can have a positive influence on the financial performance of companies – particularly over the long term (McKinsey, 2009). ESG information helps investors to be better placed to manage risk and make better informed investment decisions (Lydenberg, 2007). But the challenge for investors is to identify the relevant information and understand which forms the myriad of issues that companies are confronted with might significantly affect companies.

As pointed out by the SustainAbility report in 2002, companies communicate increasingly ESG information but they sometimes over-communicate information on ESG, which makes it difficult for investors to decipher what they are looking for (SustAinability, 2002). Indeed what investors are looking for are issues that are of material nature.

The concept of materiality comes from the field of financial auditing, and relates to the 'impacts that would cause an informed person to reach a different conclusion to make a different decision about representations shown in financial statements' (in Beloe et al., 2004). The focus is on identifying information that might be useful to decision making. In the context of CSR, the scope of materiality needs to be widened and its definition revisited to bridge the gap between the narrow focus of financial materiality and the wide lens of stakeholder perspective (Forstater et al., 2006).

Materiality requires identifying issues that (1) matter and are significant for the company and (2) are of importance to stakeholders. According to AccountAbility, 'an issue or concern becomes material if it can influence the decisions, actions and behaviour of stakeholders or the organization' (Forstater et al., 2006). Judgements are based on relevance (what matters) and significance (how much it matters), meaning that some relevant issues may not be material because they are not sufficiently significant. 'Issues that are material to key stakeholder groups can very quickly become financially material to a company' (Beloe et al., 2004)

However, it is important to differentiate between financially and non-financially material ESG factors (Lydenberg, 2007). Some ESG factors can be directly related to the individual price of stocks or the market valuation of whole industries. This is due to the fact that environmental, social and governance factors inherently require a long term perspective. Risks and reward which are related to CSR issues are best measured in years or even decades, not months or quarters. Environmental issues like climate change, resource depletion, but also environmental legislation or implementation an environmental management systems need to be looked at over several years. Social issues similarly require assessment in the long term such as adequacy of working conditions within the supply chain or implementation of a diversity policy. Those long term issues are not captured by the short term price speculation of the stock market but they do inform on the future value of the company in the long term. Therefore non financial material issues do add value to the investments with a long term appreciation.

11.7.3 Long Term Perspective

Excessive focus on quarterly earnings and incentives structures encourage corporations and investors to pursue short-term gain with inadequate regard to long term effects (Aspen Institute, 2008), which ultimately has various detrimental effects. It causes misallocation of assets; introduce dangerous volatility into financial markets; generate social and environmental damages (Tonello, 2006; Lydenberg, 2007).

RI provides an alternative to the excessive short-termism. They are long term in their perspective.

> Long term investors speculate on the value of corporations to society and the environment, while simultaneously seeking to enhance that value at the company, industry and society level (Lydenberg, 2007)

Long term investing has been encouraged by a number of organisations like CFA Institute, the Conference Board, the United Nations, the World Economic Forum and the Aspen Institute. In 2007, the Aspen Institute with an influential group of CEOs, business organisations, institutional investors, labour unions, corporate lawyers, accountants and consultants has produced guiding principles for corporations and investors, the 'Guidelines for Long Term Value Creation' (Aspen Institute, 2008). These principles seek to introduce long term bias in corporate and investment decision-making.

As mentioned earlier in this paper, many ESG issues require a long term perspective as it is looking at the long term societal and environmental impact of businesses. There are two additional arguments. RI is not meant to condemn business but rather to engage in a process of dialogue with businesses to help and encourage them to improve their CSR performance. For this purpose it is important to establish a trust relationship between investors (or shareholders) and companies and to give companies the opportunity to change. The other argument is more pragmatic as it has to do with financial performance. RI is based on the assumption that the financial performance gains from improved CSR performance accrue in the long term. Although there is not a general consensus on this, but research suggests that the relationship between CSR and financial performance is more likely to be positively correlated in the long term because of the potential favourable impact of CSR issues upon long run risk and return (Graves and Waddock, 2000; Cox et al., 2004) Cox et al., Hillman and Keim (2001) argue that good CSR activities can contribute positively to 'long term value creation'. A number of studies have argued that corporate social performance (CFP) and corporate financial performance (CFP) might be positively related in the long run (Moskowitz, 1972; Cochran and Wood, 1984; Hart, 1995; Waddock and Grave, 1997; Ruf et al., 2001). Others have shown that a low CSR performance may increase financial risks (Alexander and Buchholz, 1978; Ullman, 1985; McGuire et al., 1988).

11.7.4 Stakeholder Approach

At the core of RI is the stakeholder approach. RI evaluates firms in terms of the company's response to multiple stakeholders. Indeed as Clarkson (1995) argues, that the business world can be considered as responsible towards society as a whole, however corporations can only be held responsible towards their stakeholders (Clarkson, 1995).

Stakeholders have been broadly defined in the literature as different groups that could be affected and/or could affect the deployment of its operations (Freeman, 1984). They are characterized by a set of three key attributes: power, legitimacy and urgency (Mitchell et al., 1997).

As suggested by the stakeholder theory, RI is based on a presentation of corporations centred on management and captured by the various relationships between managers and stakeholder groups, including typically: employees, customers, suppliers, shareholders, the ecological environment and the local community. CSR requires companies to consider and balance the social and environmental interests of its stakeholders. Therefore RI has a direct interest in the specific nature of the firm's interactions with society and with its multiple stakeholders.

As a consequence and to ensure a multi-stakeholder evaluation, RI analysts base their evaluation on multiple sources including the firm itself but also a wide range of stakeholders and the media.

11.8 RI Approaches

Responsible investors are not a homogenous group. They have different expectations, interests and motivations to implement RI. As a result RI is being implemented through a variety of approaches which are not necessarily exclusive but could be combined. Table 11.2 provides an overview of the different strategies and tools used for the different strategies.

Table 11.2 RI strategies

Strategies		Tools
Avoidance	Avoid investing in companies engaged in certain business areas or practices	Negative screening e.g. tobacco, alcohol, gambling
Support	Support certain sectors or exceptional practices	Positive or thematic screening e.g. environmental technologies, bicycles, but also water, energy
Comparative	Benchmark companies' performance and take the leading ones.	Best-in-class Includes a broad range of ESG criteria (see Table 11.3)
Engagement	Engage with companies on ESG issues	Shareholder activism, dialogue e.g. shareholder resolutions, proxy voting, or closed door dialogue

11.8.1 Avoidance

This approach aims to avoid investing in companies that are engaged in business areas or practices which are morally unacceptable, or problematic. It is based on the exclusion of certain sectors or activities.

Avoidance uses negative screening. It includes in a number of screens that serve to exclude companies or sectors from the investment universe based on criteria relating to their products, services, policies, or actions; e.g. tobacco, alcohol, gambling, human rights violation and child labour. In general, the types of exclusions applied are tailored to the value sets of individual and institutional investors targeted by the fund manager. These may vary considerably from one fund to the next.

According to some recent reports, as much as 70% of the American and European RI industries may employ some kind of avoidance strategy, which makes it the dominant strategy in RI (Eurosif, 2008; US SIF, 2008).

11.8.2 Support

This approach aims to seek out and invest in companies engaged in business areas or practices which in some way benefit society.

Support is based on positive or thematic screening. Those screens seek out investments in companies engaged in activities with positive social or environmental benefits. It includes companies that demonstrate a significant involvement in business activities that are seen to be inherently beneficial to society. Positive screens can differ a lot among funds. For example Triodos Meerwaardefondsen, a Dutch RI fund, has defined a number of 'sustainable' activities which are regarded as positive screen such as environmental technology and bicycles.

This strategy is less employed than the avoidance strategy– according to Eurosif < 10% of the European RI industry employs it (Eurosif, 2008).

11.8.3 Comparative

This approach aims at selecting sector leaders on Environmental, Social and Governance criteria. Table 11.3 provides examples of ESG criteria used by the RI industry.

Table 11.3 Examples of environmental, social and governance (ESG) issues

Environmental (E)	Social (S)	Governance (G)
• Emissions	• Stakeholder relations	• Board structure
• Environmental policies	• Working conditions	• Independent directors
• Environmental management system	• Respect of human rights	• Independent leadership
• Toxic chemicals	• Diversity	• Separation of Chairman and CEO
• Genetic engineering	• Health and safety	• Remuneration
• Pollution	• HIV/AIDS	• Shareholder rights
• Water	• Product safety	• Accounting quality
• Use of resources	• Treatment of customers	• Audit quality
• Waste	• Labour relations	• Board skills

Comparative approach uses the best in class method. Companies are compared to their sector or industry group peers. It aims to invest across all industry sectors, but to select the best performing companies in each sector.

11.8.4 Engagement

This approach aims at entering into a dialogue with companies. This can be done by investing in companies which are engaged in business areas or practices which are regarded as morally unacceptable and use shareholder influence to make them change. The engagement approach can be done via confrontative or soft actions.

Confrontative actions are also called shareholder activism. It refers to shareholders' actions to exercise their rights to raise issues with management by introducing and voting on resolutions at companies' annual general meetings.

> They [the shareholders] loudly demand more environmental protection, more social justice, and the maintenance of human rights in the annual general meetings of shareholders (Critical Shareholders, 2002).

Owning stocks in a publicly traded corporation brings with it the responsibilities of ownership, as well as the opportunity to influence corporate behaviour. Over the last 30 years, shareholder activism has emerged as a popular strategy for those seeking to influence corporate behaviour on a broad range of issues. Shareholders actively invest and use their positions to affect corporate behaviour. Shareholders have the right to align directors' interests with those of shareholders and hold them to account for the management and performance of the company (Forum for the Future, 2002). Shareholders can act independently but often they charge an organisation to represent them as a group. By gathering their voices they have more impact. In the Netherlands, VBDO engages with companies in order to direct corporate polices and behaviour towards the goal of sustainable performance. In the US, Interfaith Centre on Corporate Responsibility, an international coalition of 300 institutional investors mainly religious investors with combined portfolios worth an estimated $45 billion, have been primary proponents of shareholder resolutions on social issues in recent years. Although few proposals on social issues earn a majority of votes, shareholders' engagement is an important tool in reaching management and initiating dialogue (Forum for the Future, 2002).

A softer approach is to start a dialogue with corporate managers (direct engagement conducted privately), writing letters to companies (cf. Carbon Disclosure Project) or to institutional investors and sending out press releases.

Between 30 and 40% of the US and European RI industry is engaged in some kind of shareholder activism (Eurosif, 2008; US SIF, 2008) but activities under the dialogue strategy differ a lot in the US and Europe. While the US RI industry is very active in shareholder resolution and public engagement, Europe is more active in direct private engagement (Louche and Lydenberg, 2006).

Although the avoidance strategy is still one of the dominant approaches in the RI industry, it is increasingly criticised for being too limited in its impact and scope and also for conveying the wrong message (too negative rather than stimulating companies to improve their CSR commitments) (Cowton, 1999). During these last few years, RI strategies have shifted from a negative to a more positive approach based not solely on avoidance. The trend is to develop a combined strategy based on a combination of tools–positive screening, negative screening as well engagement–to achieve a variety of objectives.

11.9 Discussion

RI has not only grown over time but it has also gained recognition among the financial as well as the boarder business community. But RI is not yet a mature field. The practice and definition of RI are still a work in progress to some extent. Changes and development are expected in the future and numerous questions still need to be debated and answered. In this section three issues are addressed: the first relates to the mainstreaming of RI, the second to fiduciary duties and the third to RI across all asset classes.

11.9.1 RI: A Niche or Mainstream?

The globalisation and intensification of the RI industry has led to the conclusion that RI is becoming mainstream (Friedman and Miles, 2001; Sparkes and Cowton, 2004; World Economic Forum, 2005; Zadek et al., 2005). A study led by Mercer Investment Consulting shows that 84% of European investment managers surveyed expect the integration of ESG factors to become mainstream within 6–10 years (Ambachtsheer, 2005). As already claimed in this chapter, RI has become a source of competitive advantage and differentiation for many financial institutions. But also the new regulatory pressures, the emerging collaborative initiatives such as the PRI or the Enhanced Analytics Initiatives (EAI), the growing shareholder activism and engagement, and the increase transparency of companies making evaluation possible are stimuli to mainstream RI.

There are clear progress being made towards mainstreaming, however the RI industry remains a relatively small activity within the financial sector and still seems to struggle to get fully accepted by the financial mainstream community. If RI is to become mainstreamed it still has to overcome a number of barriers such as:

- The lack of tools and models allowing the quantification of ESG data into stock valuation practices. The 2005s WBCSD YMT and the UNEP FI survey showed that young financial analysts felt unequipped to incorporate ESG issues into mainstream company analysis (WBCSD and UNEP Finance Initiative, 2005; Jaworski, 2007).
- The need for a cross-fertilisation between mainstream RI and ESG specialists in order to create new knowledge and new understandings is very paramount. A cross fertilisation would also help to facilitate a more holistic picture of the firm

rather than dividing on one side social and environmental issues and on the other financial factors.

- The communication gap between companies and investors. Although companies may be very active with regard to CSR, it seems that there is a communication problem between companies and investors: companies do not always communicate the information to investors in a way that would enable these investors to use the information in to evaluate the firm's performance and also firms do not communicate clearly the information investors expect from companies in terms of their CSR activities. A joint project has been established between the European Academy of Business in Society (EABIS) and the European Alliance for CSR with the backing from the European Commission[3] to develop a European framework for improved company and investor dialogue on ESG issues.
- The need to change the conventions of the investment community (Guyatt, 2005). A number of investment practices are 'conventional' meaning that they are recognised and accepted by all. For example, practices such as stock valuation models used by financial analysts are generally accepted and implemented by investment agents. In this context the diffusion of new practices such as RI is very difficult.
- The behavioural impediments. One of the dominant impediments is the short-termism of the financial market (Guyatt, 2006; Juravle and Lewis, 2008) which is going against the long term orientation of RI.

11.9.2 RI: Contradictory to Fiducially Duties?

Financial institutions are influenced by some long-established legal principles on how to manage the capital of their investors. Professional managers of investment funds such as pension funds, pension plan, or all others entrusted with management of other people's investments are legally bound to meet their fiduciary duties. They are obliged by these duties to invest carefully in the best interests of their beneficiaries (not to cause harm to the best interests of their beneficiaries or clients) and in accordance with the purposes of the particular fund. Interests usually are usually assessed using financial measures.

One may wonder whether or not fiduciary duties hinder the practice of RI. This argument has been used to restrict the use of social and environmental issues in investment decisions. A study on capital markets undertaken in Canada for the National Round Table on the Environment and the Economy concluded that 'current interpretations of the fiduciary duties of pension fund managers may unnecessarily constrain their ability to address the full range of relevant corporate responsibility considerations related to prospective investments'.[4]

---

[3] The EU laboratory is led by Lloyds TSB and Telecom Italia with participation from the business network CSR Europe. The research is being coordinated by Cranfield School of Management together with Vlerick Leuven Gent Management School and Bocconi School of Management. For more information www.investorvalue.org.

[4] Stratos Inc. (2004).

Indeed as an investment intermediary does not have the mandate to invest their clients' money according to a CSR perspective, the assumption there is that they must choose investments that maximize financial returns for their beneficiaries. A breach of the fiduciary duties is liable calls for the intermediary to compensate beneficiaries for losses attributable to this breach of duty (Richardson, 2007).

However, recently the debate has been re-opened on the definition of the scope of these duties and whether or not ESG issues should drive the consideration of large institutional investors (Lydenberg and Sinclair, 2009). In 2005, Freshfields Bruckhous Deringer, a law firm, concluded that investment managers' fiduciary duties should not necessarily preclude or overly hamper RI (Freshfields Bruckhaus Deringer, 2005). According to this report ESG information should be taken into account whenever it is relevant to the investment strategy. As the link between ESG factors and financial performance is increasingly being recognised, the integration of ESG is not only permissible but even advisable. Therefore fulfilling fiduciary obligations can actually require careful attention to corporate social and environmental performance. But the fundamental question about understanding the 'best interest' of the beneficiaries still remains to be debated. Is the best interest simply based on the price performance or does it also involve the broader societal implications which indirectly or directly may affect their non financial interests? (Lydenberg and Sinclair, 2009).

11.9.3 RI: A Practice for all Asset Classes?

The main focus of RI has been on equities –stock of quoted companies. But the concept of responsible investment can be applied equally across all asset classes (Lydenberg, 2008; UK SIF, 2008; Lydenberg and Sinclair, 2009). In 2007, the Institute for Responsible Investment published a Handbook on Responsible Investment across Asset Classes (Wood and Hoff, 2007). The handbook provides an overview for investors on how they can implement responsible investment in practices, across a wide range of asset classes and investment opportunities.

A number of new approaches and products in other asset classes have been developed embedding the RI concept such as microfinance that use cash to empower the poorest, venture capital to support alternative business models or real estate that emphasise on green building and sustainable communities. These initiatives show that there is a huge potential to widen the scope of responsible investment and thereby increase the RI market.

11.10 Conclusion

This paper has provided some insight into the investor's perspective on CSR. Investors, as a key stakeholder group, can be important catalysts for change towards sustainability. Interest of investors in CSR is reflected in the significant increase in the number of Responsible Investment practices. The expectation is that RI will keep growing and evolving in the near future. Although the focus has been essentially on equities, RI is starting to infiltrate a broader range of assets classes. The practices of RI are not homogenous. Indeed RI can be based on different strategies which can be combined in a variety of ways. In this chapter we have identified four types of strategies; namely avoidance, support, comparative and engagement. RI is still in a work in progress stage; it is still evolving. There are a number of issues and questions which still remain unanswered leaving the door wide open for creativity and innovation as well as to social, environmental and economic opportunities to take place over the next few years or even decades in this field.

References

Alexander, G. J. and T. A. Buchholz (1978). "Corporate social responsibility and stock market performance." *Academy of Management Journal* **21**(3): 479–486.

Ambachtsheer, J. (2005). *SRI: what do investment managers think?* Toronto, ON: Mercer Investment Consulting.

Aspen Institute (2008). Long-Term Value Creation: Guiding Principles for Corporations and Investors. http://www.aspeninstitute.org/atf/cf/{DEB6F227-659B-4EC8-8F84-8DF23CA704F5}/FinalPrinciples.pdf.

Bauer, R., J. Derwall, et al. (2007). "The ethical mutual fund performance debate: new evidence from Canada." *Journal of Business Ethics* **70**(2): 111–124.

Bauer, R., K. Koedijk, et al. (2002). "International evidence on ethical mutual fund performance and investment style."

Beloe, S., J. Scherer, et al. (2004). *Values for money: reviewing the quality of SRI research*. London: SustainAbility and Mistra.

Boxenbaum, E. and J. -P. Gond (2005). "Importing 'socially responsible investment' in France and Quebec: work of contextualisation across varieties of capitalism."

Clarkson, M. B. E. (1995). "A stakeholder framework for analyzing and evaluating corporate social performance." *Academy of Management Review* **20**(1): 92–117.

Cochran, P. L. and R. A. Wood (1984). "Corporate social responsibility and financial performance." *Academy of Management Journal* **27**(1): 42–56.

Cowton, C. J. (1999). "Playing by the rules: ethical criteria at an ethical investment fund." *Business Ethics: A European Review* **8**(1): 60–69.

Cox, P. B., S. Brammer, and A. Millington (2004). "An empirical examination of institutional investor preferences for corporate social performance." *Journal of Business Ethics* **52**(1): 27–43.

Critical Shareholders (2002). "Association of critical shareholders in Germany." Retrieved 16 April 2002.

CSR Europe, Deloitte, et al. (2003). *Investing in responsible business*. Brussels: Corporate Social Responsibility Europe.

Cullis, J. G. and A. Lewis (1992). "Paying to be good? U.K. ethical investments." *Kyklos* **45**(1): 3–23.

Déjean, F., J.-P. Gond, et al. (2004). "Measuring the unmeasured: an institutional entrepreneur's strategy in an emerging industry." *Human Relations* **57**(6): 741–764.

Domini, A. L. (2001). *Socially responsible investing: making a difference in making money*. Chicago, IL: Dearborn Trade.

Donaldson, T., and Preston, L. (1995). The stakeholder theory of the corporation: Concepts, evidence, and implications. *Academy of Management Review*, 20(1): 65–91.

Economist Intelligence Unit (2005). *The importance of corporate responsibility*. London: Economist Intelligence Unit.

Eurosif (2003). Socially Responsible Investment among European Institutional Investors: 2003 Report. Paris.

Eurosif (2006). European SRI Study.

Eurosif (2008). European SRI Study.

Forstater, M., S. Zadek, et al. (2006). *The materiality report – Aligning strategy, performance and reporting*. London, UK: AccountAbility.

Forum for the Future (2002). "Sustainability pays." http://www.cis.co.uk/socacc2002/pdf/SusPays.pdf.

Freeman, R. (1984). *Strategic management: a stakeholder perspective*. Englewood Cliffs, NJ: Prentice-Hall.

Freeman, R. E., Harrison, J. S., and Wicks, A. C. (2007). *Managing for Stakeholders: Survival, Reputation, and Success*: Yale University Press.

Freshfields Bruckhaus Deringer (2005). A legal framework for the integration of environmental, social and governance issues into institutional investment, UNEP FI.

Friedman, A. L. and S. Miles (2001). "Socially responsible investment and corporate social and environmental reporting in the UK: an explorative study." *Brithish Accounting Review* **33**: 523–548.

Generation IM (2009). Generation Investment Management LLP. www.generationim.com.

Graves, S. B. and S. A. Waddock (2000). "Built to last and then some. An evaluation of stakeholder relations in 'built-to-last' companies." *Business and Society Review* **105**(4): 393–418.

Guyatt, D. J. (2005). "Finance and accounting: meeting objectives and resisting conventions. A focus on institutional investors and long-term responsible investing." *Journal of Corporate Governance* **5**(3): 139–150.

Guyatt, D. J. (2006). Identifying and Overcoming Behavioural Impediments to Long Term Responsible Investments – a Focus on UK Institutional Investors. Department of Psychology, University of Bath.

Hart, S. L. (1995). "A natural resource-based view of the firm." *Academy of Management Review* **20**(4): 986–1014.

Hillman, A. J. and G. D. Keim (2001). "Shareholder value, stakeholder management and social issues: what's in the bottom line?" *Strategic Management Journal* **22**(2): 125–139.

Hobbs, M. (2008). UN PRI enlists 400 firms. *Financial Standard*. http://www.financialstandard.com.au/news/view/23618/. 28 July 2008.

Hutton, R. B., L. D'Antonio, et al. (1998). "Socially responsible investing." *Business and Society* **37**(3): 281–306.

Jaworski, W. (2007). Use of extra-financial information by research analysts and investment managers, European Center for Corporate Engagement (ECCE).

Jones, R. and A. Murrel (2001). "Signaling positive corporate social performance. An event study of family-friendly firms." *Business & Society* **40**(1): 59–78.

Juravle, C. and A. Lewis (2008). "Identifying impediments to SRI in Europe: a review of the practitioner and academic literature." *Business Ethics: A European Review* **17**(3): 285–310.

Klassen, R. D. and C. P. McLaughlin (1996). "The impact of environmental management on firm performance." *Management Science* **42**(8): 119–124.

Lipper FERI (2008) From niche to mainstream. *Hot Topics* Volume, DOI: http://www.feri-fmi.com/FERIFMI/Information/Files/Hot%20Topics%20SRI%200807.pdf.

Louche, C. (2004). Ethical investment: processes and mechanisms of institutionalisation in the Netherlands, 1990–2002. *PhD dissertation, Erasmus University Rotterdam*. Rotterdam, Optima Grafische Communicatie: Available at: https://ep.eur.nl/retrieve/3259/ESM-dissertation-003.pdf.

Louche, C. and S. Lydenberg (2006). "Socially responsible investment: difference between Europe and United States." *Vlerick Leuven Gent Management School Working Papers*.

Lydenberg, S. (2007). *Long term investing*. 2007 summit on the future of the corporation, Paper No.5.

Lydenberg, S. (2008). Form and Function: Research on Responsible Investment across Asset Classes.

Lydenberg, S. and G. Sinclair (2009). "Mainstream or daydream?" *Journal of Corporate Citizenship* June.

Margolis, J. D. and J. P. Walsh (2003). "Misery loves companies: rethinking social initiatives by business." *Administrative Science Quarterly* **48**(2): 268–305.

McGuire, J. B., A. Sundgren, et al. (1988). "Corproate social responsibility and firm financial performance." *Academy of Management Journal* **31**(4): 854–872.

McKinsey (2009). Valuing corporate social responsibility. McKinsey Global Survey Results.

McWilliams, A. and D. Siegel (2000). "Corporate social responsibility and financial performance: correlation or misspecification?" *Strategic Management Journal* **21**: 603–609.

Mercer and UNEP Financial Initiative (2007). Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors.

Michelson, G., N. Wailes, et al. (2004). "Ethical investment processes and outcomes." *Journal of Business Ethics* **52**(1): 1–10.

Mitchell, R. K., B. R. Agle, et al. (1997). "Toward a theory of stakeholder identification and salience: defining the principle of who and what really counts." *Academy of Management Review* **22**: 853–886.

Moskowitz, M. R. (1972). "Choosing socially responsible stocks." *Business and Society Review* **1**: 71–75.

Orlitzky, M., F. L. Schmidt, et al. (2003). "Corporate social and financial performance: a meta-analysis." *Organization Studies* **24**(3): 403–441.

ORSE (2003). *Guide to sustainability analysis organisations*. Paris: EDEME, EPE, ORSE.

Pava, M. L. and J. Krausz (1996). "The association between corporate social-responsibility and financial performance: the paradox of social cost." *Journal of Business Ethics* **15**: 321–357.

PLEON (2005). Accounting for Good: the Global Stakeholder Report 2005, Pleon Kohtes Klewes GmbH/Pleon b.v.

Preston, L. E. and D. P. O'Bannon (1997). "The corporate social-financial performance relationship." *Business & Society* **36**(4): 419–429.

Richardson, B. J. (2007). "Do the fiduciary duties of pension funds hinder socially responsible investment?" *Banking and Finance Law Review*, **22**(2): 145–201.

Ruf, B. M., K. Muralidhar, et al. (2001). "An empirical investigation of the relationship between change in corporate social performance and financial performance: a stakeholder theory perspective." *Journal of Business Ethics* **32**(2): 143–156.

Sakuma, K. and C. Louche (2008). "Socially responsible investment in Japan: its mechanism and drivers." *Journal of Business Ethics* **82**(2): 425–448.

Solomon, J., A. Solomon, et al. (2002). "Socially responsible investment in the UK: drivers and current issues." *Journal of General Management* **27**(3): 1–13.

Sparkes, R. (2001). "Ethical investment: whose ethics, which investment?" *Business Ethics: A European Review* **10**(3): 194–205.

Sparkes, R. and C. J. Cowton (2004). "The maturing of socially responsible investment: a review of the developing link with corporate social responsibility." *Journal of Business Ethics* **52**(1): 45–57.

Stratos Inc. (2004). *Corporate disclosure and capital markets*. Ottawa: National Round Table on the Environment and the Economy.

SustAinability (2002). *Trust us: the global reporters 2002 survey of corporate sustainability reporting*. London: SustaAinability.

Taylor Nelson Sofres (2003). Investing in responsible business – The 2003 Survey of European fund managers, financial analysts and investor relations officers, CSR Europe, Deloitte, Euronext.

Tonello, M. (2006). Revisiting Stock Market Short-Termism. Available at SSRN: http://ssrn.com/abstract=938466. The Conference Board Research Report: No. R-1386-06-RR.

Ullman, A. A. (1985). "Data in search of a theory: critical examination of the relationships among social performance, social disclosure and economic performance of U.S. firms." *Academy of management* **10**(3): 540–557.

UK SIF (2008). *Sustainable alternatives*. London: UKSIF Sustainable Pensions Project.

US SIF (2008). *2007 Report on socially responsible investing trends in US – executive summary*. Washington, DC: US Social Investment Forum.

Verheugen, G. (2008). Speech at CSR Alliance event. 4 December 2008., http://www.csreurope.org/data/files/press/20081204_verheugen_equippedforcsr.pdf.

Waddock, S. A. and S. B. Grave (1997). "The corporate social performance-financial performance link." *Strategic Management Journal* **18**(4): 303–319.

WBCSD and UNEP Finance Initiative (2005). Generation lost: young financial analysts and environmental, social and governance issues. Perspectives.

Wood, D. and B. Hoff (2007). *Handbook on responsible investment across asset classes*, Institute for Responsible Investment.

World Economic Forum (2005). *Mainstreaming responsible investment*. Cologny/Geneva, Switzerland: World Economic Forum.

Zadek, S., M. Merme, et al. (2005). *Mainstreaming responsible investment*. Geneva: Accountability & World Economic Forum.