

Responsible Investment and the Claim of Corporate Change – An Overview

Abstract

The most famous aspect of (socially) responsible investment is the widely discussed link between the stock market and CSR (Scholtens, 2006). It provides the mechanisms through which public shareholders can exert influence on corporate behavior and is the focus of this paper. However, despite being well known, this aspect of responsible investment is far from being clear. When it comes to defining responsible investment on the equity side, we can witness a jungle of diverse labels; we find different labels for the same activity, or same labels for different activities. There is widespread confusion about the various expressions used to describe responsible investment (Sparkes and Cowton, 2004, p. 46; Sullivan and Mackenzie, 2006, p. 14). The first objective of this paper is therefore to clarify some terms and definitions relevant for the study of responsible investment, and give insight into the history and key actors involved. The second objective is to identify four different approaches of how to practice responsible investment thereby providing researchers and practitioners with a simple way of how to structure their responsible investment activities. Lastly, we will explain how responsible investment is linked to Corporate Social Responsibility, as this is a major prerequisite for understanding an institutional investor's claim of corporate change and for further research on this topic.

Keywords: CSR, responsible investment, SRI, screening, enhanced analysis, shareholder activism, shareholder engagement

Introduction

“... socially responsible investing practices are not merely discretionary and desirable activities; they are a necessary imperative, which both the corporations and public pension funds, and other large institutional holders, will ignore at serious peril to themselves.”

(Sethi, 2005)

Responsible investment is a widely discussed link between the stock market and CSR (Scholtens, 2006). Institutional investors deliberately exclude companies that harm the society or the environment from their portfolio, or they use their ownership rights to express their concerns and challenge company boards on CSR issues. In short, responsible investment provides the mechanisms through which public shareholders can foster socially and ecologically sound corporate conduct and is thus a central theme for research in management science now and in the future (see e.g. Jeucken, 2004; Scholtens et al., 2008; Scholtens, 2006; Sjöström, 2008; Sparkes and Cowton, 2004).

However, when it comes to defining responsible investment, we can witness a jungle of diverse labels; we find different labels for the same activity, or same labels for different activities. There is widespread confusion about the various expressions used to describe responsible investment (Sparkes and Cowton, 2004, p. 46; Sullivan and Mackenzie, 2006, p. 14). The main objective of this paper is thus to provide a clear definition of how we understand responsible investment and its relation to CSR in order to provide scholars and practitioners with a common definitive basis upon which future research can rest.

To reach this objective, we start this paper by clarifying some terms and definitions relevant for the study of responsible investment, and giving insight into the history and key actors involved. We proceed by identifying four different approaches of how to practice responsible investment, before we then explain how responsible investment is linked to Corporate Social

Responsibility (CSR), a major pre-requisite for understanding an institutional investor's claim of fostering socially and ecologically sound corporate conduct.

The Phenomenon of Responsible Investment

Introduction and Definitions

In short, we define responsible investment as the *integration of environmental, social and governance (ESG) considerationsⁱ into (a) the investment analysis and portfolio selection processes, and/ or (b) ownership policies and practices such as the use of voting rights, while at the same time maintaining a reasonable financial return.ⁱⁱ*

Similar definitions, but with varying accentuations, can be found in Renneboog et al. (2008), Sparkes (2002), Sparkes and Cowton (2004), and Sullivan and Mackenzie (2006). Thus, responsible investment on the equity side affects two fundamental decision-making processes. First, it is concerned with the identification and the assessment of prospective investment opportunities (Scholtens, 2006), which we summarize as *entry* decision. Second, it affects the so-called *loyalty* decision, a theoretical concept brought forward by the economist Hirschman (1970). Applied to the stock market, Hirschman elaborated on the question whether an investor should use his 'voice' to influence companies in their way of using the fund, or 'exit', i.e. divest in case of a conflict of interests among investor and management.

In general, responsible investment combines two basic objectives or claims: Financial return and social good (Sparkes, 2002). This twofold aim rests on the following assumptions: First, responsible investors believe in the business case of corporate ESG activities, claiming that in the short run, responsible investment funds will show a similar performance to conventional funds, while in the long run they will even bring superior financial returns. Second, responsible investors believe that based on their investment decisions they have the right and the ability to change corporate behaviour towards a stronger notion of social responsibility,

thus ‘making a difference’ (Haigh and Hazelton, 2004; Rivoli, 2003; Smith, 2005). The combination of both, financial return and social good is the key characteristic of responsible investment: it “distinguishes [...] responsible investment from ordinary investment (which shares the first goal but is indifferent to the second), from [...] activism (which shares the second goal but is indifferent to the first)” (Hudson and Wehrell, 2005, p. 281).ⁱⁱⁱ

Although most academic and practitioner literature uses the term *socially* responsible investing or investment (SRI) to describe this investment practice (e.g. Bello, 2005; Haigh and Hazelton, 2004; Juravle and Lewis, 2008; Kinder, 2005; Sparkes, 2002; Sparkes and Cowton, 2004; Vandekerckhove et al., 2007), we will refer to ‘responsible investment’, in line with Sullivan and Mackenzie (2006), as an umbrella concept for all related and similar approaches. The reason behind is that most literature in the field of SRI solely focus on the integration of subsets of ESG criteria into the portfolio selection process, such as a categorical exclusion of tobacco companies from the investment universe; thus, they are concerned with the *entry* decision but leave out the loyalty dimension. This is reflected by the large majority of publications on *ethical* investing or investment (e.g. Harte et al., 1991; Mackenzie and Lewis, 1999; Schaefer, 2004; Sparkes, 2001), which was the older term for SRI and is often used interchangeably with it (Sparkes and Cowton, 2004, p. 46). Further examples of studies that mainly focus on portfolio selection refer to *green* (see Heinkel et al., 2001; Simpson 1991, cited in Sparkes and Cowton), *eco* (see Schaltegger and Figge, 1999), *principal-based* (see Ulrich et al., 1998), *social* (see Bruyn, 1987; Kinder et al., 1992; Moskowitz 1997), *triple-bottom-line* (see Rubinstein, 2003), and *sustainable* (see Szczesny and Wilhelm, 2005) investing or investment.

The *loyalty* question of responsible investment is addressed by a growing body of literature describing and analyzing formal rights such as voting rights or shareholder resolutions, as mechanisms to engage with companies on ESG issues *after* the investment is made with the

objective of influencing corporate actions (see David et al., 2007; Del Guercio and Hawkins, 1999; Gillan and Starks, 2000; McLaren, 2004; O'Rourke, 2003; Sjöström, 2007). Most of the studies refer to *shareholder or investor activism*, a term that is best known from the corporate governance literature, others use shareholder or investor *advocacy* (Schueth, 2003; Smith, 2005), *engagement* (Martin et al., 2007; Vandekerckhove et al., 2008, 2007), or simply *action* (Ward, 1986). While some authors use these terms to mean exactly the same thing, others make a clear distinction between them. Sparkes (2002, pp. 35-38), for example, contrasts advocacy with shareholder activism. In his view, advocacy can be defined as a single-issue campaign that has no financial concerns but seeks confrontation and publicity only; it is mostly conducted by Non-Governmental Organizations (NGOs). Sparkes (2002) thus maintains that it does not reflect the idea of responsible investment being a combination of financial and ESG objectives.

After having clarified the definitional basis of responsible investment our next section deals with the 'old' religious roots and origins of this investment practice. Also, we will examine why some authors (Schueth, 2003; Sparkes and Cowton, 2004; Sullivan and Mackenzie, 2006) argue that responsible investment has developed from a margin industry to a mainstream phenomenon.

The Evolution of Responsible Investment

Responsible investment is not a new phenomenon (Kinder et al., 1992, p. 3). The origins for what we call responsible investment can be traced back to Jewish, Christian, or Islamic traditions (Renneboog et al., 2008, p. 3). Those religions, representing a certain set of beliefs and practices, framed the way money should be used in a 'good' manner, and thus, reflected an ethical approach to investment. That may be the reason why the older term used for

responsible investment is *ethical* investment and investing (Sparkes and Cowton, 2004; see e.g., Domini, 1984).

The first modern ethical fund was founded in 1928. Following religious traditions, it screened companies on their ethical performance and avoided all 'sinful' companies (Kinder and Domini, 1997, p. 14). This investment practice represents the so-called 'avoidance' approach meaning that portfolios deliberately exclude certain industries of the stock market (Sparkes, 2002, p. 27). Still, most ethical funds in the US act under this premises, according to Schepers and Sethi (2003). The expansion of the idea of ethical investing led to the emergence of a totally new investment industry: *socially responsible investment*. At that time it represented a small, but growing *niche market* in the overall global investment market. However, while ethical investment was grounded on general religious norms and standards, SRI was more individually oriented and reflected the moral beliefs of individual investors (Renneboog et al., 2008, p. 3). This logically resulted in an enormous amount of different funds all focusing on specific aspects, some more interested in social issues, some more in the environmental dimension, e.g. green investing. In the 1960s, the demand for SRI products grew substantially, particularly fuelled by the Vietnam War and the anti-war and civil rights movements. These movements made citizens, and specifically investors, extremely sensitive to unfair and harmful governmental and/ or corporate activities, such as the misuse of human rights, and their impact on society (Ward, 1986). In this context, the first SRI mutual fund, the Pax World fund, was founded in 1971 in the US. It allowed investors who opposed militarism to pool their resources and to be part of a collective investment vehicle that expresses their concerns about companies engaged in all kind of weapon production (Renneboog et al., 2008, p. 3). Today the Pax World fund manages more than 2.6 billion USD and incorporates ESG issues into the portfolio selection process but also engages actively with companies on these issues once it is invested (Pax World, 2008).

The next major engine of the growth of SRI was the cruelty of South Africa's racist system of apartheid in the 1980s (Heese, 2005). As Sparkes (2002, p. 52) states: "If Vietnam unlocked the door to socially responsible investment, South Africa kicked it open". SRI Investors from around the world pressured companies and the government of South Africa to dismantle apartheid and urged mutual funds to divest their money from South African companies and Western firms with South African subsidiaries. In fact, the boycott of those companies provides one of the very few examples where SRI investors had a significant influence on companies' stock prices (Haigh and Hazelton, 2004, p. 64). Although there was no significant change in share prices right after the divestment, Kumar et al. (2002) found out that US and European firms showed abnormal stock returns after SRI fund managers publicly declared the end of sanctions.

Environmental disasters such as the Chernobyl nuclear power plant incident in 1986, or the Exxon Valdez oil spill in 1989 further strengthened the public awareness of environmental risks. This resulted in more and more consumers willing to pay a premium for ethical products, and investors starting to include social and environmental risks into their decision-making (Schueth, 2003, p. 190). In the 1990s another dimension in the light of the CSR debate gained enormous public attention and was of particular interest to investors: corporate governance. Corporate scandals such as Enron focused on the lack of governance structures in large companies and its financial consequences and added governance as extra dimension to the triple bottom line approach to SRI (Renneboog et al., 2008, p. 3). This finally resulted in the now common term 'ESG' considerations as criteria for investment decision-making. The revolution of information and communication technologies in the light of the globalization further added to this increasing focus on ESG issues and thus strengthened the growth of SRI (McCann et al., 2003, p. 19).

To date, the focus of SRI funds has reoriented towards the environmental dimension. Like governments and NGOs, fund managers are primarily concerned with the exposure of companies to climate change. They have started to engage in numerous collaborative projects to pressure companies to fight the climate change, such as reduce their greenhouse gas emissions. The most prominent project is the Carbon Disclosure Project (CDP) which coordinates the collaborative efforts of institutional investors with USD 57 trillion of assets under management in seeking comparable data on the world largest companies' exposure to climate change. So far, the CDP has build up the largest repository of corporate greenhouse gas emissions data as well as helped institutional investors to engage in dialogue with companies (CDP, 2008).

We can conclude that, for more than one decade now, a growing number of institutional investors including asset managers, insurance companies and pension funds have become serious about SRI (Mallin, 2004, p. 80; Sparkes and Cowton, 2004, p. 49). They have adopted a longer term investment horizon and increasingly believe that 'ethics pays' – at least in the long run (Sullivan and Mackenzie, 2006). The adoption of SRI by mainstream institutional investors can be seen "as a major landmark in the maturing of SRI" (Sparkes and Cowton, 2004, p. 46). SRI has begun to enter the *mainstream* of investment practice (McCann et al., 2003, p. 19), pushed by a significant client demand (Hellsten and Mallin, 2006, p. 399; Schueth, 2003, p. 191). In this sense and together with the increasing use of shareholder rights, authors have started to call this investment practice *responsible investment* which offers a broader perspective on an industry that earlier was considered a niche market (see Sullivan and Mackenzie, 2006). Yet, there is a lively debate about the actual adoption of SRI by mainstream institutional investors, and thus about the potential of mainstreaming SRI, with some authors arguing in favour (see Bruyn, 1987; Friedman and Miles, 2001; Mansley, 2000, p. 1; McCann et al., 2003; Sparkes and Cowton, 2004) and some remaining sceptical (see

Haigh and Hazelton, 2004).^{iv} However, they almost all agree with Solomon and his colleagues (2002) that if responsible investment is meant to be about fostering CSR “the role of the institutional investment community is essential” (p. 1, cited in Sparkes and Cowton, 2004, p. 49). The next section is thus dedicated to the role of institutional investors as key actors in driving responsible investment.

The Role of Institutional Investors as Responsible Owners

The focus of this paper is on what is known as the institutional market, which is defined as investments managed or controlled by institutional investors, including pension funds, mutual funds, insurance companies, banks and other pooled investment vehicles. Hence, institutional investors are financial intermediaries; their role in the economy is to act on behalf of others who invest their savings and pensions in those funds. It is in their fiduciary duty to act in the best interest of their beneficiaries which according to conventional finance theory is the maximization of shareholder value (Sullivan and Mackenzie, 2006, p. 15). With regard to total institutional ownership on a national level, the largest types of institutional investors usually are pension funds, both public and private^v, followed by mutual funds. Insurance companies and banks make up the smaller part of institutional ownership (for a detailed overview of institutional ownership in the US, see Ryan and Schneider, 2003). The same is true for the ‘responsible ownership’ structure in the UK and the US, both leading markets with regard to responsible investment (Kinder et al., 1992, p. 665).

As mentioned above, an adoption of ESG criteria by large institutional investors is essential if corporate and social change is desired. In the UK, which is the fastest growing responsible investment market in Europe (Eurosif, 2008), institutional investors control more than half of the largest companies’ equities. On an aggregated basis, they would have a substantial influence on the company’s business operations as well as the pricing of company shares

(Sullivan and Mackenzie, 2006, p. 15). Latest figures approve a tremendous growth of the responsible investment market. In the US, SRI assets under management (AUM) make up a total of 2.71 trillion USD in 2007 (as of 31 December 2007), representing to date 11 percent of total AUM. In the last three years it rose by more than 18 percent. Total AUM of the broader investment universe only increased by less than 3 percent in the same period of time. The amount of SRI AUM thereby represents all assets involved in either socially screened funds^{vi} or shareholder activism (US SIF, 2008).^{vii} In Europe, the most advanced responsible investment market is the UK with a total of 959 billion EUR invested in SRI assets including screened funds, activist funds and other related assets (as of 31 December 2007). The value of UK SRI funds thereby shows a substantial growth rate of 38 percent from 2005 to 2007, with a compound annual growth rate of 19 percent (UK SIF, 2008).

The shift towards a stronger incorporation of environmental, social and particularly governance issues can certainly be traced back to client demands, as shown in the last section, but also to regulatory changes. Examples of such regulations include, in 2000, the amendment to the UK Pension Act of 1995, after which pension funds have to disclose the extent to which they incorporate ESG issues into their investment decision making process, or the Renewable Energy Act in Germany, effective since 1991, which has given a tax advantage to funds investing in wind energy (Renneboog et al., 2008, p. 5). As a result, alternative funds and pension funds have become increasingly active in taking SRI seriously (Hellsten and Mallin, 2006, p. 399). Some of the world's largest pension funds publicly declare to incorporate ESG considerations into their investment decision-making processes, both before and after the investment (Mallin, 2004, p. 80). CalPers, for example, together with other institutional investors spurred the tobacco divestment of the late 1990s (Renneboog et al., 2008, p. 4).

The most significant transformation that pension funds and other institutional investors have undergone is reflected in their perceived role as *active owners* to promote socially responsible

behaviour. In addition to screened social and environmental funds, investors have become increasingly aware of their potential – and the necessity – of actively influencing corporate management through the use of their shareholder rights (Kinder et al., 1992, p. 100). The emergence of this shareholder rights movement (Davis and Thompson, 1994) in the late 1980s particularly took place in the Anglo-American countries (Aguilera et al., 2007, p. 845) and is still reflected in the record number of shareholder resolutions on corporate governance and/ or CSR filed by institutional investors in the last three years in the US (US SIF, 2008).

This activist and “noisy” (Aguilera et al., 2007, p. 846) behaviour of investors is a rather new social phenomenon. In the past (and in some countries still to date), shareholder as ‘owners’ of the company were primarily passive and silent due to the dominant logic of *dispersed ownership* (Berle and Means, 1932) and *efficient markets* (Fama, 1980).^{viii} Dispersed ownership was the result of the separation of ownership and control in the 1930s, when companies grew large, and control shifted to professional managers. Ownership, on the contrary, was split among a vast number of “unorganized stockholders who were removed from the day-to-day management of the firm” (Davis and Thompson, 1994, p. 141). The monitoring of how the firms were run was guaranteed by the efficient market hypothesis (EMH) (Fama, 1980). The EMH implies that capital markets are efficient in adjusting the share price of a company to the best information available about the company’s future performance. Thus, the share price fully reflects changes in the performance and acts as a monitoring device of corporate management. This in turn implies that “shareholder passivity is the appropriate outcome of an efficient division of labor between those who are good at owning [in the sense of risk-bearing] and those who are good at managing” (Davis and Thompson, 1994, p. 146). Davis and Thompson (1994) further argue that shareholder passivity originates out of a combination of *rational ignorance* and a *lack of expertise*, two arguments derived from agency theorists. Rational ignorance in this sense implies that it does

not pay for a shareholder to invest in voting capabilities considering the fact that his vote does not matter to the management due to his small share. The lack of expertise results out of his primary role as risk-bearer. Close to these arguments lies the free-rider problem (Olson, 1971) meaning that there is a lack of individual incentives to bear the costs of active ownership while the benefit of improved corporate governance would be spread around all investors.

Further reasons for the passivity of institutional investors can be traced back to strict *regulations* preventing investors from becoming active owners (Black, 1990). Most legal restrictions evolve out of a perceived mistrust against financial power. In the US, joint efforts, such as communications among more than ten institutional investors to discuss voting politics, had to be approved by the Securities and Exchange Commission (SEC) until late 1992 (Davis and Thompson, 1994, p. 148). In Germany, those joint efforts are still under scrutiny. In 2007, the German Federal Cabinet approved a draft of the Risk Limitation Act that aimed at hindering or even avoiding economically “undesirable” activities of financial investors such as “acting in concert” that is deemed to occur if two shareholders coordinate their conduct to influence the business direction of the issuer. Such coordinated action can involve the attribution of voting rights or other conduct *prior* to a shareholders’ meeting (Risikobegrenzungsgesetz, 2008). Since 2008, the draft bill has been subject to several amendments and has been mitigated to a substantial degree, ironically, mostly because of the collaborative engagement of active SRI institutional investors with the German government.

For the last two decades, however, we have witnessed a dramatic change in the role that institutional investors play as shareholders in corporate affairs, with a particular focus on the US and the UK: “Passive ownership has given way to active involvement” (Kinder et al., 1992, p. 100). In the light of the corporate governance debate, institutional investors have started to actively monitor corporate management, trying to align the divergent interests of management and shareholders (Jensen and Meckling, 1976). They increasingly control (not

only ratify) the outcome of shareholder proposals at Annual General Meetings (AGM), they appoint the board of directors (as monitoring authority, see Fama and Jensen, 1983), and they frequently use their voting rights. Yet, the major part of activist efforts is centred on corporate governance issues because Enron and WorldCom have clearly demonstrated that poor governance can affect the financial bottom lines (Kinder et al., 1992, p. 101). Although the US SIF (2008) figures indicate a substantial growth in the US responsible investment market, activism for CSR is still in its infancy. Thus, the discussion about the role and responsibilities of investors on ESG issues remains open. Many authors still maintain that the share of responsible investors is too small to actually have a role to play (see Haigh and Hazelton 2004, p. 61). However, some scholars maintain that the size of the share is not necessarily the only mechanism to influence corporate behaviour (see Sjöström, 2007); the way how the influence is exerted should not be neglected. Our next section will thus provide a more detailed description of the various responsible investment practices.

The Practice of Responsible Investment

The objective of responsible investment is to combine financial return with social good. In practice, we find various investment approaches how to achieve this goal. As mentioned above, one can distinguish between those approaches addressing the *entry* and those affecting the *loyalty* decision. After reviewing the academic and practitioner literature, as well as public statements of relevant institutional investors such as CalPers, we identified four different approaches: *screening*, *enhanced analysis*, *engagement*, and *activism*. While the first two approaches affect the entry decision and refer to the *investment analysis and portfolio selection processes* (in short: ‘analysis’), engagement and activism involve *ownership practices* (in short: ‘ownership’) that relate to the loyalty decision. Institutional investors may use them in combination or on their own to enhance the ESG performance of the target companies.

Responsible Analysis – The Entry Decision

According to our definition the integration of ESG considerations into investment decision-making distinguishes responsible investment from conventional investment. *ESG integration* is defined as the “inclusion by asset managers of SEE/CG^{ix}-risk and opportunities into traditional investment analysis and stock weighting and/ or selection processes” (UK SIF, 2008). The following sections look at the underlying processes: (1) screening used to identify the responsible investment universe based on ex- and inclusion criteria, and (2) enhanced analysis as a practice primarily used by mainstream institutional investors to incorporate ESG metrics into traditional risk-return analysis and portfolio modelling. These processes can be undertaken either internally by the fund manager and/ or externally by a specialist research firm and/ or rating agency, who supply the information to the fund manager (Sullivan and Mackenzie, 2006).^x

Screening

The ultimate objective of screening is the information gathering and processing to identify prospective investment opportunities (Scholtens, 2006, p. 21). In light of responsible investment screening results in an exclusion or inclusion of companies or industries. ESG criteria are thereby used *as a filter to determine (and isolate) the investment universe*. Social mutual funds are typical examples of investments using screening techniques. Three different screening methods are to be distinguished: *negative, positive, and best-in-class*.

Negative screening: Negative screening is probably the best known responsible investment approach amongst consumers. It implies the categorical *exclusion* of companies from the investment universe based on ESG considerations (Schueth, 2003, p. 190). It goes back to the dominant idea of former churches and religious groups that avoided investing in companies that were judged as unethical (Sparkes and Cowton, 2004, p. 47). Still, to date, many SRI

mutual funds, especially in the US, use the so-called ‘avoidance’ approach and exclude whole industries from their portfolios such as armoutry, tobacco, gambling, pornography, alcohol, and also recently nuclear power (Szczesny and Wilhelm, 2005, p. 10). By doing so, investors are able to align their portfolio with a certain set of values and beliefs which is why Kinder (2005, p. 11) calls this approach “*value-based*”. These values might either originate from the institutional investor’s personal beliefs, typically the case for mission-based institutions, or they reflect the prevalent consumers’, i.e. the individual investors’ interests, which is often the case for large SRI mutual funds. Investors may consequently gain a return only from companies that – in their perspective – do not harm others. According to Webley et al. (2001, p. 38) this investment style makes them ‘feel good’, while at the same time, increases their integrity. As Schueth (2003, p. 190) argues, integrity, or “moral purity” (an intentionally provocative term used by Simon et al., 1972, p. 25), thereby represents the primary investor motivation. It is again important to note that excluding a so-called ‘evil-company’ from the portfolio necessarily is an active decision. Not explicitly avoiding it would imply that “one implicitly condones [the company’s] immoral behaviour” (Larmer, 1997, p. 400). However, in light of the value pluralism that we are confronting in today’s globalized society such an ‘absolutistic’ avoidance approach is not without criticism (Sparkes and Cowton, 2004, pp. 47-48). That is why a less rigorous form of screening has emerged in the responsible investment industry: positive screening.

Positive screening: A positive screening approach implies the search for exemplary companies that outperform in ESG areas and the deliberate *inclusion* of those companies into an investment portfolio. Hence, it does not ‘punish’ companies for not being socially and environmentally responsible but ‘rewards’ those companies with outstanding performance in for example employer-employee relations, or the reduction of greenhouse gas emissions (Schueth, 2003, p. 190). Thus, companies will be included due to their positive contributions

to society and the environment, or due to transparent corporate governance. The best known example of positive screening is 'green' investing. In light of the increasing environmental consciousness back in the 1980s, the first funds using positive criteria were so-called eco-tech funds. These funds concentrated their investments in the industry of new environmental technology products that aimed at protecting our planet (Schaltegger and Figge, 1999, p. 6). However, pure positive screening is not a very widely used practice amongst SRI mutual funds (Schepers and Sethi, 2003). First, due to a limited portfolio diversification positively screened funds may bear a high investment risk. Second, the assessment of 'good' companies has proved to be even harder than of 'bad' companies considering diverging moral norms and standards. It requires an analysis of highly complex issues such as product safety, diversity, or workplace conditions (in contrast to negative screens that are more black and white). However, especially the social dimension of corporate responsibility is hard to measure and thus, difficult to serve as the sole ground for a portfolio construction (Sparkes and Cowton, 2004, p. 48). Due to these obstacles, an alternative, but related screening approach has emerged: best-in-class.

Best-in-class screening: Best-in-class screening, also known as preference approach, aims generating *comparative* criteria to create an investment universe out of the leading companies with regard to ESG performance from every industry (Vandekerckhove et al., 2007, p. 403). Hence, unlike positive or negative screening, this approach does not compare across industries or even excludes whole sectors. So for example, a fund manager who has to invest in automotive stocks may select the automotive company with the best financial performance *and* most effective carbon emission management. The advantage of best-in-class is that it allows the investor to have a diversified portfolio and still incorporate ESG considerations into the decision-making process. Examples of funds using best-in-class screening are eco-efficiency funds. In contrast to eco-tech funds, these funds do not necessarily include

companies with environmentally friendly products, but represent companies from all kind of industries that are rated ‘best-in-class’ with regard to their eco-efficiency. Eco-efficiency is defined by increased energy efficiency, reduction of use of chemicals with global warming potential, water use, increased material productivity, and many others (Schumacher-Hummel, 2005, pp. 88-92).^{xi} The best known example, however, of a best-in-class approach to managing responsible investment are the Dow Jones Sustainability Indexes (DJSI). The indexes were found by the Dow Jones Company and the Swiss Sustainable Asset Management (SAM) company in 1999 as the first global index group tracking the financial performance of companies being assessed as industry leaders with regard to ESG issues (SAM, 2008).

It is important to mention that all three screening approaches solely refer to the process of removing/ adding companies from/ to the investment universe based on ESG criteria. The valuation of these companies, however, is not (yet) affected by ESG considerations. This would be part of the so-called enhanced analysis which is explained in the next section.

Enhanced Analysis

While screening is the process of identifying the investment universe based on absolute ESG criteria, we define enhanced analysis^{xii} as the process of translating ESG data into *financial and reputational risk measures* and incorporate them into fundamental investment analysis and *portfolio selection methodology* for the purpose of making ‘responsible’ stock picking decisions. This is in line with Sullivan et al. (2006, p. 59) who refer to screening approaches as ‘SEE-driven analysis’ (or value-based analysis, see above) in contrast to ‘enhanced analysis’ driven by financial indicators. Overall, enhanced analysis aims at shifting traditional investment analysis away from short-term oriented financial metrics such as quarterly

earnings towards a more *long-term oriented valuation of stocks* with regard to a company's ESG performance (Enhanced Analytics Initiative, 2008).

The motivation of enhanced analysis is the acknowledgement that extra-financial factors such as the ESG performance drive corporate performance in the long run. These factors are often beyond the span of variables that are integrated into conventional investment analysis. Therefore, enhanced analysis represents a more holistic investment approach than a pure screening approach and is based on the *investment belief* (rather than on ethical values) that the integration of ESG issues ensures more efficient allocation of capital, hence, improves overall market returns (AXA IM, 2008). This, of course, implies an underlying belief in market imperfections as investors with better information on ESG than others are able to trade on that information to their advantage (Sullivan and Mackenzie, 2006). As Juravle and Lewis (2008) indicate, major mainstream institutional investors such as AXA Investment Managers (AXA IM) or BNP Paribas Asset Management (BNP PAM) have already started to shift their engagement in responsible investment “from an ethics-driven concern to a pragmatic risk-management issue” (p. 292). This allows them to approach responsible investment not with an ESG agenda per se, but with a fiduciary investment agenda that integrates ESG factors to the extent that they have an impact on risk and return of companies and sectors (AXA IM, 2008).

In practice, we sometimes find a combination of both, screening and enhanced analysis. The asset manager SAM, for example, first identifies a qualified investment universe, based on positive and best-in-class screening. The screening mechanism thus has a filtering function. Then, SAM derives an optimal portfolio based on integrating ESG factors into the calculation of alpha (see figure 1).^{xiii} As the alpha result determines the composition of a portfolio ESG factors consequently have a direct influence on the weighting of single portfolio positions.

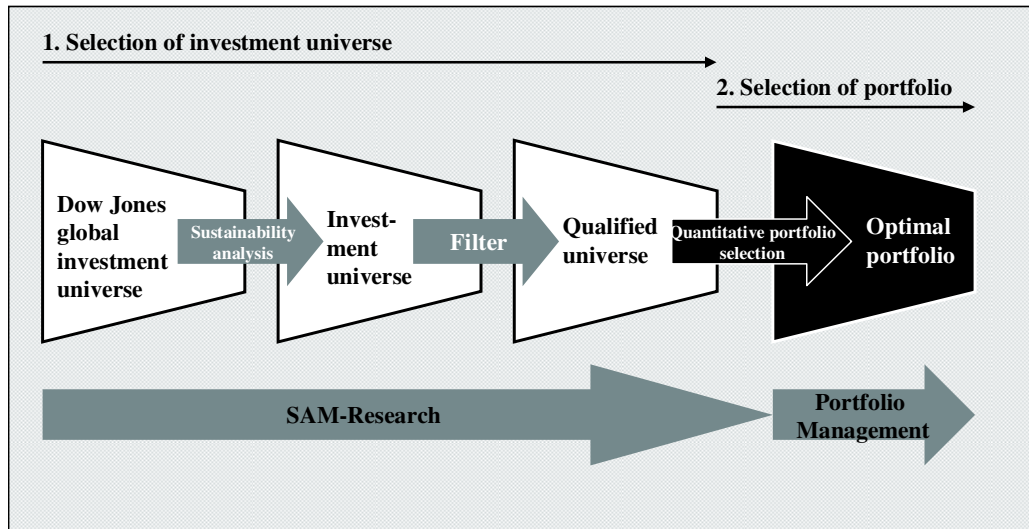


Fig. 1: SAM's practice of responsible investment (adapted from SAM, 2008).

Responsible Ownership – The Loyalty Decision

As indicated above, the loyalty decision involves the ownership practices of institutional investors. Hence, we look at those actions where investors raise their “voice” (Hirschman, 1970) to participate in corporate management’s decision-making with regard to ESG related issues *after* the investment was made, or they divest (McLaren, 2004, p. 193). In our study we differentiate between shareholder *engagement* and *activism*. Although both concepts are sometimes used interchangeably (see Clark and Hebb, 2004), we argue that activism includes all *formal* rights such as voting against management while engagement represents an *informal* approach to responsible investment, such as “behind closed doors” (Friedman and Miles, 2001, p. 536) negotiations. In distinguishing between formal and informal we follow Davis and Thompson (1994) who already made this distinction in their early article on shareholder activism and corporate control.^{xiv}

Engagement

Shareholder engagement or ‘engagement-SRI’ (see Vandekerckhove et al., 2007), has recently gained much attention within the field of responsible investment. It represents an *informal* approach to participating in corporate management’s decision-making and has been increasingly discussed as the favoured responsible investment approach of institutional investors in their attempt to drive CSR (Collier, 2004; Sparkes and Cowton, 2004; Vandekerckhove et al., 2008, 2007). When an investor engages in corporate management, he attempts to directly influence corporate behaviour through *dialogue*. In this dialogue he raises his concerns with regard to the integration of ESG issues into corporate policies and practices and asks for response from management. In contrast to screening and enhanced analysis, engagement is thus “not about ‘what corporation to invest in and which not’ but rather ‘what corporation should be lobbied and influenced’” (Vandekerckhove et al., 2008, p. 80) and *how* to practice this.^{xv} According to Lewis and Mackenzie (2000, p. 217) typical engagement activities of UK fund managers such as Friends Provident Stewardship, and Jupiter Ecology, include one-to-one meetings with managers, writing letters, and conducting industry surveys and discussing the results with management.^{xvi} As Vandekerckhove and his colleagues (2007, p. 404) maintain the crucial element in engagement is thus the communication process between the investor and corporate management and the management’s willingness to discuss ESG related issues with its shareholders. This two-way communication process was also emphasized by Hoffman (1996) in his early work on shareholder action of the Coalition for Environmentally Responsible Economies (CERES).

A general motivation of engagement according to Holland (1998) and Sullivan and Mackenzie (2006) is the information advantage that investors may gain in privately held dialogues as opposed to publicly disclosed shareholder resolutions. This, of course, is closely related to the investment belief that ESG integration leads to financial outperformance in the long run due to information inefficiencies. Other scholars however argue that the decision

whether to pursue an informal or formal approach to responsible investment depends on geographic criteria. They find that engagement is the preferred ownership practice in Europe, whereas formal activism is predominantly used in the US (Sparkes and Cowton, 2004, p. 51; Vandekerckhove et al., 2008, 2007). This can certainly be traced back to different cultural backgrounds with the US as being a more compliance-driven country and Europe as having a softer, more integrity-driven approach to ethical concerns (see Paine, 1994, for an in-depth comparison of compliance versus integrity-driven notions of ethics). Also, in reviewing the legislation on shareholder rights in various regions, Kinder and his colleagues (1992, p. 667) find that shareholder action is much more constrained in the UK than it is in the US implying that engaging in dialogue is often the more prudent way of influencing corporate decision-making from a legal perspective. To further clarify the difference between engagement and activism our next section addresses shareholder activism.

Activism

Shareholder activism is narrowly defined as the use of *formal* rights attached to ordinary shares such as filing shareholder resolutions at an AGM, voting against management, or divesting from a company, to influence or challenge the way a corporation is doing business. In a broader sense, shareholder activism also includes public media campaigning to exert pressure on corporate management. Often, activism occurs in collaborative shareholder initiatives where institutional investors “utilise their unique rights to facilitate change” (Sparkes and Cowton, 2004, p. 51).

The primary interest of activist shareholders has always been to concentrate on underperforming companies and to pressure them to act in the best interest of their shareholders, thus, maximizing shareholder value (Gillan and Starks, 2000). Probably the best known example of activism is regarding corporate governance issues. Reporting scandals

such as Enron and World.com clearly showed the relationship between good performance and good corporate governance and led to an enormous increase of activism for more disclosure and transparency (O'Rourke, 2003, p. 230). Activism for CSR however has only recently gained more attention, especially in light of climate change risks and gender issues. Here, activist shareholders aim at encouraging companies to improve their CSR management and, as indicated earlier, to maximize shareholder value in the *long run* (O'Rourke, 2003; Sjöström, 2008). One can distinguish between four strategies of activist shareholders to influence a company: (1) filing shareholder resolutions (see Del Guercio and Hawkins, 1999), (2) voting (see Davey, 1991), (3) public campaigning (see Rehfeld, 1998), and (4) divestment (see Palmiter, 2002).

Filing shareholder resolutions: Shareholders have the formal right to submit their concerns about the way a company handles ESG risks for a presentation at the AGM in front of other shareholders and corporate management to vote upon it. These concerns are put together in a shareholder resolution, also known as shareholder proposal or 'social proxy', and come in form of a request or a recommendation (O'Rourke, 2003, p. 232; Scholtens, 2006, p. 21; see figure 5 for an example). The first official church sponsored shareholder resolution was filed by the Episcopal Church in 1971. It concerned General Motors and their operations in South Africa (Kinder et al., 1992, p. 108). Since then, there has been a substantial increase in shareholder resolutions on social issues (Proffitt and Spicer, 2006; Rehbein et al., 2004). Especially in the US they have become a widely accepted tool for shareholders to tackle conflicting interests with the corporate management (Sparkes and Cowton, 2004, p. 51).^{xvii}

The 2001 Proposal

Despite its claims to be moving 'beyond petroleum', BP remains firmly wedded to fossil fuels. Oil and gas make up 99,9% of its investments. This is inconsistent with the company's public call for precautionary action on climate change – and takes no account of the effects of future climate protection measures, which are likely to restrict the production and sale of fossil fuels. Greenpeace has therefore submitted a resolution to BP's AGM, *calling on the Board to publish a report, by end of 2001, outlining how it will make the transition from fossil fuels to renewable energy.*

Fig. 2: The 'SANE BP' 2001 shareholder proposal of Greenpeace (adapted from O'Rourke, 2003, p. 235).

In general, a shareholder resolution process may lead to three outcomes. A resolution can be withdrawn, omitted, or it can be voted on. If a resolution is withdrawn by the shareholder it may indicate that a company is willing to negotiate the issue with the shareholder and to meet his requirements in a foreseeable future. A further enforcement of the resolution is thus no longer necessary. A resolution can also be omitted by the corporation for several reasons which are regulated by legal entities such as the SEC in the US. Reasons may include that a company is already implementing the proposal or that the proposal is part of ordinary management functions and thus not relevant to discuss it further at the AGM. If a resolution is neither withdrawn nor omitted it goes to the vote at the AGM. The investor who filed the resolution presents it in front of other shareholders and corporate management (O'Rourke, 2003, pp. 232-34). In general, proxies on ESG issues have only gained little support at AGMs so far; however, they raise public awareness and often force corporate management to at least think about it and respond positively at a later point of time (Sparkes and Cowton, 2004, p. 51). The entire process of filing a shareholder resolution is best pictured by Logsdon and van Buren (2008). They identify three fundamental steps, and label the three different outcomes of the process as 'accommodative' (=withdrawal), 'reactive' (=omission), or 'defensive' (=vote) *firm response* to a shareholder resolution (see figure 3). Since most of the resolutions are

withdrawn due to successful dialogues between corporate management and the shareholder, Logsdon and van Buren (2008) added ‘proactive’ as a fourth firm response.

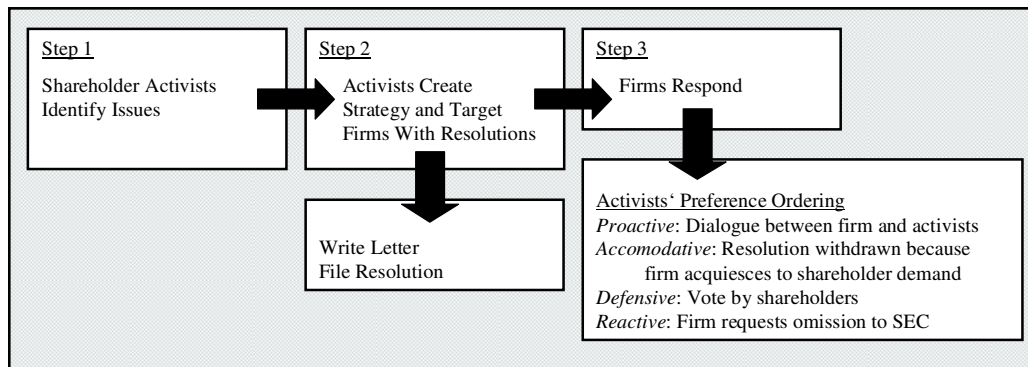


Fig. 3: Logsdon and van Buren’s model of the shareholder resolution process (adapted from Logsdon and Van Buren, 2008, p. 3).

Voting: In addition to the vote on shareholder resolutions, shareholders have the formal right to vote to approve the appointment of board directors and auditors, the board’s compensation policy, and often the annual report (Mackenzie, 2006, pp. 26-27). Also, they can use their voting rights to participate in corporate decision-making, or even interfere in case of conflicting interests, if changes in corporate strategy or possible mergers are planned. Here, of course, a substantial stake of ownership is crucial (Scholtens, 2006, p. 21).

Public campaigning: Another way of pursuing shareholder activism is to raise public awareness of a particular corporate misbehaviour through intense public campaigning (Sparkes and Cowton, 2004, p. 52). Publicity has proved to be an effective tool of changing corporate behaviour especially in the light of CSR. While purely financial concerns do not necessarily attract a wide public’s interests, social and environmental concerns expressed by large shareholder groups may result in emotional reactions by society such as large consumer boycotts as in the case of Nestlé or Shell.

Divestment: Coming back to Albert Hirschman's (1970) distinction between 'voice' and 'exit' a last option of shareholders to influence an organization and to express their concerns is by divesting from it (Lewis and Mackenzie, 2000, p. 215). Palmiter (2002) argues that the "threat (actual or implied) [of shareholders] of selling their holdings and driving down the price of the targeted company" (pp. 1437-38) has turned out to be a potentially effective way of changing corporate decision-making. Often, these threats are based on private information that shareholders gained in behind-the-scenes negotiations with corporate management. However, divestment has not always proved to be a successful way in aligning the interests of shareholder and management. While the threat of a potential exit may be effective in discouraging management from making 'bad' decisions, it however, in a proactive sense, has failed to encourage management to take 'good' actions (Admati and Pfleiderer, 2007, p. 2-3). Hence, since activism for CSR typically involves the request for 'good' action, divestment has been rarely chosen as activism strategy. Especially in the case of large pension funds, divestment of underperforming companies is not always an option; "often the holdings are so large that the shares cannot be sold without driving the price down and suffering further losses" (Gillan and Starks, 2000, p. 278).

For a summary of the four practices of responsible investment see figure 4 below.

Responsible Investment	
Responsible Analysis	Responsible Ownership
<p>Screening</p> <p>→ <i>ESG criteria as a filter to determine the investment universe</i></p> <ul style="list-style-type: none"> - Negative screening - Positive screening - Best-in-class screening 	<p>Engagement*</p> <p>→ <i>Informal approach to express ESG concerns through dialogue</i></p> <ul style="list-style-type: none"> - One-to-one meetings with corporate management - Writing letters - Conducting surveys as basis for negotiations
<p>Enhanced analysis</p> <p>→ <i>ESG criteria as risk measures to determine portfolio selection</i></p> <ul style="list-style-type: none"> - Integration of ESG issues into risk and return analysis - Subsequent integration of ESG issues into the weighting of portfolio positions 	<p>Activism*</p> <p>→ <i>Formal approach to express ESG concerns through pressure</i></p> <ul style="list-style-type: none"> - Filing shareholder resolutions - Voting - Public campaigning - Divestment

* can be done individually or collectively

Fig. 4: The four practices of responsible investment (own illustration).

These four approaches are often used in combination. Large pension funds such as CalPers, for example, are known for their screening culture as well as their ongoing dialogues with corporate management which we have introduced as engagement mechanism. Often, these negotiations take place in a first phase and are followed by an activist strategy such as filing shareholder resolutions at a later stage (CalPers, 2008).

The Link to Corporate Social Responsibility

So far, we can maintain that responsible investors take into account, evaluate, and act upon their perceptions of how companies are governed, and how they deal with environmental challenges and social concerns. This, generally speaking, relates responsible investment to the concept of CSR (Hill et al., 2007; Sparkes and Cowton, 2004). In this regard, Sparkes (2002, p. 42) argues that CSR and responsible investment are “mirror images of each other”. Both

concepts strive for the generation of financial and social good; CSR reflects the view point of the company, responsible investment that of the related investor. Since CSR has not yet been addressed so far, the next section provides a brief introduction to the concept of CSR, before we then take a closer look at how it is related to responsible investment.

The Concept of Corporate Social Responsibility

According to Donaldson (2003), “few business academics can doubt the presence of a rising desire today for answers in the area of ethics and social responsibility” (p. 363). Large corporations are increasingly held accountable for their actions and have begun to publish ‘CSR’ or ‘sustainability’ reports to inform the public of their exposure to social and environmental issues. In the meantime, private sector institutions like the Global Reporting Initiative (GRI) and public policy makers like the European Commission (EC) have discussed CSR and sustainability aspects in working groups and tried to define best practice guidelines (Brown and Fraser, 2006, p. 103). Some best practice guidelines have resulted in global standards such as the UN Global Compact or the social accountability standard SA 8000. These standards help corporations identifying their responsibilities and integrating them into their management systems and/ or their production processes and supply chains (Aguilera et al., 2007; Waddock et al., 2002).

However, although CSR appears to be a popular theme in corporate policies and practices, it remains a fuzzy and poorly defined concept (Marrewijk, 2003; Pedersen, 2006). The number of articles on CSR is vast (Campbell, 2007, p. 948); some authors even speak of CSR as a “tortured concept within the academic literature” (Godfrey and Hatch, 2007, p. 87). Moon (2007, p. 297) emphasizes that CSR is far too complex to be generalized across organizations which all have different impacts on society and environment they may be held accountable for. Also, the uncontested pluralism of values that we face to date makes it difficult to come

up with a universalized vision of ethics in general, and CSR in particular (Leisinger 2005). In an extensive review of the academic literature Carroll (1999) identifies and discusses over 25 different definitions of CSR and finds that the variety in conceptual definitions necessarily leads to a confusing variety in possible CSR measures and implementation methods. Thus, we are bound to agree with Pedersen (2006) that “there has never been and probably never will be consensus on the definition of CSR” (p. 139). At this point of the study, however, we have to compromise on the complex nature of CSR and will shortly introduce some of the well known conceptual definitions that lay the ground for our further analysis.

To start with, an often quoted definition of CSR can be found in a statement by the EC. They describe CSR “a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis” (EC, 2001). The systematic reasoning about a conceptual framework for CSR, however, started in the US in the early 1960s and moved to Europe not until a few decades later (Crane and Matten, 2004, p. 41). Probably the most accepted model of CSR is the ‘Four-Part Model of Corporate Social Responsibility’ by Archie Carroll (1979). It serves at identifying the responsibilities corporations have to bear in front of society. According to Carroll (1991), CSR can be considered as a multi-layered concept which can be differentiated into four interrelated aspects – economic, legal, ethical, and philanthropic responsibilities. A ‘true’ social responsibility requires the meeting of all four levels consecutively (Carroll and Buchholtz, 2006, p. 35). Within this model, the satisfaction of economic responsibilities comprises a reasonable return on investment, safe and adequately paid jobs and good quality at a fair price. Legal responsibility obliges corporations to abide by the law as codification of society’s moral views. Ethical responsibility goes beyond the legal framework and demands that corporations voluntarily act the way society expects them to. Finally, the fourth level of

CSR includes the philanthropic responsibility addressing all issues which are desired by society, but not necessarily expected such as charitable donations (Carroll, 1991, p. 42).

Another widely accepted view on CSR is the ‘triple-bottom-line’ (TBL) framework. TBL, or “People, Planet, Profit” (Elkington, 1997), is an approach to CSR that identifies three important responsibilities a company has to bear: *economic*, *social*, and *environmental* responsibility. TBL accounting, for example, would refer to the use of economic, social and environmental measures in the assessment of a company's performance (Crane and Matten, 2004, p. 20). The TBL approach originally stems from the debate around corporate sustainability. ‘Sustainability’ or ‘sustainable development’ has been defined by Brundtland (1987) as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. ‘Corporate sustainability’ (CS) thus relates the concept of sustainability to the corporate world and is only to be achieved if economic, social and environmental concerns are resolved and balanced. This process of resolving and balancing is then what Wempe and Kaptein (2002) refer to as CSR and view as an intermediary phase in a corporation’s attempt to become sustainable (see figure 5).

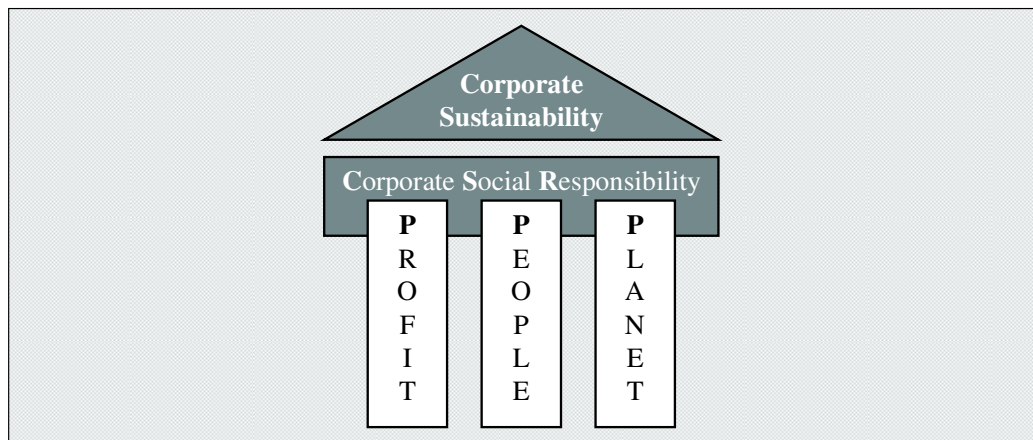


Fig. 5: Relationship CS and CSR according to Wempe and Kaptein (adapted from Wempe and Kaptein, 2002, cited in Marrewijk, 2003, p. 101).

Hence, in combining economic with social and environmental responsibility the TBL approach to CSR tries to bridge the gap in academic literature between the *primacy of shareholder wealth maximization* (Friedman, 1962) and the *primacy of managing the relationships with all stakeholders* being affected by a corporation such as consumers, employees, and the environment (Donaldson and Preston, 1995; Freeman, 1984; Freeman and Reed, 1983; Mintzberg et al., 2002; Phillips, 2003).^{xviii}

Taken together, the intense debate about CSR intends to promote a vision of business accountability to a wide range of stakeholders. It accounts for the concerns about environmental protection, transparency, and the well-being of employees and civil society in general. The emergence of this TBL thinking has, in fact, forced many corporations not only to concentrate on maximizing shareholder value but also to take a closer look at their impacts on society and environment. However, we like to emphasize that the actual *meaning* of the responsibilities that corporations bear in front of their shareholders, society and their environment can only be grasped and determined *in situ* - when a corporation actually translates those responsibilities from theory into practice (Moon, 2004). In this context, a new academic field has emerged that concentrates on the processes being involved when implementing CSR (Basu and Palazzo, 2008; Godfrey and Hatch, 2007). The next section will finally clarify how we think CSR and responsible investment are interrelated.

Investor Responsibility and the Claim of Corporate Change

We identified two links between responsible investment and CSR that we consider as relevant within the scope of this study. The first link concerns the prevalent matter of our discussion. It is *the claim of corporate change* in which responsible investment acts as a driver of CSR. The second linkage is more implicit and concerns the *social responsibility of an investor* ('investor

responsibility'), which one might argue is inherent to the term responsible investment. However, we think it is reasonable to mention it separately.

First, as claimed by Mackenzie and Lewis (1999) investors seek to change companies and push them towards a better corporate performance with regard to economic, social and environmental issues. This may include a reduction in greenhouse gas emissions, adherence to global ethical standards such as the UN Global Compact or SA 8000, or an improved governance structure. Mackenzie and Lewis (1999) argue that by promoting socially responsible behaviour investors are able to facilitate, on an aggregated basis, social change. This may be done either (i) indirectly, by incorporating ESG factors into the portfolio selection decision, or (ii) directly, by using their shareholder rights to influence a company's way of enacting CSR. Previous literature has so far come up with two possible mechanisms through which responsible investment can unfold its potential effect on corporate change with regard to CSR. First, Haigh and Hazelton (2004) as well as Scholtens (2006) identify the impact of investment decisions on the cost of capital structure of a company as a mechanism to force management to align its business activities with the investor's demands. Second, a change in corporate behaviour is likely if shareholders use their ownership rights as influence channel. Both arguments have shed a new light on the relation between responsible investment and CSR and stimulated the discussion if or if not responsible investment acts as a driver of CSR. However, the debate yet remains open.

Second, we would like to emphasize that responsible investment does not only aim at increasing the social responsibility of business companies but also, in case of institutional investment, it stresses the 'corporate' responsibility of the executive investment house. It reflects a more conscious, and thorough way of taking investment decisions, hence it (ideally) enhances the responsibility of fund management, too. The Principles for Responsible Investment (PRI), a joint initiative of the UN Global Compact and the UN Environment

Programme Finance Initiative (UNEP FI), launched in 2006, provide institutional investors with a list of possible actions for integrating ESG issues into mainstream investment decision-making and ownership practices. Thus, they aim at improving the *process of investing* by offering investors guidance in becoming more responsible (PRI, 2008).

Conclusion

In summary, responsible investment offers an array of various approaches of how to integrate social, environmental, and governance issues into an institutional investor's daily decision-making. This plentitude of different approaches however comes at risk with a clear picture of what responsible investment actually *is*. Scholars in this field of research often are confronted with contradicting definitions and interpretations, causing a widespread confusion which, in the end, may endanger the seriousness of responsible investment as field of research. For this reason, the first objective of this paper was to clarify the terminologies concerned with responsible investment so that the academic community has a solid basis on which future research can rest. Here, we have focused particularly on the different processes that constitute responsible investment: screening, enhanced analysis, activism, and engagement. A sound classification of the actual processes involved with responsible investment is especially important with regard to the recent call of scholars such as de Bakker and den Hond (2008) to adopt a process view on influence activities among various organizations, which, in the case of responsible investment, is the influence of institutional investors over corporate management.^{xix}

Our second aim of this paper was to clarify how responsible investment is linked to CSR. Our term of *investor responsibility* thereby sheds a new light on the actual tasks that institutional investors themselves have to fulfil when demanding more socially and ecologically sound corporate conduct. Interestingly, much has been written about the potential of responsible

investment to foster the social responsibility of big corporations, but very little is said on the 'corporate' responsibility of investment funds, or financial intermediaries in general (for an exception see Dembinski et al., 2003, and Hellsten and Mallin, 2006, who touch upon this question by asking how responsible or ethical is responsible investment). In the light of the global credit crisis to date, we think that this linkage between responsible investment and CSR is too important to be neglected and should thus become a central theme in management science in the foreseeable future.

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Endnotes

ⁱ Instead of ESG, some authors prefer to speak of social, environmental and ethical (SEE) issues. While SEE strengthens the ethical dimension of responsible investment, ESG emerged out of an attempt to include the corporate governance debate into the responsible investment movement. However, in academic and practitioner literature both concepts are often used interchangeably.

ⁱⁱ With our definition we closely follow the Principles for Responsible Investment (PRI), an investor initiative to promote socially responsible behaviour.

ⁱⁱⁱ The difference to conventional investment is best clarified by Sparkes (2002): “The key distinguishing feature of [...] responsible investment lies in the construction of equity portfolios whose investment objectives combine social, environmental and financial goals. When practised by institutional investors this means attempting to obtain a return on invested capital approaching that of the overall stock market” (pp. 26-27).

^{iv} See Juravle and Lewis (2008) for an excellent analysis of the impediments to mainstreaming SRI.

^v Whether a public fund is private or public depends on the sector employment of their members.

^{vi} Socially screened funds include mutual funds representing the largest share, exchange-traded funds, closed-end funds, tracked separately in 2007, alternative investment funds, such as social venture capital, double- and triple-bottom-line private equity, and hedge funds, typically organized as unregistered limited partnerships or limited liability companies, and other pooled products.

^{vii} A tiny part consists of community investing, which will be neglected as it is not part of this study.

^{viii} Dispersed ownership is a widely acknowledged logic and is vastly used in academic literature to explain passive ownership. However, it should be noted that it primarily refers to ‘Anglo-American’ countries. Germany and Japan also represent a very passive ownership culture, but in contrast to the Anglo-American model, are characterized by long-term debt finance and an ownership structure of large blockholders (Aguilera et al., 2007, pp. 844-45).

^{ix} SEE/CG stands for social, environment, and ethical/ corporate governance and can be used interchangeably with ESG.

^x Research firms such as the German oekom Research AG play an important role in providing ESG information to the fund manager, but also in interacting with the company through sending out questionnaires. In this section we will not further distinguish between who is conducting the analysis, rather we are interested in how the analysis is being conducted.

^{xi} Each criterion is weighted differently from industry to industry, but is consistent within an industry.

^{xii} Enhanced analysis is a common terminology in practitioner language but is rarely found in academic literature. However, it is considered the most important approach in the attempt to mainstreaming responsible investment (Sullivan and Mackenzie, 2006).

^{xiii} Alpha is defined as the excess rate of return on a portfolio relative to the return of the benchmark index, here the Dow Jones Index.

^{xiv} Some authors like Scholtens (2006) and Schueth (2003) have introduced engagement as a subcategory of activism. However, we believe that especially with regard to the different notions of both terms, with engagement often representing the ‘softer’ (see Solomon et al., 2004) way of influencing corporate management, a clear distinction between formal and informal is useful within the scope of this study.

^{xv} In a case study with UK investment managers Gifford (2004) identifies various factors that are relevant for effectively influencing corporate behaviour such as the type and strength of the arguments brought forward against management or the commitment that an investor has organization-wide towards the integration of ESG issues.

^{xvi} Further activities not directly addressing a specific company consist of publishing articles, generating media or press coverage, and collaborating with other investors (Lewis and Mackenzie, 2000, p. 217). Within the scope of our study, we will solely refer to engagement activities as those directly addressing corporate management.

^{xvii} Filing shareholder resolutions typically are bound to legal restrictions of the specific country such as a minimum percentage of ownership of stock. For more details on legal requirements see O'Rourke (2003).

^{xviii} Since the economic dimension implies the maximization of shareholder value, it can be used here as a substitute for all governance related issues that try to align the interests of shareholders with those of management.

^{xix} In this context, De Bakker and den Hond (2008) define the "influence of stakeholders over firms [as] the temporary outcome of processes of action, reaction, and interaction among various parties" (p. 8).