

Environment for Development

Discussion Paper Series

June 2010 ■ EFD DP 10-17

Responsible Investment

*A Vehicle for Environmentally Sustainable
Economic Growth in South Africa?*

Stéphanie Giamporcaro, Lise Pretorius, and Martine Visser



Environment for Development



RESOURCES
FOR THE FUTURE

Environment for Development

The **Environment for Development** (EfD) initiative is an environmental economics program focused on international research collaboration, policy advice, and academic training. It supports centers in Central America, China, Ethiopia, Kenya, South Africa, and Tanzania, in partnership with the Environmental Economics Unit at the University of Gothenburg in Sweden and Resources for the Future in Washington, DC. Financial support for the program is provided by the Swedish International Development Cooperation Agency (Sida). Read more about the program at www.efdinitiative.org or contact info@efdinitiative.org.

Central America

Environment for Development Program for Central America
Centro Agronómico Tropical de Investigación y Enseñanza (CATIE)
Email: centralamerica@efdinitiative.org



China

Environmental Economics Program in China (EEPC)
Peking University
Email: EEPC@pku.edu.cn



Ethiopia

Environmental Economics Policy Forum for Ethiopia (EEPFE)
Ethiopian Development Research Institute (EDRI/AAU)
Email: ethiopia@efdinitiative.org



Kenya

Environment for Development Kenya
Kenya Institute for Public Policy Research and Analysis (KIPPRA)
Nairobi University
Email: kenya@efdinitiative.org



South Africa

Environmental Policy Research Unit (EPRU)
University of Cape Town
Email: southafrica@efdinitiative.org



Tanzania

Environment for Development Tanzania
University of Dar es Salaam
Email: tanzania@efdinitiative.org



School of Business,
Economics and Law
UNIVERSITY OF GOTHENBURG



Responsible Investment: A Vehicle for Environmentally Sustainable Economic Growth in South Africa?

Stéphanie Giamporcaro, Lise Pretorius, and Martine Visser

Abstract

This paper explores whether any investment products or strategies in South Africa take environmental sustainability into account. By looking at how environmental, social, and governance (ESG) criteria are used in investment decision making, we found that most socially-responsible investment products and responsible investment strategies largely focus on infrastructure, development, and black economic empowerment. Environmental criteria do not yet receive comparable attention from South African asset managers and owners. Mainstreaming responsible investment principles will need to come from either an increase in demand for such practices by asset owners or from company positions on ESG issues.

Key Words: responsible investment, socially responsible investment, pension funds, asset managers, screening, active share ownership

JEL Classification: G23, G28, H23

© 2010 Environment for Development. All rights reserved. No portion of this paper may be reproduced without permission of the authors.

Discussion papers are research materials circulated by their authors for purposes of information and discussion. They have not necessarily undergone formal peer review.

Contents

Introduction	1
1. Defining Socially Responsible Investment	2
2. Responsible Investment Strategies	3
2.1 Negative, Positive, and Best in Sector Screening.....	3
2.2 Active Share Ownership: Engagement, Proxy Voting, and Investor Coalitions.....	4
3. Initiatives and Tools for Responsible Investment Strategies in South Africa	4
3.1 The Principles for Responsible Investment.....	5
3.2 The Johannesburg Stock Exchange Socially-Responsible Investment Index.....	6
4. Collection Data, Methodology, and Research Questions	6
4.1 Desktop Research.....	7
4.2 Interviews Targeting Responsible Investors.....	7
4.3 Characteristics of the Respondents.....	8
4.4 Interview Process and Research Questions on Practices.....	9
5. South African Socially-Responsible Investment Fund Market: A Limited Scope for an Environmental Focus	11
5.1 Responsible Investment Strategies Adopted.....	13
5.2 Socially-Responsible Investment Funds Supply and Environmental Focus.....	14
6. Socially-Responsible Investment Funds and Strategies versus Environmentally-Responsible Investment Products and Services	14
6.1 Environmental Information.....	16
6.2 Engagement and Proxy Voting Practices on Environmental Issues.....	18
6.3 Clients, Reporting, and Communication.....	18
9. Discussion	20
10. Conclusion	22
Appendixes	24
References	26

Responsible Investment: A Vehicle for Environmentally Sustainable Economic Growth in South Africa?

Stéphanie Giamporcaro, Lise Pretorius, and Martine Visser*

Introduction

In light of the meltdown of the global financial system since 2007 and growing recognition of the economic, developmental, and environmental challenges facing individual countries and the international economy alike, the nature and role of investment is becoming increasingly important. The issue is no longer that economies grow, but *how* they grow. In this sense, financial tools, such as investments, have the power to affect social, economic, and environmental outcomes. Socially responsible investment (SRI) and responsible investment (RI) strategies, or philosophies, are based on this idea.

The notion of using investment as a vehicle for social change emerged in the 1960s in the United States, where the peace and green movements led to divestiture in certain industries to match ethical positions (Heese 2005, 730). It was also the refusal of U.S. investors to invest South African companies that played an important role in bringing the concept of socially responsible investment into the international arena (*ibid.*). This investment approach quickly spread to the United Kingdom in the 1990s, where—apart from screening companies—investors adapted it by using their shareholder powers to engage with the company (initiating proposals and voting at shareholder meetings) to achieve the desired change (Giamporcaro 2006).

By 2000 in continental Europe, Switzerland, France, Belgium, and the Netherlands were the first to implement socially responsible philosophies and strategies. Here, the idea was adapted further and, instead of withholding investment from companies, continental investors chose to invest in those companies with the best social, environmental, and corporate governance credentials (*ibid.*). Although the institutionalization of such practices has been slower in South Africa than in the developed world, the origins of SRI practices there can be traced to the 1980s.

* Stéphanie Giamporcaro, Environmental Policy Research Unit, School of Economics, University of Cape Town, Rondebosch 7701, South Africa, (tel) 27-21-6505242, (email) stephanie.giamporcaro@uct.ac.za; Lise Pretorius, (email) lisenatalie@gmail.com; and Martine Visser, Environmental Policy Research Unit, School of Economics, University of Cape Town, Rondebosch 7701, South Africa, (tel) 27-21-6505242, (email) martine.visser@uct.ac.za.

Unity Incorporation, an investment group cofounded by unions, attempted to transform the companies in which their pension funds were invested by raising issues of concern to workers, especially working conditions.

Today, different ways of implementing SRI are often presented as part of the same tool box. The United Nations Environmental Program's Financial Initiative (UNEP-FI) and its *Principles for Responsible Investment* (PRI) initiative play a particularly important role. PRI, launched in 2006, led the growing commitment by large public pension funds around the world to responsible investment practices. It also helped redefine the terms and scopes of the concepts of responsible investment (RI) and environmental, social, and governance (ESG) issues. In South Africa, the investment sector in particular has, for the past decade, been developing its own response to the new world of responsible investing as demonstrated by growing participation by industry players to the PRI.

In 2010, the global issues confronting all countries present new challenges that investments must address. As the economic recession led the worldwide media headlines in 2009, it was closely followed by the rising concern for climate change. Slowly but surely, climate change and other environmental concerns, such as water scarcity and biodiversity, are climbing higher in the civic, economic, and political agendas of the leaders of the developed and developing countries. Viviers (2007) and Viviers et al. (2009), who conducted extensive research on SRI in South Africa, noted that little research has been done on the environmental aspect of responsible investment strategies. Our research, to determine whether any investment products or strategies labeled as SRI or RI take environmental sustainability into account in South Africa, contributes to this gap.

In this paper, we look closely at the different ways in which environmentally responsible investment approaches may be implemented in the local SRI industry through desktop research and a survey by interviews led among the local investment industry.

1. Defining Socially Responsible Investment

De Cleene and Sonnenberg (2004, 5) defined SRI as “investment that combines an investor's financial concerns with its commitment to social concerns, such as social justice, economic development, peace, or a healthy environment.” However, various terms used in the industry, such as SRI, responsible investment, ethical investment, and sustainable investment, often hold different meanings for different players. It is important for this paper that we clarify precisely what we mean when these terms appear. These are two useful conceptual clarifications:

- *SRI as a concept is defined by specific investment strategies and (usually) specific investment products* (Giamporcaro 2006). This practice is often linked to investing to achieve a certain social outcome. Thus, SRI strategies and products can be said to be country specific, often geared toward affecting economic or social outcomes through the investment process.
- *Responsible investment (RI) is defined as the broad integration of ESG issues into investment decision making in order to optimize financial performance.* The approach is fuelled by the recognition, especially by the large pension funds, that ESG issues have an impact on the long-term value of an investment and therefore must be considered. By including ESG issues in their investment criteria, pension funds are acting more “responsibly” toward their trustees—hence responsible investment (Noah FI, UNEP-FI, and UNISA CCC 2007).

The industry, then, consists of investors who invest in designated SRI funds, invest generally according to RI principles across all their investments, or invest in both. This paper attempts to map the South African industry in terms of how environmental criteria are taken into account through either RI as a broad investment strategy or through the existence of designated SRI funds.

2. Responsible Investment Strategies

There are two main strategies for SRI: screening, and active share ownership. They are not mutually exclusive and use depends on the investment fund.

2.1 Negative, Positive, and Best in Sector Screening

Negative screening is a strategy by which a fund declines to invest in a company that engages in certain “unethical” practices, such as promotion of tobacco products, unsustainable use of resources, or mistreatment of workers (Viviers 2007). In our analysis, we show that Shari’ah-compliant funds fall under this category, where companies are screened based on Shari’ah principles.

With *positive screening*, investors include in their portfolios companies that display good corporate citizenship according to ESG criteria. This allows investors to identify and reward those companies whose behavior coincides with the social or environmental interests of the investor (Lamore, Link, and Blackmond 2006). In South Africa, these investments often focus on specific themes, such as black economic empowerment policies within companies or

infrastructure development. Another dimension of positive screening is targeted investments, also referred to as cause-based investment. The difference between positive screening of companies (usually listed on a stock exchange) and targeted investment is that the latter finances certain projects or developments that are not listed.

Best of sector screening does not exclude any sector of activity. The strategy consists in giving an ESG rating to the companies in the same sector. Crossing ESG rating and financial information, investors attempt to invest in the best companies from both sets of criteria. This required detailed ESG scoring by criteria (Giamporcaro 2006)

2.2 Active Share Ownership: Engagement, Proxy Voting, and Investor Coalitions

Screening has often been criticized for reducing the number of companies from which investors can pick, an argument frequently used to discuss the impact of screening on financial performance. Another strategy, different from screening, is active share ownership. Investors use their shareholder rights to engage with boards to convince them to consider EGS issues (or a specific issue) directly or through proxy voting.¹ If engagement or voting fails to transform the company, the investor has the tool of divesting at its disposal (De Cleene and Sonnenberg 2004). While this strategy has the potential to be a powerful means to change the behavior of companies, shareholders need a significant stake in a company for it to be effective. Thus, substantial institutional investors possess clout here, especially the large pension funds (Sparkes and Conton 2004). International shareholder coalitions often make use of these substantial institutional investors to raise corporations' awareness around a specific issue, such as climate change (the Carbon Disclosure Project) or corruption (various transparency and anti-corruption initiatives), for example.

3. Initiatives and Tools for Responsible Investment Strategies in South Africa

Although responsible investment is not yet the consensus position, emphasizing the materiality of ESG issues in fund performance is more likely to move it from the fringe into mainstream investment practice, making it a more powerful tool for sustainability (Noah FI, UNEP-FI, and UNISA CCC 2007). The PRI is creating momentum with its network of

¹ Proxy voting is a vote cast by one person or entity for another in their absence, via delegation (or authorization) by the vote owner. Proxy votes can be used to form a voting bloc that can exercise greater influence in negotiations. Here, the asset manager acts as the proxy for its principal (the client).

responsible investors that can persuade those who still have concerns about fiduciary duties and performance (Cheek 2009). In this sense, the PRI is important to the growth of RI, especially its institutionalization in South Africa.

3.1 The Principles for Responsible Investment

PRI, an international initiative established by the UNEP Finance Initiative and partner of UN Global Compact, was launched in 2006. It totaled, in October 2009, more than 700 signatories representing more than US\$ 21 trillion. In becoming a signatory to the PRI, investors commit to acting in the best long-term interests of their beneficiaries. First, in their fiduciary role, signatories believe that ESG issues can affect the performance of investment portfolios and, second, they recognize that applying the principles better aligns investors with the broader objectives of society. As signatories, investors commit themselves to:

- incorporating ESG issues into investment analysis and decisionmaking processes;
- being proactive owners and incorporating ESG issues into their ownership policies and practices;
- seeking appropriate disclosure on ESG issues by the entities in which they invest;
- promoting acceptance and implementation of the PRI within the investment industry;
- working together to enhance their effectiveness in implementing the PRI; and
- reporting on their activities and progress towards implementing the PRI.²

On the domestic front, the South African Government Employee Pension Fund (GEPF) plays an important role in institutionalizing these principles. GEPF is one of the 30 largest pension funds in the world. These assets are managed by the Public Investment Corporation (PIC), which acts as the investment portfolio manager, as well as a number of third-party asset managers. Given the size of GEPF, its investment decisions have important economic and social outcomes. Because GEPF manages more than 50 percent of the total pension fund assets in South Africa, asset managers naturally want to manage its investments. GEPF signed the PRI in 2007 and since then has publicly communicated its willingness to act as a responsible investor (Cranston 2009)

² UNPRI.com, "The Principles," <http://www.unpri.org/principles/>.

In May 2009, GEPF led the creation of a PRI network in South Africa, the third one in the world, after Brazil and South Korea. The network aims to “raise awareness about the business case for responsible investment in order to persuade more South African pension funds and other asset owners to consider environmental, social, and corporate governance factors in their investment decisions... [and to] capture evolving best practice on how to factor ESG issues into investments processes and to implement the Principles in the South African context” (PRI and GEPF 2009, 1).

3.2 The Johannesburg Stock Exchange Socially-Responsible Investment Index

A second development in South Africa’s growing awareness of ESG issues was the introduction of the Johannesburg Stock Exchange (JSE) SRI index. The index, which was launched in 2004, assesses a company’s performance against four criteria: governance, society, environment, and economy. Inclusion in the index requires a minimum score (Sonnenberg and Hamman 2006, 307). The criteria for inclusion are reviewed every year and will progressively get more demanding over time. Since 2007, the JSE SRI index has worked in partnership with the U.K. ESG information provider EIRIS.

Regarding the environmental criteria, South African companies are classified according to a scale of low, medium, or high environmental impact. For example, mining and utilities sectors are considered to have a high impact, whereas the banking sector has a low environmental impact. Companies with greater environmental impact need high scores to meet the requirements of the index methodology. Currently, environmental scores are established through an assessment of the environmental policies, management, and reporting/disclosure practices.

4. Collection Data, Methodology, and Research Questions

We conducted our study between June and December 2009 through desktop research and interviews. The desktop research aimed primarily to measure the size and trends of the South African SRI-fund market and to obtain an initial view of the integration of environmental issues. The first goal of the interview process was to further explore the environmentally-responsible investment practices adopted by responsible investors and to complete the results gathered via the desktop research. The second goal was to collect their opinions on the integration of environmental risks in the South African investment industry, but these results are not discussed in this paper.

4.1 Desktop Research

We searched the websites of the asset managers and SRI fund providers—their quarterly reports, fund fact sheets, and investment policy statements. A database of asset managers was then created; it included PRI signatories, as well as asset managers that are not PRI signatories, but that offer SRI products. The database quantified each asset manager's involvement in SRI, if any, and outlined the strategies adopted, and the scope and focus of these funds. On the pension fund (asset owner) side, we looked further into the websites of the relevant bodies, as well as through a collection of legal documents and National Treasury Discussion Papers on pension fund legislation. The desktop research was supplemented by drawing on a range of relevant international and local literature.

4.2 Interviews Targeting Responsible Investors

As with Rainelli and Huault's (2009) work on weather derivatives markets or MacKenzie's study of carbon markets (2009), interviewing was necessary because neither media nor academic sources were sufficient to answer our research question. (Qualitative methodologies are well suited to provide context, vivid descriptions, and dynamic structures of the socially-constructed practices and representations of the people working in organizations [Locke 2001]). Face-to-face interviews were done mainly with PRI signatories. The list of the South African PRI signatories was obtained from the PRI website. Signatories are classified by the PRI initiative into three categories: asset owners, investment managers, and professional service partners.

This group of organizations, which willingly made the decision to sign the PRI principles, was targeted because we assumed, based on previous research experience in France (Giamporcaro 2006),³ that they would demonstrate a more sophisticated understanding and analysis of the integration of environmental concerns into investment decisionmaking processes and shareholder practices. Nevertheless, because investment managers represent the major bulk of PRI signatories and were our principal focus, we also decided to include:

- investment managers, which are not signatories of the PRI, but are suppliers of SRI investment products, and

³ One of the authors of the article, Stephanie Giamporcaro conducted PhD research from 2002 to 2005 on a similar interview field survey of responsible investors in France. This experience informed field research choices made for the South African study.

- the 20 biggest investment managers in South Africa, according to an Alexander Forbes Institutional Investment Survey conducted at the end of December 2008 (Alexander Forbes 2008).

The idea behind this last inclusion was to establish whether any of the largest South African asset management houses was in the process of signing the PRI or developing an SRI product. The strategy paid off because we were able to identify one asset management house preparing to sign the PRI. Finally, from a sample of 34 organizations, we conducted 22 face-to-face or telephone interviews (a 65-percent success rate) between August and December 2009 in Johannesburg and Cape Town.

Of these, we reached 12 of the 19 investment managers, 1 of the 2 asset owners, and 3 of the 6 partner service providers listed as South African PRI signatories at beginning of March 2009. (Two of the asset managers interviewed, however, were no longer listed as PRI signatories in July 2009, but two other asset managers were listed as new signatories, per Crotty [2009].) Even though the research sample is strongly biased towards signatories of the PRI, it should be emphasized that it does not mean that the survey targeted a marginal community of investors. Indeed, in terms of overall reach of the South African investment industry, the field survey reached 60 percent of the 20 biggest South African management houses, as of December 2008 (Alexander Forbes 2008).

4.3 Characteristics of the Respondents

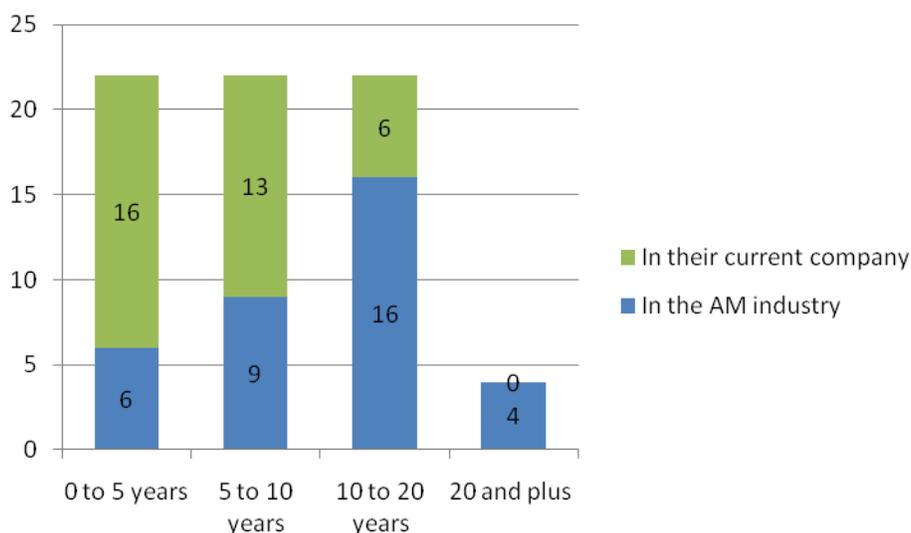
Interviews were fully transcribed and on average lasted 90 minutes. Anonymity was granted to the respondents, meaning that verbatim quotes would not be linked to their names or their organizations. When a quote is included, we identify the source by number, Respondent 1 or Respondent 8, for example. Nevertheless, in order to contextualize the research, a list of the organizations targeted and interviewed is given in the appendix.

From the 22 organizations that participated in the research, we interviewed 35 individuals. Portfolio managers (31 percent) and financial analysts (26 percent) represented the largest share of the interviewee population. Chief investment officers (14 percent) and chief executive officers (17 percent), usually accompanied by their staff, responded directly to our questions, showing apparently that the interest for responsible investment questions was embraced at the higher levels of the organizations.

Another interesting fact to note is that of the 35 individuals interviewed, 40 percent said that they led the SRI in their organizations, indicating advanced awareness of SRI and RI issues.

It also appears that the majority of the professionals we met were quite senior in the asset management industry, but that most of them had not worked in their current organization for longer than five years.

Figure 1. Investment Experience of the Survey Sample



Note: AM = asset management.

Source: Authors' own research and calculations.

Further questions were asked during the interview on asset management style, stock-picking techniques, and investment constraints adopted. Fourteen of 15 investment managers (excluding multi-fund managers) interviewed declared that they implemented active asset management techniques rather than passive techniques. Among the 14 active investment managers, 6 organizations described using a mix of qualitative and quantitative techniques, and 7 used only qualitative techniques, such as fundamental analysis of companies. Two houses declared that they also implemented hedging techniques. Only one organization described itself as a purely quantitative house. Even though it cannot be strictly statistically proven with this small qualitative sample from South Africa, it appeared (as seen in France [Giamporcaro 2006]) that, generally, qualitative stock-picking techniques share common ground with SRI and RI principles because they both rely on the necessity of in-depth analysis of companies.

4.4 Interview Process and Research Questions on Practices

The interview guideline was semi-structured. This meant that some questions were closed questions, whereas other questions were designed to let the interviewees develop their own

thinking on a specific point. The fact that interviewees presented a diversified range of practices and opinions concerning environmentally responsible investment presented challenges to the interview guideline. The major difficulty was keeping the discussion focused precisely on environmentally-responsible investment practices, instead of more general practices of responsible investment strategies and SRI products. Thus, the guideline was strictly structured, but was adapted for each interviewee, in case certain questions were not relevant for them. Nevertheless, the interviews basically followed the steps in table 1.

Table 1. Interview Guideline Framework

Part 1: Detailed information gathered on each respondent	Age, training, job function, and experience in the investment industry and the organization
Part 2: Detailed Information on the organization of each respondent	Asset management style, asset allocation, geographical zone of investment, clients, and investment philosophy
Part 3: Definition of responsible investment and environmental themes.	Spontaneous definition of SRI and RI, reaction to a specific definition of SRI, spontaneous definition of environmental themes
Part 4: Environmentally-responsible investment practices	Current SRI products and how supplied, RI philosophy, and integration of environmental concerns in the current SRI products
Part 5: General views on the future development of environmentally responsible approaches	Answers specific to each interviewee
Part 6: Identification of obstacles and enablers to a further integration of environmental concerns	"According to you, what are the main obstacles and enablers to further environmental concerns integration in the investment industry?"
Part 7: Reaction to a set of obstacles and enablers to environmentally-responsible investment, as identified in the academic literature through a series of illustrative quotes	Short-termism of the financial market, herding/peer and client pressure, incentive structures

The qualitative data about practices gathered in our semi-structured, face-to-face interviews were analyzed through a process of analytical induction, or grounded theory (Haig 1995; Jankowicz 2005). Concerning the specific theme of environmentally-responsible investment practices implemented by respondents, the following two questions structured the data analysis:

1. What do respondents do, regarding collection of environmental data, environmentally responsible investment decisionmaking, environmentally responsible engagement and proxy voting, and marketing their environmentally-responsible investment strategies to clients?

2. How will environmentally responsible investment principles become part of mainstream investment philosophy and practices in future, according to the respondents?

5. South African Socially-Responsible Investment Fund Market: A Limited Scope for an Environmental Focus

In 2006, research (Viviers 2006) on the South Africa SRI market determined that there were 35 available SRI funds, amounting to 0.7 percent of total assets under management. In July 2009, our desktop research ascertained that there were 38 SRI-labeled products in South Africa, with an approximate market value of SAR⁴ 23.28 billion. The figures calculated are an estimation of the size of the local SRI sector. The market values of the funds in the following table give the total assets managed by each fund as of June/July 2009.

Table 2. Classification of SRI Funds

Fund type	Fund name	Size of assets managed (in SAR)	Domestic assets
<i>Equity</i>	Element Earth Equity Fund	SAR 476 million	100%
	Element Islamic Equity Fund	SAR 103 million	100%
	Futuregrowth Albaraka Equity Fund	SAR 801.5 million	100%
	Futuregrowth Infrastructure and Development Equity Fund	SAR 490.2 million	100%
	Futuregrowth SRI Equity Fund	SAR 4.2 million	100%
	Investec Jadwa Africa Equity Freestyle Fund	US\$ 11 million	70%
	Investec RI Equity Fund	SAR 390 million	100%
	Oasis Crescent Equity Fund	SAR 3,127 million	83%
	Oasis Crescent International Fund of Funds	SAR 374 million	0%
	Old Mutual Community Growth Equity Fund	SAR 2.4 billion	100%
	Prescient SRI Equity Active Quant	0	100%
	Sanlam SRI Equity Fund	SAR 50 million	100%
	Sasfin TwentyTen Fund	SAR 97.04 million	100%
	STANLIB Shari'ah Equity Fund	SAR 123.4 million	100%
<i>Balanced</i>	Advantage Shari'ah Fund	SAR 4.6 million	85%

⁴ SAR = South African rand.

Environment for Development
Giamporcaro, Pretorius, and Visser

	Advantage/Momentum Super Nation Fund	SAR 72 million	100%
	Cadiz Money Market Fund	SAR 112 million	100%
	Futuregrowth SRI Balanced Fund	SAR 6 million	100%
	Investec TDI Balanced Fund	SAR 96 million	100%
	Metropolitan African Wealth Creator	SAR 1.1 billion	92%
	Old Mutual Community Growth Equity Fund of Funds	Unavailable	100%
	Sanlam Infrastructure Fund	SAR 250 million	85%
	STANLIB Corporate Wealth Development Fund	SAR 250 million	100%
	27 Four Shari'ah Fund	SAR 30 million	100%
Fixed Interest	Cadiz Infrastructure Bond Fund	SAR 53.9 million	100%
	Cadiz SRI Bond Fund	SAR 105.7 million	100%
	Coronation Siyakha Bond Fund	SAR 27 million	100%
	Futuregrowth Infrastructure and Development Bond Fund	SAR 4.6 billion	100%
	Old Mutual Community Growth Gilt Fund	SAR 900 million	100%
	Old Mutual Community Growth Money Market Fund	SAR 17.7 million	100%
	Sanlam SRI Bond Fund	SAR 150 million	85%
Private equity/Alternative	EMF Kagiso Infrastructure Empowerment Fund	SAR 649 million	100%
	Investment Solutions Sakhiswe Fund	SAR 80 million	100%
	Investment Solutions Shari'ah Fund	SAR 1 billion	85%
	Macquarie and Old Mutual AIIF (African Infrastructure Investment Fund)	SAR 721 million	80% SA
	Macquarie and Old Mutual SAIF (South African Infrastructure Fund)	SAR 1.32 billion	100%
	OMIGSA Ideas Fund	SAR 2.25 billion	85%
Property	Futuregrowth Community Property Fund	SAR 2.6 billion	100%

Source: Authors' own research and calculations.

The SRI funds are classified as equity, balanced, fixed income, private equity/alternative, and property. We wanted to ascertain the value of SRI assets in each category in proportion to total SRI assets.

Table 3. Allocation of SRI Funds

Fund type	% of SRI funds	% of value of SRI assets
Equity*	36.84	35.83
Balanced	26.12	7.74
Fixed interest	18.42	25.07
Private equity/alternative	15.78	20.19
Property**	2.63	11.17

* One of the 14 equity funds, Oasis Crescent Equity International Fund of Funds, is classified as foreign and was not included in the calculation of domestic SRI assets.

** There is only one property fund, Futuregrowth's Community Growth Property Fund, which manages assets of SAR 6.2 billion, and accounts for 11.67% of SRI assets.

Source: Authors' own calculations.

5.1 Responsible Investment Strategies Adopted

Worldwide, there are two main strategies (previously described) available to responsible investors: screening and active owner strategies. Our research identified the following strategies adopted by local SRI labeled funds:

- A majority of 22 SRI-labeled funds appear to adopt a positive screening approach (including targeted investment approaches).
- Seven funds adopt responsible strategies based on engagement and proxy voting; six of these combine this strategy with positive screening.
- Nine funds adopt negative screening (e.g., Shari'ah compliant). Shari'ah-compliant funds employ a negative screening strategy by excluding investment in alcohol; gambling; pornography; non-hallal foodstuffs; and financial institutions and companies with high levels of financial leverage, debtors, and interest income.

It is interesting to note that, unlike in France (Giamporcaro 2006) where the best of sector-screening practices (underweighting or overweighting one's portfolio based on companies' ESG scores) is widespread, SRI-labeled funds in South Africa do not apparently implement such practices. Similar to the United Kingdom, engagement and positive screening are favored.

5.2 Socially-Responsible Investment Funds Supply and Environmental Focus

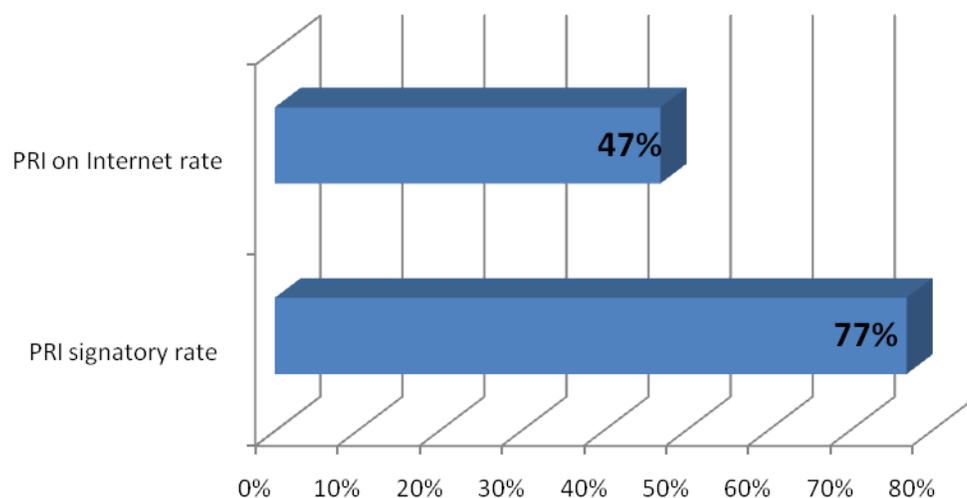
SRI funds that have a negative screening, mainly Shari'ah compliance, are not characterized by an integration of environmental concerns (24 percent). A majority of funds (58 percent), using a positive screening approach for listed equities and unlisted targeted investments, focus primarily on black economic empowerment and development goals, such as poverty alleviation, job creation, or infrastructure development (housing, transports, retailing). Some 18 percent of the funds, which mainly combine positive screening and engagement on the listed space, can be described as adopting a broad ESG focus. In all these funds, environmental issues are taken into account as part of social and corporate governance matters in the analysis of companies, investment decisionmaking, and engagement/proxy voting processes.

It is important to note that, unlike Europe, the South Africa has not so far developed an SRI asset management funds industry with thematic green funds, for example, focused on clean or renewable energies.

6. Socially-Responsible Investment Funds and Strategies versus Environmentally-Responsible Investment Products and Services

The market in South Africa for SRI funds appears to be strongly driven by a focus on social transformation, with little interest (or action) currently in environmental themes. Respondents for 15 of the 22 asset manager and asset owner organizations in the study indicated that they managed or distributed SRI-labeled funds at the time of the interviews. Eight invested in a range of SRI products and six focused their investments on a specific SRI fund. Respondent 4 explained that a range of SRI-labeled funds had been created, but that they were considered dormant products since no investors had currently invested in them. In a minority of asset managers without any SRI products, Respondents 5 and 13 explained that their companies chose not to create SRI-niche products, but to try to progressively implement a responsible investment philosophy. In line with the results of our desktop research, no respondent mentioned implementing a best-in-sector approach, where stocks in their portfolio were under- or over-weighted. Five asset managers, using the JSE SRI index, declared that their screening strategy consisted of not investing in the corporations not in the index.

Regarding the adoption of the PRI, the final research sample consisted of 17 PRI signatories (as of the time of the interviews) and 5 non-PRI signatories. Of the 5 non-PRI signatories, a majority explained that their upper management was considering signing the principles at the time of the interview. Nevertheless, funds that signed the PRI did not necessarily communicate or publish this information, even (notably) on their own websites.

Figure 2. Percentage of PRI Signatory and Communication of PRI Status on Website

Source: Authors' own calculations.

Indeed, only 47 percent of the PRI signatory respondents communicate their adoption of the principles on their corporate website. And if they do, they mostly outline the six principles without any illustrative examples as to how they actually implement the principles. No reporting on specific environmentally-responsible strategies was identified.

In terms of environmentally responsible funds, at the time of the survey, respondents had not invested in, or were not managing, any green thematic funds that tackle climate change by investing in companies attempting to reduce their carbon footprint via renewable energies or engaging in energy efficiency strategies, for example. Asked if it was something planned for the future, a majority of asset managers answered that it was not in their future plans, even though talks on climate change were taking place in their organizations. Respondent 15 explained that he did not think that the South African asset management industry would follow the European industry because a renewable energy fund, for example, would not be able to find enough large or mid-sized companies or projects in South African to invest in. Another asset manager commented that companies or funds listed on the JSE lacked of green opportunities and that in the future his organization was planning to invest in the private equity space.

The survey identified only one asset management company, Respondent 5's, which invested time and resources in an environmentally-responsible investment strategy. This manager had created a tool for measuring the carbon footprint of South African listed companies and intended to use it to assess stocks in which it invested.

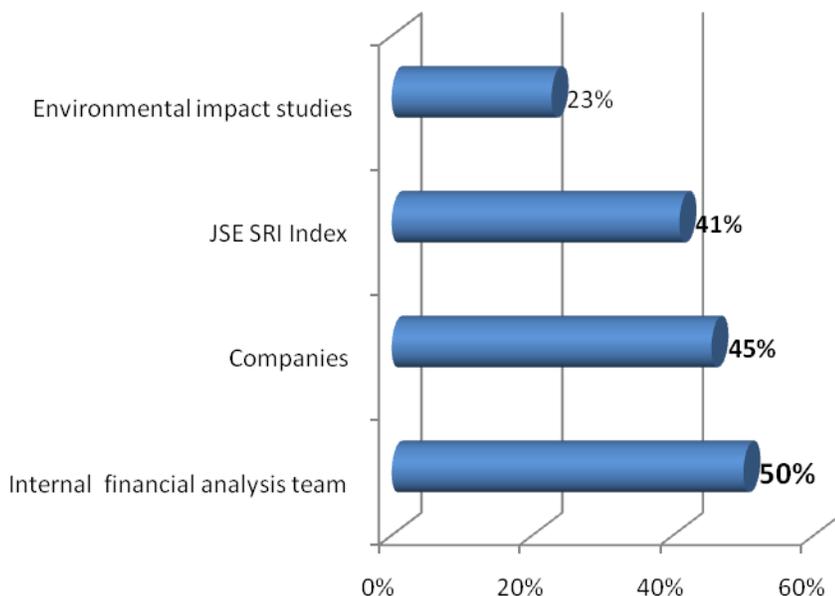
6.1 Environmental Information

Respondents 5 and 8 represented the two asset management houses that demonstrated a specific effort to look for and analyze specific information on environmental risks, such as water or climate change. These companies decried the lack of environmental disclosure by South African companies. For example, with CO₂ emissions, they highlighted the progress made by South African companies participating in the Carbon Disclosure Project,⁵ but still identified as obstacles the lack of standardization of carbon data, as well as other environmental data, such as water or energy consumption (Salgado 2009).

Respondents 5 and 8 also expressed the view that environmental data provided by the JSE SRI index was not detailed enough on environmental criteria. Nevertheless, 41 percent of the interview respondents declared that their main resource of ESG information was the JSE SRI index, although their opinions of its utility were diverse. Some respondents found that the JSE SRI index satisfied their needs, whereas other respondents who were more focused on fixed income and targeted investment did not view it as an important tool. Surprisingly, Respondents 10, 12, 13, and 14 did not seem to really be aware of the existence of the JSE SRI index.

Several times, we heard criticism about the fact that the JSE SRI index was biased toward certain sectors, such as utilities, and therefore had to be used carefully. Previous research in France (Giamporcaro 2006) also revealed this same comment about SRI indexes, that they often favored some investment sectors, depending on the SRI rating methodology adopted. Some 50 percent of the respondents declared that they went first to their own financial analysis team to get environmental information. Respondent 1 noted a generational paradigm shift in his organization. Whereas it would have been impossible to speak to and get environmental information from the previous financial analysts, he reported that today the younger generation of analysts was eager to work on these new environmental questions.

⁵ Since 2000, CDP on behalf of institutional investors challenged the world largest companies to measure and report their carbon emissions. In 2009, CDP backed by 475 institutional investors representing more than US\$ 55 trillion of funds under management sent questionnaires to more than 3,700 of the world's largest companies. In South Africa, the initiative targets the 100 largest companies on the JSE. In 2009, the response rate was 68%, compared to 59% in 2008. At the end 2009, seven South African investors had joined the CDP (CDP 2009).

Figure 3. Respondents' Environmental Sources of Information

Note: JSE SRI = Johannesburg Stock Exchange Socially Responsible Investment

Source: Authors' own calculations.

The second place that 45 percent of the interview respondents looked information on ESG, including environmental information, was their direct interactions with companies and company annual reports. On the direct interaction with companies, Respondents 19 and 20 condemned the frequent changes of corporations' heads of sustainability, which too often forced them to start from scratch when seeking ESG information.

Environmental impact studies were quoted by fixed income and targeted investment asset managers as sources because they were obligatory for a range of projects that they were inclined to invest in. Interestingly, sell-side analysis services from brokerage companies were only quoted by 14 percent of the respondents. Respondent 10 commented that he doubted that South Africa brokerage companies were gathering environmental information currently, considering the weak demand for it from investors. Academic research was only mentioned by 9 percent of the respondents as a source of environmental information.

6.2 Engagement and Proxy Voting Practices on Environmental Issues

A majority of respondents (68 percent) mentioned that they applied strategies of engagement. Among this group, eight respondents declared that they looked at governance, and less so at social and environmental issues; five respondents, however, said they only targeted corporate governance matters. It was difficult to obtain actual examples of how they actually engaged a company on environmental questions. Again, Respondent 5 was the only one who could demonstrate his company's interactions with a corporation through written correspondence on carbon emissions disclosure.

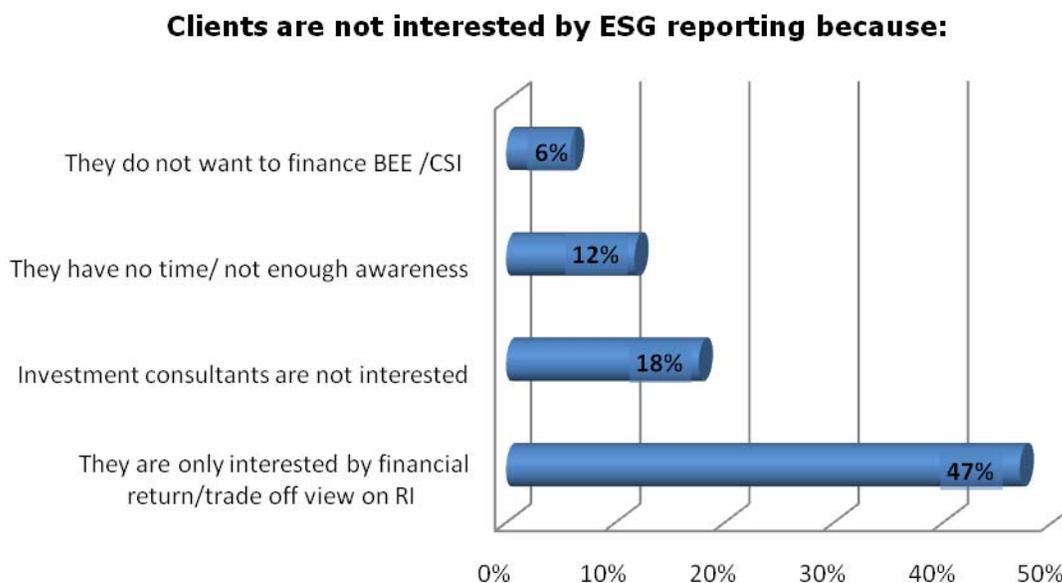
A larger majority of respondents (74 percent) said their companies were involved in proxy voting, but mostly on corporate governance. Interestingly, in terms of transparency and disclosure, only the companies of Respondents 8 and 11 posted their proxy voting policies and their proxy voting records on their website. The proxy-voting policy documents highlighted the importance of environmental disclosure. Respondent 5 did not elaborate on his organization's proxy voting policy, but did provide details on the results of its proxy voting activities aimed at the lack of environmental disclosure of specific corporations.

6.3 Clients, Reporting, and Communication

Previous research in France on RI (Giamporcaro 2006) revealed that one of the most difficult exercises for asset managers was to incorporate in their monthly, quarterly, or annual financial reports to clients the actual integration of ESG criteria in their investment decisionmaking and active share-ownership activities. Even the most advanced asset management houses, such as BNP Paribas Asset Management or Crédit Agricole, struggled for a long time on how to reflect the integration of ESG issues in their monthly report spreadsheets and their investment decisionmaking, and show how it had an impact on their financial performance. This situation is the same in South Africa. Although the total asset manager sample highlights those funds, which are SRI investment products in their monthly financial reporting, only Respondent 1 and Respondent 7 displayed monthly reporting sheets with articulated investment comments on ESG integration. Regarding marketing and presentation material, only Respondent 16 and Respondent 2 handed detailed marketing brochures to us on their SRI funds, which were also available for free on their websites.

Interestingly, this question of communication and reporting to clients triggered a lot of comments from the asset management houses, with many arguing that it was hardly worthwhile to develop ESG reporting, and even less so for environment reporting, because such reports would not be sensitive for the specific reasons in figure 4.

Figure 4. Clients and ESG Reporting



Note: BEE/CSI = black economic empowerment/corporate social investment

Source: Authors' own calculations.

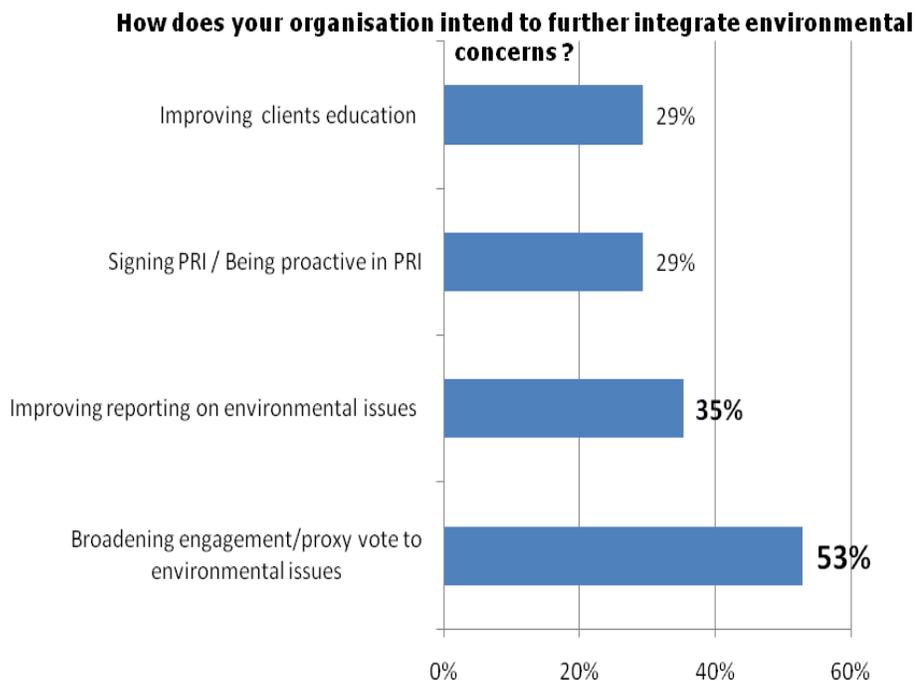
Skepticism was quite widespread among the respondents because of their view that institutional clients are only focused on financial returns and are still convinced that integration of ESG implies a trade-off between financial and extra-financial goals. Some respondents highlighted the leverage role played by the South African investment consulting industry, which largely ignores RI trends. They also stressed that asset managers and service providers lacked time to introduce ESG matters during their interactions with clients. Another view expressed by Respondent 21 was that some institutional investors interpreted RI to mean financing of corporate social investment and black economic empowerment policies and were not keen on the idea. Respondent 2 illustrated this reluctance by quoting one of his company's unconvinced institutional clients, who argued that, "It is not our role to fix the country with the retirement money of our people. It is the job of the government."

A minority of respondents (less than 12 percent) acknowledged that some of their responsible investors were interested in getting reports on the social impact of their investments. Respondent 1 explained that his organization had no difficulty interesting clients in its RI strategies because it could detail how ESG issues mattered in its investment decision process. Respondent 14 noted that the key to efficient reporting for asset managers was being able to tell

contextualized stories that linked the environmental strategic choices made by companies and their financial performance.

It is obvious that, in terms of environmentally responsible investment, more effort lies ahead for the growing South African responsible investment industry. Overall, the development of environmentally-responsible investment practices will depend on the development and the professionalization of responsible investment strategies in ESG matters. In the future, further integration of environmental concerns could occur, according to the respondents, around engagement and proxy voting concerns, especially given the willingness of GEPPF to publicly follow this route.

Figure 5. Future Practical Integration of Environmental Concerns



Source: Authors' own calculations.

9. Discussion

Currently, the demand for SRI and RI in South Africa from investors is met by the products offered on the supply side, which includes a marginal environmental focus. In addition, a major impediment to the growth of SRI and RI is that there is not enough institutional demand for these products and strategies to warrant a push by asset managers for more.

With this in mind, we bring the proposed legislation change to Regulation 28 of the Pension Funds Act, into the discussion. The proposal under consideration is that 5 percent of the assets of pension funds subject to the Regulation 28 should be invested in socially responsible assets. It is important to note here that strategic asset allocations are not yet legally prescribed. GEPF assigns its allocations by choice, for example. In recent years, there has been a heated debate in the government about introducing mandatory SRI allocations, which would apply to all pension funds that are subject to Regulation 28. This debate is important, as are the possible effects on the SRI Industry.

Opponents of the proposed legislation amending Regulation 28 argue that it may violate the principle of risk and return because Regulation 28 is a risk-limiting tool, not a prescribing tool (McNulty 2009). Interestingly, some of these opponents support SRI. Their general view is that there will be too much money chasing too few assets. If there are not enough acceptable assets to invest in under the prescribed system, prices will rise artificially, distort capital markets, and potentially compromise returns.

On the other hand, the proponents of the amendment believe that now, more than ever, ESG factors must be taken into consideration when investing (Munshi 2009). International examples provide a good case for the legislation. Pension funds in the United Kingdom must report their SRI policies and specify to what extent ESG factors are taken into account when selecting their investments. Viviers (2006) and Wildsmith (2008) believe these same requirements should apply to pension funds in South Africa. Although prescribing asset allocation would constitute a “hard” law, these international examples make use of a “soft” law, known as “comply or explain” (Giamporcaro 2009). Here, pension funds are not forced to implement RI strategies or invest in RI funds, but they must report on their ability or failure to do so. This has proven to be successful because the absence of compliance by the pension fund is noticed and acted on by the public. This could be an option for South Africa.

Current debate skims over the deeper dynamics of the SRI industry and the sustainable growth it aims to support. The debate should not center on the viability of SRI as an investment practice—there is little disagreement on this matter—but on how best it can be promoted. What differentiates RI as an overall philosophy from niche SRI products comes to the fore here. In essence, a prescribed asset allocation of 5 percent for pension funds implicitly defines SRI as a unique “asset class” of its own. Thus, it is probable, depending on compliance costs, that pension fund managers will find the quickest, cheapest way to fulfill this allocation requirement. From an RI perspective, this may or may not be helpful, depending on the supply response to the increased demand; from a market perspective, forced allocation would foster inefficiency.

Furthermore, a legislated allocation of 5 percent to SRI funds would keep it a niche and marginal product, and perhaps slow the acceptance of the PRI as the consensus. While it is important to increase demand in the local SRI sector, it should be achieved through guidance and leadership by GEPPF and the industry as a whole.

There is also another and arguably more effective way that legislation can play a role in developing responsible investment practices. Mainstreaming RI should come from either increased demand or regulation. However, the asset managers surveyed pointed out that a company's anticipation of legislation could be an incentive to change. What if legislation focuses on companies? For example, with a carbon emissions cap or a carbon tax, companies with high carbon emissions incur higher costs and their environmental externalities are internalized. From an investor's point of view, it would be a financial risk to invest in "bad" environmental companies. This, in turn, gives investors incentive to either invest in "good" companies (positive screening), divest from "bad" companies (negative screening), or engage with companies to put policies in place to reach the desired criteria (engagement). In South Africa, it is likely that the drivers of RI—especially given their environmental focus—will come from both the demand side of pension funds and from the anticipation of company regulation.

10. Conclusion

This paper describes the state of responsible investment and socially responsible investment in South Africa in 2009 and explores if and how environmental issues are being addressed by the South African investment industry. By analyzing the local SRI industry as a whole, we demonstrated that products and processes designed for SRI largely focus on black economic empowerment and domestic infrastructure. With approximately 80 percent of SRI assets focused in this area, environmental issues are a lesser concern. The industry is characterized by the use of SRI funds to underpin economic growth and by an RI philosophy (from the PRI) largely in its infancy.

The specific focus of SRI in South Africa is indicative of the unique socioeconomic challenges it faces. Perhaps when these more immediate development challenges have been addressed, the focus will turn to the environment. On the other hand, the growing global emphasis on environmental sustainability may inspire South African investors to embrace environmentally-responsible investment practices. How political and economic leaders will decide the development path of South Africa is one of the core questions to ask. The financing and investment decisions made now in South Africa will shape for a long time the lives and the landscape experienced by both the rich and poor in the country.

The interaction between demand and supply in South Africa's financial market suggests that mainstreaming RI principles will need to come from either an increased demand for such practices (from the asset owners) or from company mandates on ESG issues. Regulation could force companies (and thus investors) to internalize any negative externalities arising from their practices, bringing ESG issues into mainstream financial risk-return calculations.

Appendixes

Appendix 1: List of Websites Used

- www.27four.com (Accessed June 2010)
- www.advantageut.co.za (Accessed June 2010)
- www.cadiz.co.za (Accessed June 2010)
- www.coronation.com (Accessed June 2010)
- www.elementim.co.za (Accessed June 2010)
- www.futuregrowth.co.za (Accessed June 2010)
- www.gepf.co.za (Accessed June 2010)
- www.investec.com (Accessed June 2010)
- www.investmentsolutions.co.za (Accessed June 2010)
- www.jse.co.za (Accessed June 2010)
- www.kagiso.com (Accessed June 2010)
- www.legaecapital.co.za (Accessed June 2010)
- www.mergence.co.za (Accessed June 2010)
- www.metropolitan.co.za (Accessed June 2010)
- www.oasis.co.za (Accessed June 2010)
- www.oldmutual.co.za (Accessed June 2010)
- www.prescient.co.za (Accessed June 2010)
- www.prudential.co.za (Accessed June 2010)
- www.sanlam.co.za (Accessed June 2010)
- www.trinityholdingsgroup.com (Accessed June 2010)
- www.unpri.org (Accessed June 2010)
- www.visiocapital.co.za (Accessed June 2010)

Appendix 2: List of Respondents

Asset Managers	Interview Date
Advantage AM	October 2009
Cadiz African Harvest	September 2009
COMANCO/IDEAS Old Mutual Investment Group SA	August 2009
Coronation AM	November 2009
Element IM	September 2009
Future Growth AM Old Mutual Group	December 2009
Investec IM	August 2009
Investment Solutions	October 2009
Kagiso Asset Management	November 2009
Legae Capital	October 2009
Mergence Africa Investment	September 2009
Metropolitan AM	September 2009
Prescient AM	September 2009
Public Investment corporation	September 2009
RMB AM	September 2009
SANLAM Investment Management	August 2009
STANLIB AM	December 2009
Trinity Holding	September 2009
Asset Owners	
GEPF	October 2009
Unity Incorporation	October 2009
Service Providers	
Corporate Governance Accreditation (Pty) Ltd.	Informal itw Sept 2009
JSE	September 2009
RISCURA	September 2009

References

- Alexander Forbes. 2008. *Manager Watch Survey of Retirement Fund Investment Managers*. Sandton, South Africa: Alexander Forbes.
- CDP (Carbon Disclosure Project). 2009. *Carbon Disclosure Project: South Africa JSE 100*. Report prepared for CDP by Incite Sustainability, NBI, and CDP. London: CDP. http://www.incite.co.za/files/CDP%20South%20Africa%202009_Full.pdf. Accessed June 2010.
- Cheek, S. 2009. RI strategies gather momentum. *Global Pensions.com*, September 1, 2009. <http://www.globalpensions.com/global-pensions/feature/1531822/ri-strategies-gather-momentum>. Accessed June 2010.
- Cranston, S. 2009. Government Employee Pension Funds, Taking the high ground. *Financial Mail*, November 27, 2009.
- Crotty, A. 2009. UN expels two SA fund managers. *Business Report*, online edition, August 24, 2009. <http://www.busrep.co.za/index.php?fArticleId=5136352&fSectionId=552&fSetId=662>. Accessed June 2010.
- De Cleene, S., and D. Sonnenberg. 2004. *Socially Responsible Investment in South Africa*. 2nd ed. Report prepared for the African Institute of Corporate Citizenship. Johannesburg, South Africa: AICC.
- Giamporcaro, S. 2006. *Socially Responsible Investment between Supply and Demand: Analysis of, and Issues in, the Social Construction of Political Saving*. PhD diss., Department of Sociology, Paris V (University René Descartes-La Sorbonne).
- . 2009. *How Can Innovative Financial Tools Be Applied to Facilitate an Environmentally Responsible Growth in South Africa? Drawing Lessons from Local and International Experiences in the Application of Responsible Investment Approaches*. Paper presented at the Oikos-PRI Young Scholar Academy 2009, “Responsible Investment: Integration, Engagement, and Transparency,” Gais, Switzerland, February 8–13, 2009.
- Haig, B.D. 1995. *Grounded Theory as Scientific Method*. Champaign, IL, USA: University of Illinois Press, Philosophy of Education Society.

- Hansa, A.M. 2007. Dimensions of Sustainability. *Journal of Engineering for Sustainable Development: Energy, Environment, and Health* 2(1): 47–57.
- Heese, K. 2005. The Development of Socially Responsible Investment in South Africa: Experience and Evolution of SRI in Global Markets. *Development Southern Africa* 22(5): 729–39.
- Hoggett, J., and M. Nahan. 2002. Ethical Investment: Deconstructing the Myth. *IPA Review* 54(3): 1–6.
- Hunter, R. 2007. Pension Fund Legislation in South Africa. Unpublished article.
- Jankowicz, A.D. 2005. *Business Research Projects*. 4th ed. London: Thomson Learning.
- Lamore, R., T. Link, and T. Blackmond. 2006. Renewing People and Places: Institutional Investment Policies That Enhance Social Capital and Improve the Built Environment of Distressed Communities. *Journal of Urban Affairs* 28(5): 429–42.
- Locke, K. 2001. *Grounded Theory in Management Research*. London: Sage Publications.
- McNulty, A. 2009. Threats of Lower Returns. *Financial Mail*, May 8, 2009.
- Munshi, R. 2009. Responsible Investments Bringing Social Returns. *Financial Mail*, July 24, 2009.
- Noah FI (Noah Finance Initiative), UNEP-FI (United Nations Environment Program Finance Initiative), and UNISA CCC (UNISA Centre for Corporate Citizenship). 2007. *The State of Responsible Investment in South Africa*. Geneva: UNEP-FI, Noah-FI, and UNISA CCC.
http://www.unepfi.org/fileadmin/documents/The_State_of_Responsible_Investment_01.pdf. Accessed June 2010.
- Rainelli-Le Montagner, H., and I. Huault. 2010, forthcoming. *A Market for Weather Risk? Worlds in Conflict and Compromising*. *Organization Studies*.
- Salgado, Ingi. 2009. Mergence argues for a greater environmental disclosure in SA. *Business Report*, online edition, May 7, 2009.
- Sonnenberg, D., and R. Hamann. 2006. The JSE Socially Responsible Investment Index and the State of Sustainability Reporting in South Africa. *Development Southern Africa* 23(2): 305–320.

- Sparkes, R., and C. Conton. 2005. Investing in Socially Responsible Companies Is a Must for Public Pension Funds Because There Is No Better Alternative. *Journal of Business Ethics* 56(2): 99–129.
- UNPRI.com. The Principles. <http://www.unpri.org/principles/>. Accessed June 2010.
- UNPRI and Government Employee Pension Fund. 2009. Investors hail “landmark moment” for responsible investment in South Africa. May 21, 2009. Joint press release. http://www.unpri.org/files/SA_network_final.pdf. Accessed June 2010.
- Viviers, S. 2007. A Critical Assessment of Socially Responsible Investment in South Africa. PhD diss., Department of Economics, Nelson Mandela University, Port Elizabeth, South Africa.
- Viviers, S., J. Bosch, E. Smit, and A. Buijs. 2009. Responsible Investing in South Africa. *Investment Analysts Journal* 69: 3–16.
- Wildsmith, H. 2008. South Africa’s Largest Public Sector Pension Funds: A Collective Development Role? *Corporate Ownership and Control* 5, no. 3 (Spring).