PRI Principles for Responsible Investment

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PRI ACADEMIC NETWORK

RI QUARTERLY

THE PRI IMPACT

IN THIS ISSUE

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The PRI Academic Network's goal is to connect academic research into practice and vice-versa. We bring academics and practitioners together, showcasing the best academic research to the investment industry, and encouraging academia to respond to the research needs of investors.

Contact: academic@unpri.org

The RI Quarterly is produced by the PRI Academic Network and aims to be the go-to publication for investment professionals and anyone needing the latest research on responsible investment, but without the time to read through the original papers. Every issue will focus on a number of academic papers around a theme selected by the PRI's Academic Network Steering Committee extracting the essentials of the argument and giving key findings in a clear and concise manner.

EDITOR: Adam Aljewicz is a communications specialist and a former financial and economic journalist and editor, most recently with Dow Jones and The Wall Street Journal in London and South Africa.

FOREWORD

BACK

There are clear signs that at long last, environmental, social and governance (ESG) factors are moving away from the fringe of financial services and firmly into the mainstream as more and more investors understand that ESG factors can be used to analyse the potential for value creation across their organisations.

When the PRI was first launched, there was limited data to demonstrate how a focus on ESG factors could benefit businesses and generate wealth for investors. But now the data is catching up and we are seeing more and more reports and thought leadership around this correlation.

The articles in this edition of the newsletter touch upon many issues that that PRI has addressed since its inception. Organisations sign up to the PRI for a number of reasons. Many want to send a message across their organisations about the value of looking at ESG factors as a way to manage risk, unlock value creation and achieve a reputational and competitive advantage. Others are responding to demand from clients—both institutional and retail investors—to have more accountability and transparency behind the investment process. Others sign up to collaborate with their peers on engagements that are meaningful to the investor community. Still others see joining PRI as a way to get their voices heard about the importance of a sustainable financial services sector for future generations.

Many hurdles remain before responsible investment truly becomes mainstream. Engagement and collaboration is key for our signatories, not just with their clients but also with policymakers, regulators and other stakeholders. By so doing, investors can use their financial muscle to try and move the responsible investment agenda forward.

We hope to reach a time when we don't need to use the phrase responsible investment because all investors will understand that what we call responsible investment is just part of sound investment practices.

Fiona Reynolds
Managing Director, *PRI*

INTRODUCTION

BACK

It is my pleasure, as Chair of the Steering Committee of the Academic Network, to introduce this issue of *RI Quarterly*. The present issue centres on a topic that is close to all of us: the PRI itself. The articles below discuss the history, challenges, members and future direction of the Principles for Responsible Investment.

I personally think of this issue as a newsletter's version of the self-portrait. Just as the best painters sometimes represent themselves on a canvas, here at the *RI Quarterly* we are devoting our pages to discuss the PRI. Wit, humbleness, and a good deal of self-reflection tend to define my favourite self-portraits. Like those, the articles we bring together offer a valuable analysis on where the PRI is at the moment, as well as its past and its future prospects.

The issue leads with an article (page 4) by James Gifford, founder and Executive Director of the PRI until 2013. I've known James for the past five years, and whenever I heard him present – whether in front of my classroom at the London School of Economics, or elsewhere – he never failed to make an original and important point. His article does not disappoint. In it, James reflects upon the biggest change we have seen in the field of responsible investment during the past ten years: the shift from ethically-oriented SRI investment to a more investor-friendly ESG approach. This is an important milestone, but as James reminds us, the task is not finished. Asset owners need to push asset managers to deepen their responsibilities as investors. Externalities need to be addressed. Time horizons need to be aligned. Investment managers must be trained in ESG. The investment consultants need to understand ESG as well. There is, in short, a lot of work that lies ahead.

Steve Lydenberg of Domini Social Investments, follows with a perceptive analysis of responsible investors (page 6). If anyone is qualified to discuss this topic, that person is Steve. I first interviewed Steve back in 2009 in the very inspiring Soho offices of Domini, and it soon became clear to me that he is one of the great pioneers in the use of mainstream tools and strategies in responsible investment. In his article, Steve introduces a novel and important idea: that there are four distinct approaches to responsible investment. For instance, one stresses norms and standards, another one emphasises ratings and research, and so forth. This is relevant to corporate managers, as it is not the same to fit with existing norms of best practice than to score highly on a rating.

The article by Jean Pascal Gond and Valeria Piani deals with a classic topic of the social sciences: collaboration (page 9). Jean Pascal, who is a good London neighbour of mine at the Cass Business School and rising star in the study of responsible investment, teamed up very effectively with the practical expertise of Valeria Piani of the PRI. The result is a cogent analysis of the challenges of collaborative engagement: the authors remind us that collaboration can be a source of strength when it comes to engaging corporations, and reflect on the ways in which the PRI has helped overcome barriers to collective action.

Daniel Beunza

The article by Arleta Majoch, Tessa Hebb and Andreas Hoepner is remarkable for employing the tools and theories of academia to discuss the PRI itself (page 11). The authors, impressed me with the rigour of their research in this past September's Academic Network conference in Montreal, so it is only right for us to convey their message in this issue. They ask a simple question: why do companies sign up to the PRI? The provocative answer they provide is that commitment to responsible investment is only one of the reasons. Many others do so for what sociologists like myself would call "symbolic reasons," that is, to improve their image in front of clients.

All in all, the four articles on this issue of the *RI Quarterly* give a sense of the PRI and responsible investment at large. As with all self-portraits, some features come out looking better than others. It is my hope that this issue will also provoke useful reflection and prompt progress in the advancement of responsible investment.

THE CHANGING ROLE OF ASSET OWNERS AND THE FUTURE OF RI

BACK

REFLECTIONS ON THE PRI – THE LAST DECADE AND THE NEXT

In this summary of a book chapter, James Gifford, the founding Executive Director (2006-2013) of the UN-supported Principles for Responsible Investment (PRI), explores whether, 10 years on, the vision of mobilising asset owners around responsible investment is being achieved. He also looks to the future of responsible investment, and the role asset owners might play in bringing about further positive change. Gifford says the first era of responsible investment, pre-2004, was primarily about values-oriented and retail-focused socially responsible investment (SRI). The second era, 2004-2014, was the environmental, social and governance (ESG) era, where these issues went from being treated as irrelevant by investors to being treated as potentially material and incorporated into mainstream investment practices. This era also brought shareholder dialogue on ESG issues into the mainstream.

Article summary written by Adam Aljewicz

AUTHOR

James Gifford

The next 10 years, Gifford says, will see yet another transition, where investors will be held more accountable for their impact on the world, in the same way that the largest corporations (sometimes) are. Here are six responsibilities that Gifford believes asset owners need to improve upon over the next decade:

1. REDUCE EXTERNALITIES

Gifford believes asset owners should push for policies and frameworks that reduce the negative consequences of their actions: pushing investee companies to set minimum standards and certifications, and supporting public policy that would result in the most efficient allocation of environmental and social resources (e.g. pollution control, emissions trading schemes).

2. ALIGN TIME HORIZONS

Pension funds often have investment horizons of many decades, while most people who directly manage this pension capital are incentivised to outperform in a year or less. As a consequence, Gifford suggests there should be a greater responsibility to ensure time horizons are aligned with investment horizons, and matched more closely with the actual liabilities of long-term asset owners. The author says this would allow greater investment in less liquid asset classes, particularly those that would help to build a low-carbon future.

3. SELECT SUITABLE INVESTMENT MANAGERS AND MONITOR THEM

The author notes that the majority of asset owners outsource most, if not all, of their investment management to external investment managers. Therefore, the most important role of a responsible asset owner is to select and monitor the right managers. While this was included as a possible action of Principle 4, and progress has been made, Gifford believes there is still a long way to go. The author says the first step is to put questions and expectations about responsible investment capability into requests for proposals that go out to investment managers, the implication being that unless you are doing something on responsible investment you will miss out on investment mandates.

The next step is to ensure that managers actually implement their responsible investment policies and report on their achievements, goals and challenges in the same way they report on their financial performance. Even for those asset owners that do set long-term, sustainable investment mandates, these intentions can quickly be undone by sending mixed signals in terms of what is important. Gifford argues that a manager's investment horizon often shrinks to fit what their client is indicating is really important to them, where instead, manager meetings should be about how the ESG strategy is driving an investment strategy that will generate long-term, sustainable returns.

4. SELECT AN INVESTMENT CONSULTANT WITH THE RIGHT SKILLS

Gifford says one of the most important roles of an investment manager is to select an investment consultant who has a deep and holistic understanding of both responsible investment approaches and mainstream investment, and can be proactive in providing more sustainable investment solutions across asset classes.
The author believes the majority of

mainstream investment consultants lack any understanding of responsible investment, and don't see it as their role to show any leadership in this area. While there are ESG specialists in most large investment consultancy firms, Gifford says they are primarily servicing those clients who specifically ask for them.

5. SEEK POSITIVE IMPACT ON SOCIETY AND THE ENVIRONMENT

Gifford says progress on the PRI's two core pillars of ESG incorporation and active ownership have been made, but these two pillars are not enough. The author says a third pillar was originally mooted but didn't make the final cut, and should now be addressed: proactively allocating capital to make a positive impact on society and the environment. The author argues that capital needs to shift towards cleaner and more sustainable and impactful enterprises at scale, particularly those that are solving major global challenges such as climate change; water scarcity; sustainable agriculture and fisheries; deforestation and poverty. Gifford believes asset owners have a responsibility to be much more proactive in seeking out investments that deliver both market-rate, risk-adjusted returns and a positive impact to this century's big challenges.

6. ACT IN THE BEST INTERESTS OF CLIENTS AND MEMBERS

The author claims it is becoming clear that the finance sector primarily exists to serve itself, rather than to efficiently allocate capital to productive enterprises, while people are realising that their savings are being invested in ways that are not representing their interests.

Gifford believes the explosion in the use of smartphone technology and internet access in developing countries means that unethical or exploitative corporate practices have a greater chance of being exposed more than ever before. This transparency will shine a spotlight on who owns what, and hold asset owners to account more than ever for the actions of the companies in their portfolio.

Gifford contends that asset owners have been shielded from the types of campaigning that large corporations have faced for 25 years. They are often at least two steps removed from the actual negative impacts of corporate behaviour on the ground, and so it is easier to campaign directly against a company rather than a group of investors who may own less than one per cent of its shares. However, that is changing. The activities of NGOs such as ShareAction, and the continued shareholder activist work of groups such as The Wilderness Society, will only increase.

CONCLUSION

The author asserts there is also a large upside in moving in this direction. He believes asset owners will have the opportunity to be proactive and demonstrate that their investments are actually supporting ethical and sustainable enterprises, while protecting the environment.
He also suggests they will be able to pick and choose among hundreds of commercially-attractive sustainable investments, and be able to proudly tell their members and beneficiaries that they are helping to build the type of world their members want to retire into. As this happens, Gifford believes asset owner institutions will recognise that they do indeed have responsibilities beyond maximising returns, and that investing in ways that also enhance and protect human and environmental values is simply the way things will be done.

James Gifford, Senior Research Fellow at the Initiative for Responsible Investment, Harvard Kennedy School.
The Changing Role of Asset Owners in Responsible Investment: Reflections on the Principles for Responsible Investment – the last decade and the next.

RESPONSIBLE INVESTORS: WHO ARE THEY, WHAT THEY WANT

BACK

AUTHOR

Steve Lydenberg

Responsible investors, such as the asset owners and money managers who have committed themselves to the Principles for Responsible Investment, are; long-term in their goals and loyal to the companies they choose to invest in. Their interest in a broad range of corporate policies and practices – including environmental, social and governance (ESG) – means that they are well-informed about the strategic directions, business models, and corporate cultures of their holdings. Corporations seeking to attract well-informed, long-term investors should therefore want to seek them out, and attract and retain them.

Article summary written by Adam Aljewicz

So what types of ESG initiatives do they expect corporate managers to create, monitor, and report on, and will companies whose managers invest in such initiatives be rewarded in the marketplace? These are the kinds of questions this paper seeks to answer.

RESPONSIBLE INVESTMENT MODELS

Lydenberg identifies four distinct approaches investors typically use to frame responsible investment:

- norms and standards
- ratings and rankings
- integration with stock valuation
- alignment of business models and societal goals

In practice, according to the author, these four models are not always clearly distinguishable (norms and standards are implicit in ratings and rankings, while business models have implications for stock valuation), but each differs in its primary emphasis and is likely to lead corporate managers towards different approaches to their ESG plans, policies, practices, and communications, to emphasise different strategies and tactics. In addition, managers' understanding of these different investment approaches can lead them to formulate and target their communications differently.

CORPORATE APPROACHES TO ESG

To clarify how corporations' approaches to environmental, social and governance (ESG) issues can correspond to responsible investors' models, the author outlines several different approaches that corporate managers adopt as they implement ESG programmes:

ENRICHING STAKEHOLDER RELATIONS

Managers who believe that investing in their stakeholders – including employees, consumers, communities, suppliers and regulators, and the environment – will strengthen their company and help generate long-term financial rewards by addressing the full range of ESG issues for each stakeholder group.

This approach covers the broadest range of issues and stakeholders, but runs the risk of spreading corporate resources thin or giving equal weight to issues of varying importance. It can also fail to place sufficient emphasis on disparities between companies' underlying business models and social goals. This approach is likely to be attractive to investors who favour the norms/standards or ratings/rankings approaches to ESG.

DEVELOPING SHARED VALUE BUSINESS MODELS

Managers here focus on the core business model of the company, as opposed to stakeholder relations. The author says this approach presents opportunities to create shared value by applying business models that are both profitable for the corporation and address an unmet social or environmental need. The challenges of developing profitable business models that accomplish this goal, however, can be substantial and often involve high-risk undertakings.

For example, creating a network of small entrepreneurs in developing markets to sell consumer products, typically distributed in mass quantities through major outlets, involves a substantial commitment of corporate resources.

This approach finds particular favour with impact investors who look to the development of business models aligned with unmet societal needs and those incorporating social and environmental considerations into fundamental stock valuation.

ADDRESSING INDUSTRY-SPECIFIC MATERIALITY KEY PERFORMANCE INDICATORS

Managers here recognise that their ESG reputations will not be helped unless those ESG issues most material to their success are addressed. That means identifying the issues that have the most relevance to their specific industry pose the greatest sustainability challenges or which offer the greatest opportunities - and then focusing on them.

For example, pharmaceutical companies are likely to focus on such issues as product safety and long-term affordability; fossil fuel companies are likely to focus on climate change and alternative energy; and information technology companies are likely to focus on privacy, censorship and the digital divide, where in some regions of the developing world access to technology is currently underserved. This approach is particularly well suited to investors who seek to integrate ESG factors into stock valuations. This approach, however, can appear to give weight to ESG considerations only when they relate to the over or undervaluing of company stocks at a given moment in the markets.

Lydenberg notes that these three approaches need not be mutually exclusive, but they cannot all be given equal weight. An emphasis on stakeholders can spill over into core business models and vice versa, but when making strategic management decisions, one or the other is likely to predominate. Industry-specific sustainability issues can encompass both stakeholder issues and business model challenges, but will not be all-encompassing.

The clearer companies are about which model predominates, the easier it will be for them to communicate effectively with responsible investors and to identify those investors most likely to be aligned with their approach.

FOUR TYPES OF CORPORATE ESG IMPLEMENTATION

Once managers have decided which ESG approach to emphasise, they will then decide how best to incorporate it into daily practice. The challenges of systematic incorporation are virtually identical for whichever ESG model and investor type a company chooses to focus on. Incorporation essentially requires four steps or stages, during each of which managers must decide the extent of the commitments they are willing to make as they set about incorporating ESG concerns into their daily operations.

STRATEGIC PLANNING

ESG commitments need to be driven into corporate cultures and, in certain cases, into core business models. This ultimately requires incorporating ESG into strategic management planning and integrating what are often thought of as two separate considerations - finance and sustainability.

POLICIES AND GOALS

Policies serve as a necessary guide for creating coherent, consistent goal-setting and action, and they help drive ESG into the corporate culture.

PRACTICES

The company needs to allocate the time and resources necessary to institute these programmes thoroughly and effectively. Responsible investors, like any other investors, are interested in results: unless a company is able to demonstrate concrete progress on material issues, it will not be perceived as having achieved anything more than greenwashing. Consistency in long-term commitments to practical implementation is essential for the realisation of the value of these investments. Without this consistency, investment may be made randomly, changing management's focus from year to year, and failing to succeed in any one area.

COMMUNICATIONS

Finally, once ESG initiatives have been integrated and implemented, management will confront the question of how much of which kinds of data to report in what form and what resources to devote to communications more generally.

REPORTING

Which kind of reporting management chooses will differ partly based on which approach to ESG has been chosen:

ENRICHING STAKEHOLDER RELATIONS

If management has chosen to emphasise investments in stakeholder relations, it may want to report according to the Global Reporting Initiative (GRI) guidelines. Over the years, the GRI has engaged in a comprehensive multi-stakeholder consultation process to develop a widely accepted set of stakeholder-specific indicators. Reporting according to guidelines from the GRI, RobecoSAM, or similar organisations that stress a stakeholder-centred model, can provide credible and easily accessible frameworks for reporting.

DEVELOPING SHARED VALUE BUSINESS MODELS

If management has chosen to emphasise shared value, it may want to look to models for reporting provided by the impact investment community, such as those developed by the Global Impact Investment Rating Service (GIIRS) and the Impact Reporting and Investment Standards (IRIS). These models stress, as well as earning competitive returns on capital: the positive social and environmental impacts of the company's business model; the creation of high-quality jobs and services for underserved populations; solutions to social and environmental challenges.

ADDRESSING INDUSTRY-SPECIFIC MATERIALITY KEY PERFORMANCE INDICATORS

If management has chosen to focus on addressing the most material social and environmental key performance indicators, it may want to focus its in-depth reporting on industry-specific key performance indicators (KPIs), such as those currently being developed by the Sustainability Accounting Standards Board, the German Federal Ministry of Finance, and others.

One unresolved question is how to integrate ESG and financial data into corporate reporting. The International Integrated Reporting Council (IIRC) is currently studying how this integration might take place most productively. Given stock exchanges' interest in creating responsible investment indices and encouraging ESG disclosure through their listing standards, a movement towards compulsory integration of ESG and financial data appears well established.

INVESTOR ENGAGEMENT

As interest in the ESG aspects of corporate activities grows, responsible investors increasingly place demands on management's time to discuss and, in some cases, alter their ESG policies and practices. Investors may seek dialogue or propose stockowner resolutions, and approach companies singly or in coalitions.

THE REWARDS OF CORPORATE INVESTMENT IN ESG

Lydenberg notes that, when ESG programmes demonstrably reduce operational costs, produce efficiency gains, or otherwise have financial paybacks over reasonable time periods, managers need look no further than their bottom line to justify further investment in ESG, but that the business case for corporate social responsibility and sustainability is not always so straightforward.

The business case often depends on rewards that involve a complex mixture of tangible and intangible benefits such as enhanced reputation for quality management, increased customer loyalty, lower employee turnover, avoidance of legal liabilities or regulatory lawsuits, decreased criticism in the media and from corporate watchdogs, or early warnings about emerging social and environmental concerns. While often difficult to quantify, these intangible benefits, may well result in a higher price/earnings multiple for the company's stock.

CONCLUSION

Responsible investors – whether they focus on norms and standards, ratings and rankings, stock valuation, or business-model impacts – share an underlying concern about the sustainability of our ecological and economic systems as the world approaches a population of nine billion, and where natural resources become increasingly scarce and social inequality increasingly visible. To address these broad concerns, responsible investors look for ESG initiatives that not only reward companies directly, but also create positive externalities that benefit all. A short-term, company-specific focus can fail to capture these positive externalities.

Corporations seeking a receptive and loyal base within the responsible investment community can benefit from understanding the growing interest in these environmental, social, and governance concerns.

Steve Lydenberg, Domini Social Investments LLC;
Responsible Investors: Who Are They, What They Want
Click here to view the paper in The Journal of Applied Corporate Finance

ENABLING INSTITUTIONAL INVESTORS' COLLECTIVE ACTION: THE ROLE OF PRI

BACK

Corporate executives often struggle to focus their attention on every issue at the same time, so must prioritise the claims of the most important stakeholders. This paper explores how institutional investors can act collectively to enhance their importance in the eyes of investee company managers, in order to influence corporate behaviour on environmental, social and governance (ESG) issues. It also examines the role of enabling organisations such as the PRI, in facilitating this process through helping to overcome barriers to collective action by providing a framework for investors to work with one another. In doing so, Gond and Piani show that organisations such as the PRI can facilitate the emergence, deployment, and maintenance of collaborative actions.

Article summary written by Adam Aljewicz

AUTHORS

Jean-Pascal Gond

Valeria Piani

ANALYSIS

Gond and Piani examine how institutional investors use power, legitimacy and urgency to influence corporate behaviour on ESG issues. They explore the processes whereby institutional investors reshape executives' perception of both institutional investors and ESG issues and explain how an enabling organisation can facilitate, enhance and maintain these processes.

Power is the ability to influence or control the behaviour of individuals and organisations and defined as including:

- *coercive dimensions* that point towards the physical resources of force or restraint
- *utilitarian dimensions* that reflect the mobilisation of material or financial resources
- *normative dimensions* that correspond to the use of symbolic resources such as prestige and esteem to obtain compliance from other parties

Legitimacy is whether actions are appropriate within current systems of norms, values, beliefs, and definitions.

Urgency is whether the claim on ESG issues is perceived as requiring immediate action.

The research took account of the barriers to individual and collective action, such as free-riding behaviors from participants, and looked at the multiple roles of enabling organisations to overcome these challenges and support the collaborative engagement process. The study looked at on three case studies of investor collaboration around ESG issues, derived from posts in the PRI Clearinghouse, a signatory-led platform that is designed to encourage information sharing and collaborative engagement between investors, investee companies and policymakers.

The case studies involved investor concerns over: human rights violations in conflict zones; allegations of abusive labour practices in the iron and steel industry supply chain; corruption

3
case studies

109
investors

18.4
trillion USD assets under management

and transparency. Cumulatively, the three scenarios involved 109 investors with US$18.4 trillion of assets under management (AUM) and targeted 168 companies. Interviews were conducted in the United Kingdom, the Netherlands, New Zealand and Norway, covering asset owners/managers and mainstream and niche socially responsible investment (SRI) funds with a diverse range of AUM. The authors use archive analysis, observation, interviews and document analysis of all communications between individual investors, the collective group and the investee companies in an attempt to map and theorise the processes underlying the relationships between investors and investees, and capture the investors' experience of collaboration.

RESULTS

The research found that coalitions should not try to build all three of the power, legitimacy and urgency attributes at once, and instead recommends building the legitimacy of the group, then demonstrating its power, and finally impressing a sense of urgency and its requests by:

LEGITIMACY

- Share information on target companies or the ESG issue with other participants.
- Define and communicate to companies the business case.
- Refer to international conventions, codes and civil society reports.
- Benchmark companies on ESG issues and, if targeting laggards, refer to the best practices of their industry leaders.
- Include large mainstream investors in any coalition.

POWER

- Investors should assert themselves in early dialogue by stressing the total amount of assets under management or shareholding in the target company, and possibly publish company ESG benchmarks.
- However, the research recommends that exhibitions of collective power such as divestments, shareholder resolutions and proxy voting or other ultimatums should only be considered if companies fail to respond or perform as agreed. (Feedback showed that the "threat of action was more powerful than the action itself").

But a consistent build-up of trust over time also proves a strong tool to building influence.

URGENCY

Our findings also show that investors can collectively create a feeling of urgency on the investees' side by carefully managing the time-pressure through the use of strict deadlines for demonstrating progress or change in relation to the ESG issues at hand.

THE ROLE OF ENABLING ORGANISATIONS

The research also looked at the role of the PRI and found strong evidence that the involvement of an enabling organisation has a positive effect. It does this in the following ways:

FACILITATING EMERGENCE:

- Triggering the initiative on an issue – the PRI started a collaboration project after receiving strong demand for assistance from signatory investors.
- Offering mobilising structures – the existence of the Clearinghouse platform enabled investors with concerns on a particular issue to find like-minded investors and elaborate a common position.
- Reducing the incentive for firms to let another investor carry the burden of effort on behalf of the group – the PRI's secretariat assuming a co-ordination role can prevent a burden bias.
- Providing a structure that bears co-ordination costs – the PRI involvement reduced the co-ordination costs for investors involved in the collective action.

SUPPORTING DEPLOYMENT:

- The PRI's collective engagement framework gives investors a context to exert their influence.
- Enhancing the processes of investors' influence – evidence that the ability of the collective to use the symbolic PRI/United Nations name in negotiations enhanced their level of influence and made it "difficult, if not impossible" for corporations to ignore them, and that the PRI's involvement and "constant support" was seen as crucial in keeping up pressure, urgency and persistence.

MAINTAINING CONDITIONS:

Creating opportunities for dialogue with corporations - the PRI is better able to maintain conditions for constructive dialogue with companies rather than individual investors, especially as dialogue can typically take place over a number of months or even years.

CONCLUSIONS

Constructive dialogue between investors and investee companies requires time, knowledge and financial resources. Collaborating with peer institutions can divide the workload, share costs, prevent duplication of effort and give more weight to investor demands by increasing their power, legitimacy and urgency. Successful collaborations approach these three attributes in a staggered way, first by asserting the credentials of the coalition and not rushing to issuing ultimatums. In forming investor collective actions, the use of an enabling organisation, such as the PRI, can greatly improve the experience of the group members, enable them to apply greater pressure on company managers and lead to more successful actions. Therefore, the PRI initiative not only acts as a set of useful principles for investors but also as a catalyst for collective action.

The implications of the research are not limited to the contexts of the PRI secretariat and its Clearinghouse platform. By uncovering the mechanisms that support collective action, the findings can enhance collective action in other areas, such as for the United Nations Global Compact (UNGC), and fights against corruption, such as in Egypt or India.

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Jean-Pascal Gond and Valeria Piani

Enabling Institutional Investors' Collective Action: The Role of PRI Initiative

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SOURCES OF STAKEHOLDER SALIENCE IN THE RI MOVEMENT:

BACK

WHY DO INVESTORS SIGN THE PRINCIPLES FOR RESPONSIBLE INVESTMENT?

AUTHORS

Arleta Majoch

Andreas Hoepner

Tessa Hebb

Signing **the six Principles for Responsible Investment (PRI)** expresses commitment to becoming a responsible investor, but beyond that it means different things to different organisations. Some have only just made the decision to move towards more responsible investing, while others are already integrating environmental, social and governance (ESG) issues into every asset class. In this empirical paper, Majoch et al. examine the stakeholder relationship between the PRI and investor signatories, how it has changed over time, and how it varies between different types of investor. The findings highlight pragmatic legitimacy, organisational legitimacy, power attributes and management values as the factors having the most impact on why investors sign up to the PRI.

Article summary written by Adam Aljewicz

The picture that emerges is of a responsible investment community that sees the Principles for Responsible Investment as a path to improving their image, their standing with existing and future clients, and their investment strategy.

ANALYSIS

Using internal proprietary data covering the first five years of the PRI between 2006 and 2011, and collected directly from United Nations supported Principles for Responsible Investment's (PRI) signatories, the authors examine the attributes of the stakeholder relationship between investment organisations and the PRI.

The analysis is carried out in the framework of Mitchell's et al. (1997) theory of stakeholder salience, which defines stakeholder salience as the priority given by company managers to stakeholder claims, and its development by Gifford (2010).

The findings highlight pragmatic legitimacy, organisational legitimacy, power attributes and management values as the factors having the most impact for investors. Using responses from the annual Reporting and Assessment (R&A) Framework of PRI signatories, to determine which factors held more sway at the point of signing, and whether that had changed during the key five-year period at the beginning of the PRI's history: 2006-2011. The different types of power that factor most heavily include:

- **Normative power:** The perception that joining the PRI will have reputational or branding benefits, or be a way of signalling to clients that the organisation takes ESG issues seriously. Using normative power is linked to symbolic resources, such as media attention or reputation.
- **Utilitarian power:** Pursuing financial interest, for instance, by answering the rising demand of the market for responsible investment by fulfilling the expectations of existing or future clients.

Legitimacy is a perception that the actions of an entity are proper or appropriate within the values of society. In this study, the authors identify two different types of legitimacy which figure more heavily for investors:

- **Organisational:** The PRI is perceived as a legitimate organisation and therefore signing grants legitimacy, by association, to the organisation and is seen as a licence to operate.
- **Pragmatic:** the signatory perceives there is a business case for ESG integration and views the PRI as a useful framework for information, opportunities and support in integrating ESG into investment as a performance enhancing strategy.

Management values refer to the values of the managers in the companies and institutions involved in the survey being aligned with those represented by the PRI.

NORMATIVE AND UTILITARIAN POWER

The chart below shows the proportion of asset owners versus investment managers that indicated utilitarian and normative power as sources of salience in the decision to sign up to the PRI.

In recent years, an important motivation for signing has been normative power, which highlights how reputation and brand management is a key factor for investment firms. This has grown from the key signing motivation for 3% of sample firms in 2006 (of almost 100 respondents) to 47% in 2011 (with over 450 respondents).

Mainstream investment managers and corporate pension funds were more influenced by normative power than their Socially Responsible Investment (SRI) and public counterparts. In 2011, 40% of corporate pension funds and 21% of mainstream investment managers cited reputation and cited reputational benefits in their response, compared with just 18% of public pension funds and 11% of SRI managers. The desire to win and retain business from new and existing clients (utilitarian power) saw a similar spike, rising from 1% in 2007 to 32% in 2011. This trend was more pronounced in asset managers than asset owners, as prospective clients are increasingly quizzing investment managers on their ESG credentials.

ORGANISATIONAL AND PRAGMATIC LEGITIMACY

Another key motivator is the perceived high legitimacy of the PRI as an initiative and the view that the PRI bestows this legitimacy on those that sign up to it. A common thread from respondents was that they benefit from the credibility of the PRI within the investment community and with the companies they engage with. This view has been more common among investment managers than asset owners, and is more of a motivation among public pension funds than their corporate counterparts.

In the early stages of the PRI, many signatories joined because they believed their management values were already aligned with the principles. However, between 2009 and 2010, there was a sharp rise in organisations signing up out of pragmatic legitimacy in order to access the know-how, best practice, research and trends the PRI framework provides.

Responses from the signatories illustrate this. For instance, a French asset manager is quoted as saying:

The PRI provides an ambitious roadmap for continuous improvement with clear signposts and long-term objectives. Our organisation has managed, through its involvement in the past year, to move towards greater ESG integration more broadly (additional asset classes) and more deeply (from SRI to mainstream) (PRI R&A Framework responses, 2011)

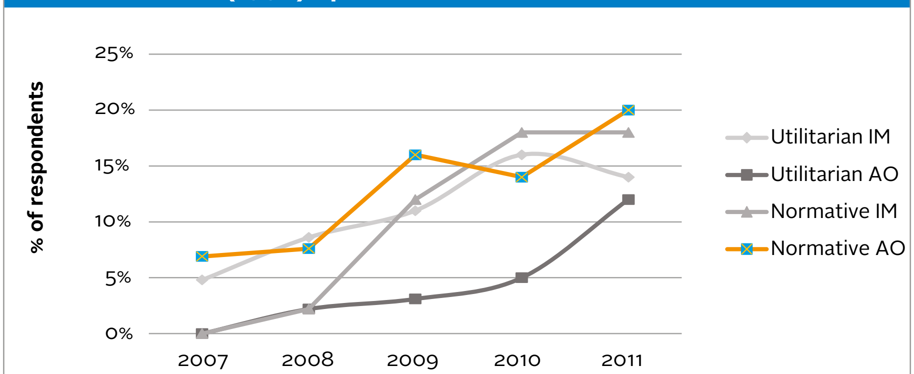
Meanwhile, a Brazilian investment manager describes the PRI as follows:

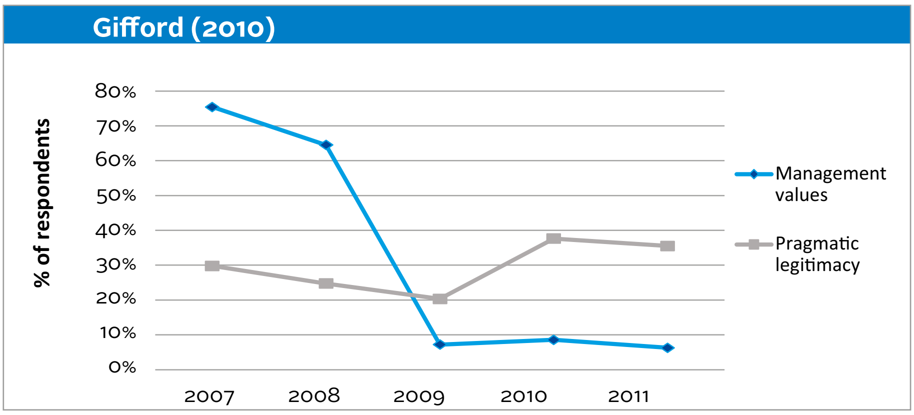
We have found a framework that accommodated our pre-signing beliefs related to ESG issues and value creation, and helped us organise or re-shape our internal analysis processes around the principles. (PRI R&A Framework responses, 2011)

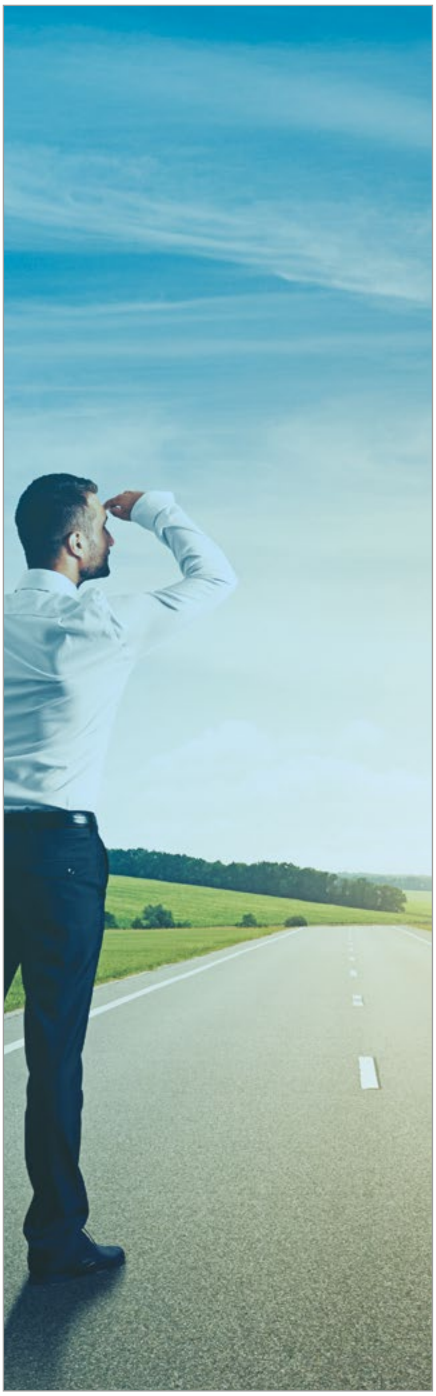
While support for pragmatic legitimacy was strong and slightly growing over the sample period, management values were mentioned by an overwhelming number of signatories in the first years of the sample period but that number was reduced greatly in the subsequent years, barely reaching 10%.

The rise in pragmatic legitimacy was predominantly driven by investment managers. Historically, it was more of a motivational factor among dedicated SRI managers than

Mitchell et al. (1997) - power attributes







mainstream investment managers – but this trend was reversed in 2010 as mainstream managers, not just their SRI counterparts, started to appreciate the pragmatic value of responsible investment, and the PRI.

As companies transition towards an ESG-integrated investment strategy, they see the PRI as a learning tool via webinars, discussions with other investors, implementation support, engagements and the PRI's research outputs.

CONCLUSION

Whilst a limitation of the research is that data was self-reported, these findings offer an interesting insight into how both the investment industry and the PRI's place in it have changed over the last decade.

The amount of responses that cite client approval and integration support as drivers for joining the PRI indicate that ESG is increasingly considered material, and is on the way to becoming mainstream. The research draws attention to how signing the Principles has been increasingly motivated by the business case for ESG integration and the opportunities ESG creates.

The authors suggest this can be seen in the replacement of the dominance of management values with the rise of factors such as utilitarian and normative power, organisational legitimacy and pragmatic legitimacy.

It gives reason to conclude that the PRI is succeeding in convincing the financial markets of the validity of ESG-integration as an investment approach, and it highlights that ESG investing is a continually developing space where investors are keen to join forces in acting, sharing knowledge and exploring ESG themes and strategies. The high degree of salience coming from a variety of sources confirms the PRI's role as central in this emerging logic.

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Arleta A. Majoch, Andreas G.F. Hoepner and Tessa Hebb

Sources of Stakeholder Salience in the Responsible Investment Movement: Why do investors sign the Principles for Responsible Investment?

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Call for Applications

oikos PRI Young Scholars Finance Academy 2015

in collaboration with The Henley Centre for Governance, Accountability and Responsible Investment (GARI)

Responsible Investing Barriers, Incentives and Building Blocks

31 May - 4 June 2015, Reading, UK

The academy provides a unique platform for exceptional PhD and post-doctoral students in the field of finance and sustainability to advance their research and expand their international research relations. Participants will benefit from presenting and discussing their work in progress with leading academics and professionals who will provide feedback and share advice about academic career and personal development. The event also includes a paper development workshop, a professional development roundtable, guest speeches and recreational outdoor excursions.

RESPONSIBLE INVESTING – BARRIERS, INCENTIVES AND BUILDING BLOCKS

Long-term investment considering environmental, social, and governance (ESG) factors has been on the radar screen of financial markets for many years. Assets in ESG-driven portfolios have grown significantly and, according to the Global Sustainable Investment Alliance reached 13.6 trillion US Dollars in 2012. At the same time, many private and institutional investors as well as asset managers have not yet embraced the concept of ESG integration. What are the barriers that keep them from moving in this direction? How could incentives be changed to increase the momentum? And what are the building blocks that drive market expansion?

To answer these and further questions, we invite papers on all stages of the responsible investment process, including, but not limited to the following topics:

1) Corporate governance and incentives for responsible investment
2) The role of company reporting for responsible investment
3) ESG integration in the portfolio construction
4) Institutional investors and shareholder engagement
5) The role of beneficiaries and intermediaries in the investment process

FURTHER INFORMATION

You can find further information on www.oikos-international.org/financeacademy

APPLICATION AND TIMELINE

Applications can be sent via email to: finance@oikos-international.org.

THE DEADLINE HAS BEEN EXTENDED TO **FEBRUARY 15, 2015.**

PRI in **Person**

London 2015

8-10 September, ICC ExCeL

We are delighted to announce that the Academic Network Conference will be part of PRI in Person for the first time with a full stream dedicated to academic research, enabling the interface between academics and investors to engage, learn and discuss the latest insights, and to network. PRI will also be holding an academic workshop, kindly hosted at the London School of Economics on 11 September. Both events will showcase research from PRI's call for papers.

PRI CALL FOR PAPERS

AWARENESS TO IMPACT: MECHANISMS OF CHANGE IN RESPONSIBLE INVESTMENT

Moving from awareness to impact is the theme this year, focusing on mechanisms that affect change and exert influence within organisations and in financial markets. We invite papers that focus on:

ESG INTEGRATION
- How does integration present itself to an organisation?
- What are the signals across the chain that help integration?
- How are ideas disseminated to change cultures and become actions?

LONG TERMISM AND OTHER INVESTMENT BIASES
- Market issues and structural inefficiencies - how can the bar be raised for the investment community as a whole rather than being focused on picking winners?

ESG ENGAGEMENT
- What approach works best for engagement, individual or collaborative?
- What are the barriers to acting in concert and how can they be addressed?

PERFORMANCE
- How is high performance achieved?
- How do organisations do well in responsible investment for their beneficiaries and other stakeholders?

The application processes will be available by the end of February 2015.

> Financial markets continue to function in ways that do not always serve investors – or society – over the longer term. The misalignment of interests and incentives, a general loss of trust in financial institutions and the ongoing allocation of capital to businesses that may prove unsustainable over the longer term continues to undermine value creation for asset owners and their ultimate beneficiaries... These market failures and inefficiencies cannot be addressed by investors or institutions acting alone.
>
> Martin Skancke Chair, PRI Advisory Council

For More Information www.unpri.org/london

The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP Finance Initiative
Changing finance, financing change

UN Global Compact

Launched in 2000, the United Nations Global Compact is a both a policy platform and a practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with 10 universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact