Envisioning Socially Responsible Investing

A Model for 2006 *

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Within the past five years, socially responsible investing (SRI) along with the related discipline of corporate social responsibility (CSR) have attracted worldwide attention. The strong momentum behind these two movements implies that they will soon work their way into the mainstream of the financial and corporate worlds. Much needs to happen, however, before they are fully integrated. This paper envisions major SRI and CSR initiatives that may well take place within the next five years in three communities: the corporate community (increased attention to mission, stakeholders and disclosure), institutional investors (increased responsibility for voting, public disclosure of social investment policies and increased intra-industry dialogue on social and corporate governance issues) and the financial community, including its academic and SRI analogues (increased attention to education, training and the professionalisation of the SRI and CSR disciplines). Looking ahead to the potential outcomes of these initiatives will help in assessing their usefulness and in allocating the resources necessary to implement them.

- Socially responsible investing
- Corporate social responsibility
- Institutional investors
- Stakeholders
- Disclosure
- Corporate governance

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After three decades of labouring to win recognition and acceptance, socially responsible investing (SRI) now stands at a crucial juncture. It has emerged from what was essentially an obscure niche financial market to become a potentially important player in a major political debate about globalisation, the relationship between corporations and society, and the role of capital in creating both social and financial value. However, if it is to realise its potential to influence corporate behaviour towards the creation of a just and sustainable society, it will need to capture the gains it has already made and realise new initiatives that will bring about meaningful change.

Increased influence

Among the indicators of the increased importance and influence of SRI are:

- The recent development of models for comprehensive, standardised disclosure of corporate data on social and environmental issues[1]
- Increased promulgation by transnational and quasi-governmental organisations of corporate codes of conduct to promote increased social and environmental responsibility[2]
- The current participation of national governments in the development of socially screened financial or consumer-oriented products[3]
- SRI pilot programmes by several of the largest pension funds in the world[4]

These developments were all but unimaginable 20 years ago when SRI was chiefly a means for church groups to avoid investing in certain industries they considered objectionable.

The debate

The vocabulary of SRI and of the allied field of corporate social responsibility (CSR) has now entered the ongoing debate about the proper form and role of global capitalism. This debate, now raging throughout the world, raises such crucial questions as:

- Can corporations' potential to do good—provide food, clothing, entertainment and employment in a world whose population will reach 8–11 billion by the middle of this century—be realised?

1 The Global Reporting Initiative is the foremost proponent of such standards. Other recent indications of the momentum behind these initiatives are the proposal by the French government for disclosure standards for environmental and employee relations indicators in corporate annual reports and the call by the Association of British Insurers for publicly traded companies to disclose regularly their external social, ethical and environmental risks and their policies for managing those risks.

2 Among these codes are such varied efforts as the United Nations Global Compact, the Global Sullivan Principles initiated by the Reverend Leon Sullivan, the Organisation for Economic Co-operation and Development's Corporate Governance Principles, and the International Chamber of Commerce's Business Charter for Sustainable Development.

3 In 2000, Norway established an environmentally screened pool of assets as a pilot project for its huge Petroleum Fund.

4 In 2002, the California Public Employees Retirement System (CAL/PERS) began applying a labour-standards screen to countries included in its emerging markets portfolio. Since 1999, the two largest pension funds in the Netherlands, ABP and PGGM, have separately inaugurated programmes to apply environmental or other social screens to a portion of their assets.

- Can corporations' potential to do harm—pillage natural resources, exploit the defenceless poor, create inequitable disparities in wealth and destroy local cultures—be tamed?
- Can the for-profit goals of transnational corporations be reconciled with the social objectives of national governments?

The stakes in this debate are high. With the collapse of the Soviet Union and other state-controlled economies, the world has placed an increasingly large bet on the marketplace to provide economic solutions to social problems. Advocates of free-market economies have argued that unfettered corporations can provide solutions to these problems. However, if the workings of the free market fail to address (or even exacerbate) the severe challenges of worldwide poverty and environmental degradation, a substantial risk exists of a major backlash not only against the corporations themselves but also against those governments that allowed them free sway.

Foreseeing complicated and challenging scenarios in the first half of the 21st century, governments and corporations are increasingly turning to the SRI and CSR communities to see if they can contribute to this debate. How meaningfully SRI and CSR will be able to contribute to this debate remains to be seen. Both are, in many senses, experiments. CSR can be viewed as implying a fundamentally changed conception of the corporation, with multiple stakeholders, not just stockowners, benefiting from its profit-generating capabilities.[5] On one level at least, SRI entails an alternative conception of the marketplace as an arbiter of social goods.[6] As with all experiments, there is no guarantee that these efforts are properly conceived or that they will be effectively executed.

The next five years

Over the past three decades, SRI has learned much about researching the social and environmental records of publicly traded corporations and influencing their behaviour. But, if this discipline is to influence business and governmental agendas, its advocates will need to articulate how it can become fully integrated into the financial and corporate communities.

SRI can help to bring about substantial changes over the next five years in three important arenas:

- Corporations
- Institutional investors
- Financial, academic and SRI communities

To realise its potential for effectiveness, however, these changes must take place soon. The growing disparity between the rich and the poor of the world and the increasingly worldwide scope of environmental crises mean that solutions to these problems, if they

5 The concept of incorporating social responsibility into the obligations of corporations has been long criticised by free-market economists. Milton Friedman, for example, termed it a 'collectivist doctrine' that implies that 'collectivist ends can be attained without collectivist means' (Friedman 1970, as cited in Waddock 2002: 10).

6 The question of what it means to use the marketplace to achieve social ends leads to a complicated and multifaceted debate. Practically, it can lead to initiatives such as the current use of the marketplace to tackle the acid rain and climate change challenges through trading pollution and greenhouse gas emission credits. Theoretically, it can lead to assertions such as those of George Soros (2000: 118), who contends that 'Social justice is outside the competence of the market economy'. This debate will be an important one in the coming years.

can be found, will not wait long. If SRI is to play a substantive role in addressing such problems, it must articulate as clearly as possible:

- The specific changes it sees as necessary over the next five years
- The steps required to make these changes happen

This paper is written primarily from a practitioner's viewpoint. It seeks to envision the logical outcome of developments already under way or implicit in the SRI and CSR movements. It is beyond its ambitions to analyse the theoretical and academic settings within which they are taking place, as important as those settings are. Instead it aspires to elaborate these multiple initiatives in a single place to provide a broad framework for future debate and an overarching perspective to assist in their implementation.

Part 1: corporations

Statements of values and disclosure of data

Corporations operating in market-driven economies are one centre of the worldwide debate over how to address problems of global warming, environmental degradation, poverty and economic development throughout the world. If they are to play a meaningful role in taking on such responsibilities and in participating in the effort to tackle these challenges, it appears likely that by 2006:

- Corporations will *state clearly and specifically their social and environmental values.*
- Corporations will *adopt specific management practices to integrate these values into their operations.*
- Corporations will *disclose comprehensive data on their actual social and environmental impacts.*[7]

The effect of these three developments will be to enable investors, regulators and consumers to measure corporations' actions against their stated goals and, taken in the aggregate, to assess the overall contributions of corporations towards the creation of a just and sustainable society. In addition, by elaborating social and environmental values corporations will confront their obligations not just to their stockowners but to other stakeholders (employees, communities, customers, the environment) as well. By integrating these values into their operations, corporations will demonstrate that they are capable of fulfilling the increased expectations that society is placing on the private sector to provide economic solutions to social problems in this new era. By disclosing social and environmental data, corporations will provide society with the tools necessary to analyse whether their behaviour represents an overall cost or a benefit.

7 Brevity dictates that many issues raised here cannot be put in their full historical and cultural contexts. Each has its advocates and detractors; each is coming to the fore now for a particular set of reasons. These developments are occurring in different ways and at different times throughout the world. Many are now already under way in Europe, which is particularly focused on environmental matters. In the United States, diversity is a notably powerful theme. European SRI is developing primarily within the context of mainstream investment houses, while in the US it is promoted by more independent organisations. Asia, Latin America and Africa will undoubtedly develop their own culturally appropriate approaches to both SRI and CSR.

Values

Although many corporations currently publish vision and mission statements, critics abound who view current corporate efforts as generally perfunctory and clichéd, no sooner promulgated than forgotten, and lacking in internal and external credibility. Moreover, the actual social and environmental management programmes implied by such statements are rarely implemented, or, when they are, are almost never co-ordinated as part of an overall management strategy.

Models for more meaningful statements and management systems are already being generated by such organisations as AccountAbility, Business for Social Responsibility, The Natural Step and the Prince of Wales International Business Leaders' Forum, as well as through work on corporate citizenship coming out of Warwick University in the UK, and on total responsibility management at Boston College in collaboration with the International Labour Office (ILO).

Within the next five years corporations will undoubtedly be compelled to articulate more clearly statements of values and mission, specifically relating them to various stakeholders: employees, customers, community and the environment, as well as stock-owners. In turn, society will then expect and demand that corporations live up to these stated goals. Whether such demands will manifest themselves as legal or regulatory initiatives (e.g. false advertising claims or regulator reprimands) or through the promotion of voluntary actions (e.g. trade association monitoring) remains to be seen. In either case, however, corporations will need to develop practical internal management strategies for incorporating their values into daily operations throughout the world and to measure the effectiveness of this implementation.

Disclosure

Although an increasing number of corporations publish environmental and health and safety reports,[8] many are simply token efforts—greenwashing—and few address the full range of social issues necessary to assess adequately a corporation's behaviour. Particularly in Europe, the language of the 'triple bottom line' has become accepted as a goal for reporting within the more progressive sectors of the corporate community.[9] However, the much-needed access to systematic, comprehensive and reliable data is far from a reality.

Within the next five years, corporations will need to address both the demands for standardised, comparable reporting and the simultaneous (and somewhat contradictory) need for data that accurately reflects the variations and idiosyncrasies of national regulations, local cultural norms, industry-specific challenges and noteworthy corporate traditions.

This is a technically complicated and politically sophisticated undertaking, on which the Global Reporting Initiative has already embarked.[10] Substantial interest in such disclosure requirements is now starting to emerge from national regulatory bodies as well.

The coming availability of this data will pose new and substantial challenges for the SRI world. The most important of these will be to develop appropriate methods of analysis for this data. Disclosure of data is only the first step on the road to interpretation of corporations' relative performance in addressing social and environmental issues. As the US experience with the extensive data disclosed under the Toxics Release Inventory

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8 The Centre for Environmental Informatics at the University of Sunderland in the UK maintains a website with links to 200 corporate environmental reports and over 100 more general corporate social reports. See the website at http://cei.sunderland.ac.uk/core.htm.

9 Among European companies often cited as having particularly strong environmental and social reports are Royal Dutch Shell, Novo Nordisk, British Telecom and BP Amoco.

10 See the GRI website at www.globalreporting.org.

and the Home Mortgage Disclosure Act has shown, a sophisticated understanding of the nature of the data and its relations to specific company operations is often crucial. Without such analyses, increased disclosure will be of little use.

Important next steps in the corporate world

In both the values and the disclosure arenas, the challenges are formidable. At issue is the creation and implementation of a fundamentally altered conception of the corporation[11] and a new means of measuring its value.

Incorporating values

The SRI world will continue its efforts to persuade corporate management that it must make an unflagging commitment to groups of stakeholders wider than simply stockowners. One of its goals should be to make this major commitment for managers as easy and painless as possible, and simultaneously to persuade these managers that the need and demand for this next step is inexorable. Four efforts in particular will be useful in moving towards these dual goals.

1. Develop models. Values models should be developed and promulgated to assist management in this process. Sandra Waddock at Boston College and Charles Bodwell of the ILO have coined the term 'total responsibility management' to describe the full range of communications with and commitments to stakeholders that managers must employ in order to address effectively CSR challenges (see the Waddock and Bodwell paper in this issue). A variety of similar initiatives, many with an emphasis on the environment and sustainability, are also under way through AccountAbility, The Natural Step, SustainAbility, Warwick University in the UK and various business schools in the US and elsewhere.[12]

Within the next five years, these programmes and resources will:

- Create clear models of meaningful and comprehensive value statements
- Educate managers on how to implement such values within their organisations
- Facilitate dialogue between management and stakeholders on the expectations aroused by such statements
- Train managers on how to measure and report on progress in attaining these often lofty goals

Implicit in building such models is the assumption that there is a 'business case' for managing corporations responsibly. For example, Waddock and Bodwell have argued that 'there is little difference between managing for responsibility and managing well'

11 In his criticism of corporate social responsibility, David Henderson stresses strongly that proponents of the concept are proposing 'a new variant, a new model, of capitalism' and that the 'potentially damaging effects of CSR . . . extend to economic systems as a whole, as well as to individual enterprises'. Henderson is correct in stressing the fundamental alteration in the conception of corporations' role in society implicit in CSR. His concerns about CSR's potentially damaging effects deserve careful consideration. Although this paper is not the proper forum in which to fully address the issue, it should be noted that CSR and SRI might well offer the corporate world the best solution to a crisis of legitimacy that it currently faces (Henderson 2001: 42-43, 80).

12 The type of overarching vision and commitment needed to successfully implement such programmes has also been spelled out in such business books as James C. Collins and Jerry I. Porras, *Built to Last: Successful Habits of Visionary Companies* (1994).

(Waddock *et al*. 2001).[13] Further work on this topic will be needed to deepen the understanding and potential limits of this proposition along financial dimensions.

2. Create demand. A steady demand from stakeholders for responsible management will also need to be nurtured, to assure that managers do not forget the urgency of this task. Corporate management is far more likely to act responsibly towards all stakeholders when it hears consistently from them. Examples of how this latent demand can be encouraged and communicated include the following.

- **Employees**. Those seeking employment at large and small corporations should be empowered to demand details on their prospective employers' social responsibility and environmental management systems. Union, as well as non-union, employees should expect a full understanding of these systems as part of renegotiating their contracts.
- **Consumers**. Major institutional consumers—including municipal and state governments, hospitals, universities and cultural institutions—should be able to demand specific or comprehensive evidence of responsible management systems and practices when requesting bids for goods and services. Because of the size and continuity of such contracts, these institutional consumers have particular leverage in entering into serious dialogue with their vendors on social and environmental issues.
- **Communities**. As towns, cities and states consider proposals by various corporations to locate plants and facilities in their communities, they should have the means to demand complete information on companies' past records on the treatment of employees and retirees, community involvement and the environment. Similarly, they should be able to seek corporate commitments to help in the building of strong and vital communities.

For these changes to occur, however, the SRI community will need to develop resources for each of these stakeholders so that they can quickly and economically obtain access to reliable information for such dialogues. These stakeholders need to know:

- The right questions to ask
- The significance of the data they receive
- How to interpret conflicting claims
- What requests for corporate commitments are reasonable
- How to conduct a productive dialogue with professional management

These resources can be tailored to the specific circumstances of each of these stakeholders, and should be easy to use. These resources are in all likelihood a public good: that is, there is not currently a self-sustaining market for them. Therefore, government and the non-profit world will, at least initially, be the forum in which they will be created. The SRI world will be able to provide valuable resources and expertise in support of their creation.

13 An excellent and definitive summary of academic studies on the links between CSR and financial performance has identified 80 studies treating CSR as an independent variable, of which 58% found a positive relationship to financial performance, 24% found no relationship, 19% found a mixed relationship and 5% a negative relationship. It also identified 19 studies where CSR was treated as a dependent variable, of which 68% found a positive relationship to financial performance, 16% a mixed relationship and 16% no relationship (Margolis and Walsh 2001: 10-11).

3. Enrich the stakeholder model. One of the most difficult challenges corporate managers will face is that of allocating scarce resources among competing stakeholders. Generating profits for stockowners is itself challenging, but satisfying the competing claims of employees, consumers, communities and the environment multiplies the complexity of the task. The problem is both theoretical and practical. What is the theoretical justification for rewarding one stakeholder (e.g. a charitable contribution to a community group) at the expense of another (e.g. a salary raise forgone)? What are the practical considerations for choosing between competing stakeholder claims? How can stakeholders themselves be convinced of the fairness of management's allocations of these rewards? Moreover, under such a stakeholder model, there is a danger that the environment, often considered a stakeholder but without a natural advocate, could be pushed into the background.

These are crucial and difficult questions, the answers to which are not obvious. Theoretical and practical frameworks will need to be developed. A number of approaches are possible.

- During the 1990s, work by Margaret Blair of the Brookings Institute and a working group convened by the late Max Clarkson at the University of Toronto suggested that stakeholders be defined as those who have something at risk (at stake) in the corporation. It may be possible to tie this concept of risk to that of reward in devising a model for appropriate allocation of resources (Clarkson Centre for Business Ethics 1999).[14]
- The political philosopher Ronald Dworkin has suggested that the legitimacy of governments hinges on their ability to demonstrate equal concern for all members of society and provide them with equal resources for the leading of a responsible life (Dworkin 2000). Development of an analogous principle within the corporate context might prove fruitful.[15]

It will also be important for SRI to address the question of whether the business case for CSR implies a substantially larger pool of profits that mean greater rewards for all stakeholders, or one that is only modestly increased and therefore will necessitate the reallocation of profits from stockowners to other stakeholders.

Whatever the approach, it is clear that, to address such questions successfully, the SRI community will want to draw on a broad spectrum of thinkers about the nature of corporations and markets in society.

Implicit in the creation of an enriched stakeholder model is a long-term commitment to increased dialogue between corporations and stakeholders. A major contribution to

14 Their definitions of sustainability and stakeholders are as follows: 'Sustainable profit is possible only when the legitimate needs and expectations of all relevant stakeholders are satisfied. A "stake" is something of value, some form of capital, financial, physical or human, that is placed at risk. "Stakeholders" in a corporation are individuals or groups that voluntarily make, take or have a stake in the corporation and consequently bear some form of risk in anticipation of gain or increase in value as a result of the corporation's performance. "Involuntary" stakeholders are individuals or groups that are, or could be, affected, placed at risk, or harmed as a consequence of the corporation's activities; their stakes are not assumed willingly or knowingly.' Blair argues that: 'stakeholders should be defined as all parties who have contributed inputs to the enterprise and who, as a result, have at risk investments that are highly specialised to the enterprise. These parties inevitably share in the residual risk of the firm.' She also asserts that 'employees, as well as shareholders, are likely to be residual claimants and, therefore, residual risk-bearers'. Blair's work goes far towards establishing circumstances under which employees can legitimately claim a share of the residual rewards of corporations' returns (Blair 1995: 238-39).

15 Both these concepts raise a host of complicated questions about how to measure risks and rewards in the corporate context, and why corporations should shoulder the expense of such measurements. The magnitude of these tasks should not be underestimated.

promoting such dialogue will be the development of structures within which such dialogue can take place.

4. Address the question of regulation. Finally, the SRI community will need to recognise explicitly that neither it nor CSR can operate without strong and fair governmental structures and regulatory frameworks. The proper balance between governmental regulation and market mechanisms is a complicated debate, the outcome of which will undoubtedly reflect cultural and historical differences in differing societies. This debate will also be further complicated by playing itself out simultaneously on local, national and transnational levels.

One underlying assumption in this debate is that to change substantially and rapidly the corporate community will need (and will itself demand) regulatory prompting. Embedded here are important questions about 'level playing fields'. Why should Royal Dutch Shell go to the effort and expense of implementing comprehensive environmental and social programmes if its competitors are not required to consider these issues? At some point, Shell's competitiveness could suffer and its independence be jeopardised (i.e. its stock price falls and an unencumbered competitor buys it up).[16]

Basic regulatory frameworks are necessary to establish level playing fields. However, fundamental questions about the extent and nature of this regulation will need to be answered. They include:

- What types of regulation are most effective and simultaneously least intrusive? To what extent can and should disclosure substitute for command-and-control governmental regulation?
- Should regulation be local, national or transnational, or some combination of these three?
- How can such regulation provide a floor from which new initiatives can be built, rather than a ceiling that impedes innovation?

By coming to grips with these challenging questions, the SRI world can play an important role in this debate.

Requiring disclosure

Two important challenges will need to be addressed on the disclosure front.

- How to balance the demand for global standardised reporting with the need for the development of national, local and industry-specific reporting guidelines
- How to analyse and interpret the wealth of data that will soon be available

Standardisation of disclosure. Finding the right balance between disclosure of standardised, globally comparable data and disclosure tailored to national or industry norms is an eminently solvable problem, as the current work of the Global Reporting Initiative (GRI) demonstrates. GRI has recognised that industry-specific data is necessary to complement global 'core' indicators and has established industry-focused working groups to develop appropriate specialised indicators.

16 Proponents of CSR often point to environmental and energy efficiency programmes where cost savings and social responsibility go hand in hand. It is important to acknowledge, however, that not all CSR programmes, whether they involve environmental, safety, employee benefits or community initiatives, can be shown to have short-term benefits to the corporate bottom line. To make the benefits arguments for many such initiatives, long-term horizons are necessary. Long-term arguments can be difficult to make within the context of publicly traded companies, because they conflict with the short-term perspectives of the financial marketplace.

A further complication will soon need to be addressed as national governments and industry trade associations seek to develop their own disclosure standards. In mid-2001, for example, the French government proposed a detailed set of environmental and employee relations disclosure requirements in corporate annual reports. As GRI is demonstrating, an appropriate balance between national regulatory disclosure requirements and global voluntary initiatives will need to be found.

Analysing the data. The SRI community will want to take a number of steps to assure the intelligent analysis of the wealth of data that will soon be available. Among the most important of these are the following.

- Assure the centralised availability of this data. The easier this data is to obtain, the greater and richer the use to which it will be put. A single website is an obvious approach. A first step in this direction has been taken by the Centre for Environmental Informatics,[17] which maintains a website with links to over 200 corporate environmental reports and over 100 corporate social reports. The SRI community will need to support and cultivate such efforts to assure that comprehensive centralised resources are available.
- Strengthen the work of the independent research organisations providing overall assessments of corporations' social and environmental records. This means, among other things, that financial service firms will need to be persuaded to allocate substantial budgets to purchase these social and environmental analyses—budgets similar to those already allocated to the purchase of financial data and analyses. The SRI community must undertake a focused campaign to educate the financial community on the need to spend scarce resources here.
- Encourage a diversity of approaches and viewpoints among SRI analysis firms. The debate over what constitutes innovative and forward-looking corporate practice will be well served if multiple and diverse models are developed. For example, different analytical approaches are being developed in the US by such firms as Innovest and KLD Research and Analytics. The SRI community will find it advantageous to cultivate a range of different analytical approaches.
- Support the creation of specialised, niche-market research firms that focus on specific issues or industries. For example, a wealth of environmental data is available in the US through the disclosure requirements of the Toxics Release Inventory, and on bank lending patterns through the Home Mortgage Disclosure Act (HMDA). The sheer volume and complexity of this type of data virtually require that specialised research firms be created to analyse and interpret it. It would be a waste of time and scarce resources for the more generalised SRI research firms to duplicate these extensive analyses. For example, one such specialised research firm in the US is CANICCOR, which focuses on the analysis of banking-industry HMDA data. To date this organisation has been supported largely by church groups. Support from the SRI and financial communities will be necessary if such important resources are to survive.
- Help corporations with the time-consuming and often confusing task of reporting various data in varying formats to different audiences. Two efforts can reasonably be undertaken here. The SRI community can explore the development of technologically sophisticated systems that make this reporting easier and more efficient. Simultaneously, it should convince corporate managers that the time and expense

17 See footnote on page 61. See also the listings, without accompanying links or text, maintained by Next Step Consulting Ltd, at www.corporate-register.com.

of communication and transparency on these issues is an important everyday cost of doing business, no different from the time and expense necessary for public financial reporting. Such corporations as General Motors and Baxter International have been forward-thinking in committing resources to communication and transparency on environmental and social issues, as have a substantial number of European firms.

Part 2: the institutional investment community

Statements of social and environmental concerns, voting and communications

The concept of responsible ownership will become accepted within the institutional investor world by 2006. Constituting some of the largest financial institutions in the world, these investors include pension funds, mutual funds, insurance companies and commercial banks. Among other things, they are the largest stockholders—and therefore the most influential owners—of transnational corporations. Next to government regulation, their potential to directly influence corporations is unparalleled.

Within the next five years, three important developments are likely to occur, moving these institutions towards a far more active role as investors. These three developments can be said to fall under the rubric of **responsible ownership**.

- These institutions will be required[18] to *adopt comprehensive voting policies on social, environmental and corporate governance issues including guidelines for voting and the disclosure of actual votes.*
- These institutions will be required to *state publicly the extent to which they incorporate social and environmental issues in their investment practices.*
- These institutions will *undertake ongoing dialogue among themselves on social and environmental issues*, as they already do on corporate governance. As this occurs, the artificial distinction between corporate governance and issues of social and environmental concern will quite appropriately begin to blur.

Responsible ownership

Since Berle and Means published their seminal work on the relationship between corporate managers and owners in 1932, it has often been observed that the managers of modern corporations have been divorced from the responsibilities and burdens of ownership and that, in their irresponsible freedom, these managers have little incentive to act in society's best interests. Only owners—such as pension funds that want their participants to retire in a safe, clean and survivable world—can consistently steer corporations towards long-term sustainability, rather than short-term profit.[19]

18 Although regulation is often a cumbersome tool for prompting constructive institutional initiatives, this and the following recommendation focus on two areas where relatively simple regulation can quickly bring substantive results. One theme in this paper is the need to strike the proper balance between regulation and voluntary initiatives, identifying those areas for which one or the other is more appropriate and effective.

19 A crucial element of this debate within the institutional investment world is the question of whether or not there is a financial benefit to social screening or analysis in stock picking. Those in the SRI community frequently make the case that analysis of the social and environmental records of companies can provide insight into the quality of corporations' top management, an insight that is important in fundamental stock analysis. See in particular Van Dyck and Paulker 2001: 4-8.

Robert A.G. Monks has recently argued that only the world's largest pension funds, as the largest single owners of corporate stock, can assure that corporate managers take their responsibilities to society and the environment seriously (Monks 2001: 9). Without question, these large institutional investors have unparalleled access to corporate management. Whether they are willing to raise social and environmental issues with management as part of their fiduciary responsibilities to the participants in these retirement plans is still an open question.[20]

As of July 2000, regulators in the UK took a simple but revolutionary step. They required the approximately 10,000 pension funds in that country to incorporate into their policy guidelines a position on social and environmental issues, even if their position is that they do not consider such issues. This requirement has been remarkably effective in prompting pension funds to recognise their responsibilities in these areas.[21]

Until this requirement is extended not only to pension funds in other countries but also to other types of institutional investors (most notably, mutual funds), its full potential to influence these financial giants will not be realised.

Just as in a democratic political system, an engaged citizenship that votes is a key to a vibrant and vital society, so stockholders that vote on issues brought before management at annual meetings are a key to the concept of responsive ownership. For the better part of the 20th century the 'Wall Street rule' for stockowners has prevailed—if you disagree with management, walk (i.e. sell your stock), don't talk (i.e. don't file shareholder resolutions, vote against management's recommendations or otherwise seek to make your opinions heard).

More than in other countries, regulators in the US have historically provided stockowners with access to the proxy statements of corporations to raise issues of social and environmental concern. As a consequence, hundreds of social shareholder resolutions appear in proxy statements for corporate annual meetings in the US each year. Since 1988, the US Department of Labor has made it clear that it considers voting proxies part of the fiduciary duties of private pension fund managers.[22] In addition, reflecting their particular commitments in this area, SRI mutual funds in the US have long voted their proxies along lines consistent with their social screens. In 1999 the Domini Social Equity Fund became the first mutual fund to publicly disclose its actual votes on its website.

Until these sporadic efforts become more widespread and generally accepted, voting by institutional investors will remain a largely unexplored and untapped resource in promoting responsible ownership.

Although mainstream institutional investors shied away from social and environmental concerns during the 1990s, they have aggressively attacked issues of corporate

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20 In 2001 the Universities Superannuation Scheme, one of the largest pension funds in the UK, commissioned a study on climate change and hosted a seminar for other institutional investors on this issue. This cutting-edge effort exemplifies the kind of leadership role that pension funds might take in the future on such issues.

21 An October 2000 survey of the 508 largest pension funds in the UK by UK Social Investment Forum found that, for the 171 pension funds responding, 59% of the funds, representing 78% of assets, incorporate socially responsible investment into their investment strategies either by engagement or by specific request to their fund managers. Similar regulations have subsequently been adopted in Germany and Belgium.

22 In its letter of 23 February 1988 to Avon Products, Inc., the Department of Labor asserted that 'In general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock.' On 12 February 2002, the chairman of the Securities and Exchange Commission, Harvey L. Pitt, asserted that 'An investment adviser must exercise its responsibility to vote the shares of its clients in a manner that is consistent with . . . its fiduciary duties under federal and state law to act in the best interests of its clients.' This extension to money managers of the fiduciary duty to vote proxies independently is a substantial step in the promotion of the concept of responsible ownership (Lubin 2002).

governance. Most influential in the corporate governance dialogue has been the International Corporate Governance Network, a worldwide association of institutional investors founded in 1995. In response to this concern by institutional investors, hundreds of sets of guidelines for best practices in corporate governance have recently been issued by corporations, trade associations and quasi-regulatory bodies around the world. Among the most influential of these are the guidelines drawn up by the Organisation for Economic Co-operation and Development (OECD), establishing four core values that all codes of corporate governance should embrace (fairness, transparency, accountability and responsibility), while simultaneously encouraging local variations tailored to regional and national custom and regulation.

As encouraging as these developments are, they fall far short of creating a framework within which responsible ownership is the norm.

Important next steps in the institutional investment world

Encouraging institutional investors to conceive of their role as responsible owners is not a simple task. Regulatory changes can help to force the issue, but without the development of resources to facilitate action, genuine change will not occur.

Implementing responsible voting

Changes in national regulatory structures can do much to encourage and increase responsible ownership by requiring voting on issues appearing on proxy statements.[23]

Requiring development of voting guidelines and disclosure. Building on current developments in the US, financial regulators around the world can consider requiring pension funds, mutual funds and other institutional investors to develop and publish proxy voting guidelines, stating their positions on social and environmental issues. In addition, and equally important, they can consider requirements to make actual votes available to participants and investors. In December 2001, Domini Social Investments called on the Securities and Exchange Commission to require all US mutual funds to disclose their votes each year.[24]

Developing clear models for voting guidelines and disclosures. The SRI community will continue to improve its development of model investment and proxy voting guidelines that can be used by institutional investors to address social and environmental issues. These models can demonstrate the range of options available to these institutions, and help them to benefit from the previous experience of others. Already such firms as KLD Research and Analytics in the US and AccountAbility in the UK have developed proven expertise in these areas.

Encouraging responsible ownership

Similarly, relatively minor regulatory initiatives coupled with the provision of clear models for change will prompt institutional investors to make substantial advances in addressing social and environmental issues. Two initiatives in particular will speed and facilitate meaningful change.

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23 National regulators may also want to facilitate stockowner access to the proxy statement (i.e. make it easier to file shareholder resolutions), but such decisions need to be taken in the context of local cultural norms.

24 Letter to Harvey L. Pitt, Chairman, United States Securities and Exchange Commissions, 27 November 2001.

Requiring statements on social and environmental concerns. Building on the UK model, financial regulators in other countries around the world will consider requiring pension funds to state their commitment (if any) to address social and environmental concerns in their investment practices. The simplicity and elegance of the UK regulation makes it particularly effective. Germany and Belgium have already passed similar legislation. The next major advance will be to apply this same principle to mutual funds, insurance companies, banks, foundations, universities and other institutional investors. This expanded application of the requirement, although a radical departure from current thinking and practices, would go far towards compelling these organisations to recognise their responsibilities as well.[25]

Developing clear models for such statements. Such regulations will only prove effective, however, if resources are available to these institutions—many of which are not philosophically inclined to tackle these new and complicated issues—to implement these polices in a simple and professional manner. The SRI community will need to help institutional investors in this process by developing a range of consulting services. Primary among these will be the development of clear models for such statements and the exploration of the financial implications of adopting such policies. This is a task for which SRI trade associations may be particularly well suited. Already, some organisations, such as ASRIA in Asia, are taking preliminary steps in this direction.

Creating ongoing dialogue

The SRI community can also play a catalytic role in encouraging large institutional investors to consider SRI seriously and to communicate among themselves about the implications of important social and environmental issues.[26]

Encouraging new institutional investor associations. The SRI community can encourage and assist in the development of associations of institutional investors concerned with social and environmental issues. Once dialogue among these investors embraces such issues, the adoption by corporations of formal programmes and internal policies on these issues will not be far behind. The SRI community will need to work to introduce such vocabulary and issues into the debates by institutional investors on the subject of corporate governance, or to help create a parallel association of institutional investors focusing specifically on social and environmental issues.[27]

Educating the financial consultant community. The SRI community will also need to develop educational programmes for financial consulting firms. These consulting firms are crucial gatekeepers for institutional investors. In general, they are currently ignorant of, and sceptical about, SRI. A well-informed consultant community will be crucial in helping institutional investors in these areas. Among the issues that need to be most

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25 In the first major step in this direction, an Australian law in effect as of March 2002 requires mutual fund and life insurance investment product managers to disclose the extent to which they take, or do not take, into account labour standards, environmental, social or ethical considerations.

26 A similar mission of the SRI community has been its ongoing effort to educate the retail investor about SRI opportunities and initiatives. Over the years, this effort has been the primary driving force behind much of the increasing demand for SRI products in the US. Such organisations as Coop America and the US Social Investment Forum have played and will continue to play an important role in such initiatives.

27 In April 2002, CERES (Coalition for Environmentally Responsible Economies) launched its Sustainable Governance Project, which will first focus on climate change issues. CERES intends to sponsor a series of studies that will 'explore the convergence of best practice in sustainability and corporate governance'.

directly addressed are those of performance (what financial effects do social screens have on the performance of investment portfolios) and fiduciary obligations.[28]

Part 3: the financial, academic and SRI communities

Incorporation, institutionalisation and professionalisation

SRI and CSR, as they come to play a more prominent role on the corporate and financial landscapes over the next five years, will be institutionalised and professionalised within the financial, academic and SRI communities. Steps will be taken to increase training and education, to create standards and quality controls, and to develop rigorous theoretical frameworks in all three communities. The following crucial developments are likely to occur before 2006, as these communities come to play a meaningful part in the current debate about the proper role of corporations in society.

- *Mainstream financial firms will train their analysts to routinely incorporate CSR considerations into securities analysis* for stocks and bonds. These considerations will supplement traditional financial analyses with analyses of the value added to companies by CSR initiatives or of the risks created by their failure to address specific social and environmental concerns. Similarly, financial-industry trade journals and conferences will routinely incorporate SRI and CSR topics. A parallel education process will also need to take place in the accounting community.[29]
- *The academic community will offer courses and grant degrees in CSR and SRI*. The academic world will be able to provide the financial and corporate worlds with a steady stream of graduates highly trained in these areas. In addition, academic researchers and theoreticians will more thoroughly debate crucial aspects of SRI, helping to define and strengthen the field.
- The SRI industry will develop quality standards, undertake theoretical research on topics of communal concern, and create a network of issue-specific, niche-market research firms to analyse particularly complicated sets of social and environmental data.

28 In 2001, the US-based SRI information and consulting firm SRI WorldGroup, Inc., published *Sustainable and Responsible Investment Strategies: A Guide for Fiduciaries and Institutional Investors*, a substantial and thorough document that provides background on, among other things, issues of performance and fiduciary responsibilities. See the website, www.ishareowner.com. A report prepared by the UK groups Traidcraft Exchange and War on Want, entitled *Socially Responsible Investment and International Development: A Guide for Trustees and Fund Managers,* examines similar issues. See the website, www.justpensions.org.

29 Since the 1970s, the accounting profession has taken up the question of CSR several times and in several guises. In the 1970s, when the catch phrase was 'corporate social accountability', various pioneering efforts were made to quantify the costs and benefits of corporate social initiatives. For example, ABT Associates, the Massachusetts-based social policy research firm, included in its annual reports a cost–benefit analysis of its internal socially related initiatives, such as childcare benefits. In the early 1990s, firms such as Ben & Jerry's Ice Cream and The Body Shop pioneered the concept of social audits, publishing simultaneously financial and social audits annually for shareholders. In the late 1990s, large accounting firms saw the need for verification of labour standards, sustainable forestry certification and similar socially oriented initiatives as a potential market for their practice. These efforts, however, met with limited success. Currently, there is also a discussion about the need for revised accounting principles that reflect a corporation's 'intangible' assets, including human capital and intellectual property. (See Blair and Wallman 2001 for a US perspective on this issue.) Because of their many complications, questions relating CSR and SRI to accounting are beyond the scope of this paper. Substantive work in this area is currently being done by the Institute of Social and Ethical Accountability (AccountAbility) in the UK.

In all three of these areas, tentative first steps are already being taken.

Stock analysis

The more progressive insurance companies and banks in the UK and Europe have already taken initial steps towards integrating social and environmental criteria into their stock analysis. For example, in 2002 in the UK, Morley Asset Management, the money management subsidiary of CGNU (the largest insurance company in that country), created an 11-member SRI team, including four fund managers and four researchers. This team regularly communicates its findings to the conventional fund managers at Morley, highlighting in particular industry-specific SRI issues that might be of significance in stock valuation. ING, the largest financial services firm in the Netherlands, has an eight-member sustainability team charged with integrating sustainability and financial concerns throughout its research and operations. Despite these pioneering efforts, the financial world is still a long way from the routine incorporation of CSR analyses.

CSR and SRI education

Since 1998 in the US, the Aspen Institute has been monitoring business schools' incorporation of CSR and SRI into their curricula. Its *Beyond Grey Pinstripes 2001* study noted limited progress and some outstanding examples of business school programmes addressing social impact.[30] On the whole, however, it noted that 'very little [is] being done to integrate a broad vision of social or environmental stewardship into required MBA course work or to explore these dynamics through rigorous research' (World Resources Institute and Aspen Institute 2001: 5).[31]

In a pioneering effort, Nyenrode University in the Netherlands has the first endowed chair in SRI in Europe, offers elective courses in SRI, and has launched an SRI education programme for pension fund officials.

In addition, in an effort that bridges the gap between the academic and financial worlds, since 1996 Lloyd Kurtz, in conjunction with the US Social Investment Forum, has co-ordinated the annual awarding of the Moskowitz Prize for outstanding research articles on socially responsible investing.[32]

SRI professionalisation

Within the SRI community, trade associations have formed in the US, Canada, the UK and Europe. In Asia, in 2001, ASRIA was founded in Hong Kong to play a catalytic role in developing SRI in that region. Through conferences, these associations provide valuable forums for education and discussions by practitioners of SRI. However, as a community, the SRI world has not yet taken the necessary systematic steps towards industry-wide research and theoretical thinking.

Important next steps for the financial, academic and SRI communities

Each of these communities is bound by its own traditions that often slow its progress, despite the apparent need. The financial community is philosophically disposed to be cautious about CSR and SRI. The academic community can be late to recognise major developments in the fast-changing financial marketplace. Limited resources have slowed the SRI community's progress in fulfilling the demands created by its success.

30 Harvard University, Loyola Marymount University, University of Michigan, University of North Carolina and York University were singled out for particular praise.

31 See the website, www.beyondgreypinstripes.org.

32 A number of scholarly journals provide a forum for the discussion of CSR and SRI issues, including *Business and Society*, *The Journal of Corporate Citizenship*, *Corporate Reputation Review*, *Journal of Investing*, *Business Ethics Quarterly* and *Business and Society Review*.

Incorporating SRI and CSR into financial analysis

Within the financial community, much important work will need to be done before SRI and CSR can be integrated into mainstream financial analysis. Among the most important of these initiatives will be the following.

- **Development of financial valuation models**. Financial valuation models that incorporate social and environmental data will be developed and tested.
- **Industry educational requirements in CSR and SRI**. The self-certification and training process for financial analysts (e.g. AIMR's Chartered Financial Analyst curriculum) will incorporate the fundamentals of SRI and CSR.
- **Education of financial industry management**. The senior executives and boards of directors of financial services companies will educate themselves in the importance of systematic institutional commitments to these areas.

The SRI community can play a leading role by working with the financial community to help it to realise that its best long-term interests are served by increasing its skills and capabilities in each of these areas.

Creating CSR and SRI academic tracks

In coming years, the academic community will undoubtedly expand educational offerings and the focus of its fundamental research to embrace the newly developing fields of SRI and CSR. Without properly trained graduates entering these fields, progress towards the legitimisation and incorporation of both in the financial and corporate worlds will be unnecessarily slowed. Among the initiatives that will occur in the academic world are the following.

- **Development of curriculum and degrees**. Graduate business programmes will develop and offer courses in SRI and CSR, and ultimately grant MBAs with a specialisation in these two fields. These courses can help those entering the business world to better understand the changing society in which the business world now operates. To support the development of such courses and programmes, the SRI community should share its knowledge and experience in these fields.
- **Creation of research centres**. Academic research centres will be founded that focus specifically on SRI issues.[33]
- **Development of research opportunities**. SRI research firms will share their data with academics to facilitate increased rigorous research on these issues. For example, data from KLD Research and Analytics in the US has already provided the basis for a substantial number of academic articles and can provide a model for future initiatives.

Professionalisation of the SRI community

Much work will need to be done by the SRI community over the next five years to professionalise its activities.

Developing SRI research standards and protocols. The SRI community will need to develop specific quality standards for its research processes. These research process

33 As the Aspen Institute study notes, a number of academic research centres already focus on the environment (e.g. George Washington University, Hong Kong Polytechnic, Huddersfield University). Preliminary efforts to incorporate SRI into the graduate-level curriculum are currently under way at Georgetown University.

standards may be modelled on manufacturing process standards such as ISO 9000, stressing procedures, not results. Such standards will help the SRI community to assure the institutional investment world that the highest-possible-quality data is available. For example, in 2002 the Sustainable Investment Research International (SiRi) Group—an international consortium of 11 SRI research firms—began implementation of a series of quality procedures and research protocols for its profiles of 500 large transnational corporations, published in a uniform and comparable format.[34]

Creation of an SRI trade association think-tank. Among the first steps that a national or regional SRI trade association—or a global network of such associations—will consider is the establishment of a think-tank to tackle critical problems of communal interest and of such a scale that individual members lack the resources to address these thoroughly. Issues addressed might include:

- The development of a defensible social 'accounting' system or a similar definition of 'social returns'. Pioneering work in this area has been done by Jed Emerson and the Roberts Foundation.[35]
- The creation of a framework within which reputation is considered and valued as a corporate asset. Initial work is currently being done by the Reputation Institute to quantify the value of reputation to corporations.[36] The *Corporate Reputation Review* covers developments in this arena. In addition, corporations are increasingly integrating reputation and brand-name concerns. For example, Intel Corporation currently uses the vocabulary of reputation to help its managers worldwide to identify emerging social and environmental issues that might be of importance to the corporation.[37]
- The consideration of a theoretical framework that will bridge the gap between apparently disparate SRI activities such as community economic development (micro-lending, social-purpose venture capital, community-building philanthropy, economically targeted investments, etc.) and the social screening of publicly traded transnational corporations. It is also important that such considerations grapple with the relationship between the practices of SRI and worldwide international trade protocols (World Trade Organisation policies, international corporate governance guidelines, NAFTA obligations and so on). By implication, SRI will need to flesh out its relationship to the complicated issue of international development. Aside from initiatives on 'fair' trade, SRI has only peripherally dealt with this highly visible debate.
- Creation of a stronger, more coherent vocabulary for social investing. The SRI community has long bemoaned the inadequacy of the terminology it has at hand to describe and define its activities. Work should be done to integrate SRI and mainstream financial industry vocabulary and to bring coherence to the proliferation of SRI-related terms (i.e. social investing, socially responsible investing, ethical investing, triple-bottom-line investing, sustainable investing, best-of-class investing, corporate citizenship, social venture capital, community investing, economically targeted investing and so on).

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34 For background on the SiRi Group, see its website, www.sirigroup.org.

35 See *Social Return on Investment Methodology: Analysing the Value of Social Purpose Enterprise within a Social Return Framework* available on the Roberts Foundation website, www.redf.org.

36 This academic centre is based at New York University under the leadership of Professor Charles Fombrun. See its website at www.reputationinstitute.com.

37 David Stangis, Intel Corporate Responsibility, conversation with the author, November 2001.

- Promulgation of advocacy pieces addressing regulatory issues, such as those immediately affecting corporate disclosure and transparency, and opening a dialogue with government and regulators. To date the SRI world has done little to define the specific roles it sees for government in managing the relations between corporations and society.
- Publication of background pieces on the fundamental dilemmas posed for the SRI world by emerging issues such as genetic engineering, privacy in the age of electronic telecommunications and international labour standards. It is only logical that the initial basic work on these broad issues of communal concern be tackled by an industry-wide SRI organisation.
- Publication of summaries of ongoing debates (academic and otherwise) about the relationship between financial and social performance.

Creation of issue-specific, niche-market SRI analytics firms. The SRI community will want to develop a network of research organisations that will analyse the massive amounts of industry data becoming available. Already in the US the SRI community faces an apparently insurmountable challenge in analysing:

- The voluminous data available on the release of toxic chemicals required under the Toxics Release Inventory
- The equally voluminous data on bank lending patterns, particularly those for economically disadvantaged neighbourhoods, available under the HMDA
- The extensive data on union relations available through the National Labour Relations Board's history of actions brought by unions and management, and on corporate worker safety fines and other actions brought as a result of inspections by the Occupational Health and Safety Administration
- Interpretation of military contracting information published by the US Department of Defense, notably for the computer and telecommunications industries
- Reliable facts on the relative labour practices of apparel, footwear, toy, computer and other companies in developing countries

Such information is of great interest to SRI researchers and money managers wishing to compare the social and environmental records of companies within specific industries. It is also of great use to SRI money managers entering into dialogue with corporations on specific issues.

However, this data is often difficult to gather and interpret because company-specific circumstances abound, regional and local contexts vary wildly, the data's quality is irregular, and factors of scale affect interpretation. Moreover, such analyses are expensive because these issues require substantial reservoirs of technical expertise to master, methodological decisions are of crucial importance and continuity of approach is essential for consistent comparisons of companies' records over time.[38]

It is ironic, although understandable, that the SRI community has difficulty supporting such research. It is critical that it does so, however, if it is to achieve an unassailable reputation for the quality of its work.

38 Such specialised niche-market firms can also play the valuable role of commenting on proposed changes in national regulations that would affect the quality of data available to the research community, a task few other groups in the SRI world are equipped to do.

To establish such a network, the SRI community will need to tackle the challenging task of identifying new funding sources for such research. Among the ground-breaking steps that may well be taken towards this end are the following.

- Create SRI-industry-related foundations that would make grants to such research organisations and pressure the conventional foundation world to provide such research organisations with systematic funding
- Convince governmental or quasi-governmental organisations that such research organisations need support and that their data is of interest
- Co-operate with mainstream industry trade associations in the collection and analysis of social data or create alternative industry trade associations to collect and analyse such data (i.e. a trade association of community development banks that sponsors research on the banking industry and community development issues)

Conclusion

It may be difficult to imagine that these developments will take place within the next five years. If in 1996 we were to have described the magnitude of the changes that have in fact occurred through 2001, it would have seemed equally incredible. Progress will not be easy. Dead ends will be encountered. Debates on difficult issues will need to be resolved. Without the considerable efforts and skills of many people and organisations, these projections will not be effectively realised. However, the momentum behind the global experiment with market economies currently under way now appears so strong that—barring unforeseen disasters—many, if not all, of these developments will take place.

Having brought together in one place a condensed vision of the developments and initiatives that may occur by 2006, we hope to set the stage for further debate on their usefulness and effectiveness and on the allocation of resources necessary for their realisation.

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