# Annotated Bibliography on “The Relevance of ESG Issues from the Standpoint of Large Institutional Investors: A Specific Focus on Emerging Markets.”

Corporate engagement on environmental, social, and governance (ESG) issues has been effectively utilized by certain institutional investors wanting to influence more responsible corporate practices within the companies they own in their portfolio. These investors reason that affecting responsible corporate practices will lead to risk reduction or long-term financial return, if not both of these simultaneously, and is thereby required by fiduciary duty. Some Large institutional investors had, so far, been clearly successful at using this investment strategy in developed markets. But, whereas the implications of long-term universal ownership had been implicit in these investors recognition of and action on ESG issues in developed markets, the preconditions that would have made corporate engagement in emerging markets viable had simply not been established. And thus, these investors resorted to other, less involved, forms of investment in these regions, thereby undermining the corporate responsibility of the emerging market companies held in their investment portfolio.

This annotated bibliography was made with the intention to understand the motivation for a possible shift in the emerging market investment strategies of institutional investors. Fifty pieces of literature, a large part of which are academic articles and industry reports, were reviewed for this purpose. The pieces are listed in order of importance and alphabetical ranking. The bibliography first presents the ten most important pieces reviewed, followed by the next fifteen and the next twenty-five.

**Recommended Reading**

**1. Dowell, G., S. Hart and B. Yeung. (2000) "Do Corporate Global Environmental Standards Create or Destroy Market Value?" Management Science 46(8):1059-1074.**

The authors analyze the global environmental standards of a sample of US-based MNEs in relation to their stock market performance and find that firms adopting a single, stringent global environmental standard have much higher market values, as measured by Tobin’s q, than firms defaulting to less stringent, or poorly enforced host country standards. Thus, developing countries that use lax environmental regulations to attract foreign direct investment may end up attracting poorer quality, and perhaps, less competitive firms.

The provided literature review offers useful insight on the relationship between environmental standards and financial indicators. Notably: by specifying a single corporate standard, performance monitoring and evaluation costs might be reduced since a single set of values, specifications, and procedures can be deployed throughout the world, without the need to consider local deviations from the norm (pg 5); firms can actually use the environment as a strategic competitive advantage by speeding up the process and thus out-compete local firms with lesser financial means, knowledge, and capability (pg 6); and, by committing to standards that exceed those of the host country, the company might benefit from heightened employee morale and thus productivity (Romm, 1993) (Id).

The authors argue against the ‘race to the bottom’ as a desirable competitive strategy. There appears to be forces that encourage MNEs to integrate and standardize their environmental practices globally and that it may make business sense in some cases to adopt global standards that exceed those required by some local laws or regulations, especially when environmental laws and regulations become more stringent as an economy grows (pg 2). By investing in state-of-the-art technology and processes in developing countries, MNE facilities may be able to achieve simultaneously world class cost, quality, and environmental performance (Id). In addition, MNE's may reap standardization benefits and other intangible advantages like positive reputation effects (Id).

The authors find that firms adopting a stringent global environmental standard have higher market values, as measured by Tobin’s q (market value over replacement costs of tangible assets) (pg 2). Their results have important implications: "better firms" appear to adopt higher environmental standards and pollute less. Adopting stringent environmental standards may actually be more profitable than defaulting to lower local environmental standards (pg 18). Companies with lower market values tend to pursue lower environmental standards. Perhaps, these companies opt to default to host country standards because they lack the means to make the investment in environmentally superior technology world-wide. They may also be less well run companies focusing on short term cost savings. This might include, but is certainly not limited to, strategies such as recapitalizing old production assets, extending obsolete product life cycles, and exploiting low labor costs.

**2. Eccles, Robert G. and Sesia, Aldo,CalPERS' Emerging Equity in the Markets Principle(March 08, 2009). HBS Case No. 409-054; Harvard Business School Organizational Behavior Unit. Available at SSRN: http://ssrn.com/abstract=1408570**

In this case study, the authors examine one question facing CalPERS in the wake of their new principles-based approach to investing in emerging markets. This question is whether to invest in PetroChina, which had been off-limits previously due to the screening criteria that were used to identify which countries qualified for emerging markets investments. The case also raises the issue of the difference between "value" and "values" investing and the future importance of ESG investing.

Previous to November 2007, CalPERS internal and external money managers were prohibited from investing in the developing countries that failed to meet certain standards for political stability, human rights, market regulation, etc. The new principles-based approach would allow CalPERS money managers to invest in companies that were financially attractive and competitively positioned provided their business practices were sound from an environmental, social, & governance (ESG) perspective regardless of where they were located. By allowing investment in these types of companies regardless of where they operated, CalPERS had hoped to improve its investment returns. The case is set in January 2009, a little more than a year from the time the principles-based approach had been adopted. It is a good time to review the implementation process and how the new principles-based approach changed CaIPERS' emerging market equities portfolios and their returns. The case focuses on one of CalPERS' external fund managers, Dimensional Fund Advisors, and a service provider to DFA and CalPERS, KLD Research & Analytics.

Aside from its principle contribution, the case study provides insight on the reasons behind the change in the policy to investing in emerging markets along with the internal process required for fund managers to implement the new principles.

An interesting fact to highlight from the case is that: Before the implementation of the Emerging Markets Principles, the top three countries represented in the CalPERS emerging markets portfolio—internal and external were Korea, South-Africa, and Taiwan. However, once the new principles were implemented, about 90% of companies that were added to the portfolio were based in China or Russia (pg9).

The authors conclude the study with Stausboll's concerns as she assumed her new role as CEO of CalPERS: 1) Had the new principles been effective? Should CalPERS instruct all of its external emerging markets equity managers to use KLD's research in making their investment decisions, as did Dimensional? Should CalPERS use the upcoming KLD ESG rating system to determine in which companies to invest in the US and other developed markets? If so, should CalPERS use it internally or require its external money managers to also use KLD's ratings? In brief, what is the right balance between "value" and "values" investing?

**3 . Gugler, P. and Shi, J. Y. J. "Corporate Social Responsibility for Developing Country Multinational Corporations: Lost War in Pertaining Global Competitiveness?" Journal of Business Ethics (2008).**

This article explores the North-South division through the analysis how corporate responsibility has an increasingly important role to play in leveraging the comparative advantage of the North and the South in the globalization.

It is commonly agreed that the comparative advantage of the South is mainly based on low cost, one of the crucial cost-minimizing factors being lower social and environment standards (pg 8). Under the CSR pressures imposed by different stakeholder groups, especially criticized for their irresponsible sourcing from the South, MNEs from the North responded by establishing private supplier's Code of Conducts usually containing higher standards than what the host country has put in place, and making them mandatory in selecting suppliers (Id). Thus, CSR accentuates the power imbalance between large MNEs from the North and small suppliers from developing countries (Id).

Most firms, as well as the governments from the South often regard the CSR to be largely founded on Anglo-American philosophies and values, and its requirements as an imposed burden by their business partners, therefore, address the issue in a ''mock compliance'' manner, such as in many Chinese factories (Chan, 2004) (pg 11).

Page 13 presents a nice table (1) on the evolution of CSR in China.

The authors make reference to an UNCTAD survey that found the main driving force for Chinese MNEs' internationalization is ''the need to bypass trade barriers'' and ''the need to utilize domestic production capacity'' because the home market for their products is too small, are key drivers of internationalization (pg 14). (WIR 2006, p. 156). The future ''Chinese giants'' will unavoidably encounter the CSR challenges when they move to a market with higher social standards, as demonstrated in Part II: 2 in this article, and what left to Chinese MNEs, and other developing-country MNEs, is to find out how to apply CSR to enhance their visibility and marketability through intangible assets building and technology and management innovation, or they can risk of being perceived as exploitative and CSR-unfriendly (Id). From the same report: ‘‘While adherence to various internationally adopted CSR standards may entail costs for the companies concerned, it can also generate important advantages, not only for the host country but also for the investing firms and their home economies’’ (WIR 2006, p. 240) (Id).

**4. Hebb, T. and D. Wójick. (2005) "Global standards and emerging markets: the institutional investment value chain and the CalPERS investment strategy." Environment and Planning A 37:1955-1974.**

The authors argue that nation-states are key actors in global standards setting since countries and their regulatory regimes are central to external-capital-investment decisions (pg 1957). The authors find that convergence to global standards occurs when key actors in the investment value chain demand levels of corporate and social behaviour greater than those currently consistent with countries' regulatory frameworks (Ibid). The authors establish this claim using three critical pieces of analysis. First, they show that countries' legal origins are no longer strong determinants for achieving the global standards required for investment in emerging markets (La Porta et al, 1997) (Ibid). Second, they demonstrate that emerging-market countries, when excluded from foreign investment, improve their corporate practices and standards in order to attract that investment in the future (Ibid). Third, they find that convergence to global standards is not strongly influenced by the wealth of the emerging-market country, but rather as a direct reaction to exclusion from foreign investment in the previous period (Ibid). To reach these conclusions the authors examine country-specific investment decisions taken by institutional investors in emerging markets with particular reference to the CalPERS decision to exclude some emerging-market countries from its portfolio (Ibid). The authors utilized the unique dataset developed for CalPERS by Wilshire and Associates over the two time periods on the basis of seven specific country market factors (Ibid). The study also draws on a number of qualitative and quantitative methods.

The authors introduce the institutional investment value chain which links the demands of institutional investors with increased unified global standards of corporate, social, and environmental behaviour and the heightened transparency necessary to benchmark the outcomes of such behavior (pg 1958). In this value chain, investors benchmark countries and companies against a set of global standards to ensure capital preservation and wealth enhancement in the face of increased country and corporate uncertainty endemic to emerging markets. Rating agencies and nongovernmental organizations (NGOs) provide the lens through which raised corporate-governance and responsibility standards are both generated and monitored, providing financial and nonfinancial information from which pension funds and other institutional investors can make informed investment decisions and establishing common behavioural frameworks and standards across multilayered jurisdictions. These groups provide external monitoring of countrywide and firm-level standards using the media as their dissemination tool in order to make their findings public, in effect creating a venue for mandatory involuntary reporting.

Institutional investors react to this information by redirecting their capital flows accordingly. The threat of capital flight and the allure of external investment affects a convergence to global standards.

The authors argue that the ability and willingness of countries to adopt global standards in the face of capital-market exclusion are unrelated to the origins of their legal regimes (pg 1967). The inclusion of a country in one or another family of legal origin (either German, French, or English) did not bear any significance for the country's Wilshire rating, neither for the total score nor for the score in any of the sub factors (pg 1968). The authors find strong evidence that countries with low scores in 2002, particularly those countries excluded from the CalPERS investment portfolio, worked hard to raise their scores over the year (pg 1970). The authors also find an even more significant negative relationship between the starting level of the score and the change in the score (Ibid). The authors' findings thus supports investor intuition that applying both financial and nonfinancial standards to entire countries within emerging-markets portfolios acts as a catalyst to raise standards beyond those currently consistent with the countries' regulatory frameworks (pg 1971).

**5. Kiernan, Matthew J.,Universal Owners and ESG: Leaving Money on the Table?. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 478-485, May 2007. Available at SSRN: http://ssrn.com/abstract=984340 or DOI: 10.1111/j.1467-8683.2007.00580.x**

This article is a good introduction to Innovest Strategic Value Advisors and its approach to approach to sustainable investment. The following is a summary of the most pertinent information:

Innovest's approach to sustainable investment research is predicated on a number of basic, core beliefs.

The first belief is that there are limitations of traditional, accounting-driven investment analysis that are becoming increasingly apparent. These methods are often static and retrospective. A more dynamic, forward-looking analysis of companies' 'intangible value drivers' should provide much richer insights into companies' true risk profiles and competitive potential.

The second core belief is that companies' ability to manage ESG risks and opportunities has already become directly relevant to their competitiveness and profitability, and will become increasingly critical for the foreseeable future.

The third is that companies' performance on a number of ESG issues can provide robust insights about the quality of its overall strategic management, organisational agility and responsiveness. It is directly relevant to companies' competitiveness and financial performance.

The fourth is that the materiality of different ESG factors differs substantially with each industry sector. Any truly robust analysis must start with an in-depth assessment of the competitive dynamics, risks and opportunities in each particular sector.

Our fifth basic belief is that this type of analysis is most useful when it is combined with traditional financial analysis. Innovest's ESG analysis has been explicitly designed as an 'alpha overlay' which is intended to add value to traditional approaches rather than to replace them.

Innovest's research attempts to focus on those factors which contribute most heavily to financial outperformance – those factors that can directly enhance shareholder value by contributing to competitive advantage, risk reduction or both ie. cost reduction through energy efficiency measures; the creation of new markets through differentiated, more 'sustainable' products and services; and a superior ability to attract, retain and motivate top talent (pg 123). At the heart of Innovest's analytical model is the attempt to balance the level of ESG-driven investment risk with the companies' managerial and financial capacity to manage that risk successfully and profitably into the future (pg 124). Different industry sectors place differing premiums on the multiplicity of different sustainability factors. Environmental performance, for example, is clearly a better leading indicator of management quality and competitiveness in the oil and gas sector than it is in software.

**6. Lydenberg, Steven,Universal Investors and Socially Responsible Investors: A Tale of Emerging Affinities. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 467-477, May 2007. Available at SSRN: http://ssrn.com/abstract=986885**

The author posits three types of investors in today's financial markets: Universal Investors, Social Investors and Rational Investors. He argues that the Universal and Social Investor are theoretically inclined to seek returns that benefit society and the environment as a whole, while the tenets of modern portfolio theory lead the Rational Investor to seek returns based primarily on market price. Because of the dominance of modern portfolio theory, the actual practices of the Universal and Social Investor reproduce those of the Rational Investor in most regards today. However, Universal and Social Investors are now pioneering at least three investment practices that promote returns to the economy and society. These are engagement with corporate management, investments that benefit underserved communities, and the setting of social and environmental standards in selecting investments. These practices differ from those of the mainstream in that they deliberately take into account more than market price in seeking returns on investments.

The author argues that measuring the value of corporations to society solely on their stock price and their ability to raise that price is not only a narrow expression of the value of corporations to society, but a potentially dangerous one. It views Universal and Social Investors as having the potential to build on and improve upon the practices of Rational Investors by developing an expanded and more complete conception of investment returns and of corporations' role in providing those returns.

The author suggests that in practice, the tenets of Rational Investors tend to dictate the practices of Universal Investors and Social Investors in the current marketplace because the fundamentals of modern portfolio theory, the measurement of financial returns against market benchmarks based on stock price, and the fiduciary duties that tie investment practices to these same benchmarks all complicate decisions by institutional investors today to act other than as Rational Investors (pp 468).

The author makes the distinction between two types of returns sought by investors in the market place: Returns to the Market (RM), a zero-sum game in which winners in the market benefit at the expense of losers, creating above average returns by exploiting temporary market inefficiencies; and, Returns to the Economy and Society (RES), which is the creation of a healthy and wealthy society and adds to the overall fundamental value of the marketplace and creates a spillover effect that adds value beyond the marketplace. RES would be generated by: innovative goods and services, advances in environmental sustainability that addresses global challenges, and practices that assures all levels of society equal access to products and services crucial to economic development.

The rational investor seeks to capture RM through active trading and minimizing costs (mainly transaction costs). The tools that this investor has developed provide excellent means to measure investors, risk and reward relative to markets. They have not developed tools, however, to measure the effect of their investments on the economy, the environment, or society more generally. They therefore find themselves opposed to the creation of RES at the expense of short-term RM. Universal investors on the other hand should, according to the author, have no interest in RM (pp 470) because RM is by definition a zero-sum game. These investors are therefore interested in RES since it will increase the overall value of their portfolio.

Universal investor practice today, however, would differ from the above mentioned theory (pp 471) because they combine stock indexing to reduce management fees with active management to add alpha. They do so because their performance is almost always measured against market-based benchmarks and the relative returns of peers, rather than against the ability to assure the opportunity for high-quality life to beneficiaries. Moreover, their ability to measure RES is substantially less developed than for RM.

Social investors on the other hand pursue RM that results from the inefficient market analysis by rational investors, but not in a way that undercuts ht creation of a just and sustainable society (Id).

The author concludes that stock price alone is not an adequate measurement of the value of corporations to society today is an assertion increasingly finding its way into the mainstream. And, if universal (complete) investors are to build on and improve upon the practices of Rational Investors,

however, they must supplement their current practices of standards setting, engagement and community investing with the development of a sophisticated and robust set of measurement tools for Returns to the Economy and Society.

**7. Scherer, Andreas Georg and Palazzo, Guido,Globalization and Corporate Social Responsibility. THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY, A. Crane, A. McWilliams, D. Matten, J. Moon, D. Siegel, eds., pp. 413-431, Oxford University Press, 2008. Available at SSRN: http://ssrn.com/abstract=989565**

The authors focus on the “problem” of globalization and its consequences for theorizing on corporate social responsibility (CSR). The authors start off with “in as much as the state apparatus does not work perfectly there is a demand for social responsibilities of business” and that “with globalization, it seems, the negative consequences of businesses have intensified.” The authors hold that the solution of globalization problems is not just a matter of degree of engagement in CSR but rather, with globalization, a paradigm shift is necessary in the debate on CSR. Current discussions on CSR are based on the assumption that responsible firms operate within a more or less properly working political framework of rules and regulations which are defined by governmental authorities. With globalization, they suggest that this assumption does not hold any more. The global framework of rules would be fragile and incomplete. Therefore, business firms would have an additional political responsibility to contribute to the development and proper working of global governance. The authors describe the current situation as one with regulatory gaps, an erosion of national governance, and a loss in moral and cultural homogeneity in the corporate environment (pp 3).

During the process of globalization, the nation state loses much of its political steering capacity (e.g., Beck 2000; Habermas 2001; Strange 1996). The state's enforcement power is bound to its territory while the subjects of state regulation, especially the business firms, have massively expanded their activities beyond national borders. At the same time, new social and environmental challenges emerge which are transnational in scope and cannot be regulated or governed unilaterally (e.g., global warming, crime and terrorism, diseases, etc) (pp 4).

The authors propose that, in this new situation the traditional division of labour between nation state politics and private business may not be sufficient to guarantee the efficient and peaceful integration of society (pg 9). Therefore, with globalization, business firms become political actors that have social responsibilities beyond their economic role, and the mere compliance to the law and rules of common decency is not the appropriate response to the new challenges (Id).

The authors then suggest that the smaller influence of national governments on large corporations is – at least partly – balanced by the politicization of civil society (pp 17). What has been labeled "globalization from below" (Beck 2000: 68) describes the growing power of civil society actors to influence decision making processes in governments and corporations. "The NGO's role and influence have exploded in the last half decade" (Mathews 1997: 53) (Id).

The authors conclude that political solutions for societal challenges are no longer limited to the political system but have become embedded in decentralized processes that include non-state actors such as NGOs and corporations. This new phenomenon would go beyond the mainstream understanding of corporate responsibility. On the global playing field, corporations have to be understood as economic and political actors.

**8. Schnietz, K. E. and M. J. Epstein. (2005) "Exploring the Financial Value of a Reputation for Corporate Social Responsibility During a Crisis." Corporate Reputation Review 7(4):327-345.**

This paper draws on literature from the fields of reputation, strategy, risk and social responsibility to outline the reasons why there might be financial value in a reputation for corporate social responsibility during a crisis and then tests them by examining investor reaction to the 1999 Seattle World Trade Organization (WTO) failure, caused by disagreement among member nations on labor and environmental standards and public protests over the same.

Specifically, this paper examines whether there is financial value in a reputation for corporate social responsibility during a crisis, or an insulating effect to an exogenous shock that is likely to financially harm a firm. The authors take advantage of an event uniquely suited to measure the economic effect of a reputation for social responsibility, the 1999 failed World Trade Organization ministerial meeting in Seattle.

The authors position their hypothesis primarily within the resource-based view of the firm's reputation, drawing upon research and treating corporate reputation as an intangible economic asset that contributes to a firm's sustainable competitive advantage (pg 329). In short, reputation may facilitate complex, long-term stakeholder management which, in turn, ought to enhance a firm's ability to outperform against its competitors, either by increasing revenues or reducing costs (Hillman and Keim, 2001; Russo and Fouts, 1997) (Id). To this end, Fombrun (2001: 24) claims 'reputations have considerable hidden value as a form of insurance — they act like a ''reservoir of goodwill'' '. Jones et al. (2000) have subjected the crisis theory of value to a corporate reputation to a test on a large sample. They found that firms scoring highly in Fortune magazine's annual survey of the 'Most Admired Firms in America' suffered lower market valuation losses in the October 13, 1989 stock market plunge (the S&P 500 declined by 7 per cent on that day), than did firms with lower Fortune reputation ratings.

The authors find that the portfolio of Fortune 500 firms with a reputation for social responsibility (DSI-included firms) declined by slightly more than 1 per cent, although this decline was not significant. In contrast, the portfolio of Fortune 500 firms without a reputation for social responsibility (DSIexcluded firms) declined significantly by 2.36 per cent. In comparison there was no statistically significant decline in the sample of firms with a reputation for social responsibility. Similar findings were established within industries. Similarly the authors found no significant decline in value in the most labour-abusing and environmentally damaging industries for firms with a reputation for CSR while those without a reputation for CSR experienced significant declines in value.

Of use for our research, the authors incorporated three widely used control variables that may affect a firm's stock return (McWilliams and Siegel, 2000; Russo and Fouts, 1997). Size is calculated as the log of the firm's 1999 revenues. Risk is calculated as a firm's debt to asset ratio. R&D intensity is calculated as a firm's R&D expenditure divided by total sales and was included here because its inclusion materially (and detrimentally) changed Waddock and Graves' (1997) results (McWilliams and Siegel, 2000) (pg 339).

**9. Soederberg, S. (2007) 'The "New Conditionality" of Socially Responsible Investment: The Politics of Equity Financing in the Global South'. New Political Economy 12:4.**

The author argues that CalPERS Permissible Country Index (PCI) mirrors the most recent revision of the neo-liberal development discourse and policy, which the IFC refers to as 'entrepreneurial development'(pg 478). According to this argument, the strategy aims not only to encourage a greater involvement of the private sector in development, but also legitimizes deepening forms of dependency on, and discipline of, foreign capital in emerging markets (Ibid). CalPERS mandate of attaining 'enduring value' in emerging market investment through the PCI would be nothing more than a progressive sheen (Ibid). The author suggests the term 'new conditionality' to describe the increasing ability of capital interests to discipline states and societies in the Third World by defining, quantitatively measuring and judging which countries are either desirable or undesirable investment sites, and consequently offering/withholding financing and favourable terms to these states and societies (pg 483).

In the Third World, CalPERS prefers exit strategies as opposed to exercising its voice, as it does in the US (pg 484). This is believed to be due to high levels of family and/or state ownership in publicly the listed corporations of these regions, and CalPERS minority shareholder position in those companies(Ibid). On the other hand, if change is to take place at the company level, it must be accompanied by 'big picture' reforms at the level of legal and political systems (Ibid). Therefore, CalPERS tends to be a short term investor in these regions.

The author highlights criticism of CalPERS PCI policy. 1) CalPERS Board Members – 10 out of 13 of whom are union members, union officers or current and former politicians, and most of whom depend or depended on union support and endorsement – have been accused of using the PCI to further their careers (driven by votes, not a social conscience) in an attempt to grandstand ethical investment, as opposed to market activism (pg 490). 2) The PCI guidelines and their goal of building enduring value do not extend to CalPERS' private equity funds, which invest on behalf of the pension fund (pg 492). These private equity funds hold investments in countries that have been black listed by the PCI (Ibid). Private equity funds are not concerned with the social criteria of their investments (Ibid).

The author concludes that the tension underlying the PCI and entrepreneurial development not only entails intensified forms of exploitation and domination, so as to secure the expansion of Western-based pension fund capital, but also growing political and social unrest associated with the legitimacy crisis of neo-liberal-led capitalism (pg 493). The author's ultimate position is that CalPERS should work towards using voice, by forming alliances with local unions and progressive NGOs in the emerging markets, as opposed to 'exit' as a disciplinary strategy (Ibid).

**10. Vogel, David J.,Private Global Business Regulation. Annual Review of Political Science, Vol. 11, June 2008. Available at SSRN: http://ssrn.com/abstract=1141447**

The author seeks to shed light on the phenomenon of codes, regulations, and standards that are not enforced by any state and that address the social and environmental impacts of global firms and markets, especially in developing countries (pg 262). The article provides an comprehensive review of the scholarly literature on this topic.

The author notes that an important advantage of civil regulations is that they essentially bypass ongoing conflicts about state sovereignty, which have often restricted western governments from using trade policies to affect the domestic regulations of developing countries (pg 265). Thus, ironically, WTO rules have created an important incentive for using voluntary, private standards rather than public ones, since the latter can be more readily challenged as nontariff trade barriers (Ibid). Although the adoption of civil regulations by governments would clearly strengthen their effectiveness, it would also subject them to WTO scrutiny (Ibid). Originated in response to activist pressures, these newer forms of industry self-regulation politicize business decision making, pressuring firms to make expenditures and commitments they would not otherwise have made (pg 263). They are also more likely to either directly or indirectly involve political constituencies outside the firm.

“One of the most significant changes in recent years is that the ‘who’ in ‘who governs?’ must now be expanded to include the participation of nongovernmental and noncorporate actors” (Haufler 2006, p. 92) (Ibid). An important voluntary global environmental standard, ISO 14001, “fits within an emerging paradigm shift in environmental law, from a media-specific ‘command-and-control’ approach to controlling emission and wastes to an approach more focused on voluntary, incentive-based, market-based, and information-based approaches” (Roht-Arriaza 2000, p. 273) (pg 265). Civil regulation has thus also emerged in order to “help empower global civil society by providing activist groups with political levers that exist outside state systems” (Falkner 2003, p. 79) (pg 267). By providing opportunities for consumers and investors to engage in politics via markets, civil regulation has created new sites for political activity outside states (Micheletti & Stolle 2007) (Ibid). Private codes of conduct are thus “regarded by their proponents as civilizing influences that temper the hazards of global market forces by giving globalization a human face” (Cutler 2006, p. 200) (Ibid).

Many activist groups have decided that working directly with companies to develop and help enforce global codes of conduct for them and their suppliers constitutes an effective, albeit a second-best, strategy for bringing about substantive social and environmental improvements in developing countries (Ibid). Although adversarial relationships between NGOs and firms continue, both informal and formal cooperation between global firms and transnational NGOs have measurably increased (Ibid). There is considerable evidence of “a shift [by NGOs] from boycotts to global partnerships” (Domask 2003, p. 157) (Ibid). Such cooperative relationships have increased the ability of NGOs to participate in and influence corporate decisions regarding global labor and environmental practices (Ibid).

The author concludes by outlining a research agenda. Notably: We know much more about what codes require and why firms have subscribed to them than we do about the extent of actual business compliance. Scholars need to get inside the “black box” of firms to better understand how civil regulations have changed their behaviors. How do both global firms and their developing country suppliers determine what financial and organizational resources to allocate to complying with them? How do they balance the costs of acting more “responsibly” with the business risks of not doing so? In what ways has the often-cited change in business values and norms actually affected the decisions of global firms, such as where to outsource and invest and whether to pay a premium for more responsibly produced products?

**The Next 15 Pieces:**

**11. Barber, Brad M.,Monitoring the Monitor: Evaluating CalPERS' Activism(November 2006). Available at SSRN: http://ssrn.com/abstract=890321**

The author reviews the theory and empirical evidence underlying the motivation for institutional activism. In theory, the merits of institutional activism hinge critically on two agency costs: (1) the conflicts of interest between corporate managers and shareholders, and (2) the conflicts of interest between portfolio managers and investors. This leads to two types of institutional activism: shareholder activism and social activism. While portfolio managers can use their position to monitor conflicts that might arise between managers and shareholders (shareholder activism), they can also abuse their position by pursuing actions that advance their own moral values or political interests at the expense of investors (social activism).

In general, the author argues that institutional activism should be limited shareholder activism where there is strong theoretical and empirical evidence indicating the proposed reforms will increase shareholder value. When institutions are forced to engage in social activism and take positions on sensitive issues, he argues, portfolio managers should pursue the moral values or political interests of their investors rather than themselves.

Using simple empirical methods, he estimates the gains to the high profile activism of CalPERS focus list firms over the period 1992 to 2005. His short-run analysis indicates that CalPERS activism yields small, but positive, market reactions of 23 basis points (bps) on the date focus list firms are publicly announced. This translates into a total wealth creation of $3.1 billion ($224 million annually) over the 14 year period. Portfolios of focus list firms earn annualized abnormal returns ranging from 2.4 to 4.8 percentage points annually at holding periods ranging from 6 months to 5 years (pg 2). If these abnormal returns are causally linked to the activism of CalPERS, the wealth creation is enormous -- as much as 20 times greater than the short-run benefits and as large as $89.5 billion through December 2005. Unfortunately, while economically large and positive, the estimates of long-run abnormal returns are not reliably positive (Id). He concludes his analysis that the shareholder value created by CalPERS activism justifies the expenditures on the resources required to bring about this activism (pg 11).

He concludes, however, that when institutions engage in social activism that cannot reasonably be expected to maximize shareholder value, the preferences of investors should be given top priority (pg 18). Institutions must open lines of communication with investors; they must understand how investors stand on moral issues that might affect investment policy (Id). He gives the example of tobacco divestment which cost CalPERS over 650 Million dollars from year 2000 to 2006. Never were the investors consulted.

**12. Benson, K. L., T. J. Brailsford and J. E. Humphrey. (2006) "Do Socially Responsible Fund Managers Really Invest Differently?" Journal of Business Ethics 65(4):337-357.**

This paper examines whether the portfolio allocation across industry sectors and the stock-picking ability of SRI managers are different when compared to conventional fund managers. The study finds that SRI funds exhibit different industry betas consistent with different portfolio positions, but that these differences vary from year to year.

As a basis for their study, the authors refer to numerous studies that found no overall difference in performance between SRI funds and their conventional counterparts. The authors ask: If SRI funds do not differ materially, then how do they differ? The key purpose of this study is to provide an analysis of the relative portfolio composition of SRI funds. Specifically, the study focuses on the industry composition of the investment portfolio comparing SRI funds to conventional mutual funds. In so doing, the authors provide an empirical analysis of SRI fund investment practices. After assessing the industry allocations they also consider the stock selection abilities of the fund managers.

The authors found that 92% of all funds exhibit at least one industry beta statistically significantly different from one, with the majority of funds having positive betas on the information technology industry which is not surprising given that the sample period overlaps with the dot.com boom. These findings are consistent with most managers attempting to earn additional returns by industry selection and avoiding index replication.

In tests of differences between SRI and conventional funds, the results show that the estimated industry betas between the two groups are significantly different for the telecommunications and utilities industries. This is a key finding of the paper as it demonstrates that despite exhibiting similar performance, the returns of SRI funds are generated through different industry exposures when compared to conventional funds, which is consistent with SRI managers holding different portfolio positions. This result counters the public criticism that SRI funds are a marketing ploy and confirms they are not merely ‘‘conventional funds in disguise’’ (Bauer et al., 2004). In terms of stock-picking skill, the study has found that overall, there is no significant difference between SRI managers and their conventional counterparts.

**13. Clark, G. L. and T. Hebb. (2004) "Pension Fund Corporate Engagement. The Fifth Stage of Capitalism." Relations Industrielles/Industrial Relations 59(1):142-171.**

The authors suggest that pension fund corporate engagement is the fifth stage of capitalism and that it may well hold answers to aligning company managers’ decisions with both shareholders and stakeholders through raised standards of firm behavior (pg 163).

The fifth stage of capitalism is an expansion on the work of Robert Clark (1981) from his paper “The Four Stages of Capitalism,” which offers an interesting model to examine how capitalism has changed over time (pg 146). In the first stage the entrepreneur was the primary actor and the object of his activity was the private corporation. The second stage saw the professional business manager usurping the role of entrepreneur. The third stage of capitalism witnessed the ascendancy of the portfolio manager with the rise of financial intermediation in the capital supply chain. The fourth stage of capitalism, which emerged in the 1970s and 1980s, heralded the beneficiary as the principal actor and the professionalizing of the savings function as the object. Peter Drucker (1976) went so far as to call this stage the Unseen Revolution, positing such power in the hands of beneficiaries that he attached the term socialism to the new role they were to play. Each of these distinct stages procreates the next, with the object of action becoming the primary actor of the next generation. In the fourth stage, beneficiaries are the principal actor. For both R. Clark (1981) and Drucker (1976), these beneficiaries represent an era of ‘pension fund socialism’ with mass control of the financial system. But neither thinker fully articulates the mechanisms by which such dispersed ownership would act in concert.

The authors posit that the fifth stage of capitalism is not one defined in terms of pension fund socialism but rather in terms of pension fund capitalism. Their construct builds on Robert Clark’s model by offering deeper insight into the evolving nature of pension funds and the role they play in today’s financial system. Today’s pension funds are shifting decision making roles within the corporation (pg 143). Pension funds have re-aggregated the previously dispersed shareholders with concentrations of ownership unseen since the great industrialists of the 19th century and are using this concentration of power to actively engage company management in order to raise firm-level standards of behavior across a range of issues, including, accountability, transparency, and social and environmental standards (Ibid).

Stage five capitalists are value investors who derive long-term share value from the fundamentals of the firm rather than through the growth of the stock or sector (pg 148). What differentiates these investors from the earlier stage four as envisioned by Robert Clark is that they not only seek out firm fundamentals as the key driver of future growth, but in addition are beginning to bring their influence to bear on firm-level standards and management oversight in order to ensure these fundamentals are maintained when faced with the uncertainty of future events (Ibid). This change in philosophy on the part of pension funds has driven seismic shifts in 'Wall Street' conventional wisdom (pg 151). The first is a shift in investment style away from 'growth' and toward 'value' investing (Ibid). The second is increasing awareness among pension fund investors about their apparent short-term myopia and the prospects for a longer-term investment horizon necessary to realize increased share price from 'value' investing (Ibid). The third change is a return back to active investment management over passive investment strategies (Ibid). All three investment strategies require both the need to seek firm fundamentals that deliver value over time, and a lengthening of investment time horizons in order to realize equity premium increases over the long run (Ibid).

One of the significant changes between fourth stage and fifth stage capitalists is their newfound ability to work in coalition in order to affect the governance of their investee firms (Monks 2001; Strickland, Wiles and Zenner 1996). Such coalitions are possible because changes in securities laws allow for easier communication between shareholders and because transaction costs of both monitoring and coordinating responses have been lowered when measured against the increases in share value such activity generates.

Many pension fund investors argue that greater regard for the long-term impacts of firm decision-making and increased corporate social responsibility reduces risk, adds share value, and in the long run serves owners' interests better than short-term decisions based strictly on financial data (pg 157). While pension fund investors seek control to increase social and environmental standards, they are not acting solely in response to broad societal demands for corporate awareness of external stakeholders (pg 158). Rather they adopt this course of action because increased social and environmental standards lower risk and uncertainty over the long run and hence have the potential to pay off for these investors over time (Ibid).

The authors conclude that pension funds are redefining the power relationships within the firm (pg 163) and that corporate engagement should be seen as a tool to raise firm level accountability, transparency, and social and environmental standards, not as a vehicle for major transformation of the capitalist system (pg 160).

**14. Derwall, Jeroen, Bauer, Rob, Guenster, Nadja and Koedijk, Kees C. G.,The Eco-Efficiency Premium Puzzle. Financial Analysts Journal, Vol. 61, No. 2, pp. 51-63, March/April 2005. Available at SSRN: http://ssrn.com/abstract=713861**

The authors examine the financial performance of firms as it relates to their eco-efficiency relative to their peers. Based on Innovest Strategic Value Advisors' corporate eco-efficiency scores, the study constructed and evaluated two equity portfolios that differed in eco-efficiency. The Innovest scores build on the concept of "eco-efficiency," which can be interpreted as the economic value a company adds (e.g., by producing products and delivering services) relative to the waste it generates when creating that value. The authors use Cahart (1997) to evaluate the portfolios while controlling for multiple non-environmental factors known to determine stock performance (size, value versus growth, momentum effects). They find that the high-ranked portfolio is reported to have earned a significant average factor-adjusted return of 3.98 percent a year, whereas the low ranked portfolio performed poorly. Factor loadings on the additional determinants, size, value versus growth and momentum, are generally significant. For both the high-ranked portfolio and the low-ranked portfolio, the coefficient on size is significantly negative, which implies a bias toward large-cap stocks in the Innovest database. The factor loadings on value versus growth suggest that the high-ranked portfolio was somewhat growth-stock oriented during the period examined whereas the low-ranked portfolio was significantly tilted toward value stocks.

In an attempt to explain their results, the authors control for investment style and industry biases. They find that both of these factors fail to explain the observed performance differential. The nature of the eco-efficiency differential remains undetermined. They suggest that it might be attributable to latent risk factors or to mispricing. They offer the alternative explanation that their findings are the result of the market's inability to price eco-efficiency in an efficient manner. They also find that, in the presence of transaction costs, the excess return on the best-in-class portfolio remained statistically significant. For instance, even in the scenario of 200 bp transaction costs, we found that the annualized alpha of the best-in-class portfolio is still large (3.43 percent) and statistically significant at the 10 percent level.

**15. Elsayed, A. and D. Paton. (2005) "The impact of environmental performance on firm performance: static and dynamic panel data evidence." Structural Changes and Economic Dynamics 16:395-412.**

By conducting a static and dynamic analysis of the impact of environmental performance on financial performance, the authors find that environmental performance has a neutral impact on firm performance. This finding is consistent with theoretical work suggesting that firms invest in environmental initiatives until the point where the marginal cost of such investments equals the marginal benefit.

Their dynamic panel data estimates reveal only very weak evidence that environmental performance affects financial performance. In contrast, cross-section and pooled estimates using the same data suggest that lagged environmental performance exerts a strongly significant impact on firm performance. The most likely explanation for the difference between these findings is that there exist unobservable firm effects that are important in explaining financial performance.

The authors find some evidence of a differential impact of environmental performance across industries for one measure of financial performance. Specifically, environmental performance appears to have a positive impact on the return on assets for firms in the chemical and telecommunication industries and a negative impact for firms in textiles, clothing, metals and motor vehicles. These results suggest that allowing for firm heterogeneity is much more important than allowing for dynamic effects in studies of the environmental/financial performance relationship. Indeed, studies which ignore the existence of firm effects (such as Russo and Fouts, 1997; Dowell et al., 2000) are likely to lead to incorrect inferences regarding the impact of environmental performance on financial performance.

The weight of their evidence is that environmental performance has very little impact on financial performance. This finding is consistent with theoretical work in which firms invest in environmental initiatives until the point where the marginal cost of such investments equals the marginal benefit.

**16. Guerard, J. B., Is there a cost to being socially responsible in investing? Journal of Investing. New York: Summer 1997. Vol 6, Iss 2; 11.**

This study seeks to find if being socially responsible in investing destroys or creates value for the investor. The author compares returns of a screened and unscreened portfolio. The screens used in this analysis are provided by Kinder, Lydenberg, and Domini (KLD), and address the following social investing issues: military; nuclear power; product (alcohol, tobacco, and gambling); and environment. The author finds that the Vantage Global Advisors' (VGA) unscreened 1,300-stock universe produced a 1.068% monthly average return during the January 1987-December 1994 period, so a $1.00 investment grew to $2.77. A corresponding investment in the socially screened universe would have grown to $2.74, for a 1.057% average monthly return. The authors conclude from this result that there is no significant difference between the average monthly returns of the screened and unscreened universes during the 1987-1994 period.

The author finds that socially screened-out stocks had higher market capitalizations and were more value oriented than the unscreened universe, a condition noted by Kurtz and DiBartolomeo [1996]. There is a statistically significant difference between the unscreened VGA universe lower price-to-book ratio and the higher price-to-book ratio of the Vantage screened universe. Fama and French [1995] have found that smaller stocks with lower price-to-book ratios tend to outperform larger stocks with higher price-tobook ratios in the very long run. Controlling for these factors, the author finds the socially responsible portfolio outperforms significantly. The estimate composite model produces an average annual return of 15.88% for the 1987-1994 period, while the S&P 500 less its exclusions produces an average annual return of 11.87%.

**17. Hawley, James P. and Williams, Andrew T.,Universal Owners: Challenges and Opportunities. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 415-420, May 2007. Available at SSRN: http://ssrn.com/abstract=984335 or DOI: 10.1111/j.1467-8683.2007.00574.x**

The author defines universal ownership (UO) and outlines the challenges and opportunities that face the universal owners. He also highlights what he calls the systemic, conceptual and methodological issues that confront the concept.

To communicate the emergence and the current state of universal ownership, the author begins by explaining the underlying construct of the concept, beginning with the rise of fiduciary institutions. He points out that institutional investors are bound by the duty of loyalty and the duty of care. Over time the problem of loyalty has become progressively more complex as it has come to involve an ever-growing chain of intermediaries acting as agents for the ultimate investor or beneficiary, and as agents come to have their own agents of professional investors, investment managers, investment advisors, investment lawyers and so on. Fiduciary capitalism is typified by highly diversified equity holdings by a large number of institutional investors however, in the USA, the top 100 of them hold 52% of all publicly held corporations. He explains that their ability to meet their fiduciary obligations to their beneficiaries depends to a critically large extent on the performance of the economy as a whole and therefore, since their portfolio represents the entire market, their portfolio internalizes both positive and negative externalities. This compels economic interest in the performance of the economy as a whole. Moreover, since many of the institutional investors are pension funds, they naturally have a long term horizon.

The author asserts that institutional investors need to adopt the UO mindset and then adopt actions that will reflect this mindset. Actions such as engaging in large issues that generate major impacts on portfolios, but which fall outside typical firm-by-firm or even industry-by-industry analysis. This would lead to cooperation amongst UO. It will also lead to more sustainable corporate practices because business which seem eager to make long-term investments to reduce carbon emissions in electrical generation, for example, need investors – and universal owners are naturally well positioned – to appreciate the wisdom of their strategy and be willing to patiently stand with them until the strategy bears fruit (pp 417).

There are conceptual issues with UO that are not yet clear. First, is it possible to mobilize pension fund beneficiaries and the "average" investor, typically in mutual funds, to consider and articulate his or her interests? Also, does the rise of mutual funds and hedge funds undercut possible long-term generic growth? That is, if hedge funds do not act on consistent good governance principles with their investments, will we begin to see a reversion of governance practices to early 1990s levels, to say nothing of the environmental and social ones (pp 418)?

The author suggest a number of opportunities that institutional investors might take to act like institutional investors. 1- To view returns as generated by the portfolio as a whole, not simply by individual holdings. 2- To adopt explicit statements and policies that acknowledge an institution's status as a universal owner such as Hermes' Principle 10. 3- Join other universal owners to influence public policy on universal owners issues. 4 - to grade companies by giving out stars to top performers, and perhaps, as we understand both CalPERS and Hermes have done, to development alternative investment vehicles which weight toward high performers.

**18. Hawley, Williams (2003), Shifting Ground: Emerging Global Corporate Governance Standards and the Rise of Fiduciary Capitalism**

The authors argue that institutional owners have a unique perspective and voice with which to contribute to the formulation of global standards in a variety of areas on the basis of their long-term financial interests. This conclusion is supported by an analytic review of the current state of global corporate governance, including multilateral initiatives (for example, the Organisation for Economic Co-operation and Development, the World Bank); an analysis of significant institutional investors, the role of various rating agencies (for example, Fitch, Moody's), the International Corporate Governance Network, and the growing role of various nongovernmental organizations (for example, the Coalition for Environmentally Responsible Economics, the Carbon Disclosure Project) in relation to corporate governance (pg 1995).

The authors suggest that there is a global emergence of a double and partially intersecting set of corporate-governance standards, the combined origins of which lie in the state sector, in the institutional investor sector, which invests in equity markets across borders, and among nongovernmental organizations as they impact large institutional owners, governmental regulatory bodies, and individual corporations (pg 1995). The drivers of these trends would be the self interest of institutional investors and the expansion of the concept of fiduciary duty and obligation, which originate overwhelmingly in common-law countries that (not coincidentally) are also the countries in which large global-equity institutional investors are domiciled (Id). Building on their previous work (Hawley and Williams, 2000), we argue in this paper that economic and social trends in common-law countries are in the process of expanding the concept of fiduciary obligation—in practice through market pressures, as well as in law, regulatory rulings, and stock-exchange-listing requirements (pg 1996).

The authors point out Charles Oman's argument that, ``As globalization enhances the strength of market forces relative to that of regulation by national and sub-national governments, corporate governance [as a market force] thus becomes still more important'' (Oman, 2003,page 10) (pg 1997). Thus, with the growth of deregulation and the concomitant rise of market mechanisms, market actors have been under far greater pressures to account for (and internalize) externality costs (for example, environmental damage), and to consider social investment issues (for example, education and public health) (Oman, 2003, page 10) (Id).

The authors present a good overview of the emergence of international organizations and their role in the expansion of fiduciary obligations.

**19. Jensen, M. C. (2001) "Value Maximization, Stakeholder Theory, and the Corporate Objective Function." Journal of Applied Corporate Finance 14(3):8-21.**

With reference to the role of the corporate objective function in corporate productivity and efficiency, social welfare, and the accountability of managers and directors, the author argues that since it is logically impossible to maximize in more than one dimension, purposeful behavior requires a single valued objective function. Social welfare is maximized when each firm in an economy maximizes its total market value.

Stakeholder theory argues that managers should make decisions so as to take account of the interests of all stakeholders in a firm but it refuses to specify how to make the necessary tradeoffs among these competing interests they leave managers with a theory that makes it impossible for them to make purposeful decisions. With no way to keep score, stakeholder theory makes managers unaccountable for their actions. It seems clear that such a theory can be attractive to the self-interest of managers and directors.

Value maximization, on the other hand, takes more than acceptance of value maximization as the organizational objective. A firm cannot maximize value if it ignores the interest of its stakeholders. In this article, the author offers a proposal to clarify what he believes is the proper relation between value maximization and stakeholder theory. He calls it enlightened value maximization, and this is identical to what he call enlightened stakeholder theory. Enlightened stakeholder theory specifies long-term value maximization as the firm's objective and therefore solves the problems that arise from the multiple objectives that accompany traditional stakeholder theory. In order to maximize value, corporate managers must not only satisfy, but enlist the support of, all corporate stakeholders—customers, employees, managers, suppliers, local communities (pg 9).

The virtue of the Balanced Scorecard is that the process of creating the scorecard can add significant value by helping managers understand both the company's strategy and the drivers of value in their businesses (Id). But companies embracing stakeholder theory will experience managerial confusion, conflict, inefficiency, and perhaps even competitive failure (Id). The author gives an example of a business unit that has as its goal, balancing optimal profit and market share (pg 10). The author suggests that it leaves the managers with no objective thus resulting in confusion and lack of purpose that will handicap the firm in its competition for survival (pg 11).

The author's position is that value—meaning "social" value— is created whenever a firm produces an output, or set of outputs, that is valued by its customers at more than the value of the inputs it consumes (as valued by their suppliers) in the production of the outputs(Id). Firm value is simply the long-term market value of this expected stream of benefits. The author acknowledges that there are circumstances when the value-maximizing criterion does not maximize social welfare—notably, when there are monopolies or "externalities." However, the author believes that resolving externality and monopoly problems is the legitimate domain of the government in its rule-setting function (pg 12).

Maximizing the total market value of the firm is the objective function that will guide managers in making the optimal tradeoffs among multiple constituencies (or stakeholders) (Id). It tells the firm to spend an additional dollar of resources to satisfy the desires of each constituency as long as that constituency values the result at more than a dollar (Id). It is precisely because profit is the amount by which revenues exceed costs—by which the value of output exceeds the value of inputs—that profit maximization leads to an efficient social outcome (Id). Therefore, as long as there are no externalities in the output markets, the value to society of the goods and services produced by the firm is at least as great as the price the firm receives for the sale of those goods and services (pg 13).

When the a company acquires an additional unit of any input(s) to produce an additional unit of any output, it increases social welfare by at least the amount of its profit (Id). Knowing whether society will be benefited or harmed requires knowing whether the future output will be valuable enough to offset the cost of having people give up their labor, capital, and material inputs in the present. Interest rates help us make this decision by telling us the cost of giving up a unit of a good today for receipt at some time in the future (Id). In this world, individuals are as well off as possible if they maximize their wealth as measured by the discounted present value of all future claims (Id). The corporate objective function that maximizes social welfare thus becomes "maximize current total firm market value." It tells firms to expand output and investment to the point where the present market value of the firm is at a maximum (Id). How to choose among multiple constituencies with competing and, in some cases, conflicting interests? Value maximization (or value seeking) provides the following answer to the tradeoff question: Spend an additional dollar on any constituency provided the long-term value added to the firm from such expenditure is a dollar or more (pg 14).

The author suggests that stakeholder theory is embraced by so many managers and directors because it allows them to pursue their own interests at the expense of the firm's financial claimants and society at large (Id). The author also suggests that there is something deeper than self-interest— something rooted in the evolution of the human psyche— that is driving our attraction to stakeholder theory (Id). Many people are drawn to stakeholder theory through their evolutionary attachment to the small group and the family and since the free market works in very complicated and subtle ways, we have a system in which human beings must simultaneously exist in two orders…

The author concludes that for those intent on improving management, organizational governance, and performance, there is a way out of the conflict between value maximizing and stakeholder theory. It lies in the melding together of what he calls "enlightened value maximization" and "enlightened stakeholder theory (pg 16). Enlightened value maximization recognizes that communication with and motivation of an organization's managers, employees, and partners is extremely difficult. Value maximization is not a vision or a strategy or even a purpose; it is the scorecard for the organization. They must be turned on by the vision or the strategy in the sense that it taps into some human desire or passion of their own. it is a basic principle of enlightened value maximization that we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency (Id).

**20. Jorge A. Chan-Lau (2004), Pension Funds and Emerging Markets, IMF Working Paper**

This paper focuses on the investment behavior of pension funds in developed and emerging market countries. First, it analyzes the main determinants of the emerging market asset allocation of pension funds in developed countries. Second, it assesses how pension funds in emerging markets have contributed to the development of local securities markets. Third, it analyzes the determinants of pension funds' investment performance. The paper concludes with a discussion of why the emerging market asset allocation of pension funds in developed countries is likely to increase and what the challenges faced by pension funds in emerging markets are.

In terms of assets under management, pension fund assets in the developed world greatly exceed the market capitalization of external and domestic emerging markets. Thus, even a small permanent allocation by pension funds to the emerging market asset class may have a stabilizing effect (pg 3). Pension funds could contribute to stabilize emerging markets as their behavior mimics the behavior of dedicated emerging market investors (pg 5).

From a strategic asset allocation perspective a number of factors determine pension funds' exposure to foreign securities, and emerging markets in particular. They include the risk aversion of pension fund trustees – the repeated occurrence of financial crisis in emerging markets have heightened the perception that emerging markets are excessively volatile and has lead to the fear of facing short-term losses; the increased importance of 401(k)retirement plans where employees are responsible for the asset allocation leads towards more conservative portfolio strategies (Davis and Steil, 2001) (pg 8) – investments in domestic assets match better domestic liabilities than investments in foreign securities and render it easier to attain almost perfect the correlation between assets and liabilities and rules out the possibility that liabilities may exceed assets in the future – whether pension plans offer defined-benefits plans rather than defined-contribution plans -- the appropriate investment strategy in defined-contribution plans is to maximize the expected return of the portfolio for a given level of risk, as suggested by modern portfolio theory – the requirement to follow socially responsible investment guidelines – CalPERS' for example – and investment regulation. Also, pension plans facing serious financing gaps may have incentives to search for yield-enhancing investment strategies, including investing in emerging market securities (pg 14).

Government sponsored pay-as-you-go systems in Europe and Japan are under duress because of declining fertility rates and longer life expectancies (pg 24). Early retirement policies implemented within OECD member countries have compounded the underfunding problem faced by their pension systems.29 Therefore, there is increased pressure to reform the current pay-as-you-go systems and move towards fully funded systems. This move would increase demand for financial assets that may benefit emerging markets (Id).

Investment practices also impact the tendency of pension funds to invest in emerging markets. For one, the herd behavior of external consultants is present among external asset managers. And since these managers' performance is compared to the industry average, it creates an incentive to mimic the rest of the industry. The external delegation of asset allocation and security selection also has a negative impact on the buy-and-hold preference of pension funds since external asset managers tend to trade actively to avoid underperforming their peer group. Moreover, pension funds in the United-States allocate assets to emerging markets based on the relative weight of emerging market equities in global equity indices such as Morgan Stanley's All Country World Index (ACWI) (Id).

**21. Kiernan, Matthew J.,Universal Owners and ESG: Leaving Money on the Table?. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 478-485, May 2007. Available at SSRN: http://ssrn.com/abstract=984340 or DOI: 10.1111/j.1467-8683.2007.00580.x**

The author starts on the premise that Intellectual capital has become the most important factor in creating wealth; ergo, identifying and managing it has become the single most important driver of competitive advantage and sustainable value-creation. Yet accounting statements have almost no light to shed on these "non-traditional" value – and investment risk – drivers. According to the author, against that backdrop, even mediocre ESG analysis – much of which concentrates on precisely those "intangibles" – starts to look positively robust (pp 480). And as we move deeper and deeper into the era of knowledge-value and intangibles, conventional balance sheets and profit and loss statements are capturing less and less of a company's true value, investment risk and competitive potential.

The author suggests a number of converging global "megatrends" that make it highly probable that the magnitude and economic importance of "ESG externalities" will only grow larger over the next decade: globalization; tightening notional, regional and global regulatory requirements; changing expectations for both consumers and individual investors; growing pressures from international government organizations; and, the emergence of fiduciary capitalism (pp 481).

He proposes that universal owners jump into the fray now, on a "no-regret" basis to take into account all forms of capital, not only financial capital, but also stakeholder, human, strategic governance, and environment capital into their investment decision. He proposes now as the best time because levels of analytical and measurement precision of ESG that is currently desired may never be attained. ESG issues need to be consciously, visibly and systematically integrated into the nuts and bolts of investing: asset allocation, stock selection and portfolio construction. He states the personal intellectual inertia and collective organizational inertia for the failure of universal owners to act on ESG issues.

**22. Ladekarl, Jeppe and Zervos, Sara,Housekeeping and Plumbing: The Investability of Emerging Markets(February 25, 2004). World Bank Policy Research Working Paper No. 3229. Available at SSRN: http://ssrn.com/abstract=610270**

This paper looks at the investment allocation process employed by portfolio investors in emerging markets. In particular, it examines the first of a two-stage decision process: first, investors create a sub-set of investable countries to be analyzed later in further detail; second, they weigh expected returns versus risk and subsequently allocate their funds.

This study hypothesizes that the determination of whether a country is investable or not is influenced by a number of factors, especially related to size, quality of "housekeeping" (macro policies, political economy, local financial markets, corporate governance, etc.) and efficiency of "plumbing" (legal and regulatory framework, custody, clearing and settlement, taxes, etc.). By interviewing many types of these investors in both the United States and the United Kingdom, the authors delve into their decision-making processes as well as attempt to uncover the factors they indicate matter most in defining the investable universe. The authors determine the relative importance of such housekeeping and plumbing factors while highlighting the role of external issues, such as index benchmarking and U.S.

foreign policy. The authors recognize from the outset that the most profound effects on investment flows, or the required minimum expected returns, arise from improvements or deteriorations in macro policies and political stability. However, at the margin, improvements can be made in country policies that will, for a given macro situation, improve the ability of a country to attract international investment flows.

The authors note that one of the most rigorous publicly available investment guidelines has been developed by CalPERS (pg 7). The CalPERS methodology uses a quantitative model with data input from external sources (Ibid). For example, Dimensional, then one of CalPERS three active emerging market external fund managers, indicated that the initial universe of companies in investable countries in June 2003 was 359 but that 77 of these were excluded from the potential “buy list” due to their individual failure to comply with the overall investability criteria. Genesis. Indicated that they had reviewed 521 individual companies in 13 emerging markets and “failed” 47 of those due to their inability to comply with overall “investability” criteria (pg 7). The authors criticize CalPERS Permissible Country Policy on the basis that the list is based on criteria unrelated to profitability, stating what if an attractive investment opportunity arises from outside the list (pg 8)? However, from the country perspective, small improvements in its risk assessment may result in big reductions in the expected required returns and a substantial reduction in financing costs.

Table 2 on page 25 presents the most important factors influencing the inevitability decision of investors. Appendix 1 provides the sources of data that are used by CalPERS to produce its Permissible Country List.

**23. Manheim, J. B. (2004b) "Corporate Dissonance: The Strategic Use of CSR Investing." (Paper presented at the conference “Socially Responsible Investing; Pension Funds” in Washington D.C., June 7th), Available: http://www.aei.org/events/eventID.832,filter.all/event_detail.asp (Accessed: 2006, December, 29).**

In this article, the author addresses the dynamic process of generating pressure and channeling response that lies at the core of corporate activism (pg 2). He argues that dissonance theory can be usefully applied to understand the persuasive strategy being employed by anti-corporate activists to force changes in corporate behavior, and through them, in the aggregate, in the direction of social and economic policy at a most basic level (Id).

First, the author supposes that we begin from the rather different premise that a corporation is a social institution whose purpose is precisely to balance sets of sometimes reinforcing and sometimes contradictory interests with diverse goals, only some of which are economic. Where the interests of these corporate stakeholders are sufficiently aligned, the corporation will succeed in the marketplace, defend its interests in the polity and contribute to the advancement of society in ways consistent with the objectives of its particular stakeholder set (pg 3). Where they fall out of alignment, pressure will be generated on the corporation to restore the previous state of balance, i.e., to change its behaviors (Id).

It is this process of maintaining and restoring balance, then, that suggests the parallels to the balance theories in social psychology. But in lieu of cognitive dissonance representing a state of imbalance among mental constructs, we have what might be termed corporative dissonance – a state of imbalance among stakeholder interests. And just as the theory of cognitive dissonance points to a growing pressure to restore the psychological balance, and to do so via the path of least resistance, a theory of corporative dissonance might similarly predict increasing business pressure on corporations to restore their respective reputations, independence, economic power, profitability, legitimacy and the like, and to do so by the most cost-effective route.

The author outline the systematic exploitation of these leverage points by influential actors within the CSR investment community in order to generate corporative dissonance and to channel dissonance reduction toward outcomes regarded by that community as desirable. The main elements of his argument include the application of power structure analysis, advancing systemic changes in shareholders' rights, waging proxy battles over corporate governance and social policy, and the integration of this effort in the form of a social netwar. I will argue that, to the extent such efforts are effective in the aggregate, broad changes in the character, functioning, standing and impact of the corporation as a social institution will follow (with either intended or unintended consequences).

Pension funds such as CalPERS have been able to coalesce together to leverage their influence on target companies to bring changes in corporate behavior, facilitated domestically through such organizations as the Council of Institutional Investors (CII). The author presents the interweb of pension funds and these activist organizations such as the International Institutional Advisor Group and the International Corporate Governance network, to name a notable few (pg 11). The result of all this networking is a collection of interconnected actors operating with a measure of coordination, but with a decentralized leadership, to legitimize one another and to impose an international regime of governance standards on US (and other) corporations through proxy battles and other means (pg 14).

The article is a good starting point for understanding of the integrated effort of pension funds in "pro-CSR reform." (pg 12)

**24. Sethi, S. P. (2005) "Investing in Socially Responsible Companies is a Must for Public Pension Funds - Because There is no Better Alternative." Journal of Business Ethics 56(2):99-129.**

In this paper, the authors assert that, contrary to conventional wisdom, pension funds, and for that matter other mutual funds, must be concerned with the long-term survival and growth of corporations (pg 99). The authors demonstrate that current measurement of future risk assessment invariably understates, and quite often completely overlooks, these long-term risks because of the inherent bias towards short-run on the part of financial intermediaries whose compensation depends greatly on short-term results (Id). The authors argue that the implications of universal ownership make it so that an exclusionary, and even a primary, focus on short-term financial criteria is no longer a viable option. It also calls for the pension funds to encourage greater transparency and accountability of the entire corporate sector through improved corporate governance. Thus socially responsible investing practices are not merely discretionary and desirable activities; they are a necessary imperative.

Socially responsible companies these companies minimize negative externalities and accentuate positive externalities. Consequently, these companies also minimize future financial risks emanating from imprudent or unsafe business practices (pg 101). Thus these companies are comparatively better and relatively safer long-term investment choices (Id). The authors assert that under prevailing conditions of imperfect markets, and concentration of capital and technology, an exclusive or even primary emphasis on return on capital, which is generally narrowly defined and with a short-term time perspective, would inflict enormous harm on the maintenance of free enterprise system, however imperfect (pg 102). The authors make a good point by differentiating between different types of SR investments and different types of pension funds. They suggest that the suitability of particular type of SR investment depends on the type of pension funds (pg 103).

The authors suggest three important reasons account for the slow growth in the development of more elaborate and rigorous measurements of SRI-based performance variables (pg 108). (1) Corporations and industry groups are reluctant to undertake such research because it would force them to take an account of future uncertainty, which would likely lower corporate performance based on current financial criteria (this would affect stock price and management compensation. (2) Major financial and lending institutions are also reluctant to promote such research because its long-term consequences makes it difficult to find common ground for estimating their potential impact on corporate and industry performance. (3) Most public pensions have been on the defensive in pushing their concept of the importance of SRI-based investment criteria lest they be accused of shirking their fiduciary responsibility.

The authors also introduce the tragedy of the commons and government's decreasing ability to provide enforceable mechanism to ensure the survival of the commons (pg 112). The author points out that businesses earning above average profits must justify those profits through better performance and accountability to other stakeholders. When accomplished voluntarily, these actions are called CSR (Id). Where businesses externalize some of their costs to other members of society, the SRI movement has concentrated its efforts toward improvement through proxy voting and shareholder activism (Id). Voluntary reporting codes lack measures of performance and compliance verification and therefore, corporations must become an active agent for social change if it is to make the world safe for democracy and, indeed, for capitalism (pg 114). Pension funds and other large institutional holders can play a critical role in improving the overall quality of corporate conduct, i.e. make them SRI-appropriate, by taking a holistic approach to evaluating corporate performance from a long-term perspective (Id).

**25. Thamotheram, Raj and Wildsmith, Helen,Increasing Long-Term Market Returns: Realising the Potential of Collective Pension Fund Action. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 438-454, May 2007. Available at SSRN: http://ssrn.com/abstract=984338 or DOI: 10.1111/j.1467-8683.2007.00577.x**

The authors seek to offer a perspective from two practitioners on how the potential for retirement fund collaboration to improve long-term market returns could be realized. After looking at the Universal Owner hypothesis and long-term market returns, and their relevance to pension funds, the paper looks at collaboration to date, and the problems of collective action in general. After outlining several current collaborative opportunities, the ways in which they address the problems of collective action are outlined. The paper ends with a call to action to the leaders of the world's largest pension funds.

The authors' propose that the world's largest pension funds have a timely and unique role. They have a fiduciary responsibility for the financial well-being of their members in their retirement years and on the impact of externalities on future pensioner's living standards. Pension fund decision makers also have the responsibility to ensure inter-generational equity and to discourage the cannibalization of the future for the benefit of the present.

The authors suggest that pension funds' trustees and executives would identify major externalities and market failures, outline effective ways to address these issues and build commitments to change. Page 441 presents a number of incisive questions on the extent of pension fund trustee's fiduciary duties. They also suggest that the PRI, as an initiative led by asset owners and which focus on professional partners – who have very considerable influence in their own right– could be a highly significant factor in defining how the investment supply chain chooses to relate to this debate.

**The Next 25 Pieces:**

**26. Alicia Munnel and Annika Sunden, "Social Investing: Pension Plans Should Just Say 'No,' " paper prepared for the conference "Cost and Benefits: 'Socially Responsible Investing and Pension Funds" (Washington: American Enterprise Institue, June 7, 2004)**

This paper argues that current social investing initiatives are generally not effective and, even if they were, public plans should not engage in any form of social investing, and while private plans have more leeway, they should not be sacrificing returns for social considerations (pg 2). The paper makes the following points. First, negative social screens to rid portfolios of "sin" stocks probably accomplish nothing in terms of their impact on the targeted firm, as long as the marginal investor is available to purchase the stock (Id). Second, if done perfectly – full diversification and no politics – social investing is probably close to costless in terms of returns to shareholders. Third, with zero benefits and zero costs, social investing is probably fine in situations where the stakeholder and the decision maker are the same, and no politics are involved (Id). In the case of private plans, the stakeholders and decision makers may be the same, suggesting that negative social screens, which are generally costless, are probably fine. But private plans should not engage in investments that sacrifice returns for social considerations. Public pensions are institutions where the decision makers and the stakeholders are very different and it is dangerous in such a politically charged environment to permit decision makers to deviate from the pursuit of maximum return for a given level of risk.

The author reasons that social investing does not have a financial impact on the companies whose securities are bought into or sold on the mandate of SI because the demand for a company's stock is almost perfectly elastic (the textbook argument) (pg 7). He states the index effect to prove that the demand curve for stocks is horizontal (pg 10). An horizontal demand curve for a company's stock also implies that if a company's stock price dips temporarily below a level consistent with the discounted value of future earnings, then investors not involved with screening will buy shares and restore the price. He states studies of the South-African Boycott that concluded that there is no evidence that the pension fund divestment announcements hurt firms with major South African operations, nor did it affect the South-American indexes (pg 13). He states that the likely explanation is that the boycott reallocated shares and operations from 'socially responsible investors' to indifferent investors and countries. This would prove that economically targeted investments, in the face of efficient capital markets, are unlikely to turn up investments that yield market returns and accomplish other goals. According to the author, markets are efficient and therefore render social investing futile.

**27. Barnett, M. L. and R. M. Salomon. (2006) "Beyond dichotomy: The curvilinear relationship between social responsibility and financial performance." Strategic Management Journal 27(11):1101-1122.**

The authors combine modern portfolio and stakeholder theories and find that the financial loss borne by an SRI fund due to poor diversification is offset as social screening intensifies because better-managed and more stable firms are selected into its portfolio. They provide support for this hypothesis through an empirical test on a panel of 61 SRI funds from 1972 to 2000. The results show that as the number of social screens used by an SRI fund increases, financial returns decline at first, but then rebound as the number of screens reaches a maximum.

They also find that financial performance varies with the types of social screens used: Community relations screening increased financial performance, but environmental and labor relations screening decreased financial performance.

The average SRI fund in their study held about 67 % of its portfolio in equity and 16 percent in bonds. The authors found that the greater the percentage of assets allocated to stocks, the greater the mutual fund financial performance (pg 1113). Funds with a greater percentage of equity investments achieved the best overall risk-adjusted performance, while funds that invested heavily in bonds were the worst overall performers (Id).

The authors contend that their results suggest that those who base their arguments on the financial logic of modern portfolio theory and those who support instrumental stakeholder theory may not be at odds (pg 1119). Funds that use few screens gain the benefits of diversification, and those that filter stocks and limit their universe of investments do not handicap their portfolio as much as some contend (Id). The real danger, they suggest, lies in not committing to one strategy or the other—in being 'stuck in the middle.' Failure to control for screening intensity amongst SRI funds may explain, in part, the mixed findings that have allowed this debate to rage on for so long (Id).

**28. Beardsell, Julie,The Influence of CSR Disclosure On Corporate Governance and Company Performance.(November 21, 2008). SMC Working Paper Series ISSN 1662-761X. Available at SSRN: http://ssrn.com/abstract=1302314**

This paper explores how the application of CSR starts with vision, innovation and an organizational design to tackle CSR at the core of a firm's business strategy. Of interest to our research, the author explores various forms of self-regulatory practices which are applied on a discretionary. She argues that while incomplete contracts and imperfect knowledge debar form resorting to reputation effects in order to support discretional self-regulation, an explicit standard for CSR strategic management – both publicly shared by stakeholders and firms through social dialogue – make it possible to put again at work the reputation mechanism inducing endogenous incentives of compliance with a voluntary standard.

This paper reveals how those companies that have embraced CSR – becoming part of the solution – are setting the standards for others to follow and, in some cases, through their global supply chains are taking action where dialogues have failed. In return such firms have found significant competitive advantages in the form of improved financial performance, enhanced brand image and reputation and attractiveness to increasingly sophisticated institutional investors.

The author contemplates that there are two main groups of challenges for firms in CSR: (1) understanding society's expectations; and (2) implementing activities to deliver on these expectations. Firms realize that standards play an important role in promoting these two general objectives. Globalization and the associated increase in interconnectivity between countries and regions have led to a situation where international standards are increasingly important. In the global discussion on this subject, standardization engages the private sector in a way that no other process is doing of has ever done! Indeed, in many cases the private sector is driving SR standardization.

An example: In its recent strategic planning document, "ISO Horizon 2010 – Standards for a Sustainable World," the ISO Central Secretariat identifies as a key driver "the urgency of a responsible approach to sustainable development, covering economic, social and environmental aspects, where all actors in society have a role to play and all companies and organizations have new commitments to make." ISO is one of the most important international standard-setting bodies and has for over 50 years helped to ensure that standardization is an effective tool.

The author thus concludes that complying with international standards can be a source of competitive advantage.

**29. Bernstein, A. "Incorporating Labor and Human Rights Risk Into Investment Decisions." Occasional Paper Series. No 2. September 2008**

The author proposes that there must be more objective and quantitative data available about corporate practices affecting labour and human rights. In the absence of government regulation, the investment community may only find robust labor and human rights data, and achieve meaningful reductions in risky corporate behavior, by adopting the shareholder engagement tactics used to pressure companies about environmental and governance risks.

The author's thinking is that a company's performance – and hence its stock price – could be endangered if its business practices run the risk of violating national or international social standards on labor and human rights or causing adverse impacts on local communities and cultures. Such violations may damage a company's reputation, undermining its standing with consumers, regulators, and lawmakers. They also may weaken its operational performance by increasing employee turnover and inhibiting worker motivation and productivity. Therefore some investors are attempting to track related human capital metrics such as health and safety, team production systems, compensation, training, and worker skill levels. This paper analyzes a specific subset of factors that fall under the social category, namely, labor and human rights risks involving a company's employees and those in its global supply chain.

The first section of the paper sketches out a brief history of how LHR and other ESG concerns have migrated from moral investment concerns to financial ones in both portfolio analysis and global lending. The second considers the methodological hurdles involved in the LHR investment thesis, including the identification of the criteria used and the deficiencies of the data sources available to assess LHR factors. The third examines possible approaches investors could use to gather more robust LHR data. It also considers how investor concerns could mesh with corporate codes of conduct and the labor monitoring regimes designed to uphold them.

The author surveys the landscape of LHR methods used by leaders such as Goldman Sachs and Risk Metrics. He also mentions CalPERS new attempt at engaging emerging market companies on ESG issues such as LHR through their new principles-approach.

All in all, this paper makes it clear that more research remains to be done to define the LHR criteria that might relate to corporate performance. Already established standards such as the ILO principles and national labour laws were constructed the principal of social concern in mind, not financial returns. But however investors define LHR metrics, obtaining detailed data about them will require major effort given the often sensitive nature of the issues involved.

**30. Fama, E. F., The Journal of Finance, Vol. 25, No. 2, Papers and Proceedings of the Twenty-Eighth Annual Meeting of the American Finance Association New York, N.Y. December, 28-30, 1969. (May, 1970), pp. 383-417.**

The author reviews theory and empirical work on the efficient market hypothesis (EMH). The following is a summary of his paper.

The primary role of the capital market is the allocation of ownership of the economy's capital stock. In general terms, the ideal is a market in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production-investment decisions, and investors can choose among the securities that represent ownership of firms' activities under the assumption that security prices at any time "fully reflect" all available information. To test for the weak form of the EMH one must be concerned with historical prices. To test for the semi-strong form of the EMH, one must be concerned with whether prices adjust to other information that is obviously publicly available. To test for the strong form of the EMH, one must be concerned with whether given investors or groups have monopolistic access to any information relevant for price formation. The categorization of the three different forms of the hypothesis would serve to the useful purpose of allowing us to pinpoint the level of information at which the hypothesis breaks down. The author contends that there is no important evidence against the weak and semi-strong forms and only limited evidence against the hypothesis in the stong form test (insider trading, etc.)

The author provides a comprehensive overlook of the models used to test for the EMH.

The author concludes that the EMH seems a good first (and second) approximation of reality.

**31. Fitzgerald, Niall; Chairman of Unilever (2003). Rebuilding Trust in Business, 'A Perspective On Corporate Social Responsibility In The 21st Century'**

This article is based on a speech given by given by Niall Fitzgerald, Chairman of Unilever at London Business School in October 2003. Mr. Fitzgerald shares a business challenge Unilever encountered in India. He highlights the social implications of the challenge and shows how evaluating business decision based on social criteria is a subjective endeavour. He believes that business has a very important and central role in society. It also has a responsibility towards the general wellbeing of stakeholders.

He explains how Unilever founders had strong values and a clear commitment to corporate social responsibility. (It wasn't called that then, but that is what it was). He had clear moral views and believed he had a moral responsibility to help, both through business and his personal actions. His vision for his company was itself an expression of his values (pp 3):" To make cleanliness commonplace; to lessen work for women; to foster health and contribute to personal attractiveness, that life may be more enjoyable and rewarding for the people who use our products."

He then sets out to answer three questions: What is the relationship of business to society? How do you ensure a company behaves responsibly and earns and keeps the trust of society? And what role can multinational companies like Unilever play in helping to address major global issues in society today?

Concerning how business relates to society, he states that (pp 4): it is useful to set out the purpose for which a company, by which I mean a limited liability company, was created. While the creation of profit is an important result of a company's existence, it was not for the creation of profits that companies were primarily designed. Incorporation with limited liability was a concept created by society as a means of enabling people to exploit opportunities, manage risks and accomplish something together profitably that they could not achieve separately. At Unilever, they contribute to social wellbeing by creating long-term sustainable business for their stakeholders, mostly through innovation. Unilever is guided by core principles which set out their aspirations and operating standards. They stress that ensuring that a business behaves responsibly is a never-ending commitment and one that is constantly evolving (pp 9) and that a clear framework and clear responsibilities for directors and shareholders, linked to a code of business principles operating throughout the business, provide a sound basis on which to demonstrate the greater transparency and accountability that is needed (pp 10).

Mr. Chairman also makes clear the power of diversity and its necessity to ensure the competitive survival of Unilever, stating that diversity is crucially interconnected with their ability to lead and manage a successful, multinational, multicultural, consumer goods business in the twenty-first century (pp 12).

An inspiring quote on page 14: "At the international level, the need for a common vision of integrated economic development for the benefit of all has never been greater." On page 15: "Business must also make more effort to demonstrate that it is socially responsible, culturally sensitive, committed to diversity and honest in its governance. Not only is it in our commercial interest to do so, it is crucial for the sake of those in developing countries who are not yet sharing in the benefits of globalization. It is vital if we are to achieve our shared social and environmental goals."

**32. "Gaining ground: Integrating environmental, social and governance (ESG) factors into investment processes in emerging markets" March 2009. Mercer, IFC.**

While asset managers in developed markets are often credited with being a step ahead in factoring ESG issues into investment decisions, this latest research from Mercer and sponsored by IFC reveals that emerging market asset managers are beginning to take ESG issues seriously (1). This latest research suggests that sustainable investment in emerging markets has grown to over US$300 billion in assets under management (Id). IFC and Mercer produced the first-ever rating on ESG practices of fund managers in China, India, South Korea and Brazil and identified best-practice ESG examples to pre-empt potential risks and enhance returns (Id).

There are three parts to this study (3): Global survey of investment managers of emerging market equities (EME) responding to questions about their ESG capabilities; Country level research of ESG capabilities of mainstream investment managers based in Brazil, China, India and South Korea; and, Research on Sustainable Investment (SI)-labeled equity investment products across the emerging markets region.

Key trends (4): the growth of sustainable investments was primarily driven by investors in developed markets investing in EME to achieve diversification benefits – some $50 billion of this reflects funds which are specifically branded as socially responsible or sustainable; asset owners based in developed markets who have taken an ESG integrated approach in their equity mandates, are currently driving the growth of sustainable investment in emerging markets; while a good proportion of the managers with the largest mandates tend to vote proxies where they can, engagement on ESG issues is not commonly pursued by most EME managers; the key differentiators between the leaders and laggards on ESG integration and active ownership was the investment horizon adopted by the portfolio managers (long-term vs. short-term); many investment managers tend to actively investigate governance standards in their meetings with, and appraisals of, investee companies, and considered it material at a stock selection stage.

Key Findings: ESG issues are taken into account in almost half (47%) of the EME products offered by the managers (pg 14). With respect to engagement on ESG issues, only 21% of the strategies surveyed raised corporate governance concerns with management of their investee companies, and only 18% of strategies researched raised broad ESG concerns (Id). Of the 177 managers investing in EME surveyed, almost half (46%) have a policy regarding the integration of ESG issues into their investment process (pg 15). The EME managers were also asked about the extent to which they collaborate with other investment managers when engaging with investee companies: 45% responded limited collaboration and 35% responded regular collaboration (pg 17).

Broad themes (pg 48): sustainability issues are at least as, if not more, important in developing markets than developed markets however there are still significant shortages in research coverage of EMEs and working with the diversity of cultures and regulatory environments can be resource-intensive.

**33. Hagart, G., Knoepfel, I. onValues ltd. November 2007. Emerging markets investments: do environmental, social and governance issues matter? Outcomes of a Mistra's workshop for investment professionals and academics.**

This report summarizes the outcomes of a workshop held in Stockholm on 17 October 2007 by Mistra, The Foundation for Strategic Environmental Research, on the integration of environmental, social and governance (ESG) issues into emerging markets (EM) investments.

Key insights gained from the workshop: corporate governance at the company level is the obvious starting point for international EM investors; environmental issues were seen as the strongest source of investment opportunities; engagement, participants stressed the importance of meeting management and discussing ESG issues; and, optimism about the potential for such engagement to influence corporate behavior.

The materiality of environmental, social and governance (ESG) issues is particularly pronounced for companies based or with substantial operations in emerging markets because of issues such as political stability, governance, corruption and education levels on macro growth rates in emerging markets. A relative lack of oversight by regulators and gatekeepers such as analysts and institutional investors in such markets results in weaker investor protection and ultimately higher agency costs.

Priority ESG issues to consider in EM (pg 6): proper governance can be a useful indicator of which management teams can spot material ESG-related risks and capture opportunities and therefore is not only seen as a set of downside risks to be mitigated, but also as a pathway to potential opportunities; large families and governments were mentioned as problematic in terms of minority shareholder protection and there is also the risk of local shareholders acting in concert without the knowledge of international investors; corporate culture can be seen as a proxy for overall ESG performance by looking for signs of a culture of integrity that pervades the company from executive management to the factory floor; investors in emerging markets should prioritize the impact of rising costs and shortages of energy and water on potential emerging markets investments; (both source of risk and opportunity); and, the reputational risks related to poor environmental and social performance in the company's supply chain can be substantial.

In the case of China, participants mentioned the downside risk arising from the rapidly changing (and unpredictable) regulation at the local and national levels. An ability to anticipate changing regulations with respect to environmental and social issues could pave the way to substantial opportunities, but participants (even those with a good network of local contacts) cautioned that it was difficult to forecast regulatory changes reliably (especially in terms of timing) (pg 8). Also, Chinese companies often have problems with disclosure (on ESG issues and more broadly) (Id).

**34. Heal, G., 2005. "Corporate Social Responsibility: An Economic and Financial Framework," The Geneva Papers on Risk and Insurance - Issues and Practice, Palgrave Macmillan Journals, vol. 30(3), pages 387-409, July.**

The author analyzes corporate social responsibility (CSR) from economic and financial perspectives, and suggests how it is reflected in financial markets. He defines CSR as a program of actions to reduce externalized costs or to avoid distributional conflicts. It would have evolved in response to market failures, a Coasian solution to problems associated with social costs. The analysis suggests that there is a resource-allocation role for CSR programs in cases of market failure through private–social cost differentials, and also where distributional disagreements are strong. He proposes that in some sectors of the economy private and social costs are roughly in line and distributional debates are unusual: here CSR would have little role to play. Such sectors would be outnumbered by those where CSR can play a valuable role in ensuring that the invisible hand acts, as intended, to produce the social good. It would also act to improve corporate profits and guard against reputational risks.

The author provides a good succinct literature review of the link between CSR and financial performance through: (1) Risk Management, (2) Reduced waste, (3) Improving relations with regulators, (4) Generating brand equity, (5) Improved human relations and employee productivity, and, (6) Lower cost of capital. He provides support from the following studies: Dasgupta et al. (2001), which studied the way in which capital markets in Argentina, Chile, Mexico and the Philippines reacted to information about a firm's environmental performance – In the case of recognition of superior performance, the average rise in stock market value was 20 per cent, and in cases of poor performance the drop in value ranged from 5 per cent to 15 per cent (pp 398), Dasgupta et al.(2004) found similar results for The Republic of Korea, and Dowell, Hart and Yeung (2000) which was the object of my literature review. The author highlights the following statement from the latter study: "capital market valuations internalize externalities, that is, the capital markets recognize difference between private and social costs and treat the excess of social over private as a liability that the corporation will have to meet at some point."

The author concludes that there is a resource-allocation role for CSR programmes in cases of market failure through private–social cost differentials, and also in cases where distributional disagreements are likely to be strong.

**35. Johnson, Lyman P. Q. and Millon, David K.,Recalling Why Corporate Officers are Fiduciaries. William & Mary Law Review, Vol. 46, 2005. Available at SSRN: http://ssrn.com/abstract=557926**

Peter D. Kinder recommended this paper as extremely important, citing "a persuasive argument for applying traditional agency law principles to corporate relationships." In this 59 page paper, the authors draw attention to the fact that state fiduciary law makes no distinction between fiduciary duties of officers and directors and proceed to differentiating their separate duties and legal roles within a corporation. The thesis is that corporate officers are fiduciaries because they are agents while directors are fiduciaries for the corporation and its stockholders notwithstanding they are not agents (pg 9). The authors help us recall that stockholders elect directors who, by statute, exercise, or authorize others to exercise, all corporate powers and manage, or direct others in the management of, the business and affairs of the corporation (pg 10).

The board of directors, in other words, is endowed with plenary governance authority and is the body most centrally responsible for the well-being of the corporate enterprise (Id). Critically, however, although officers, like all agents, are to act on behalf of their principal,35 it is not their function, nor is it within their fiduciary duty, to monitor their own performance on behalf of the principal (pg 11). That function remains the responsibility of the principal itself, whether it is an individual or a complex organization. (Id). However, directors have the tendency to, after delegating responsibilities to management, avoid developing structures, systems and mechanisms to monitor, supervise, and, if need be, control management on an ongoing basis (Id). Failure to discharge that function is an abdication of the board of directors' statutory responsibility for providing "direction" over the corporation's business and affairs, and it is a breach of the fiduciary duties it owes to the corporation and its stockholders (Id).

The overly "cozy" relationship between boards of directors and senior officers that has been the subject of much recent criticism may result in a corporate culture where directors do not regard officers as persons owing high fiduciary duties to the corporation (pg 16) and they may feel indebted to the officer or believe it is their responsibility to support senior officers. There are several historical explanations for this reversal of control from the principal to the agent. First, rather than directors selecting the CEO, the CEO often handpicked candidates for the board (pg 19). Second, the CEO, rather than the board, usually selected a successor CEO (pg 20). Third, the board generally did not establish corporate objectives, strategies and broad policies; this was done by the CEO (Id). Finally, the board's key roles shrank to offering advice and counsel to the CEO, serving as discipline for the CEO through the ritual of the CEO making regular reports to the board, and acting as a decision-making body only in crisis (Id). Moreover, when that crisis involved declining enterprise profitability, directors tended to procrastinate and avoid taking corrective action, preferring instead to simply hope the situation would somehow improve (Id). The authors also blame the nexus of contracts view of the firm for drawing attention away from the only true agency relationship in corporate governance – the corporation-officer relationship.

The authors point out that, as fiduciaries, officers owes several duties to the corporation that exist independently of contract. Breach of these duties affords the corporate principal a host of remedies, including a tort action against the agent for losses caused by the breach (pg 33). One cornerstone fiduciary duty owed by officers is a duty of loyalty, which requires the agent to act solely for the benefit of the corporate principal (Id). There are many aspects to the agent's duty of loyalty. These include: not acting adversely to the principal without consent; not acting on behalf of one with interests adverse to the principal without consent; not competing with the principal; not wrongly appropriating a corporate opportunity; providing an accounting to the principal for profits; and not using or wrongly communicating confidential information (Id). The duty of loyalty requires an officer to advance the well-being of the company, not simply refrain from harming it. 164 What has not yet been required of an officer – unlike a director in a change of control setting – is an overarching duty or a situation-specific duty to maximize the wealth of the corporation (or stockholders). Officers are to be loyal, but they are not legally constrained or governed by the stockholder wealth maximand (pg 34).

Besides owing a duty of loyalty, officers owe a duty of ordinary care, and simple negligence is a breach of this duty (pg 34). Additional important duties include a duty of good conduct, a duty to provide information and assist directors in understanding the significance of reported information − which probably should entail a “duty of availability” for open discussion with directors as well as the reporting of “packaged” information − and a duty to obey the principal, among others (Id). By way of contrast, a corporate director owes fewer duties (pg 35). These include a duty of loyalty (also multi-faceted) and duties of due care and good faith (Id).

An appreciation of officers’ status as agents of the corporate principal may also help, indirectly, to clarify the appropriate standard governing board decision making. If the officers are supposed to act on behalf of the corporate entity – which comprises more than just the shareholders – it makes no sense to conceive of directors’ fiduciary duties as running solely to the shareholders (pg 49). Instead it should be understood that directors, in the discharge of their monitoring function, should evaluate officer performance by reference to the well-being of the corporation as a whole (Id).

**36. Kawamura, M. (2002) "How Socially Responsible Investment (SRI) Could Redefine Corporate Excellence in the 21st Century." (Working Paper NLI Research Institute 2002 No. 160.), Available: http://www.nli-research.co.jp/english/socioeconomics/2002/li0201a.html (Accessed: 2009, May, 25).**

This paper describes developments in SRI in Japan and abroad, and examines the possibility that it could actually redefine the criteria of corporate excellence for the 21st century.

The author’s main contribution is in his conclusion. He concludes that regardless of the particular form, SRI offers a way for investors to express their own social priorities— whether for social justice, economic development, world peace, or environmental preservation —based on how they invest and that, by changing where funds are invested and altering the condition of companies, SRI can transform markets and the flow of funds in society. In the past, corporate excellence had been defined in terms of product quality, price, delivery time, and profitability. However, this definition will no longer suffice in the 21st century; excellent companies not only must pursue economic rationality, but social and environmental rationality. Stated differently, market valuation will reflect the relationship of companies to society, as well as their underlying integrity and ethical values. In this sense, SRI promises to be a powerful tool for redefining excellent companies in the context of their social existence. SRI represents an ideal opportunity for individuals to participate in the flow of funds in society.

The author also presents a brief survey of SRI’s manifestation around the world, across time and regions.

**37. Lee, C. M. C. and D. Ng. (2004) "Corruption and International Valuation: Does virtue pay?" (Unpublished Working Paper, Cornell University),**

This study integrates the valuation literature in finance with a vast literature in political science and economics on corruption. Using firm-level data from 43 countries, the authors investigate the relation between corruption and international corporate values. Their analysis shows that firms from more (less) corrupt countries trade at significantly lower (higher) market multiples. Further analysis shows that this result is attributable primarily to higher required rates of equity return in more corrupt countries, and is robust after the inclusion of numerous control variables. They conclude that corruption has significant economic consequences for shareholder value.

In more corrupt regimes, agents must expend higher costs and greater effort in all their contractual transactions – e.g., to reduce counter-party risk, to monitor performance, and to enforce property rights. These higher transaction costs, like the cost of illiquidity (Amihud and Mendelson (1986)) or elevated information risk (Easley and O'Hara (2004), Bhattacharya and Daouk (2002), Bhattacharya et al. (2003)), are not easily diversified away (pg 2). The authors show in a simple model that, when even when global markets are reasonably integrated, increased contracting costs will lead to higher required rates of return on a country's equity investments. They find that firms from more (less) corrupt countries trade at significantly lower (higher) market multiples, after controlling for other factors and that this result derives mainly from the effect of corruption on required rates of return, rather than on expected earnings growth or future profitability.

**38. Mistra – The Foundation for Strategic Environmental Research. (2005) "Screening of Screening Companies." (SustainAbility), Available: http://www.sustainability.com/downloads_public/insight_reports/screening.pdf (Accessed: 2006, December, 28).**

This report includes a summary of SRI-market developments and key characteristics of best practice. It also briefly presents identified best-practice examples based on MISTRA's key requirements. The assessment of existing products/services has therefore focused on products/services that specifically consider company strategies, organization and management systems and also benchmark the companies' environmental performance (pg 5).

The first section presents the different screening procedures that are practiced by screening companies. It addresses such questions as: what sources of information are used and what the different methods of managing assets are.

The second section focuses on the methodology of SRI funds – ie. Triple-bottom-line. Best-in-class, weighing opportunities and sustainability risks, and the combination of qualitative and quantitative analysis.

The third section presents the characteristics of best practices used by select fund managers and screening companies.

**39. Monks, Robert A.G.,Two Challenges for Fiduciary Capitalism. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 486-492, May 2007. Available at SSRN: http://ssrn.com/abstract=984341 or DOI: 10.1111/j.1467-8683.2007.00581.x**

This paper addresses two fundamental challenges to the further progress of fiduciary ownership: the first is to ensure the participation of the full spectrum of institutions in ownership initiatives; and the second is to ensure enforcement of fiduciary obligations either by direct government action or through private litigants. For the author, the typical "owners" of publicly listed corporations are the long-term investors – the typical pensioner who has 20 years before vesting and wants to retire into a clean and civil world. This paper is the account of owners' efforts to have their interests effectively represented by their "trustee" (pp 487).

The author suggests that trustees do away with their fiduciary responsibility in two ways (pp 486). On the one hand, the trustees make extensive use of trust assets to protect themselves against any possibility of liability by hiring "consultants", the sum of whose contribution to the economic welfare of participants is highly problematic (Id). Their real value is in providing trustees defense against any claim of negligence (Id). On the other hand, trustees, with "no skin in the game" are motivated to adopt the most minimalist policies of investment, thus ensuring mediocre results (Id).

The author's stance is that the ultimate necessity for ownership involvement is to legitimate corporate power (pp 488). Owners, roughly half of the population, uniquely are entitled to judge the appropriate balance between public and private interests, between societal and corporate responsibility for the externalized liabilities of business (Id). He suggests that the beneficiaries rise up against trustees for more accountability. He also suggests (unspecifically) that we reform incentives of fund managers and that there be more oversight from regulatory agents.

**40. Robert H. Montgomery & Gregory F. Maggio. Fostering Labor Rights in Developing Countries: An Investors' Approach to Managing Labor Issues. Journal of Business Ethics.**

In this paper, the authors present a methodology to assist investors in large scale private infrastructure and other industry sector projects to utilize internationally recognized core labor rights and related standards for fostering sound labor management, especially in developing countries. Their methodology involves due diligence or analysis of labor conditions and subsequent supervision and monitoring of performance and promotes the use of best practices to complement existing minimum requirements.

This approach was developed and applied over several years through field experience, research, and input from labor rights practitioners. The paper discusses the various components of the methodology, including establishing a normative labor framework of applicable requirements and implementing a process for assessing compliance with these requirements (pg 200). The methodology provides user-friendly tools, set out in tables and charts containing questions and indicators that are intended to offer guidance in determining whether a project is conforming to applicable labor rights requirements (Id). The data generated by these tools form baselines for reporting on and developing follow-up recommendations for project compliance to help companies and their lending institutions manage labor-related risks more effectively (Id). The paper presents three project case studies to demonstrate applications of the methodology to concrete field situations. It also discusses the challenges in using the methodology and, more broadly, in addressing labor issues in large private sector projects (Id).

The authors' approach seeks to complement other existing avenues for facilitating compliance with national labor law requirements and, where national laws fall short of international standards, for promoting compliance with internationally recognized norms (pg 201). The authors propose that their methodology should not be perceived as an end in itself, but as a tool for ensuring sound labor management and thus increasing project financial and socio-economic development goals while reducing financial and legal risks (pg 216).

**41. Rodriguez, P., D. S. Siegel, A. Hillman and L. Eden. (2006) "Three Lenses on the Multinational Enterprise: Politics, Corruption, and Corporate Social Responsibility." (Unpublished Working Paper 0608, Department of Economics, Rensselaer Polytechnic Institute), Available: http://www.economics.rpi.edu/workingpapers/rpi0608.pdf (Accessed: 2006, December, 27).**

In this article the authors explore the rich opportunities for the integration and extension of disciplinary perspectives in addressing the interconnected nature of politics, corruption, and corporate social responsibility of the multinational enterprise. Building on this three lenses framework, the authors identify common concepts and tools, outline an agenda for additional theoretical and empirical research, and review relevant literature.

The authors' literature review on the country-level determinants and implications of corruption and CSR for the MNE is extensive. Most of the discussion centers on the MNE's strategic management of corruption and CSR. Both corruption and CSR can be used to create value for the MNE but corruption is more often associated with a destruction of value. The authors make the distinction between different types of CSR as dependent on the MNE's motives. Overall, the article is insightful. It is relevant to our current research because it helps explain why CSR practices vary across countries. The discussion on the determinants of corruption is also insightful to our research because it highlights the relation between FDI and host country risk factors.

**42. Sir Geoffrey Chandler, "Corporate Social Responsibility: The International Aspects", Keynote Address to Conference: Corporate Social Responsibility & the Role of the Lawyer", Amsterdam, June 25, 2004**

The author chronicles the rise and importance of CSR. He begins with the Abolition Society and how thir first NGO found it necessary to argue a business case pointing out that the loss of seamen on the West African voyage exceeded in cost to the country the value of trade. Slavery was later abolished some 40 years following their establishment. This pattern would have been replicated by NGO to this day.\

The author suggests that we are witnessing the evolution of a market, which is not a 'free' market, but a market bounded by moral parameters. Without such boundaries, the it would not have survived. The challenge today would be to extend those boundaries to match the values of contemporary society. The most important lesson from history of the company would be that the interests of all stakeholders other than shareholders have been protected by external pressures and legislation, rarely by corporate initiatives. A new construct must take into account the recent globalized state of the world economy where companies' influence extends far beyond the national boundaries of its operations. Today's companies would have a greater immediate potential for good and harm than almost any other constituency.

**43. Smith T., "Social investing: challenging institutional investors to meet their fiduciary responsibilities", Conference on Socially Responsible Investing and Pension Funds, AEI, Washington, DC, June 7, 2004**

The author discusses social investing in theory and practice, including what motivates religious investors, activist state or city pension funds, labor unions, and foundations, and how each understands their fiduciary responsibilities. He provides an overview of the industry, including its investment strategies and its international growth prospects. The paper discusses current trends in social investing in corporate governance and key social issues such as global warming. He suggests the interest in social investing and its growth reflects not only a fundamental shift in social values but also a more nuanced understanding of fiduciary responsibility and how it contributes to competitive performance.

**44. Statman, Meir,Normal Investors, Then and Now. Financial Analysts Journal, Vol. 61, No. 2, pp. 31-36, March/April 2005. Available at SSRN: http://ssrn.com/abstract=713822**

The author sets on a mission to establish that investors are not rational. He begins by pointing to two viewpoints: (1) that mutual funds rarely achieve alpha creation and therefore index funds are the way to go, and (2) that index funds are more volatile than mutual funds therefore mutual funds are the way to go. The author seems to advocate index funds by asserting that investors are not rational, but normal, and they are therefore affected by cognitive biases and emotions; rational investors are not. Rational investors care only about the risk and expected return of their overall portfolios; normal investors care about more than that.

Rational investor was first coined as a term by Miller and Modgilliani to describe those that "always prefer more wealth to less and are indifferent as to whether a given increment to their wealth takes the form of cash payments or an increase in the market value of their holdings of shares (pg 32)." The preference of rational investors for more rather than less and the power of arbitrage also underlie the efficient market hypothesis (EMH), the second foundation block of standard finance. An efficient market is a market where prices are always equal to fundamental values. The author then goes on to describing the theory behind all three forms of the EMH along with its supporters.

The author then starts out to highlight different studies proving that investors are normal. Investors tend to "sell winners to early and ride losers too long." A cognitive bias would lead normal investors to consider their stocks one by one, in mental accounts distinct from their overall portfolios, and to distinguish paper losses from realized losses. Normal investors are reluctant to realize losses because realization closes mental accounts at a loss, thereby extinguishing all hope of recovery and inflicting the emotional pain of regret (pg 34). The author then chronicles how these irrationalities led to the creation of new models, such as the three-factors, model to compensate for the short-comings of the CAPM, which assumed that investors are rational (pg 35). Statman suggests that newer models that incorporate the fact that investors are interested in more than money payoffs but that they also want the pleasure of holding growth stocks or the virtue of holding socially responsible stocks, and their tastes may affect stock prices. These would have a place in asset pricing models.

**45. Sustainability Management and Reporting: Benefits for Financial Institutions in Developing and Emerging Economies (December 2006). UNEP FI**

This report is remarkable for its wealth of fifteen case studies on financial institutions and their experience with sustainability management and reporting.

As a summary, the report points out that the take up of Sustainability Management and Reporting (SMR) by financial institutions especially in developing and emerging economies is still low whilst the financial sector plays an important role in sustainable development as intermediaries to the allocation of capital (pg 2). The report assumes lack of awareness and capacity as the two main barriers hindering many financial institutions to implement SMR (Id). The report identifies four primary ways in which implementing SMR can provide benefits to financial institutions: revenue growth, risk management, access to capital, and cost savings and efficiency (Id). As for revenue growth, SMR may be used as a framework to develop new products and services and drive revenue growth through i) early market entry into new socio-environmental business opportunities, ii) enhancing reputational advantage in a new and growing market and iii) by SMR displaying the institution's commitment towards sustainability. As for risk management, in a world where new regulations and expectations of the social responsibility of financial institutions are growing, SMR assists in appropriately assessing these risks within the institution's overall credit risk analysis and other financial decision-makings. As for access to capital, many financial institutions especially in developing and emerging economies also have found that SMR improves its access to both public and private capital and in assisting the organization in meeting its stock exchange listing requirements. As for cost savings and efficiency: if an SMR is installed systematically and is consequently embraced across all company divisions it should lead to a better-managed organization.

The document provides case study examples for all these above mentioned ways in which SMR implementation provides benefits to financial institutions.

**46. Thomas, Simon, Repetto, Robert and Dias, Daniel,Integrated Environmental and Financial Performance Metrics for Investment Analysis and Portfolio Management. Corporate Governance: An International Review, Vol. 15, No. 3, pp. 421-426, May 2007. Available at SSRN: http://ssrn.com/abstract=984336 or DOI: 10.1111/j.1467-8683.2007.00575.x**

This paper introduces a new measure, based on a study by Trucost and Dr Robert Repetto, combining external environmental costs with established measures of economic value added, and demonstrates how this measure can be incorporated into financial analysis. The authors propose that external environmental costs are relevant to all investors. The authors illustrate their new measures with data from US electric utilities and how the environmental exposures of different fund managers and portfolios can be compared. They claim that with such measures fund managers can understand and control portfolio-wide environmental risks, demonstrate their environmental credentials quantitatively and objectively and compete for the increasing number of investment mandates that have an environmental component.

The first measure proposed by the authors is termed TRUEVA. This measure subtracts from the firm's operating surplus not only its costs of capital but also the environmental damages it imposes elsewhere in the economy. True value added recognizes that a company produces not only useful products for which customers are willing to pay but also wastes and emissions which impose damages and which victims would pay to avoid (pp 423). The companies with a significantly negative TRUEVA must be regarded as quite exposed to future restrictions on greenhouse gas emissions and tighter air quality restrictions based on health, acid rain, visibility and other concerns (pp 424). Its corollary, TRUROC is seven times higher than its conventional counterpart ROC. This suggests that tere is a large degree of unaccounted for risk among companies in the industry (pp 425).

The authors illustrate their results with a sample of large US electric power company and estimate environmental damage costs conservatively.

**47. Tozer, D. (2006) "Broadening horizons for responsible investment: an analysis of 50 major emerging market companies." (EIRiS – Ethical Investment Research Service), Available: http://www.eiris.org/files/research%20publications/emergingmarketseep06.pdf (Accessed: 2006, December, 20).**

EIRIS conducted a study of 50 major emerging market companies to assess what opportunities exist for responsible investors. It found that the overwhelming majority of companies in the study have shown evidence of addressing at least some environmental, social and governance issues in their public disclosures, with some significantly so (pg 1).

On the other hand, those emerging market companies that do devote resources to CSR activities may well gain potential financial benefits from being seen as leaders among their peers (pg 27). Overall the study confirms that for those investors who are prepared to embrace the investment opportunities, an SRI approach for emerging markets can extract diversity in company performance, provide potential choices among companies and offer ways in which SRI investors can extend their horizons (Id). Not only might this be financially rewarding (if other commentators are correct in their assessments), but it could also help bring sustainability improvements along the way (Id).

The report provides key insight on the background of SRI in emerging markets:

ASrIA has observed that globalization and related market developments are amplifying environmental, social and governance (ESG) trends that are strongly linked to the economic growth of China and India (pg 4).

'Responsible companies are better managed, have access to new markets, face fewer risks, have better branding and reputations and have more loyal and better-trained workforces (pg 5). The strongest link existed between 'environmental process improvement' and 'cost savings and productivity'. Others have identified a strong link between corporate governance practices and share performance. if investors ignore corporate governance issues during boom times, they may suffer severely during market downturns. 'The shares of well governed companies tend to perform better during recessions than the market as a whole (Id).'

In May 2006 the Bank of China attracted headlines when it proclaimed the launch of China's first SRI fund, the BOC Sustainable Growth Equity Fund (pg 7).

Factors that hinder SRI in EM: fund managers do not fully appreciate how EM companies are structured and governed; there is limited disclosure from EM companies or on the part of state authorities; bad corporate governance; government and family ownership; weak enforcement of regulation; doubts about the honesty of disclosed information; barriers (cultural, linguistic) to engagement; and, insufficient amount of research. Political risk, ethics and corporate governance are the key concerns among investors in the BRIC economies (pg 8).

**48. Who Cares Wins – Future Proof? Embedding environmental, social and governance issues in investment markets (January 2009). IFC, Global Compact.**

This report summarizes the strategic outcomes of the Who Cares Wins Initiative — a series of working conferences and financial industry consultations that took place between 2004 and 2008 (pg 7). The Initiative aimed to increase the industry's understanding of the risks and opportunities presented by environmental, social and governance (ESG) issues, and to improve their consideration in investment decision-making (Id). In concluding four years of discussion with the industry, the report proposes a number of actions to further ESG integration and, ultimately, to set the investment system on a more sustainable, long-term footing.

The Who Cares Wins consultations looked in-depth at the relationships of key actors, including asset owners (pension funds and other institutional investors), asset managers, investment researchers and regulators. This report offers a set of key recommendations for each of the actors in order to improve and scale up ESG integration considerably. The dynamic nature of the financial industry means that each actor is highly dependent on other actors. It also means that changes in the behaviour of key actors, such as the asset owners at the top of the chain, can rapidly unblock stalled situations and move the system to a new equilibrium.

Of note particular note: to improve ESG integration in emerging markets investment (a special focus area of the WCW Initiative), the following key recommendations were formulated: include ESG issues in regular company meetings and engagement activities; perform a systematic review of the ESG exposure of investments in emerging markets; consider collaborating with other investors in requiring minimum ESG disclosure standards from local legislators and exchanges; and, consider the potential for small allocations to frontier markets not only to deliver attractive returns but also to establish basic investability conditions (such as custody, efficient settlement services, etc.) and management awareness of material ESG issues.

This report also includes a road map to markets that are more 'future proof' by suggesting a set of ten recommendations for different investment market actors – from regulators and government to asset managers to asset owners to research providers.

**49. Willis, A. (2003) "The Role of Global Reporting Initiative's Sustainability Reporting Guidelines in them Social Screening of Investments." Journal of Business Ethics 43(3):233-237.**

This paper summarizes the purpose and nature of the Global Reporting Initiative and its Sustainability Reporting Guidelines. It also describes how the GRI can benefit investment screening for socially responsible investing.

GRI's declared mission was to elevate sustainability reporting practices to a level equivalent to that of financial reporting in rigor, comparability, audit ability and general acceptance. In delivering this, SRI fund managers are better able to make reasonable decisions concerning sustainable investments.

In conclusion it indicates the role that the SRI community should play in the future of the GRI and the evolution of the Guidelines. The GRI Guidelines are emerging as an important instrument in enabling companies to communicate with their stakeholders about performance and accountability beyond just the financial bottom line. The more that mainstream capital markets seek to differentiate between companies on social and environmental aspects of performance, the more they will in effect shift towards criteria similar to many of those used in SRI screening6. Tools like the Dow Jones Sustainability Group Index, the Jantzi Social Index and EcoValue'21 will motivate and inform this shift, as well as act as another source of input to the steady evolution of the GRI Guidelines.

**50. Zadek, S., M. Merme and R. Samans. (2005) "Mainstreaming Responsible Investment." (World Economic Forum), Available: http://www.weforum.org/pdf/mri.pdf (Accessed: 2007, February, 25).**

The report starts on the premise that: "today, beneficial owners — those who will ultimately benefit from share ownership of large corporations — are no longer the wealthy privileged few. And that increasingly on a global basis, the beneficial owners are now the huge majority of working people who have their pensions and other life savings invested in shares of the world's largest companies (pp 7)." Funds have an ever-larger proportion of their equity invested internationally and constitute majority ownership of our corporate world. Each pensioner owns a tiny interest in vast numbers of companies. Most individual participants in pension plans, mutual funds, and insurance companies are investing to provide for their retirement or other long-term financial needs. Social and environmental factors can be quite significant drivers of longer term financial performance, particularly through their influence on the enabling environment for business operations and investment. In the long run, the vitality of markets is influenced greatly by prevailing legal, regulatory and macroeconomic conditions, which ultimately reflect policy.

The authors contend that investment is first and foremost about meeting the needs of the owners of capital. Therefore the fiduciary role of trustees is to "meet the intrinsic interests of pension plan participants and insurance policyholders in not only competitive near-term returns, but also the long-term vitality of their countries' economies, societies and environments (pp 8)." This would require the deliberate incorporation of material social and environmental aspects of corporate performance in investment analysis and decision making, grounded in:

1) full appreciation of the rights and long-term interests of the ultimate beneficiaries of funds that typically have very long-term liabilities; and

2) broad understanding of the factors, such as social and environmental considerations, that could influence returns over the long term.

Specific Impediments: On the asset management side the authors blame the high level of regulatory awareness and scrutiny, combined with the widespread use of benchmark indices and clients' gradually shrinking time horizons for performance evaluation, as a powerful driver of conservatism among fund managers with respect to innovation. Moreover, a tracking error that has declined overtime is likely to further encourage the clustering of fund manager's performance around narrowly defined benchmarks and discourage the adoption of broader, long-term perspectives in fund manager's investment decision. On the pension funds side the authors highlight that most funds fail to meet the bedrock governance standards they increasingly demand of companies. Notably: savers can rarely discover how their funds are managed and have no voice in how the funds operate or who makes key fund decisions; trustees are not getting trained, spend too little time on the job, communicate too little with scheme members, ignore shareowner activism and socially responsible investment; moreover, trustees are typically not paid or given authority comparable to directors at public companies, and few spend efforts assessing their own performance or communicating with beneficiaries; and, trustee boards may be swayed by excessive political factors. These impediments must be countered by reforming incentives, training management and trustees to understand their duty and how to deliver it, and putting in place certain policies that will promote transparency and quality information.

The report also presents the investment management, sell-side analyst, and pension fund's insightful perspectives on responsible investing.