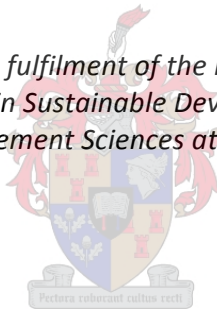


# **The Dynamics Influencing Progress Towards Responsible Investment: A Process Study of the Agency of the Code for Responsible Investment in South Africa (CRISA)**

by  
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*Thesis presented in partial fulfilment of the requirements for the degree of Master of Philosophy in Sustainable Development in the Faculty of Economic and Management Sciences at Stellenbosch University*



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March 2016

## Declaration

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March 2016

## Abstract

Changes in investment strategies and capital flows are needed in order to support a transition to a sustainable economy. However, despite the rise in popularity of the concept of responsible investment, which recognises the need to take into account environmental, social and governance issues into investment decisions, the pace of change within the investment industry appears slow and disconnected from sustainability challenges. In South Africa, notwithstanding a leading voluntary and regulatory framework in line with international recommendations, progress towards responsible investment appears slow and uneven.

Given the importance of time in sustainability issues, the research investigates responsible investment and the agency of supporting institutional strategies in the context of a *process* study. The objective of the research is to gain an understanding of the dynamics at play within the investment industry and to assess the agency of the Code for Responsible Investment in South Africa (CRISA) to promote progress towards responsible investment in South Africa.

Using grounded theory methodology and drawing on the discipline of Systems Dynamics, the study develops a conceptual process framework to explore the underlying processes influencing progress towards responsible investment and evaluate the extent to which these are affected by institutional strategies. The conceptual *process* framework shows how responsible investment, in its current implementation, is unable to shift investment practices in time to support a sustainable economy. The dynamics of change are too slow relative to the time horizon to generate a meaningful transformation. Drawing attention to the role of learning processes and mental models, the conceptual *process* framework challenges the theories, assumptions and practices underlying the intentions of the investment industry and calls for new institutional strategies to encourage an ideological framework consistent with the operating principles of a sustainable economy.

In light of the conceptual framework, the study evaluates the agency of the Code for Responsible Investment in South Africa (CRISA) and its supporting regulatory framework to drive transformational change within the South African investment industry. The empirical study is constructed as a multi-method

research using quantitative and qualitative methods as well as expert reviews to analyse progress over three years. The findings indicate that the Code for Responsible Investment in South Africa (CRISA)'s agency to modify the investment practices of institutional investors and their service providers in South Africa is limited, slow and difficult to substantiate. While some disclosure trends appeared encouraging, these mask major issues with regard the quality, consistency, comparability and reliability of data available. Except for a few leaders, the industry is characterised by an instrumental and discretionary approach to responsible investment, which yields little effective change in terms behaviour and practices.

Finally, confronting theoretical propositions with empirical findings, the research challenges the strategies used so far to promote responsible investment. The research advances that unless the regulatory environment offers conceptual clarity and takes a firm and consistent stance in support of the sustainability imperative, the Code for Responsible Investment in South Africa (CRISA)'s agency within the dynamics of change in South Africa is likely to remain limited, inconsistent and temporarily disconnected from the problems it tries to address.

## Opsomming

Ten spyte van die styging in gewildheid van die konsep van verantwoordelike belegging wat die behoefte om omgewings, sosiale en bestuurskwessies in beleggingsbesluite erken en in ag neem, kom die tempo van verandering binne die beleggingsbedryf stadig en verwyderd van volhoubare uitdagings voor. In Suid-Afrika, ten spyte van 'n baanbreker vrywillige en regulerende raamwerk in lyn met internasionale aanbevelings, kom dit voor asof vordering na verantwoordelike belegging stadig en oneweredig is.

Gegewe die belangrikheid van tyd in volhoubare kwessies, ondersoek hierdie navorsingstuk verantwoordelike belegging en die rol van die ondersteuning van institusionele strategieë in die konteks van 'n proses studie. Die doel van die navorsing is om 'n beter begrip van die dinamika in die beleggingsbedryf te verkry en die rol van die Kode vir Verantwoordelike Belegging in Suid-Afrika (CRISA) te evalueer om sodoende vordering na verantwoordelike belegging in Suid-Afrika te bevorder.

Deur gebruik te maak van gegronde teorie metodologie en te leen van die dissipline van Stelsel Dinamika, ontwikkel die studie 'n konseptuele proses raamwerk om die onderliggende prosesse wat vordering na verantwoordelike belegging beïnvloed te verken en om die mate waarin dit beïnvloed word deur institusionele strategieë te evalueer. Die konseptuele proses raamwerk dui aan hoe verantwoordelike belegging, in sy huidige implementering, nie in staat is om beleggings praktyke betyds te verskuif om 'n volhoubare ekonomie te ondersteun nie. Die dinamika van verandering is te stadig, relatief tot die tydlyn, om betekenisvolle transformasie te genereer. Deur aandag te vestig op die rol van leerprosesse en verstandelike modelle, toets die konseptuele proses raamwerk die teorieë, aannames en praktyke onderliggend aan die intensie van die belegging bedryf en behoefte vir nuwe institusionele strategieë om 'n ideologiese raamwerk in ooreenstemming met die bedryfstelsel beginsels van 'n volhoubare ekonomie aan te moedig.

Gesien in die lig van die konseptuele raamwerk, evalueer die studie die rol van die Kode vir Verantwoordelike Belegging in Suid-Afrika (CRISA) en sy ondersteunende regulerende raamwerk om transformasie binne die Suid-Afrikaanse beleggings bedryf aan te moedig. Die empiriese studie is saamgestel as 'n multi-metode navorsingstuk met behulp van kwantitatiewe en kwalitatiewe metodes sowel as deskundige resensies om vordering oor die afgelope drie jaar te ontleed. Die bevindinge dui daarop dat die Kode vir Verantwoordelike Belegging in Suid-Afrika (CRISA) se rol om die beleggings

praktyke van institusionele beleggers en hul diensverskaffers in Suid-Afrika te verander beperk, stadig en moeilik om te staaf is. Terwyl sommige bekendmakings tendense bemoedigend is, word belangrike kwessies met betrekking tot die gehalte, konsekwentheid, vergelykbaarheid en betroubaarheid van beskikbare data verskans. Buiten vir 'n paar banbrekers, word die bedryf gekenmerk deur 'n instrumentele en diskresionêre benadering tot verantwoordelike belegging, wat min effektiewe verandering in terme van gedrag en praktyke oplewer

Ten slotte, deur die teoretiese stellings met empiriese bevindinge te konfronteer, formuleer die navorsing 'n kousale verduideliking van CRISA se rol binne die dinamika wat die vordering na verantwoordelike belegging in Suid-Afrika beïnvloed. Die navorsing beveel aan dat, tensy die regulatoriese omgewing konseptuele duidelikheid kan bied en 'n ferm en konsekwente houding met betrekking tot die ondersteuning van die volhoubaarheidsdoelwitte inneem, sal die Kode vir Verantwoordelike Belegging in Suid-Afrika (CRISA) se rol binne die dinamika van verandering in Suid-Afrika waarskynlik beperk, teenstrydig en tydelik ontkoppel van die probleme wat dit probeer aan spreek bly.

## Acknowledgements

I would like to thank my co-supervisor, Jess Schulschenk, for the challenging discussions, her constant encouragement, her wise counsel and her availability despite her busy schedule.

To the people at the Sustainability Institute and my supervisor Professor Mark Swilling, I thank you for the wonderful learning opportunity and the supportive structure you have provided. The Sustainability Institute has been a life changing experience. I see the world through new eyes and feel motivated and empowered to use my knowledge to make a difference.

I would like to thank the CRISA committee members for endorsing this research, inviting me to take part in the committee meetings, providing valuable insights and making it possible for me to use the data gathered in 2013.

To Ernst and Young, thank you for initiating this research and being a supportive infrastructure from which to conduct my inquiry.

To my partner, Robert de Rooy, thank you for your love and support, for reading through all my drafts, providing insightful feedback, challenging me on my understanding of System Dynamics and making valuable recommendations.

To Wouda and Klass for being so supportive, considerate and helpful. Thank you for your availability and your dedication in looking after Maxime, when I needed time to concentrate on my research.

Lastly to my children, India, Noa and Maxime, thank you for being such an inspiration, for your encouragements and for putting up with my absence, both physical and in mind.

## List of Acronyms and Abbreviations

- CRISA: Code for Responsible Investment South Africa
- ESG: Environmental, Social and Governance
- GEPF: Government Employee Pension Fund
- GTM: Grounded Theory Methodology
- UN PRI: United Nations Principles for Responsible Investment
- RI: Responsible Investment
- SD: Systems Dynamics



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## 1. Chapter One: Introduction

*“The defining challenge of the 21st century will be to transform the system governing markets so that they work for, rather than against, sustainability.”*

*One Planet Business: Creating Value within Planetary Limits (2007)*

### 1.1 Background & motivations

#### 1.1.1 *The unsustainability of current economic trends*

In 1987, the Brundtland Commission popularised the term *sustainable development* in its report titled ‘Our Common Future’ (WCED, 1987). Marking an important milestone in terms of political consensus, the report recognised the negative environmental and social impact of our economic activities and defined sustainable development as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (WCED, 1987). The report stressed that “the continuity of development in time has become a world problem” (Sachs, 1999:29). It further emphasised the idea that growth should occur while safeguarding the economic, social and environmental security of future generations, thus preserving a degree of inter-generational equity (Sachs, 2008).

However, the last 28 years have witnessed an acceleration of unsustainable growth trends to alarming levels. Fuelled by a resource intensive global development path, the effects of environmental externalities, growing social inequalities and poor governance are leaving the world at risk of a systemic breakdown (WEF, 2015). The magnitude of impacts is without precedent in recorded history and outstrips the ability of the scientific community to forecast the consequences with confidence (Olivier *et al.*, 2013; IPCC, 2014; Steffen *et al.*, 2015). The situation is especially worrying, as complex systems do not behave predictably and linearly. They tip over abruptly and irreversibly (Rockström, 2010). The group of scientists working on a Planetary Boundary Framework has warned that we are no longer operating in a “safe space for humanity” and transformative action is urgently needed (Rockström, 2010; Steffen *et al.*, 2015). In this context, transformative action “an irreversible, persistent adjustment in societal values, outlooks and behaviours of sufficient ‘width and depth’ to alter any preceding situation” (Avelino *et al.*, 2014:2).

Today, as highlighted by the 2015 Global Risk Report published by the World Economic Forum, global and systemic risks are no longer intangible or long term. They have become material in the short term and are projected to have “significant negative impact for several countries or industries within the next 10 years” (WEF, 2015). The message of urgency is further substantiated by the IPCC 5<sup>th</sup> assessment report, which recommends that we transition to a low carbon economy within the next 15 years. “Delaying mitigation efforts through 2030 is estimated to substantially increase the difficulty of the transition to low longer-term emissions levels and narrow the range of options consistent with maintaining temperature change below 2 °C relative to pre-industrial levels” (IPCC, 2014:12).

### **1.1.2 Major role of the financial industry**

If the world economy is to successfully transition to a sustainable development path, the role of financial markets and the behaviour of the investment industry must be taken into account (Richardson, 2009b; Peetz and Murray, 2013; IPCC, 2014). Playing a major role in current development choices, the investment industry has the power to lock the economy into a dependency path or act as catalysts to empower an equitable and sustainable future.

With the ascendance of neoliberal ideology in the 1980s and the rise of the notion of ‘shareholder primacy’, global finance capital has played an increasingly dominant role in economic activities (Sethi, 2005; Martin, 2009; Wen, 2009; Sandbu, 2012). Today, a small number of financial institutions control a substantial proportion of corporate shares in the world. The concentration of ownership and the ‘financialisation’ of the economy have further accelerated since the global financial crisis in 2008, shifting further the balance of power towards finance capital (Peetz and Murray, 2013).

This shift in power towards large shareholders and the acceleration of the unsustainable trend has been associated with an increase in short-term profit maximisation considerations (Barton, 2011; Peetz and Murray, 2013; Clarke, G. *et al.*, 2014; Bailey *et al.*, 2014; Barton and Wiseman, 2014). This clearly emerges from a *McKinsey Quarterly* report, which surveyed more than 1,000 board members and corporate executives from around the world on behalf of the Canada Pension Plan Investment Board (CPPIB). In the survey, 79% of respondents felt a strong pressure “to deliver financial results in two years or less” (Bailey *et al.*, 2014:2). They specifically emphasised the pressure exercised by board members to deliver better quarterly financial performance. In this context, corporate executives increasingly made use of short-term investment strategies, short-term incentives and short-term performance measurements to the detriment of more sustainable strategies. 63% of respondents pointed out that the short term pressure from

shareholders had considerably increased in the last five years, and 86% stated that short-termism was a major cause in the disconnect between awareness of the sustainability agenda and the inability to act on it (Bailey *et al.*, 2014; Barton and Wiseman, 2014; Clarke, G. *et al.*, 2014).

Whilst currently exacerbating global risks and unsustainable economic trends, the large economic influence exerted by financial markets can also be channelled to ensure that corporations abide by environmental and social standards consistent with long-term sustainability (Richardson and Cragg, 2010; Barton and Wiseman, 2014; Clarke, G. *et al.*, 2014). Richardson and Cragg even argue that, as “financial institutions manage the assets of millions of people” and “‘wholesale’ decisions concerning future development”, they have a public and moral responsibility to do so (Richardson and Cragg, 2010:32). Above all, it must be acknowledged that any transition scenario would require large changes in investment patterns. As pointed out by the IPCC with regard to climate change, “Mitigation scenarios in which policies stabilize atmospheric concentrations [...] lead to substantial shifts in annual investment flows during the period 2010–2029 compared to baseline scenarios” (IPCC, 2014:26).

### **1.1.3 Responsible Investment: a global movement**

Along with a growing awareness around sustainability issues in the late 1990's and on a larger scale since the launch of the United Nation supported Principle for Responsible Investment (PRI) initiative in April 2006, a segment of the investment community increasingly started taking into account environmental, social and governance (ESG) factors in their investment decision (Wen, 2009; Woods and Urwin, 2010). This phenomenon provided the foundation for the concept of Responsible Investment (RI), which specifically acknowledges the relevance of ESG issues in investment decisions (Woods and Urwin, 2010). Distinct from earlier ‘ethical investment’, RI is based on a ‘business case’ approach “whereby social and environmental problems, including global warming, are addressed on the basis of the relative financial risks and opportunities to the investor” (Richardson, 2009b:598).

While there has been a lack of consensus around the definition of RI and related terms, some degree of standardisation of the terminology is occurring through PRI initiative (Sandberg *et al.*, 2008; Herringer *et al.*, 2009; Wen, 2009; Woods and Urwin, 2010; Eccles, 2010). PRI defines RI as “the integration of ESG criteria into mainstream investment decision-making and ownership practices” and provides a framework “flexible enough to be adopted by the majority of signatories without raising contentious issues” (Sandberg *et al.*, 2008:522). Promoting a longer-term investment horizon and sustainable approaches, the PRI initiative is strong of 1380 signatories worldwide, representing \$59 trillion of assets under management (AUM) and

amounting to more than half of the world's institutional assets (PRI, 2015). Voluntary and aspirational, the PRI initiative has been associated with the 'mainstreaming' of RI amongst Institutional investors and their service providers (Woods and Urwin, 2010; PRI, 2015).

However, critics argue that the lack of stated expectations, performance standards, audit or regulatory mechanism as well as the lack of specified timeframe and ethical stance leave the PRI initiative inadequate as a response to the global and systemic crisis that the world is facing (Richardson, 2009a; Urwin, 2010; Richardson and Cragg, 2010; Peetz and Murray, 2013). Richardson, in particular, argues, "Unmonitored corporate commitments without sanctions for noncompliance are unlikely to improve corporate behaviour" and could further be used strategically as marketing tools to avoid "reflective moral deliberation and principled behaviour" (Richardson, 2009a:27-28).

#### **1.1.4 An emerging trend in South Africa**

In South Africa, the uptake of RI approaches by institutional investors and their service providers has historically been slow compared to international benchmarks (Eccles *et al.*, 2007; Herringer *et al.* 2009; Viviers and Firer, 2012). However, the pressure to consider RI considerably evolved with the amendment to Regulation 28 of the Pension Funds Act 24/1956 and the release of the Code for Responsible Investment in South Africa (CRISA) in 2011. In line with the recommendations from the Freshfields report (UNEPFI, 2005:13), the amended Regulation28 requires all South African pension funds to 'explicitly consider' a responsible investment approach as part of their fiduciary duty towards beneficiaries (National Treasury, 2011). CRISA emerged as an industry initiative to support the implementation of the amended Regulation28 and to guide the industry towards responsible practices. Strongly inspired by the PRI initiative, CRISA uses a voluntary approach, relying on market forces and self-regulation, to encourage transparency and the consideration of ESG factors in investment decisions (IoDSAa, 2013; Giamporcaro and Viviers 2014). Together with Regulation 28, CRISA constitutes the backbone of the institutional framework supporting progress towards RI in South Africa.

However, despite this leading framework, changes in investment practices amongst institutional investors and their service providers in South Africa have been slow and uneven (Viviers and Firer, 2013). A recent survey commissioned by the CRISA Committee and Ernst and Young and for which I was the lead researcher showed that while there are early encouraging trends in terms of commitments towards RI, there are major issues with regard to the quality and the consistency of data available. In its conclusion, the report described



the industry as “largely characterised by a passive and selective approach to responsible investment” (IoDSAb, 2013:13).

### **1.1.5 Evaluating the materiality of change in time**

Despite the good intentions and voluntary commitments, the RI market fails to exert a meaningful pressure on corporate behaviours and financial market (Richardson, 2009b; Humphrey and Tan, 2012; Giamporcaro and Pretorius, 2012). Whether internationally or in South Africa, short-term trends have continued to accelerate and ESG or climate related issues are not properly priced into stocks (Sandberg, 2010; Clarke, G. *et al*, 2014; Barton, 2011; Bailey *et al.*, 2014; Barton and Wiseman, 2014). Negative perceptions about RI remain whilst ESG data, necessary for investment analysis, are rare and of poor quality (Herringer *et al.*, 2009; Richardson, 2009a; Berry and Junkus, 2013; Escrig-Olmedo *et al.*, 2013).

Richardson and Cragg argue that the mainstreaming of RI is taking place “in a manner that works largely within the existing analytical and normative framework of the financial economy” (2010:27). Most initiatives “optimistically project that what is good for the environment is also good for business” (Richardson, 2009b:608). The transition agenda has been framed as a technical and managerial challenge, in line with the ‘ecological modernization’ discourse. As pointed out by Richardson, the risk is that “such optimism can be a pretext for the perpetuation of business-as-usual” and result in the delaying of meaningful change (2009b:609).

To conclude, it appears that while progress towards RI has been significant in many respects, it has nevertheless, lacked the urgency, determination and depth required by the current situation. The changes taking place in the financial realm appear disconnected from the challenges at hand (Clarke, L. *et al*, 2014; WEF, 2015). Internationally or in South Africa, proponents of sustainable development are pointing to a gap between the urgency of the problem and pace of change within the investment industry (Clarke, L. *et al*, 2014; IPCC, 2014; Giamporcaro, 2014).

## 1.2 Research rationale

Whilst flooded with information with regard to sustainability and climate change risks, the actions taken by the investment community to adjust investment practices have not been evidenced to be sufficient to tackle its role in supporting unsustainable growth (Olivier, *et al.*, 2013; Clarke, L. *et al.*, 2014; IPCC, 2014; WEF, 2015). As the window of opportunity to transition to a low carbon economy narrows to a 5-15 year timeframe, researchers and practitioners alike wonder what is preventing awareness of risks from transforming into action and how the industry can overcome its resistance to change (Richardson, 2009b; ILG, 2014).

In this context, it becomes important to investigate and assess the agency of institutional strategies employed to support the development of RI practices. In this study, institutional strategies are understood as formal regulations that affect "the rules of the game" for organisations, including their "values, meanings, and culture" (Stinchcombe, 1997; Scott, 1987:496). Institutional environments "are characterized by the elaboration of rules and requirements to which individual organizations must conform if they are to receive support and legitimacy" (Scott and Meyer, 1983:149). In line with core institutional traditions, organisations are seen as the product of common understandings and shared interpretations of acceptable norms of collective activity (Suddaby *et al.*, 2010:1235).

Existing research on RI have investigated a wide variety of aspects of the concept, its practice and its reach, both internationally and in the local South African context. Several studies have aimed at defining, justifying or offering critical views on the concept of RI, thus emphasising the evolution, the underpinnings and the ambiguities of the concept (Sandberg *et al.*, 2009; Herrerger *et al.*, 2009; Martin, 2009; Wen, 2009; Richardson, 2009a; Richardson and Cragg, 2010; Eccles, 2010; Sandberg, 2010; Woods and Urwin, 2010; Sandbu, 2012; Juhani Lehtonen, 2013). Others have focused on discussing or developing practical tools related to the implementation of RI strategies (Sethi, 2005; Urwin, 2010; Renneboog *et al.*, 2011; Berry *et al.*, 2012; Sandberg, 2013; Humphrey and Tan, 2013; Gond and Boxenbaum, 2013; Viviers, 2013). A number of researchers have also investigated the ability and power of the banking sector to tackle sustainability and climate related issues (Richardson, 2009b; Wen, 2009; MacLeod and Park, 2011; Peetz and Murray, 2013; Gupta *et al.*, 2014). Finally, a growing body of literature has emerged over the last decade investigating the state of RI implementation, reasons for adoption and its general reach into the market (Wen, 2009; Richardson, 2011; Sievänen *et al.*, 2012; Giamporcaro and Pretorius, 2012; Escrig-Olmedo *et al.*, 2013; Bakker and Giamporcaro, 2013; Viviers and Firer, 2013; von Arx and Ziegler, 2013).

Notwithstanding the importance of existing research, there has been little inquiry into the underlying dynamics at play, their embedded temporal implications and the impacts of institutional strategies employed to promote RI.

In this context, it is suggested that System Dynamics (SD) can help gain deeper insights into the multi-level phenomena at play within a system, specifically with regard to sustainability and transition issues (Baets and Oldenboom, 2009). As defined by Pruydt, “System Dynamics (SD) is a method to describe, model, simulate and analyse dynamically complex issues and/or systems in terms of the processes, information, organizational boundaries and strategies” (2013:1). SD generally focuses on modelling issues or problems within a system (Pruydt, 2013). It draws attention to the interconnectedness of all components and provides tools to map “the assumed/perceived underlying (material, informational, social,...) structure of largely closed real-world systems” (Pruydt, 2013:33). In doing so, it offers an endogenous explanation of the problem and allows the formulation of a possible theory on how behaviours are generated or perpetuated by the model structure (Sterman, 2000; Pruydt, 2013).

Researchers in the field of Process Studies have further advanced that *time* is a central variable that needs to be incorporated in the theorisation process. Often incorporating SD tools to produce “knowledge about *how* to produce the changes that the evidence suggests are desirable” (Langley *et al.*, 2013:4), process studies focus on the driving patterns of change, highlighting their “temporality, activity and flow” and revealing “the dynamic activity underlying the maintenance and the reproduction of stability” (Langley *et al.*, 2013:1). Moving away from a “variance theorizing” that generates “know-that type of knowledge”, process studies engage in “process theorizing” to produce “know-how knowledge” (Langley *et al.*, 2013:4). In trying to make knowledge actionable, time must be explicitly integrated into explanations and propositions.

To date, research focused on corporate and financial sustainability has not given temporal concepts much attention (Slawinski *et al.*, 2015). What is lacking to improve understanding and drive transformational change is a dynamic view of the influences affecting the progress towards RI and a better understanding on how these underlying influences affect institutional strategies. Thus, in addressing the need to bridge the gap between the urgency of sustainability issues and the pace of change within the investment industry, a process study of change using SD concepts and tools could help identify the key drivers and barriers to progress, and gain insights into the agency of institutional strategies.

The South African context then provides a particularly interesting case to confront the findings to a practical setting and gain insights into the agency of local institutional strategies. To date, apart from the survey commissioned by the CRISA Committee and Ernst and Young in 2013, there has been no in-depth academic research on the agency of CRISA and its supportive regulatory environment. A dynamic perspective can help gain a better understanding of CRISA's agency on the South African investment industry and assist in the conceptualisation of possible points of intervention to drive transformational change within the industry.

### 1.3 Research question and objective

In this context, I explored the system dynamics and underlying processes influencing progress towards RI in order to answer the following interrelated questions: 'What are the underlying dynamics influencing progress towards RI?' and 'What is CRISA's agency on the dynamics influencing RI in South Africa?' The objectives of the research were to formulate an explanation of CRISA's agency within the dynamics influencing progress towards RI in South Africa and conceptualise possible interventions. The research questions and objectives are summarised in figure 1.

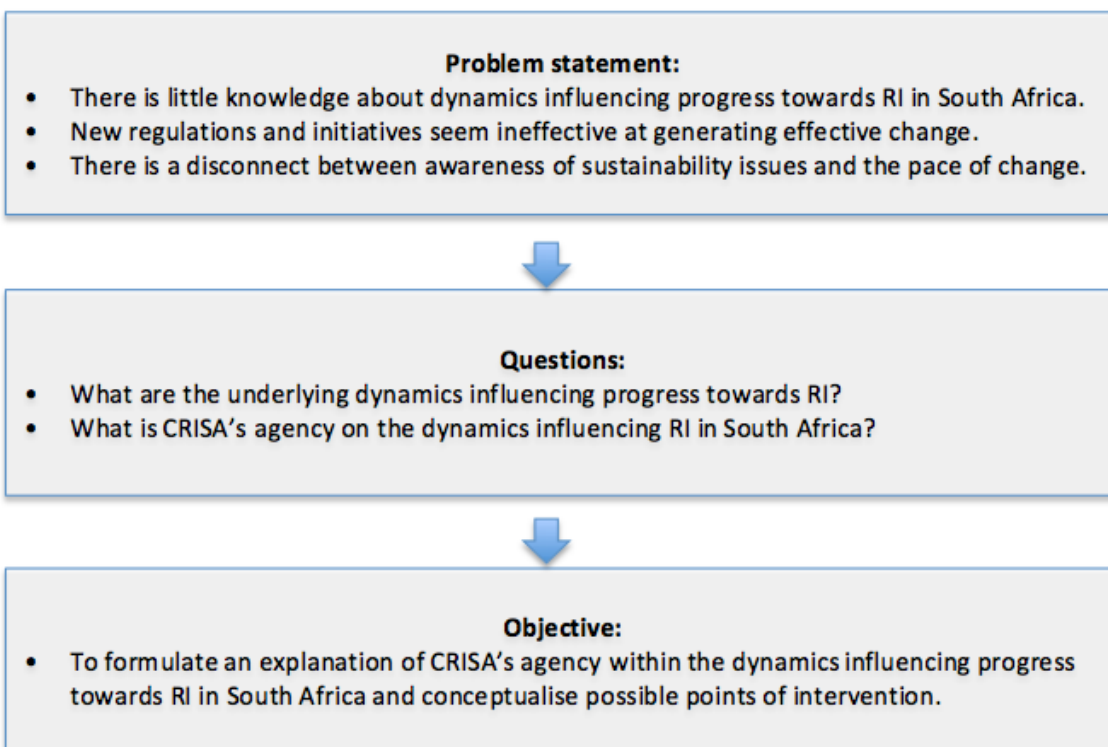


Figure 1: Summary of research question and objectives

## 1.4 Relevance of the study

Achieving sustainable development and mitigating climate change are global objectives, which cannot be achieved without a “substantial shifts in annual investment flows during the period 2010–2029” both globally and locally (IPCC, 2014:26).

While mitigation commitments from developing countries have traditionally been controversial in international negotiations, often expressed in a discourse of development versus environmental responsibilities, South Africa has committed to a 34% reduction in greenhouse gas emissions from “business as usual” by 2020 and 42% by 2025 (Shrivastava *et al.*, 2014; De Vos, 2014). Shrivastava *et al.* further point out that “The discourse has visibly gone through a transition with the general acceptance of the idea that the objectives of economic growth and development planning need to be situated within the framework of a transition to a low-carbon economy and the decision at COP-13 (COP = Conference of Parties) stating that developing countries will take ‘nationally appropriate mitigation actions (NAMAs)’ in the context of sustainable development” (Shrivastava *et al.*, 2014:23).

South Africa’s National Strategy for Sustainable Development and Action Plan (NSSD 1) supports this transition and states that “South Africa aspires to be a sustainable, economically prosperous and self-reliant nation state that safeguards its democracy by meeting the fundamental human needs of its people, by managing its limited ecological resources responsibly for current and future generations, and by advancing efficient and effective integrated planning and governance through national, regional and global collaboration” (Department of Environmental Affairs, 2011).

Changes in investment strategies and capital flows will need to be made in order to achieve this plan. The amendments made to Regulation 28 of the Pension Funds Act 24/1956 and the release of CRISA represent recognition of this necessity by the government and the industry.

The present research aims to support the transition to sustainable development in South Africa by providing insights into the dynamics influencing progress towards RI. Such insights could help improve CRISA’s agency and/or support the design of institutional strategies aiming at promoting RI practices in South Africa.

## 1.5 Chapter summary and thesis outline

### 1.5.1 Summary

Despite international awareness of the unsustainability of current development trends, businesses and governments have taken limited measures over the last decades to change the course of action. The result is a world at imminent risk of systemic breakdown, no longer operating in a “safe space for humanity”, and which requires urgent transformative actions (Rockström, 2010). As global finance plays an increasingly dominant role in development choices, any successful transition will need to take into account the role of the financial industry and will require a shift in investment patterns (IPCC, 2014; Gupta *et al.*, 2014). Currently exacerbating short-term strategies focused on quarterly financial performance to the detriment of a sustainable agenda, investors have a responsibility to reassess their influence and act as catalysts for change in corporate behaviour.

This acknowledgment has led to the emergence of the international concept of RI, which specifically recognises and addresses ESG issues in investment decisions as a means to limit financial risks. Mainstreamed internationally by the voluntary and aspirational PRI initiative, this business-oriented response has gained momentum, thus promoting convenient and non-contentious guidelines to the financial community (Sandberg *et al.*, 2008; Herringer *et al.*, 2009; Wen, 2009; Woods and Urwin, 2010; Eccles, 2010; PRI, 2015). In South Africa, despite a comparably lower initial uptake, RI approaches are gaining support (Eccles *et al.* 2007, Herringer *et al.* 2009). The amendments to Regulation 28 and the emergence of CRISA in 2012 have further provided a framework to promote change in investment practices in line with international recommendations (Viviers and Firer, 2012; IoDSA, 2013a).

However, whilst changes to investment practices have been welcomed and encouraging, it is questionable whether they are transformational and adapted to address the challenges at hand. Failing to slow down the acceleration of short-term trends and lacking broad-based support, RI has optimistically been framed as a managerial challenge, within a context of “business-as-usual”. Internationally or in South Africa, the pace and the nature of change appears disconnected from the problems facing humanity. (Richardson and Cragg, 2010; Giamporcaro and Pretorius, 2012; Clarke, L. *et al.*, 2014)

Researchers in the field of System Dynamics (SD) have advanced that SD could provide meaningful methods and tools to understand complex dynamic issues and gain insights into the drivers of change (Pruydt, 2013). Used in the context of process studies, which explicitly incorporates temporal considerations in the analysis

of tensions, contradictions and interactions contributing to change, SD can support the identification, understanding and illustration of the dynamic processes that underlie stability as well as change (Langley *et al.*, 2013).

In this context, the current research intends to explore the underlying dynamics processes influencing RI and more specifically, investigate CRISA's agency on the drivers and the barriers of progress towards RI in South Africa. The research's objective is to formulate explanations and conceptualise points of intervention to accelerate change in the institutional investment industry. As South Africa's transition towards sustainable development cannot be achieved without a shift in investment patterns, its findings aim at supporting such a transition by making evidence more actionable and assisting in the design of institutional strategies.

### **1.5.2 Thesis outline**

The first chapter has provided an introduction to the research, including background information and motivations, the rationale for the research, the question and objectives and the significance of the research.

Chapter Two, entitled 'Design, Methodology and Methods' covers the research design, the conceptual framework, the methods used and the validity of the research. The aim of this chapter is to provide an in-depth explanation of the methodological choices and demonstrate that the research process was followed with consistency, structure, rigour and awareness of methodological expectations.

Chapter Three sets out to investigate the dynamics influencing the concept and the agency of RI practices. This chapter explores international trends and presents a conceptual *process* framework, using the theories of complexity and system's dynamics, to identify drivers and barriers to change. The insights gained using the systems' dynamic perspective are used to evaluate the impact of behavioural norms and value systems on the current dynamics at play. Challenging the intentions and the strategies used so far to promote RI, the conceptual process framework develops a set of theoretical propositions that form the basis of a dynamic hypothesis surrounding RI's agency to generate transformative change.

In Chapter Four, the research analyses the South African context and evaluates CRISA's agency to promote RI in South Africa. After gathering background information on the evolution of RI in South Africa, the research assesses CRISA's agency by analysing public disclosure trends over three years and positioning the findings within the context of the main drivers and barriers towards RI in South Africa.

The last chapter (Chapter Five) confronts the theoretical propositions with the empirical findings and concludes on the main findings of the research, before presenting a series of recommendations and identifying opportunities for further scholarship.



## 2 Chapter Two: Research Design, Methodologies and Methods

### 2.1 Research design

The research I undertook is a multi-method empirical study, which uses Maxwell's 'Interactive Model of Research Design' as an underlying structure (Maxwell, 2004). This model is described in Figure 2: Maxwell's Interactive Model of Research Design (2004). The model uses a component approach to research design, where "the different parts of a design form an integrated and interacting whole, with each component being tied to several others, rather than being linked in a linear or cyclic sequence" (Maxwell, 2009:216).

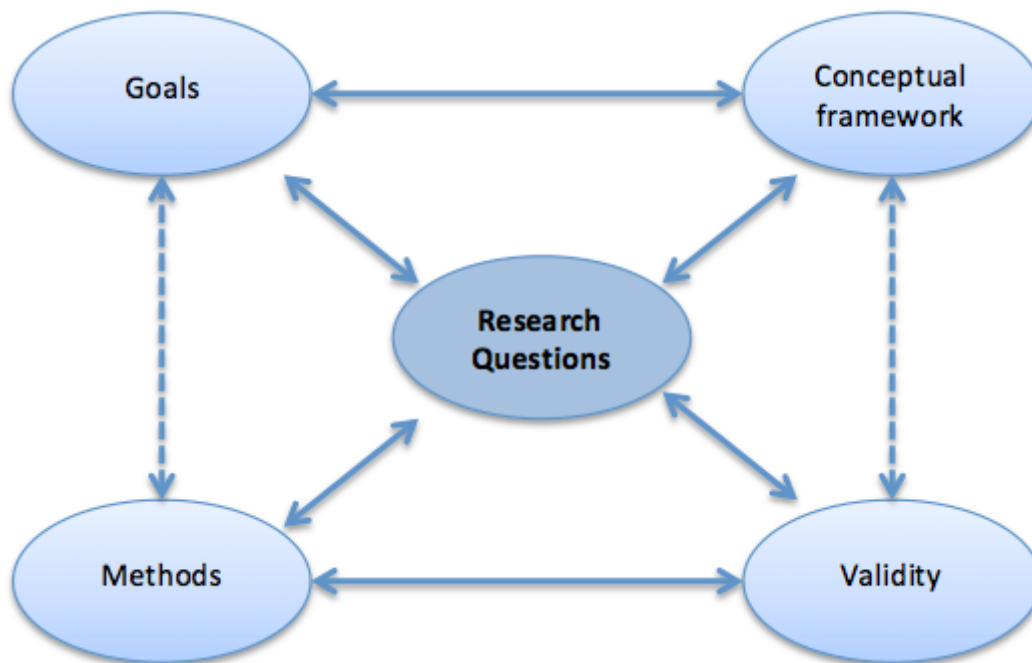


Figure 2: Maxwell's Interactive Model of Research Design (2004)

Qualitative or multi-method research generally requires more flexibility and less restrictive design concepts than traditional quantitative studies (Yin, 2011). In line with this, Maxwell's model accepts a diversity of data sources and methodological choices. Whilst not presupposing any particular order or directionality, Maxwell's model allows for an iterative process well suited for developing explanations of phenomena or influences (Maxwell, 2009; Yin, 2009).

Maxwell's research design approach further suggests that there should be a close integration between the components of the 'upper part' of the model (the goals and the conceptual framework) in line with the research question. This 'unit' should provide the theoretical concepts and inform the models that can be applied to improve our understanding of phenomena. The 'bottom' of the triangle (the methods and validity) should also be closely integrated to ensure the validity and the relevance of the research outcome in relation to the research question. (Maxwell, 2009)

Having already presented the research question and objective, I will follow Maxwell's recommendations in this chapter and discuss the methodology as divided into three interrelated components: conceptual framework, methods and validity.

## **2.2 Conceptual framework**

As defined by Miles and Huberman, a conceptual framework "explains, either graphically or in narrative form, the main things to be studied—the key factors, concepts, or variables—and the presumed relationships among them" (1994:18).

Sometimes referred to as the 'literature review' – but more critical – a conceptual framework treats the literature as 'ideas' and 'possibilities' regarding what is going on and attempts to reframe the issues in an alternative way (Maxwell, 2009). It connects the adopted (2.2.1) research paradigm, (2.2.2) exploratory studies, (2.2.3) existing theory and research, (2.2.4) the researcher's experiential knowledge, and (5) conceptual mapping exercises to *construct* a critical framework (Maxwell, 2009).

### **2.2.1 Research paradigm**

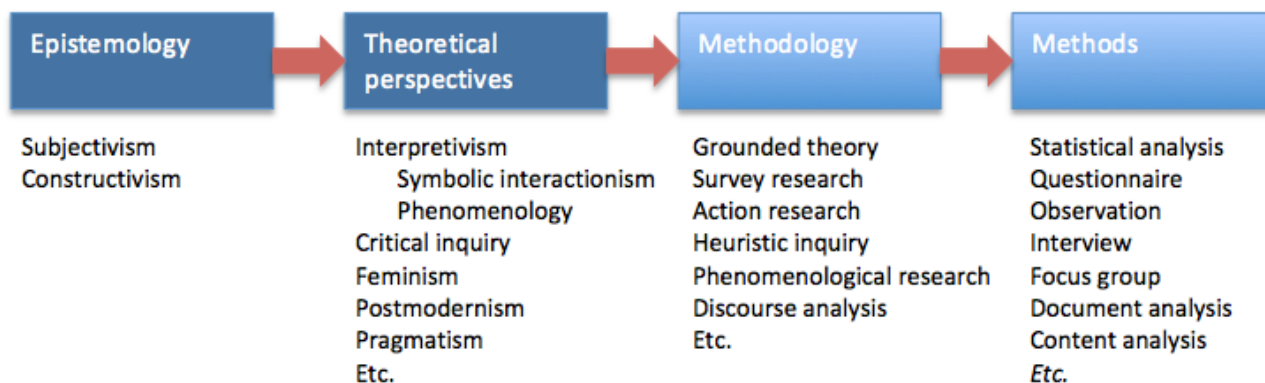
As explained by Maxwell, a research paradigm refers to "philosophical assumptions about the nature of the world (ontology) and how we can understand it (epistemology)" and can "also typically include specific methodological strategies linked to these assumptions" (Maxwell, 2009:224). The research paradigm provides an ideological foundation to the research and 'pulls it together' by ensuring a philosophical and methodological consistency. It further enhances the researcher's reflexivity or ability "to reflect on the research process" (Bryant and Charmaz, 2007:518). Reflexivity is "a chance for the researchers to rethink, ground, or justify their own decisions and to communicate the process of theory development to their co-researchers as well as to research participants" (Bryant and Charmaz, 2007:519). As pointed out by Pruydt,

clarifying the research paradigm is especially important when investigating system dynamics as each paradigmatic assumption carries different implications in terms of goals, interpretation and communication of the research outcome (Pruydt, 2006:23).

In light of this comment, and in close consideration for the present research's questions and objective, the paradigmatic stance of the research will be articulated in terms of (i) philosophical assumptions and (ii) methodological strategies.

(i) According to Michael Crotty (1998), terminologies used in research are often confused "with epistemologies, theoretical perspectives, methodologies and methods thrown together in grab-bag style as if they were all comparable terms" (Crotty, 1998:3). While Crotty claims that there are strong interrelationships between these terms, he suggests proceeding with a specific 'hierarchy of decisions' early on in the research design. For Crotty, the choice of epistemology influences the theoretical perspectives, which in turn will impact the methodology and the methods used (Crotty, 1998; Gray, 2009).

Crotty does not specifically refer to *ontology* in his process, claiming that the epistemology and ontology are mutually dependent and often hard to conceptually distinguish from one another: "to talk about the construction of meaning is to talk of the construction of a meaningful reality" (Crotty, 1998:10). Instead, Crotty suggests clarifying the 'theoretical perspective' of the research, which he defines as "The philosophical stance informing the methodology" (Crotty, 1998:3), and which results from a chosen epistemological and ontological stance. Figure 3: Relationships between epistemologies, theoretical perspectives, methodologies and research methods. Source: Adapted from Crotty (1998) describes the relationship between epistemologies, theoretical perspectives, methodologies and research methods.



**Figure 3: Relationships between epistemologies, theoretical perspectives, methodologies and research methods.**  
Source: Adapted from Crotty (1998)

In light of this decision framework, the philosophical assumptions that guided the present research can be ascribed to a *Constructivist epistemological stance* and an *Interpretivist theoretical perspective*.

Over the past few decades *Constructivism* has gained influence in explaining how knowledge is produced (Gordon, 2009). In the constructivist stance, “Truth and meaning do not exist in some external world, but are created by the subject’s interactions with the world. Meaning is *constructed* not discovered, so subjects construct their own meaning in different ways, even in relation to the same phenomenon. Hence, multiple, contradictory but equally valid accounts of the world can exist” (Gray, 2009:20). Human meanings are therefore viewed as the result of “constructed frameworks rather than direct reflections of the real” (Raskin, 2008:16).

The constructivist epistemological stance is closely related to *Interpretivist theoretical perspectives*. Interpretivism looks for “culturally derived and historically situated interpretations of the social life-world” (Crotty, 1998:67). In this context, the world is mediated through the interpretative process of the mind (Williams and May, 1996; Gray, 2009). Within the interpretivist approach, the present research has selected the *Symbolic Interactionist* perspective. Strongly influenced by the work of American pragmatist philosophers John Dewey and George Mead in the 1930s, this perspective is especially concerned with “ways of conceptualizing human behaviour that focus on people’s practices and lived realities” (Gray, 2009:24). According to this philosophy, ‘meaning’, including the definition of the self, arises from the process of social interaction and can be revised on the basis of experience or experiential knowledge (Gray, 2009).

Constructivism and Symbolic Interactionism are philosophical assumptions that are well suited to process studies (Langley *et al.*, 2013). Within this perspective, ‘process’ meets ‘practice’. Therefore “how the past is drawn upon and made relevant to the present is not an atomistic or random exercise but crucially depends on the social practices in which actors are embedded” (Langley *et al.*, 2013:5). The on-going interactions between individuals, organizations, contexts and social expectations permeate and orient how things unfold and change over time.

(ii) In terms of methodology, the present research makes use of Grounded Theory Methodology (GTM), often associated with symbolic interactionist perspective (Gray, 2009).

Grounded theory methodology aims at understanding complex socio-economic processes, through an interpretive process and “the actual production of meaning and concepts used by social actors in real settings” (Gephart, 2004:457). Developed by Glaser and Strauss (1967) in their book “The discovery of grounded theory: strategies for the qualitative research”, the methodology was developed “to understand the process by which actors construct meaning out of inter-subjective experiences” (Suddaby, 2006:634). As explained by Kathy Charmaz (2006:6), “It moved the qualitative inquiry beyond descriptive studies into the realm of explanatory theoretical framework, thereby providing abstract, conceptual understanding of the studies phenomena”. Emerging from the data, grounded theory emphasises that explanations must be relevant and have a practical utility to the situation being researched (Marshall Egan, 2002).

Since its inception, GTM has evolved to become what Gallie (1955) refers to as a ‘contested concept’ (Charmaz 2004; Bryant and Charmaz, 2007). Whilst the initial approach was highly flexible and open, subsequent developments by Strauss and Corbin (1998) made use of rigid processes for data collection, coding and analysis. The last major development came with Charmaz’s Constructivist Grounded Theory (2000), which “emphasises how data, analysis, and methodological strategies become constructed, and takes into account the research contexts and the researchers position, perspective, priorities and interactions” (Charmaz, 2006:10). Thus today, there are three major schools of GTM, the Glaserian (or classical GTM), the Strauss and Corbin school and the Constructivist, which have further diversified in what can be seen as a ‘family of methods’, which share ‘essential properties’ (Bryant and Charmaz, 2007).

The present research adopted the constructivist approach to grounded theory developed by Kathy Charmaz (Charmaz, 1995; 2000), as it makes explicit that “theoretical rendering offers an interpretive portrayal of the studies world, not an exact picture of it” (Charmaz, 2006:10). This approach is also in line with subsequent writing from Juliet Corbin, who agrees that concept and theories are constructed to develop knowledge and help us understand the world (Corbin and Strauss, 2008). Unlike objectivist grounded theory, which rests in the positivist tradition and favours deterministic explanations that can be universally generalised, constructivist grounded theory is in line with *interpretive* theory. It calls “for the imaginative understanding of the studied phenomenon. This type of theory assumes emergent, multiple realities; interderminacy; fact and values as linked; truth as provisional; and social life as processual” (Charmaz, 2006:126).

### **2.2.2 Exploratory field investigations**

Exploratory field investigations are the second element of the conceptual framework. Staying true to the research paradigm, exploratory field investigations were conducted before the commencement of the

literature review to identify key concerns and themes. The objective behind engaging in the early exploratory investigations was to start the study with a fresh mind, unburdened by existing ideological assumptions (Bryant and Charmaz, 2007; Maxwell, 2009).

Indeed, grounded theory advocates initiating the research process by selecting a first 'area of inquiry'. This can be a group of people, a place, a context or a phenomenon. During this initial phase, the researcher focuses on "relaying initial observations and maintaining a theoretical sensitivity" (Marshall Egan, 2002:282). To remain open to the theory emergence process, the present research engaged first in field investigations before reading any established theoretical framework (Marshall Egan, 2002; Suddaby, 2006).

Thus, the study was initiated by meeting with some members of the CRISA committee, analysing the online marketing materials relating to RI from a selected group of financial institutions and conducting a small number of semi-structured phone interviews with industry professionals. Exploratory investigations were further substantiated by the research conducted on behalf of Ernst and Young and the CRISA committee in 2013, which focused on sampling, gathering and analysing field data.

This rather 'in-depth' exploratory process allowed me to refine the research question, to frame the area of investigation and to identify key areas of concerns, without the constraints of any theoretical lens.

#### **Reflection on Grounded Theory Methodology (GTM) and the initiation of the research**

The choice of methodology has multiple implications on the type and the timing of literature review, on how data is gathered and processed, and on how experiential knowledge is used. All aspects of the research must be consistent.

When I initially considered using Grounded Theory Methodology (GTM) for my MPhil research, I felt uneasy about conducting field investigations before undertaking a thorough literature review. I was not convinced that what was advocated by the Galserian ('Classic') approach to GTM made sense for someone new to a particular field of study. I firmly believed that I needed a significant theoretical background to guide the research process. For some time, I tried to find justifications to proceed differently. I now realise that my initial fears were not founded and that there is great value in starting a research with exploratory field investigations.

Looking back, I was very fortunate that I was precipitated into my research at a time when I was not familiar with RI. As I accepted the responsibility from Ernst and Young and the CRISA committee, my internal debate was cut short. I only had time for a very brief survey of a few academic papers on RI before engaging with the field research; gathering data, reviewing publicly disclosed information available on websites and integrated reports, and conducting interviews. I was under pressure to deliver results according to a deadline, so I had to get going.

My research thus initially developed as a pragmatic analysis and understanding of the problem, driven by field data and first hand, practical information from practitioners. The data I gathered was progressively coded to create clusters of information and to generate key themes for further investigation. Through this process I developed a personal sensitivity for the subject, free from any theoretical lens and unbiased by other's opinions.

In the second phase of my research, I then used the practical knowledge gained during the field investigation as a benchmark to confront, inquire and analyse the literature. Again, I engaged in a similar process as with the field data, coding each literature article to extract themes that could then be clusters and categorised. This process allowed me to progressively gain a deeper and more theoretical understanding of what I had observed. Over time, I witnessed the emergence of dominant causal links and key relationships within my data. Each new article I read added granularity to my analysis, whilst the coding and categorisation process enabled a higher level of abstraction.

What I mostly value in GTM is that instead of justifying 'on the ground' what I would have read in the literature – I used the literature to deepen my understanding of the observed phenomena, and progressively integrate more complexity into my knowledge. It felt profoundly different from previous research methods and allowed themes to emerge more freely, unprejudiced by expert interpretation. The 'sensitivity' derived from the open-minded process generated a thread that I carried throughout my research.

#### **Text Box 1: Reflections on GTM and exploratory field investigations**

### **2.2.3 Existing theory and research**

Existing theory and research as well as industry publications were reviewed in order to organise available data, identify key themes and provide a constant source of comparative information. In dealing with this third element of the conceptual framework, the research did not limit itself to scholarly articles but included unpublished work, conference proceedings, industry publications and newspaper articles (Locke, Spirduso and Silverman, 2000 cited in Maxwell, 2009).

The resulting broad 'literature review' was used to challenge ideas emerging from initial field studies (Maxwell, 2009). Together with the memo writing, it allowed the identification of the key 'categories' or variables in the conceptual framework.

The initial literature was obtained by using a keyword search in scholarly databases, using words such as “responsible investment”, “ethical investment”, “impact investing”, “business ethics”, “corporate social responsibility”, “values and investments” or “climate change funds”. A snowball technique was then applied to expand and intensify the literature review, using the references provided by each article or publication. “Snowballing is the process whereby you start with a small number of articles and expand this number with the help of the initial ones” (Ang, 2014:6). As Siah Hwee Ang specifies “The snowballing method represents a convenient approach to a literature review when the scope is uncertain or when a few authoritative articles can be identified” (2014:6). The present research was careful to balance efforts between *convergent* and *divergent* searches, to ensure that the research covered a broad array of interconnected issues, whilst at the same time avoiding an information overload (Ang, 2014). Furthermore, a ‘cut off’ window of 15 years was used – with some exceptions for key authors – and efforts were specifically deployed to find journals or other relevant information published in the last five years.

In line with the research paradigm, each piece of data was analysed and coded into categories. Staying true to GTM, I used “an organic process of theory emergence” (Suddaby, 2006:634) and did not engage in hypothesis testing, as this would have gone against the notion of theoretical emergence (Marshall Egan, 2002; Suddaby, 2006). The research made use of two dominant concepts in grounded theory: “*constant comparison*” and “*theoretical sampling*”. Constant comparison means that information is collected and analysed simultaneously. Theoretical sampling implies that the developing theory guided the researcher regarding where and what type of data was collected. These two concepts thus lead to an iterative process, which constantly feeds ideas and new theoretical propositions into the developing narrative, as described in Figure 4: Grounded Theory Process - personal interpretation.

In line with the philosophical assumptions of the research, categories did not emerge automatically. They arose from the creative engagement and the interpretation of the data, which led to a progressive analytical abstraction (Bryant and Charmaz, 2007).

To facilitate the coding process, I used a software called NVIVO®. This software has been especially designed to assist qualitative researchers using a grounded theory approach. It facilitates the referencing, categorising, linking and analysing of data and provides tools to group ideas and concepts (Bazeley and Jackson, 2013). Its integration of memos with internal and external data sources enables the researcher to have a full view of the developing theory.



Dey, cited in Bryant and Charmaz (2007), argues that the use of software is encouraging as it provides “a more diligent and disciplined approach to the auditing of the creative process”. While it is clear that the research process must remain in the hands of the researcher and that software cannot expedite the analysis, “some form of repository, plus sorting and retrieval facilities has proved useful” (Bryant and Charmaz, 2007:24).

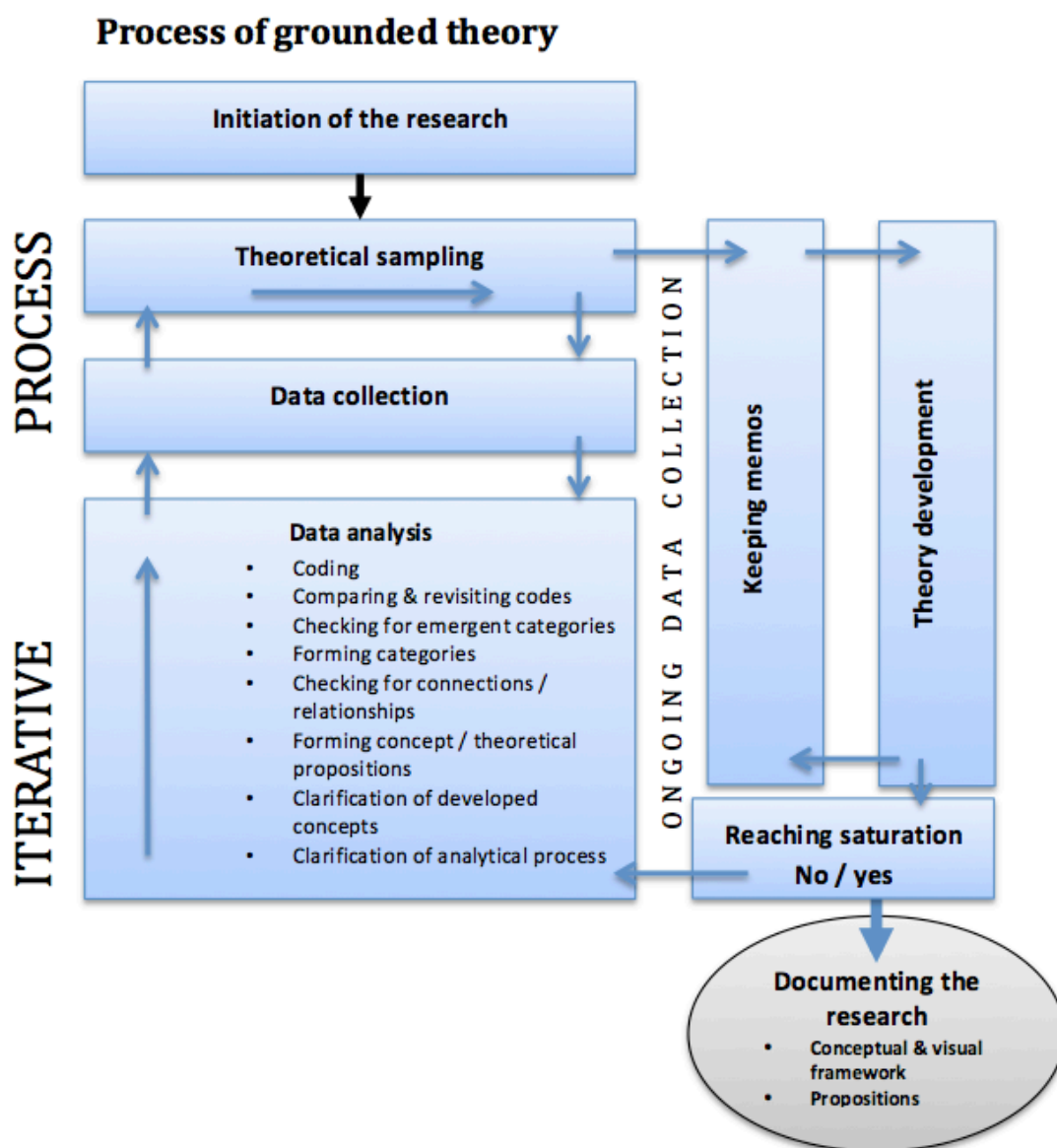


Figure 4: Grounded Theory Process - personal interpretation based on Suddaby (2006) and Partington (2002)

The flexibility of the research process and the creativity involved in the interpretive process are both the strengths and the limitations of grounded theory. On one hand, it generates in-depth insights into specific situations and benefits from high construct validity (Mouton, 2001). However, on the other hand, it is time consuming and can suffer validity issues from potential bias of the researcher. Methodological rigour and transparency are thus imperative, together with a constant awareness about the on-going interactions between the researcher and the data generated (Mouton, 2001; Suddaby, 2006).

#### **2.2.4 *Experiential knowledge***

The fourth building block of the conceptual framework is experiential knowledge. The incorporation of a researcher's experiential knowledge has increasingly gained support as a way to generate insights and hypothesis (Strauss, 1987). Grounded theory makes explicit use of 'experiential data' through a permanent memo writing process. As described by Bryant and Charmaz, memos are "the narrated records of a theorist's analytical conversations with himself/herself about the research data; as such they provide particular ways of knowing" (2007).

For the present research, I made a systematic use of memo writing. While the earlier memos were more speculative, centred on questions, the later ones recorded personal interpretations of what was taking place and allowed the emergence of a narrative attempt at explaining the situation. Examples of memos are used throughout the thesis to illustrate the methodological process and the evolution of my views.

The main sources of experiential knowledge came from my personal attempts at applying a RI strategy to my savings and through the experience, insights and relationships gained while conducting, on behalf of Ernst and Young, the research commissioned by CRISA in 2013. Making the choice to invest according to RI principles proved to be very challenging but allowed me to gain insights into the institutions offering retail products, the type of products available and their market positioning, the accessibility, liquidity and performance advertised and the trade-offs demanded. The process is described in Text Box 2: Applying an RI strategy to my own investments. On the other hand, conducting the research commissioned by CRISA in 2013 gave me access to a valuable data set, tools that could be used for comparisons, a network of supporting relationships, key access points into the industry and practical insights into the governing principles of the RI community.

### **Applying an RI strategy to my own investments**

*As I engaged in this research, I decided to review how my personal assets were invested. I initially thought this would be rather easy. My savings being mainly in Europe, my research indicated that RI products were widely available in most banks. I thought it was just a matter of reviewing the products I had subscribed to and selecting new ones.*

*The process took over eighteen months and revealed several findings: (1) RI products were not easily accessible in mainstream banks, (2) knowledge of these products was extremely limited, and investment in RI products was discouraged, (3) RI products could take on a variety of meanings and forms, and (4) RI came at a high initial financial cost. However, (5) to date, the more rigorous RI fund has provided me with the best returns ...*

*(1) At the time, my savings and investments were spread across two European banks: Dexia Asset Management and Royal Bank of Scotland. Whilst both were listed as banks providing RI products, none of them provided RI products to retail investors. The managers I spoke to had no knowledge of these products and could not inform me of the requirements to access them.*

*(2) As I shared my determination to review my portfolio according to RI principles and change banks if necessary, I was told that RI products were 'risky', 'costly, and 'a marketing trend' with limited future. I was told that RI products would lower the returns I could expect out of my investment accounts and could potentially limit my ability to qualify for a loan.*

*(3) Investigating new banks and assessing their RI products was lengthy and difficult.*

- a. In most cases, access to product information was not easily available and took time to locate. Most products available used a 'best in class' strategy, but criteria for inclusions were not clear. Most RI funds I reviewed included oil and gas companies, mining companies and other resource-intensive companies. I was told this was a prerequisite to meet the minimum return expectations of clients.*
- b. Several products were 'funds of funds', with very limited information on the definitions, strategies and criteria used, and very high entry and management fees. These costs were attributed to the additional research and analysis required in RI fund management. The projected performance was just under traditional market expectations.*
- c. The only bank that provided clear, immediate and unambiguous information on RI was Triodos bank. Sustainability focused, Triodos uses a combination of negative and positive screening to create and sustainable and ethical 'investment universe' in line with the clear vision and mission of the bank. Consistent and unbiased, their product offering was structured around a straightforward commitment to sustainability. They catered for big or small investors, and could adjust the degree of risk/return by changing the equity/ debt ratio.*

(4) I selected two banks, which I felt provided the most comprehensive information: one ‘mainstream’ bank – BNP Paribas Fortis – and one ‘alternative’ sustainable bank – Triodos. I transferred 30% of my assets to the BNP and 70% to Triodos. Return projections provided by the BNP were higher than those of Triodos. However, this process came at a high initial cost. The BNP could only offer structured products to small retail investors. I had to ‘sell’ all my investment and buy shares of their FoF SRI Balanced fund at an entry cost of 1%. Triodos had a wider and more flexible offer but required that I liquidate all positions that were not consistent with their investment universe. Even though in the past I had actively tried to invest responsibly, I was told that about 40% of my investments were not ‘ethical’... The time to sell was not ideal and I suffered a 6% initial loss.

(5) Eighteen months later (1 October 2015), the performance of my account invested according to the strict ethical Triodos investment universe is performing much better than the less strict best-in-class BNP fund. I have not only recovered the initial ‘loss’ suffered during my transition to Triodos, I have gained a further 4.3% in the last 12 months. On the other hand, the FoF SRI Balanced fund has not performed well. On top of the initial 1% cost, I lost an additional 2% over the last 12 months. The specialisation of Triodos in RI, the availability of ‘open’ (non-structured) products for small investors and the core availability of ESG research seems to provide them with an edge that structured products offered by mainstream banks cannot match.

From this experience, it appears that profits and responsibility are not in opposition, as long as expectations are not to maximise returns. Using a strict ethical approach can provide adequate returns whilst building a sustainable economy.

#### **Text Box 2: Applying an RI strategy to my own investments**

### **2.2.5 Mapping and visual tools**

The last aspect of the conceptual framework addresses the integration of mapping and visual tools. While some grounded theory practitioners like Stern (1994) criticise strongly the use of diagrams and visual representation, others like Clarke argue that visual representations are essential to grounded theory work (Clarke, A., 2005; Bryant and Charmaz, 2007). In line with the latter view, the present research made a central use of visual tools to further the analysis, to generate concepts from what could otherwise been seen as unorganised data, and to support the initiation of the writing and underlying narrative of the research. This approach is further supported, in practice, by process researchers who generally “draw on visual maps or diagrams to represent processes and their iterative dynamics” (Langley *et al.*, 2013).

With reference to the research question, the research made use of *qualitative* Systems Dynamics (SD) tools to map the conceptual framework and gain a visual understanding of the developing explanation. Mapping and visual tools are generally useful in SD to understand the relationship and connections between elements

of the system. The objective was to provide a simplified representation of the issues focusing on key variables in the system and some of the relations between these elements (Pruydt, 2013).

While SD may include both qualitative and quantitative steps, I made use, in the present study, of the initial *qualitative* stages of SD research, namely: *articulating the problem dynamically, constructing a conceptual model and formulating a causal theory (or dynamic hypothesis) on how the problematic behaviour is generated* (Richardson and Pugh, 1989; Sterman, 2000; Pruydt, 2013). The rationale behind this is that these conceptual stages are best suited to analyse phenomena that are difficult to quantify and to reveal “the dynamic activity underlying the maintenance and the reproduction of stability” (Langley *et al.*, 2013:1; Pruydt, 2013). Qualitative SD can help identify “multiple interacting *perception* of ‘reality’” and initiate a learning process of the ‘soft systems’ dynamics at play (Checkland and Holwell 2004; Morecroft, 2007:148). This is in line with the stated intention of this *process* study and its underlying constructivist epistemological stance.

**Memo 22 July 2015 2:15pm:**

*Getting the right level of abstraction, most adequate for the conceptualisation effort, is really hard and extremely frustrating at times!*

*I keep trying to represent the system instead of the problem – and therefore end up having too many variables. I try to define causal links for too many nodes. I must focus on the problem. I thought this process would be rather easy. I was completely mistaken. I am at my 20<sup>th</sup> design trial and it still feels too complicated.*

**Memo 27 July 2015 11:30am:**

*Instead of looking at my overall coded data, I decide to use the first section of the chapter to identify the key variables. I highlight only the variables, which I used in my assessment of the situation (chapter 3.2) and cross-reference the variables with the coded data. The objective is to start from the problem as it manifests itself and how it is evidenced. As I am cross-referencing the key variables with all my categories of code, I select the nodes that matched the variables in the assessment. This reduces the number of variables to consider and focuses the system design on the problem.*

**Text Box 3: Personal memos 22 and 27 July 2015**

The conceptualisation was carried out using a two-step approach: firstly by determining the most important variables and establishing the system boundary, and secondly by exploring the causal links amongst the key variables and uncovering the overall dynamic behaviour of the system.

The first step was accomplished using a specific SD tool called a *subsystem diagram* (Forrester, 1964; Sterman, 2000). As stated by Sterman, “Subsystem diagrams convey information on the boundary and the level of aggregation in the model” but do not show the feedback systems (Sterman, 2000:99). The diagram focused on the ‘business case’ RI – as currently promoted within the industry - and its current perceived reality and decision structures. The variables were aggregated to allow a consistent level of abstraction and to facilitate the exploration of current process dynamics (Richardson and Pugh, 1989; Sterman, 2000; Morecroft, 2007). The effort aimed at illustrating the scope of the system being considered and capturing the most important variables, which generate the problem behaviour (Richardson and Pugh, 1989). It aimed at providing an overview of what we know of the system, without containing too much detail (Sterman, 2000). As stated by Pruydt, subsystem or sector diagrams are “ideally suited to provide a big picture overview of issues” (2013:42).

The second step of the conceptualisation process was conducted using a Causal Loop Diagram (CLD). Causal Loop Diagrams are an important SD tool, enabling the representation of feedback structures in system and allowing the consideration of its full dynamic properties (Probst and Bassi, 2014). Whilst there are generally several causes and effects in a system, Causal Loop Diagrams investigate the dominant influences, their multiple interconnections and the nature of feedbacks. Sometimes referred to as influence diagrams, Causal Loop Diagrams highlight the nature of *causal links* between variables (Richardson and Pugh, 1989).

The most important variables for the conceptualisation effort were extracted from the categories that emerged during the first stage of the study, and which made use of grounded theory methodology (GTM) to analyse the context and the symptoms of the problem. In line with the philosophical assumptions of the research, the process relied on creative engagement and the interpretation of the data to progressively reach to a level of analytical abstraction. The *categories of data* that emerged out of the GTM process allowed the identification of the key variables used in the SD modelling process (Bryant and Charmaz, 2007; Probst and Bassi, 2014).

**Memo 28 July 2015:**

*The subsystem diagram is really helpful to map the problem, look at flows, and see the big pictures. The most determining variables are starting to emerge.*

**Memo 3 August 2015:**

*Yes! Finally I feel a breakthrough moment! It is fascinating. In a way, the SD process ends up revealing a very 'obvious' behaviour; i.e.: a goal seeking behaviour. Somehow, this is what I expected to find and I am not overly surprised. Yet, the fact that it is there, with clear and little arguable causal links, gives me a profound insight. Instead of thinking that maybe ... It feels like a realisation. I feel that I now know. The process has provided validity to the assessment.*

*Sitting back, I am frightened by the implied consequences revealed by the SD process: Left to current practices, RI will be unable to shift investment practices in the timeframe required to support a sustainable economy. I feel quite overwhelmed.*

*With a verbal assessment, you can always argue. It's a view, an opinion – and only as good as its arguments. But causal link and feedback views take some of the bias of the assessment away. SD gives an almost binary /mathematical view. If A goes up, B goes down. It is not about whether A is right or wrong. It is about the likely effect of obvious causal links between two variables. This has been a fascinating process!*

**Text Box 4: Personal memos 28 July and 3 August 2015**

Although the mapping or modelling process appears as the last phase in the construction of the conceptual framework, modelling is not a waterfall process (Morecroft, 2007). In the present research, the modelling was thus conducted as an iterative process in parallel to the coding and the categorization. At different stages in the research, this parallel processes revealed the need to revise variables or the model structure. Modelling was used as an explorative process of knowledge-generation, which was feeding back into other aspects of the research (Richardson and Pugh 1981 cited in Pruydt, 2013). The conceptualisation phase used Vensim PLE<sup>®</sup> to model the system structure and the feedback mechanisms. Vensim PLE<sup>®</sup> is the reference software used for academic research in the field of SD (Sterman, 2000).

The result of the mapping process was a visual narrative, representing different aspects of the conceptual framework, pointing to key variables and processes, which affect the progress towards RI.

## 2.3 Methods

Having presented the conceptual framework, the next component of Maxwell's interactive design model to be discussed relates to the methods used. Within the methodological paradigm of grounded theory, the study was constructed as a multi-method research making use of (i) quantitative and (ii) qualitative methods as well as (iii) expert reviews.

### 2.3.1 *Quantitative data collection and analysis*

To gain greater insights into industry trends and the influence of CRISA, a selected set of data was gathered from a representative sample of 47 companies (institutional investors and service providers). The sample emanated from work commissioned by the CRISA Committee and Ernst and Young in 2013 (IoDSA, 2013b) and was therefore well suited to establish comparisons and trends. Institutions were selected based on their size to ensure that most assets under management (AUM) in South Africa were included (about R5 trillion). The large sample was well suited to analyse data on the basis of statistical occurrences. The sample was discussed at length with the CRISA committee<sup>1</sup> to ensure that no major institution had been left out and to start building a relationship with key individuals within the RI community (Maxwell, 2009).

Details of the sample group are provided in Appendix A: List of surveyed institutions. An estimation of the size of the sample, in terms of AUM, is provided in Appendix B: Size of Asset Under Management (AUM)

This part of the research focused on publicly available information, i.e. from data accessible on public websites, annual reports and sustainability reports. During this process I confronted how institutions disclosed information regarding RI with the disclosure framework published by CRISA. Data was gathered over three years: in August 2013, August 2014 and August 2015. The second and third years of data collection allowed me to cross-check the validity of the first year's findings and to initiate some analysis of year-on-year progress.

As detailed in Table 1, the sample group was structured into three types and four categories of institutions. This ensured a granularity of understanding of trends within the investment chain.

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<sup>1</sup> The CRISA committee is constituted of RI consultants and industry professional



Types of institution	Categories	Number
Asset owners	Pension funds	20
Both asset owner and service providers	Large financial institutions (including collective investment schemes and insurance providers)	9
Service providers	Asset managers	14
	Asset consultants	4
<b>Total</b>		<b>47</b>

**Table 1: Types and categories of sampled institutions**

In line with the research commissioned by the CRISA Committee and Ernst and Young in 2013, I used a matrix to assess the disclosure level of each institution. Based on the three elements of the disclosure framework, the matrix included 34 variables or questions. As argued by Catherine Cassell and Sara Nadin, “Data matrices are a way of displaying data in a format where it is readily accessible for the process of analysis and interpretation” (Cassell and Nadin, 2008). The matrix rated the availability of information. For those institutions disclosing information, the matrix also evaluated the quality of the information provided. The matrix, thus, provides an overview of the level and quality of disclosure as per CRISA’s guidelines by the South African investment industry. The matrix is presented in Appendix D: Data Matrix.

My analysis of the data focused on establishing statistical occurrences to identify how the different categories of institutions disclosed information and publicly committed to RI. As explained by Puzicha and Hofmann (1998), “the ultimate goal of statistical modelling is to explain observed data with a *probabilistic* model”. This implies a certain degree of simplification, to reduce the complexity of the raw data and to allow the samples to be displayed in terms of frequency distribution.

In this context, my research established the frequency of each rating per category of institution and per variable. This enabled the identification of trends and issues within each segment of the investment chain and highlighted patterns of disclosure in relation to each variable (question) of the matrix.

### **2.3.2 Qualitative data collection and analysis**

I further gathered qualitative data using (i) semi-constructed interviews and (ii) personal observations.

(i) As pointed out by Partington (2002), interviews can help sensitise the researcher to what informants (in this case industry professionals) view as important. In the present research, interviews were partly

structured, with pre-defined questions, and partly open-ended. The pre-defined questions were designed to gather information on specific concerns or themes identified during preliminary phases of the study. The open-ended part of the interviews allowed the research to open a window into the world of the informants and to gain insights into the specific sensitivities or concerns that guided their responses. It further allowed me to uncover issues that had not previously been raised or identified. Especially in the context of grounded theory, having part of the interviews being open-ended was essential to limit the “expectancy effect” and distortions or bias, common in qualitative research (Mouton, 2000).

The research made use of purposeful sampling (Patton, 1990), deliberately selecting people (or representatives of institutions) based on the importance and representative nature of the information they could provide. The sample selected was small but chosen for its typicality and relevance in understanding behaviours/concerns across the industry (Maxwell, 2009). Details of the sample are available in Appendix C: List of interviewees.

Most interviews were conducted over the phone. An example of the type of questions discussed is provided in Appendix E: Example of interview questions. At the request of certain interviewees, a summary of the outcome was sent to the interviewees to ensure that a proper understanding of their perspective (or their institution’s perspective) had been captured. Each interviewee could make edits, and the resulting data was then used for further coding and categorising using the grounded theory methodology. Thus, the data analysis process took place simultaneously with the data collection (Partington, 2002).

During the analysis phase, the data was ‘fractured’ and rearranged in categories to check for relationships and connections, and to facilitate the emergence of theoretical propositions (Maxwell, 2009; Partington, 2002). The systematic memo-writing process, which took place in parallel to data coding and analysis, tried to avoid the creation of ‘analytic blinders’. As pointed out by Maxwell, neglecting contextual and contiguous relationships while categorising the data can sometimes prevent the emergence of alternative explanations (2009). Memos, therefore, focused on the contextualisation of information in relation to the emerging explanation.

(ii) Personal observations were also used to pick up theoretical sensitivities and themes. As defined by Quest *et al.*, “participant observations aim at “discovering through immersion and participation the hows and whys of human behaviour in a particular context” (Quest *et al.*, 2012:75). They allow uncovering “aspects of social scenes that use rules and norms that the participants may experience without explicitly talking about, that operate on automatic or subconscious levels, or are even officially off limits for discussion or taboo” (Quest *et al.*, 2012:75).

**Memo 23 December 2014 4:36 pm**

*It seems that throughout this research my optimism about RI is going up and down. Some articles bring my hopes up but many bring my hopes down. It feels like the main progress is towards the mainstreaming of a type of RI, which is without substance. The main issues - self-reflexion - is not taking place.*

*I feel the risk of ‘green washing’ is bigger than ever. But maybe I am just impatient and unrealistic in my expectations. Changes are slow to take place, especially in such self-assured environment.*

*Maybe the ‘green washing’ phase is necessary to initiate a discussion and start a more profound process of value change. I have doubts though...*

*Changes in the financial system seem to be significantly outpaced by the changes in the planetary/social systems. There is a ‘build up’ in the natural/social system that is ignored by the economic, financial and even political systems. Where does this lead?*

*While capital and capitalism need to change for the planet to heal, will incremental changes be meaningful enough and accelerate fast enough to have a timely effect? RI appears to be a slow process, geared towards appearances and profits rather than real thoughtful consideration of our future. Can RI be effective without an ethical debate on the place and role of business?*

**Text Box 5: Personal memo 23 December 2014**

Most of these observations took place while attending CRISA committee meetings and during panel discussions or workshops organised by the industry on the topic of RI. Between 2013 and 2015 I took part in five CRISA meetings. I attended three panel discussions, two breakfast presentations and two training sessions organised by the industry.

Taking note of the unsaid in certain exchanges, the uncomfortable reactions to certain propositions, the constraints imposed on the investigation or the enthusiasm for certain ideas, these observations focused on

the “mood” and expectations that overshadowed the research and that only an ‘insider’ could gather. To witness behaviours or reactions that happen “below the level of conscious thought” implied not just being present, but also at times, taking an active part in the debates (Quest *et al.*, 2012:79). Essential to the research process, personal observations enabled to make connections and provided a source of explanation to the emerging narrative. During panel discussions or workshops, I focused on ‘how’ information was presented and by whom, the use of language, the type of questions asked to establish the ‘positioning’ of the RI debate by the industry and evaluated the readiness of different audiences. These included – the general public, pension fund trustees, fund managers and industry consultants.

### **2.3.3 Expert reviews**

Receiving feedback from informants was integral to the research process. In line with the pragmatic epistemology and the desire to ensure that the research carries a practical validity, different stages in the research process provided for reviews by experts and industry professionals. “Member-checking is the process of verifying information with the targeted group. It allows the stakeholder or participant the chance to correct errors of fact or errors of interpretation. Member checks add to the validity of the observer’s interpretation of qualitative observations” (Simon, 2011). This method was used both as a formative and summative evaluation strategy, to improve the study and ensure its relevance with regard to the research question.

Three reviews took place: at the beginning of the process to gather insights and adjust the matrix’s structure; at the end of the first year of research to present preliminary findings; and during the second year of the research to discuss key industry concerns in relation to RI, present recommendations and gather feedback. The information gathered from the reviews was recorded and then selectively used in the research process.

Research by Kwok and Sharp (1998) and by Roberts (1999) recommend the use of feedback from practitioners as well as from peers familiar with the research subject to overcoming problems related to the *construct validity* of qualitative research (cited in Modell, 2005). Construct validity evaluates how theoretical concepts incorporate and make sense of operational and empirical phenomena. Modell further points out “This is especially useful where prior research provides few or inadequate measurement instruments to operationalize key constructs” (Modell, 2005:237). This was, therefore, extremely valuable for the present research as it provided a way to gain an ‘evaluative’ perspective, which could not be accessed otherwise.

## 2.4 Validity

Having discussed the conceptual framework and the methods, this section will discuss the final component of Maxwell's interactive design model: validity. Maxwell points out that it is generally beneficial for qualitative research to *build into the research design* some process controls and check to anticipate or address unanticipated validity threats. In his concern, Maxwell specifically invites qualitative researchers to focus on two types of threat: the “researcher *bias* and the effect of the researcher on the setting or individuals studied, generally known as *reactivity*” (Maxwell, 2009:243). To this list, a last threat could be added: the sometimes-problematic *evaluative criteria* of qualitative research methodologies.

*Bias* implies that the research can be distorted by the author's preconceptions and values. In qualitative research – as in the present study - the objective is not to eliminate all possible sources of bias, but rather to understand *how* the researcher's views and values could affect the research in order to conduct the research cognisant and reflective upon these influences, in fairness and integrity (Maxwell, 2009).

In qualitative research, the threat represented by *reactivity* cannot be eliminated. However, it can be managed in such a way as to become a productive influence in the research process (Atkinson and Hammersley, 1994). The risk of reactivity is especially present during interviews – which is one of the methods used in this study. In this instance, it is especially important to be conscious of that influence and how it can affect the interview outcome (Maxwell, 2009).

Finally, qualitative researches are sometimes hard to evaluate, especially in the context of the term ‘*validity*’, which often presupposes the positivist assumption that there is single and objective truth to be uncovered by the research. As argued by Juliet Corbin, the objective in qualitative research might be *quality* and *credibility* rather than validity. She points out, “I [Corbin] don't feel conformable using the terms ‘*validity*’ and ‘*reliability*’ when discussing qualitative research. These terms carry with them too many quantitative implications. [...] I would rather use the term ‘*credibility*’ (Glaser and Strauss, 1967; Lincoln and Guba, 1985) when talking about qualitative research” (Corbin, 2008:301).

To address these threats, the present research built into its design a triangulation methodology and further supported the research process through the use of certain technological tools.

### 2.4.1 Triangulation

Emerging out of Campbell's work in psychology and later conceptualised by Norman Denzin (1970), triangulation systematically relates multiple methods in order to improve the validity (or credibility) of qualitative research (Fielding and Fielding, 2008:1). As defined by Atkinson and Hammersley "What is involved in triangulation is not the combination of different kinds of data per se, but rather an attempt to relate different sorts of data in such a way as to counteract various possible threats to the validity of (their) analysis" (1994:199).

Whilst in its classic approach, triangulation was seeking to 'objectivise' and 'confirm' research results by using cross-validation between methods, it is now understood that "triangulation in itself is no guarantee of internal and external validity" (Fielding and Fielding, 2008:3). Rather, its real value lies in the fact that it encourages a more critical stance towards data and methods. As argued by Fielding and Fielding "the value of triangulation lies more in 'quality control' than any guarantee of 'validity'. The approach promotes more complex research designs that oblige researchers to be more clear about what relationships they seek to study, what they will take as indicators of these relationships, and so on" (Fielding and Fielding, 2008:4). Triangulation adds analytical breadth or depth to qualitative studies.

In this context, the triangulation methodology used in the design of the present research can be described by the Figure 5. The multi-method strategy used qualitative and quantitative methods together with expert reviews (Jik, 1979). The aim of this approach was to qualify trends, to quantify the evidence and to frame and evaluate the interpretative perspective.

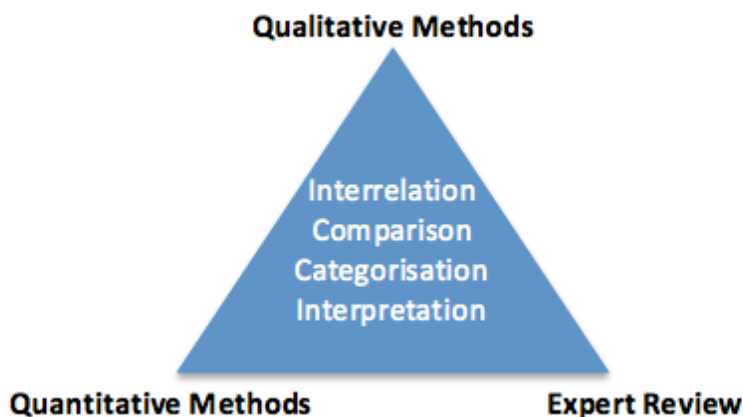


Figure 5: Visual summary of the triangulation approach used in the present research, adapted from Caracelli and Green (1997)

Recent triangulation approaches, such as those developed by Caracelli and Greene (1997), are well suited to the research design and the overarching paradigm chosen for the present research. Classifying triangulation research into component designs and integrated designs, Caracelli and Greene have identified different strategies to integrate qualitative and quantitative data, including the use of conceptual categories emergent from the analysis of one type of data to the analysis of a contrasting data type (Typological development) (1997). They have further emphasised the need to integrate multiple forms of data to produce a new dataset. As highlighted by Fielding and Fielding (2008), this represents a move towards the interrelation rather than just the juxtaposition of different data types.

Consistent with grounded theory methodology, the selected approach to triangulation further supports the interpretivist philosophy underlying the present research. As pointed out by Fielding and Fielding (2008) “Accepting the case for interrelating data from different sources is to accept a moderate relativistic epistemology, one that justifies the value of knowledge from many sources, rather than elevating one source”. Furthermore, when accepting empirically based results that have identifiable and defined limits “we implicitly accept the constant and un-evadable necessity for interpretation and change of aspect” (Needham 1983:32).

#### **2.4.2 Use of software**

The research further made use of certain computer software. The aim behind this decision was not to shortcut the research process, nor to expect computer-generated results. The objective was to enhance the reliability and traceability of data, promote a systematic approach to analysis and facilitate the triangulation of methods. Having previously discussed how software was used within the context of GTM, this section will focus on how software was used to support triangulation in the context of enhancing credibility.

As pointed out by Fielding and Fielding (2008), certain software have emerged as a means of facilitating Caracelli and Green’s integrated approach and to interrelate qualitative and quantitative. One of these computer-assisted qualitative data analysis (‘CAQDAS’) is NVIVO®, the software used in the present research. Bazeley and Jackson, for example, argue that such software allow transcendence of the distinction between quantitative and qualitative and facilitate the interpretation process (2013). Quantitative data can be imported for interrelation with qualitative data, whilst categories of qualitative data can be exported to facilitate statistical analysis. Both types of data can be queried and ‘collections’ can be made, thus offering yet different opportunities for visualisation and interpretation. Example of coding and extracts from NVIVO®

are available in Appendix F: Extract from NVIVO®– coding of stakeholders and in Appendix G: Extract from NVIVO®– coding of RI defining elements.

Whilst care needs to be taken to avoid computer programs stifling the creative process of the qualitative research or turning it into a mechanical process, software can be invaluable tools to organise, sort, reshuffle and evaluate data. As highlighted by Dey, “computers can help us confront the data more effectively, by making it easy to analyse data in different ways” (1993:227). They further offer an “audit trail” of the researcher’s work, providing arguments for the credibility of the research and substantiating the authenticity of its interpretative process (Corbin, 2008:310).

## 2.5 Limitations

In approaching this study I was aware that certain limitations could affect the research process and my answers to the research questions:

First, I engaged in the research with my own experiential knowledge, opinions with regard to the financial industry and a specific understanding of sustainability. My background is likely to have influenced my selection, analysis and interpretation of the data. In the context of a constructivist grounded theory methodology, this could have led to the use of ‘pet concepts’ or a preference for specific codes and categories. My system of reference and affiliations participated in generating ‘relative’ propositions that resulted from a creative and imaginative engagement with the data. The emergent research process resulted in a *representation* of the phenomena, not a replication. Constructivist grounded theory methodology explicitly assumes that theoretical proposition resulting from the research process offer an ‘interpretive portrayal of the studies world’ (Charmaz, 2006).

The numerical data that formed the basis of my assessment of CRISA’s agency is not as rich in meaning as textual data. The data was captured manually and thus, allowance must be made for possible errors. Further errors could have arisen from the statistical analysis. The poor comparability of data and the inferences or interpretation that had to be made in the absence of accurate primary data further need to be taken into account. The selectivity of data could have biased further the interpretation.

I conducted only a limited number of interviews. My purposeful selection could have led to a partial and incomplete perception of industry practices. The restricted sample carries the risk of a lack of generalizability



of the results. The observations made whilst attending meetings, workshops or events could have had different meanings. I was only an interpreter of the scene.

I, therefore, recognise that this study is not an accurate representation of the state of RI, but rather a critical interpretation of the observed phenomena.

## **2.6 Ethics**

The research was conducted in full knowledge of the code of ethics and guidelines applicable to my field of study. In light of the applicable guidelines, the study had limited foreseeable ethical implications. Ethical clearance was obtained on the 18<sup>th</sup> November 2014 with reference: DESC/Feront/Nov2014/16.

The only foreseeable risk was one of discomfort or inconvenience for the people that I intended to interview. The magnitude of inconvenience should not have been greater than what people might encounter, ordinarily, in their daily lives.

In my encounters with interviewees or expert panels, my intentions were to gain a greater understanding of the reality of RI practices by institutional investors and their service providers. The study did not investigate personal aspects of people's lives. It sought information and opinions related to the industry and the practice of RI. Participants were adults, authorised by their institution to speak to the public.

Respondents were asked to give consent. No information was gathered without informed consent. Care was taken to avoid generating expectations of change or future involvement that could not be met. The research process was guided by principles of integrity, respect and responsibility towards the people involved in the research. The information gathered was anonymous, and only the names of respondents appear in the list of interviewees.

## **2.7 Chapter summary and conclusion**

As presented in this chapter, the present research is an empirical qualitative study, using a component approach based on Maxwell's Interactive Model Design. The research questions, its goals, the conceptual framework, methods and validity are treated as inter-related components allowing a multi-directional iterative research process. Since the research questions and goals were discussed in the introduction, this

chapter, therefore, focuses on explaining the research's approach to the conceptual framework, methods and validity.

The conceptual framework integrates five elements to construct a critical foundation for the research: a research paradigm, exploratory studies, existing theory and research, personal experiential knowledge and conceptual mapping exercises (Maxwell, 2009). The research paradigm of the present research is founded on a constructivist epistemological stance, an interpretivist theoretical perspective and uses Grounded Theory Methodology (GTM) in its constructivist orientation to analyse, interpret and understand the studied phenomena (Crotty, 1998; Bryant and Charmaz, 2007). As advocated by GTM, I conducted exploratory field investigations as a first 'area of inquiry', prior to the acquisition of any theoretical lens, to refine the research question and identify key areas of investigations (Marshall Egan, 2002; Suddaby, 2006; Corbin and Strauss, 2008). Analysing existing theory and research allowed for a broad literature review, instrumental in identifying key categories and developing theoretical propositions. My personal experiential knowledge was used to generate insights and hypothesis (Marshall Egan, 2002; Suddaby, 2006; Charmaz, 2007). I gained experiential knowledge through memo-writing, engaging personally in the process of investing responsibly, and by conducting research on behalf of CRISA. Finally, I used mapping and visualisation efforts using qualitative System Dynamic (SD) tools to represent different narratives of the issue, illustrate dynamic processes, review variables and support the knowledge generation process (Sterman, 2000; Pruydt, 2013).

In terms of methods, the empirical study is constructed as a multi-method research using quantitative and qualitative methods as well as expert reviews (Mouton, 2000; Maxwell, 2009). Quantitative methods used three years of publicly available data to establish statistical occurrences. I used a data matrix that involved 34 questions and variables to rate the availability and the quality of information disclosed by a sample of 47 representatives financial institutions. Qualitative data was collected using semi-constructed interviews and personal observations (Partington, 2002). The data collected from the interviews was analysed and arranged into categories whilst personal observations allowed the establishment of connections and supported the emergence of theoretical propositions. Expert reviews were used to evaluate and validate theoretical concepts, gather further insights and gain a practical perspective on issues and propositions (Simon, 2011).

Finally, the approach of this research to 'validity', the last component of Maxwell's Interactive Model Design, focused on building, into the research design, some controls and methods to anticipate or address validity threats (Maxwell, 2009). Reframed as quality and credibility, validity was addressed by using a triangulation methodology and certain technological tools. Encouraging a critical perspective on data and methods, the

selected triangulation approach allowed for the interrelation of different data types in order to better qualify trends, clarify relationships, quantify evidence and evaluate the interpretative stance (Fielding and Fielding, 2008). The use of software technology, whilst supporting the triangulation methodology, further enhanced the reliability and the traceability of data, and the rigour of the analysis (Corbin, 2008).

This chapter has described and explained the methodological considerations of the present research, and the next chapters will discuss the findings.

## 3 Chapter Three: Responsible Investment In The Context Of A Dynamic Approach: A Conceptual 'Process' Framework

### 3.1 Introduction

In building a conceptual framework, I relied on an iterative process integrating five elements: the selected research paradigm, initial exploratory studies, personal experiential knowledge, existing theory and research, and conceptual modelling exercises (Maxwell, 2009). More extensive and critical than a 'literature review', a conceptual framework treats the literature as 'ideas' and 'possibilities' regarding what is going on and attempts to reframe the issues in an alternative way (Maxwell, 2009). Drawing on the discipline of Systems Dynamics (SD) to integrate a temporal dimension and develop a *process* study of the issue, I set out to investigate the concept of RI in the context of a dynamic approach. The process used a creative engagement and the interpretation of the data to progressively reach a level of analytical abstraction and gain theoretical insights into the problem (Bryant and Charmaz, 2007; Probst and Bassi, 2014).

The resulting conceptual 'process' framework aims at gaining an understanding of the dynamic influences affecting the concept and the agency of RI. The framework is presented as three interrelated sections. The first section presents global trends in RI and assesses the level of change in the investment industry. The second section investigates and conceptualises interconnections and relationships in order to formulate a dynamic hypothesis regarding how RI is likely to evolve over time. Finally the third section builds on the insights resulting from the conceptualisation effort and explores their implications in terms of change processes and RI agency.

### 3.2 Responsible Investment: A concept for transformation?

A process study investigates how and why phenomena emerge, develop and/or terminate over time, thereby explicitly incorporating "temporal progressions of activities as elements of explanation and understanding" (Langley *et al.*, 2013:1). It is based on the premise that temporality matters highly when analysing concepts and to make knowledge and propositions actionable. Given the inescapability and critical significance of time in sustainability issues such as climate change, it appears reasonable to analyse the concept of RI and its efficiency in the context of time (Slawinski *et al.*, 2015). Thus, using grounded theory

methodology and the principle of theory emergence, I started by assessing the *value proposition, practice* and *agency of RI* in light of the evolving concerns, uncertainties and urgencies it tries to address.

### **3.2.1 Concept and value proposition**

In trying to make sense of RI's current value proposition, it is important to look back at its origin and recent evolution. The roots of RI can be traced back to the negative screening of faith-based organisations and what is today referred to as 'ethical investment' (Sethi, 2005; Richardson, 2009a; Richardson and Cragg, 2010; Woods and Urwin, 2010; Viviers, 2013; Juhani Lehtonen, 2013). While the concept of 'ethical investment' has often been contested, it can be defined as "decision-making framed and guided by moral principles, such as respect for fundamental human rights and ecological, social and economic sustainability, in contrast to decision-making with its commitment to these values being only instrumental and self-serving" (Richardson and Cragg, 2010:22). Indeed, from the 1700s anti-slavery campaigns led by the Quakers to the financial embargo against apartheid South Africa's in the 1970s and 1980s, ethical investments were "motivated primarily by unadulterated ethical concerns rather than the prospect of financial reward" (Richardson and Cragg, 2010:21). However, the discourse has changed dramatically in the last thirty years. On one side the growing public and institutional awareness of a broader range of social and sustainability concerns required the integration of environmental, social and governance (ESG) issues into mainstream investment practices (Woods and Urwin, 2010:2). On the other hand, the exclusion of entire business sectors was considered too demanding by many investors and incompatible with the necessity for a return on investment. "Ethical investment' could no longer accommodate the enlarged connotation" and furthermore, it "could give people the confusing impression that the mainstream approaches to investments are unethical" (Wen, 2009:312). It was gradually replaced by the term 'responsible investment' (Juhani Lehtonen, 2013).

Beyond the change (and a watering-down) in the terminology, RI is today something of an 'umbrella concept' (Sethi, 2005) for a range of different investment practices, which take into account social and/or environmental issues (Woods and Urwin, 2010). Also referred to by some authors as Socially Responsible Investment (SRI) or Sustainable Investing, RI incorporates various considerations ranging from climate change and pollution to executive remuneration. Whilst the concept has suffered definitional and terminological ambiguity (Sethi, 2005; Sandberg *et al.*, 2009; Viviers *et al.*, 2009; Woods and Urwin, 2010), the various terms have been used to mean more or less the same thing (Sandberg *et al.*, 2009), the main characteristic being "the integration of certain non-financial concerns in the investment process" (Woods and Urwin, 2010:3).

Today, it is further argued that a level of standardisation of the RI terminology is occurring through the United Nations Principles for Responsible Investment (PRI) movement (Herringer *et al.*, 2009; Sandberg *et al.*, 2009; Eccles, 2010; Woods and Urwin, 2010). Structured around six core principles, the central focus of the PRI movement is the integration of ESG criteria into mainstream investment processes and ownership practices “to the extent that they are perceivable as financially ‘material’” (Richardson and Cragg, 2010:27). The financially-oriented justifications and the overall ‘business case’ approach promoted by the PRI has made RI more palatable to large institutional investors (Herringer *et al.*, 2009; Wen 2009; Richardson and Cragg, 2010). This approach addresses many investors’ reservations pertaining to fiduciary duty, reduced investment universe, or ethics driving investment decisions (Sethi, 2005; Sandberg *et al.*, 2009; Richardson and Cragg, 2010; Woods and Urwin, 2010; Eccles, 2010). It is in line with many institutional investors and financial service providers’ view that their primary ethical and legal obligation remains to maximize profits. ESG issues, including global warming, are addressed “on the basis of the relative financial risks and opportunities to the investor” (Richardson, 2009b:598).

### **3.2.2 The practice of RI**

In line with market logic and influenced by the notion of ‘ecological modernization’, RI relies on voluntary and flexible commitments to reconcile financial markets with sustainability principles. Market forces and related factors such as competition, financial performance or client perception are the main drivers for the adoption of responsible strategies. This is supported by evidence, which suggests that over 70% of fund managers and analysts engage in RI as a means “(1) to satisfy their clients and to prevent the loss of customers and (2) to improve firms’ financial performance” (CSR Europe, 2003; Wen 2009:319). RI complements the dominant financial criteria of investment selection to allow for “comparatively better and relatively safer long-term investment returns” (Sethi, 2005:107). RI is also underpinned by the ‘ecological modernization’ discourse, popular in Western environmental policy-making since the 1990s, which reconciles economic development with sustainability objectives through technological innovation, management insights and the effect of competition (Richardson, 2009a). It anticipates that environment improvements will ultimately be good for business by enhancing market competitiveness and profitability (Costanza, 2009).

The rise of RI has been supported by the growing acceptance of stakeholder theory (Freeman, 1984) and the promotion of integrated reporting practices. Widely used to promote RI, stakeholder theory has become “an umbrella term for a variety of approaches to manage stakeholder relations” (Wall and Greiling, 2011:105). The stakeholder perspective has been developed within a broad range of theoretical frameworks with

different focus and understanding of value creation. However, a common theme is the recognition of the “moral responsibility of corporations towards their stakeholders” (Sandbu, 2012:97). Cooperative and responsible attitudes are seen as competitive advantages. Taking into account the interests of stakeholders should drive both the outcome and decision-making processes of businesses (Wall and Greiling, 2011). Challenging the role of business in society, this perspective coincides with the rise of integrated reporting practices (Steyn, 2014). Integrated reporting supports RI by expanding the range of reporting requirements into environmental, social and governance aspects of businesses. Whilst still nascent and voluntary, this form of reporting is expected to provide metrics from which to assess corporate ESG performance (Richardson and Cragg, 2010). Once common practice, “it is hoped that normal competitive forces and public pressure would make [integrated reporting practices] more substantive and meaningful” (Sethi, 2005:113).

The evolution of RI further coincides with a drift towards corporate self-regulation in most Western economies (Richardson, 2009a). With the aim of inducing positive changes in behaviours through reflection and learning, commitments to RI are mostly voluntary and self-regulated. In the case of PRI, emphasis is placed on being part of a network, “with opportunities to pool resources and influence, lowering the costs and increasing the effectiveness of research and active ownership practices” (Richardson, 2009a:615). Beyond their voluntary character, commitments are flexible in nature, thus allowing financial institutions to frame RI in the context of their own understanding of sustainability, their decision-making processes and their operating parameter (Sievänen et al, 2013). RI is a framework in which differences in beliefs, measurement standards and level of commitments can be freely expressed, thereby leaving financial institutions with significant discretion in terms of investment universe and practices. Most voluntary mechanisms, including the Global Reporting Initiative and the Carbon Disclosure Project, focus on promoting disclosure and transparency, leaving financiers the option not to invest responsibly, insofar as they disclose their decisions (Richardson, 2009a; Juhani Lehtonen, 2013; Brown, 2013; Gond and Boxenbaum, 2013).

Today, RI encompasses a broad range of investment strategies, motivations and practices, and involves a heterogeneous group of market participants (Wen, 2009; Berry and Junkus, 2013; Humphrey and Tan, 2014). Practices extend from traditional negative screening practices (excluding controversial businesses or industries), to positive screening (focusing on sustainable businesses or industries) or best of sector investment (concentrating on top performing firms with regard to ESG criteria). They also include strategic or targeted approaches, such as impact investment, or approaches focused on shareholder activism and engagement activities with boards and directors (EUROSIF, 2005; Giamporcaro and Pretorius, 2012; Viviers *et al.*, 2013; Sievänen et al, 2013). More recently, practices have evolved to include easier and more passive

tactics such as integration. This approach allows investors to consider ESG risks without modifying their investment strategies. ESG analysis is used for both stock picking and selling. The goal is “to deliver profit, rather than sustainability” and “take advantage of the market through under-analysed themes” whilst adapting to new regulatory environmental (EUROSIF, 2005:28).

### **3.2.3 Assessing the agency of RI**

Strong of 1380 signatories worldwide, representing \$59 trillion of assets under management (AUM) and amounting to more than half of the world’s institutional assets (UNPRI, 2015a), the PRI initiative seems to be succeeding in establishing RI as an acceptable investment approach. Gaining in popularity, its stated goal is to continue mainstreaming this approach until the consideration of ESG factors becomes a normal investment practice across the industry (Sandberg *et al.*, 2009; UNPRI, 2015b). Providing opportunities to convene, collaborate and build awareness around major sustainability issues, PRI further provides standardised reporting formats to facilitate the comparability of information and improve the accountability of signatories (UNPRI, 2015a). As RI influences a substantial portion of the capital markets of the major Western economies, it cannot be considered a small niche market anymore (EUROSIF, 2013; Humphrey and Tan, 2014; UNPRI, 2015b). It is therefore expected that RI should have some positive effects on corporate behaviour. Sethi (2005) has suggested that RI should drive responsible corporate conduct in society. Atkins *et al.*, and Richardson and Cragg have further shown that there is strong empirical evidence that corporate executives can be persuaded to act responsibly “based on the perceived impact on their personal reputation and/or that of their company (Atkins *et al.*, 2006; Richardson and Cragg, 2010:29).

However, the current form of RI has become barely distinguishable from conventional investing, leading researchers to question ‘what’ is actually being mainstreamed and whether mainstreaming is taking place at the expense of substance (Richardson, 2009a; Viviers, 2013). Furthermore, it has become questionable whether the prevalent ‘business case’ RI is sufficient to be a means for sustainable development and temporally relevant to generate transformative action (Wen 2009; Richardson, 2009b; Richardson and Cragg, 2010; Viviers, 2013). Taking climate change as a benchmark, if the timeframe to transition to a low carbon economy is 5-15 years, the effectiveness of RI is called into question (IPCC, 2014; WEF, 2015).

Firstly, the voluntary commitments and flexible standards have been criticised for their vagueness and self-serving attributes (Richardson, 2009a; Woods and Urwin, 2010; Juhani Lehtonen, 2013). This is partly due to the lack of a common definition of sustainability. The often-cited Brundtland report definition, identified as “development that meets the needs of the present without compromising the ability of future generations



to meet their own needs” (WCED, 1987), is generally subject to discretionary interpretation by the investment community (Richardson, 2009a; Sandberg *et al.*, 2009; Woods and Urwin, 2010; Peetz and Murray, 2013). The same is true for notions such as Corporate Social Responsibility (CSR), further adding to the confusion and limiting the reliability of ESG data (Richardson, 2009a; Wen, 2009; EUROSIF, 2013; Berry and Junkus, 2013; Montiel and Delgado-Ceballos, 2014). The lack of definitions has led to minimalistic standards and the proliferation of practices, making any empirical measurement or evaluation difficult (Wen, 2009; Urwin, 2010; Richardson and Cragg, 2010). As fund managers are given excessive discretionary powers to select ESG criteria and define RI approaches, the investment universe is unrestrained and any company can virtually be part of an RI index (Wen, 2009). This was demonstrated by a survey conducted by Paul Hawken, which showed that “more than 90% of the Fortune 500 companies are invested in by at least one SRI fund” (Vogel 2005:40 cited in Wen, 2009). To complete the picture, there has been an unsanctioned tendency for financial institutions “to report only the favourable numbers, with companies withholding any information they think might reflect badly on the organisation” (Adams and Frost, 2008:297 cited in Klettner *et al.*, 2014). As advanced by Richardson (2009), the *laissez-faire* in the RI market has allowed a superficial attitude to proliferate, where marketing prevails over principled behaviour.

Secondly, evidence shows that RI’s overall ability to curb market excesses remains unproven and several factors highlight its limitation as a comprehensive solution to address corporate unsustainability (Wen, 2009; Woods and Urwin, 2010). To begin with, recent research has shown that the majority of institutional investors continue to ignore ESG considerations, despite being PRI signatories (UNEPFI, 2009; Sandberg, 2010; Woods and Urwin, 2010; PRI, 2015). Thus, irrespective of the potential size and capacity of the RI sector, its ability to influence corporate conduct remains largely theoretical. Its impact is further difficult, if not impossible, to assess and quantify due to definitional and implementation ambiguities (Sandberg *et al.*, 2009). Moreover, it is important to note that small shareholding positions do not have a material impact on a firms’ share price and cost of capital (Sievänen *et al.*, 2012). A great deal of coordination efforts is therefore required from investors in order to reach a significant threshold through collective actions (Richardson, 2009b; Sievänen *et al.*, 2012). Furthermore, many investors have a negative perception of RI products and strategies, being unaware that the returns provided by RI funds are generally in line with performances from other investment strategies. Contrary to empirical results, they believe that RI funds and strategies generally underperform due to their constraints (Escrig-Olmedo *et al.*, 2013).

Thirdly, institutional strategies have relied strongly on asset owners to drive the uptake of RI practices and have not been very successful (Herringer *et al.*, 2009; Viviers, 2013; PRI, 2015). Whilst asset owners are

expected to review management mandates in line with RI and ensure implementation by their service providers, empirical research shows that many asset owners are not ‘following through’ with their service providers (UNPRI, 2015b). Moreover, many small asset owners do not have the resources and the skills to challenge traditional investment strategies (Sethi, 2005; Sievänen *et al.*, 2012; IoDSA, 2013b). Many asset owners tend to rely on the advice of their service providers, whose offers tend to be guided by money inflows and management fees rather than sustainability objectives (Sethi, 2005; McLeod and Park, 2011; Renneboog *et al.*, 2011; UNPRI, 2015b). As expressed by Sethi: “The markets apparently are unable to correct this situation since all intermediaries are driven by similar considerations and ‘competitive checks and balances’ do not seem to operate effectively” (2005:106). Moreover, the large number of asset managers that are PRI signatories tend to implement RI only when mandated to do so by asset owners (EUROSIF, 2013; UNPRI, 2015b).

Finally, it has been pointed out that short-term returns remain prioritised over long-term benefits, impeding further the substantive growth of the RI sector, whose benefits are mostly associated with long-term investment performance (Sethi, 2005, Wen, 2009, Herringer *et al.*, 2009). Most investment funds act as short-term speculators rather than long-term owners whilst the industry mostly uses short-term performance benchmarks to rate investment strategies. As the financial markets struggle to factor in the long-term price of the externalities associated with sustainability issues, the balance of power decidedly lies with the short-term (Wen, 2009; Herringer *et al.*, 2009; Peetz and Murray, 2013).

The current situation leads to question the notion of *action* versus *inaction* in the context of sustainability and climate change (Slawinski *et al.* 2015). Both long-term and urgent, sustainability and climate change issues are unique challenges for which there are “no tangible short term benefits and only uncertain benefit in the long run” (Slawinski *et al.* 2015:6). Yet, whilst their worse impacts may be distant in time, they require short-term action. Caught in the tension between uncertainty and urgency, RI seems to privilege short-term incremental improvements in investment practices over radical changes (Richardson, 2009b). Action is thus measured ‘relative’ to a baseline year or industry best practices (Slawinski *et al.* 2015; Kendall and Willard, 2015). Although the relative improvements are welcome and necessary, they appear to be insufficient and inadequate to generate the large transformational changes that need to take place, especially considering the short time that is available (Slawinski *et al.* 2015). Hence, failing to produce a purposeful and far-reaching change, it can be argued that RI, in its present form, is sanctioning and covering up for the perpetuation of *inaction* (Richardson, 2009b; Eccles, 2010). Furthermore, leaving the dominance of the market logic unchallenged, the ‘business case’ RI remains present-focused and undervalues future outcomes.

The market's preoccupation with share prices and competition limits how investors can integrate long-term considerations in their core business practices, because the potential impact of time-distant phenomenon is considered too uncertain and is therefore discounted (Thornton *et al.*, 2012; Slawinski *et al.* 2015). The market logic seems to trigger a time asymmetry, which prevents investors from engaging in effective *action*.

In summary to this assessment of the value proposition and the agency of the concept of RI, it appears that the mainstreaming of the flexible 'business case' RI cannot be called an appropriate response to the global and systemic crisis the world is facing and that RI's apparent success should not lure us into complacency (Richardson, 2009b; Urwin, 2010; Richardson and Cragg, 2010; Peetz and Murray, 2012). RI appears as a concept for continuity rather than transformation, thereby failing to address investors' responsibility in corporate inaction over sustainability issues. The incremental improvements that this popular concept promotes, stripped from any ethical stance, are no substitutes for meaningful action. Dominated by vague and self-serving commitments, locked into the market logic and lacking urgency, RI appears temporally and substantially disconnected from the problems facing humanity (Richardson and Cragg, 2010; Sandberg, 2010; Giamporcaro and Pretorius, 2012; Berry and Junkus, 2013; Escrig-Olmedo *et al.*, 2013; Clarke, L. *et al.*, 2014; Bailey *et al.*, 2014; Barton and Wiseman, 2014).

### **3.3 RI in the context of Systems Dynamics**

As RI is falling short of generating the required transformative action, it appears important to gain a dynamic view of the influences affecting its progress and evolution. Uncovering these dynamics can lead to insights into the multi-level phenomena at play and provide explanations for the current situation. With this in mind, the present study drew on the discipline of Systems Dynamics (SD) to analyse dynamically the issues "in terms of the processes, information, organizational boundaries and strategies" (Pruydt, 2013:1). SD is a method that provides tools to map "the assumed/perceived underlying (material, informational, social, ...) structure of largely closed real-world systems" (Pruydt, 2013:33). The research used the qualitative stages of SD analysis to understand the causal links and interconnectedness of the different components in the system. The aim was to provide an endogenous explanation of the problem and formulate of a possible causal theory on how behaviours are generated or perpetuated by the model structure (Sterman, 2000; Pruydt, 2013).

To proceed, I will discuss the benefits of using an SD approach to problem solving before articulating the problem dynamically and presenting the conceptualisation effort. A dynamic hypothesis (or working theory) is formulated based on the findings.

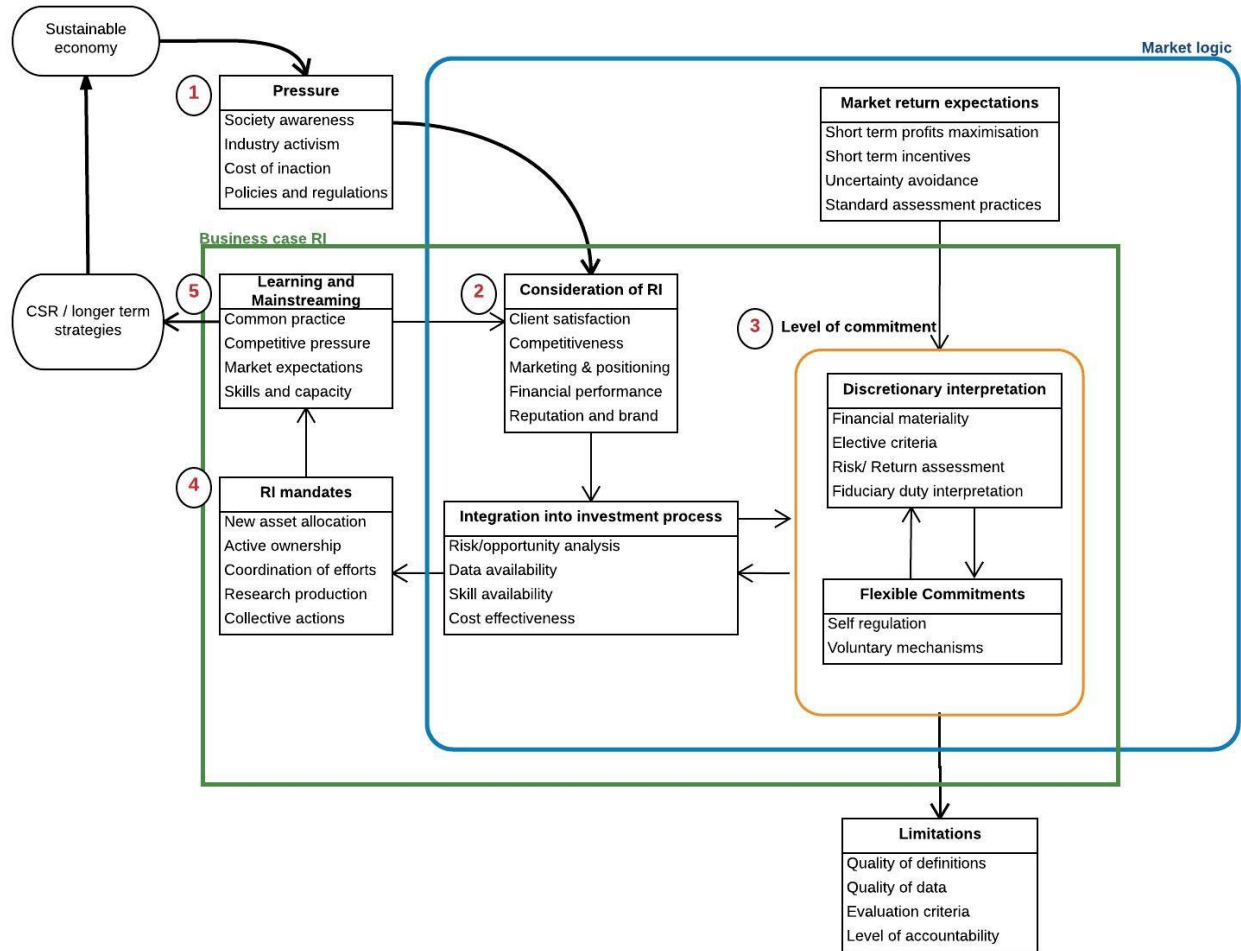
### **3.3.1 From open-loop thinking to feedback systems**

Solutions to problems are often devised following a linear sequence of 'problem-plan-action', which does not take into account the fact that actions then alter the state of the system and can result in new sets of problems or a different understanding of the problem. This approach to problem solving is often referred to as 'open-loop thinking' (Richardson and Pugh, 1989) or as an 'event-oriented' approach to problem solving (Sterman, 2000).

In an 'event-oriented' approach, RI and its agency over time can be described as follows:

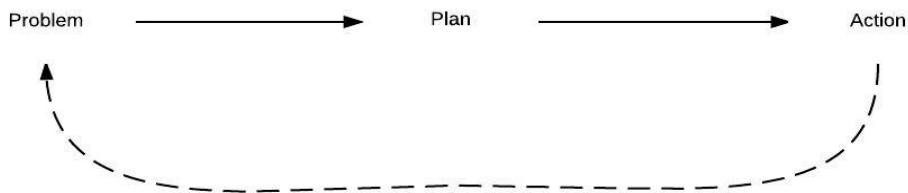
- 1 Pressure to move towards a sustainable economy leads institutional investors to consider RI;
- 2 The consideration and the integration of RI into investment processes are accommodated on the conditional basis that it meets market return expectations and respects the dominant fiduciary duty interpretation;
- 3 To meet these requirements, the level of commitment is flexible and based on discretionary interpretation criteria;
- 4 Management mandates change to integrate RI principles, progressively increasing competitive pressure and leading to the mainstreaming of RI practices across the industry; and
- 5 This cycle of learning and capacity building is expected to lead in time to more principled behaviour within the investment community, in turn putting pressure on the corporate world to act more responsibly, thus addressing sustainability issues.

The event-oriented approach and its agency over time to RI is illustrated in Figure 6.



**Figure 6: Event-oriented view of RI**

However, such an approach fails to take into account that the system reacts to solutions and it ignores the *feedback mechanisms* influencing the outcome of decisions (Sterman, 2000; Morecroft 2007). This is illustrated in Figure 7. Feedback mechanisms are patterns of interactions among different components in a system and are responsible for the dynamic behaviour of the system (its change over time) (Richardson and Pugh, 1989; Sterman, 2000).

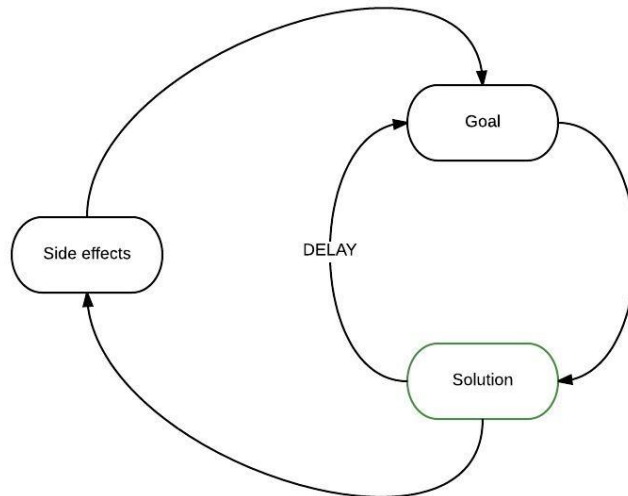


**Figure 7: Comparison of open-loop and feedback approaches to problem solving (Richardson and Pugh, 1989:5)**

As can be observed in Figure 6: Event-oriented view of RI, the 'business case' RI selectively observes and acknowledges effects. This solution is built within the market logic and relies on assumptions that are consistent with this logic. The positive effects of competitive pressure on learning and mainstreaming are built upon. However, the possible limitations and delays due to the selective level of commitment are overlooked. As such, possible limitations in the quality of definitions and data, the use of discretionary evaluation criteria and poor consistency and accountability are not addressed in the present implementation of RI. They are expected to self-correct over time as learning and reflection take place. However, the impact that such limitations could have on the learning and mainstreaming processes themselves are not confronted. There are no mechanisms to limit delays and fast-track learning and capacity building processes. Business case RI is a flexible concept with no deadline.

The SD approach "takes the philosophical position that feedback structures are responsible for the changes we experience over time" and it looks "*within* a system for the sources of its problem behaviour" (Richardson and Pugh, 1989:15). Feedback mechanisms are either self-reinforcing (positive) or self-correcting/balancing (negative). Self-reinforcing feedbacks tend to amplify what is happening while self-correcting feedback counteract or oppose change (Sterman, 2000; Pruydt, 2013). Both can have immediate effects or delayed outcomes, which are not perceived immediately.

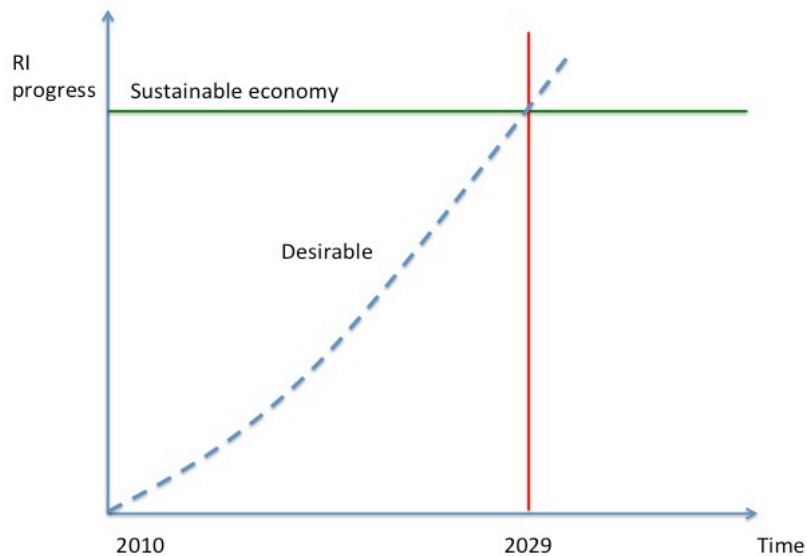
SD assumes that human systems are feedback systems and thus, "solving complex problems in such systems is likely to require the understandings of the relationships between feedback structures and the problematic behaviour observed" (Richardson and Pugh, 1989:12). As such, RI is a solution embedded in a system of feedbacks. Using an SD perspective, the system structure affecting RI could be schematised in the diagram depicted in Figure 8.



**Figure 8: System Structure**

### **3.3.2 Articulating the problem dynamically**

To give relevance to the temporal dimension, the SD perspective articulates the problem (or goal) dynamically, as a *reference behaviour mode* or a pattern of behaviour in the context a time horizon (Richardson and Pugh, 1989). As such, Figure 9: Reference Behaviour Mode describes the dynamic consequences that would be observed should RI be effective in reaching its goals. In this study, the time horizon presented is 10 to 15 years, to purposefully frame our understanding of RI (and progress that needs to be achieved) in the context of the current urgency to transition to a sustainable economy (Rockström *et al.*, 2009; IPCC, 2014; Steffen *et al.*, 2015). For the purpose of the conceptual effort, a sustainable economy is defined as a dynamic economy that operates within the thresholds defined by the *planetary boundaries framework* (Rockström *et al.*, 2009; Steffen *et al.*, 2015). In such an economy, investments and capital flows that support ecologically harmful industries are phased out to the benefit of businesses that operate within the planetary boundaries. In this context, stock selection, asset allocation, portfolio construction, as well as shareholder engagement and voting practices are consistent with long-term value generation and support a sustainable agenda, as defined by the Brundtland Report (WCED, 1987).



**Figure 9: Reference Behaviour Mode**

The graph in Figure 9: Reference Behaviour Mode is therefore built around the assumption that RI should support a sustainable economy within the next 15 years. It depicts the *desirable* evolution of RI progress as an ‘exponential growth’ behaviour, whereby the more RI is integrated within investment practices, the more it becomes mainstream, thus creating an accelerating virtuous cycle (Richardson and Pugh, 1989; Sterman, 2000; Morecroft, 2007). In such structures of behaviours, feedback loops act “to generate growth, amplify deviations, and reinforce change” (Sterman, 2000:111).

The problem, as identified in the first part of this chapter, is that RI is temporally disconnected from its goal and currently falls short of transforming industry practices. The *actual* evolution of RI might therefore be quite different from the desirable evolution, and could exhibit a different dynamic behaviour (evolution over time).

### **3.3.3 Conceptualisation**

In this context, the purpose of the modelling effort was to:

- 1) Map the driving influences (feedback mechanisms) and their dynamic consequences on the evolution of RI; and
- 2) Present a visual understanding of RI’s actual progress and compare it with the desirable evolution.



Figure 10 provides a Causal Loop Diagram aimed at revealing “what is connected and how changes in one part of the system might propagate to others and return” (Morecroft, 2007:51). The Causal Loop Diagram identified both the obvious and hidden interconnectedness in order to highlight the “path-time” or behaviour over time that is pre-determined by the system structure and its network of feedback loops (Sterman, 2000; Morecroft, 2007; Probst and Bassi, 2014).

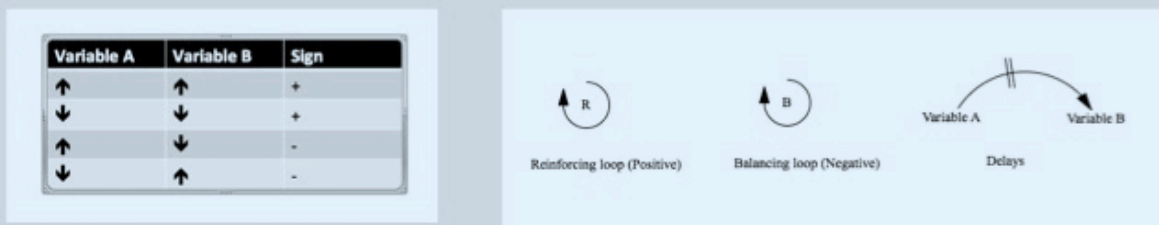
### How to read a Causal Loop Diagram

Causal Loop Diagrams include variables and arrows, linking the variables with a sign (either + or -). As explained by Sterman “each causal link is assigned a polarity, either positive (+) or negative (-) to indicate how the dependent variable changes when the independent variable changes” (2000: 138). A positive link indicates that when the independent variable (or cause) increases or decreases, the dependent variable moves in the **same** direction. A negative link indicates that when the independent variable increases or decreases, the dependent variable moves in the **opposite** direction (See table below copied from Probst and Bassi, 2014: 48).

The link polarities indicate “what would happen if the variable were to change” (Sterman, 2000: 139). They do not describe the behaviour of the system nor what actually happens. Simplifications of the system, Causal Loop Diagrams do not take into account all inputs but rather focus on the most influential variables in respect of the problem behaviour *ceteris paribus* (assuming other inputs are constant).

Feedback loops are the result of the cumulative effects of its causal links and are identified as either positive (R for Reinforcing) or negative (B for Balancing). Reinforcing loops tend to amplify what is happening in the system and balancing loops tend to counteract or oppose what is happening (Richardson and Pugh, 1989; Sterman, 2000).

Given system inertia, delays are critical in understanding dynamics. Causal Loop Diagrams must include the delays that are significant relative to the time horizon considered (Sterman, 2000; Morecroft 2007).



Text Box 6: How to read a Causal Loop Diagram

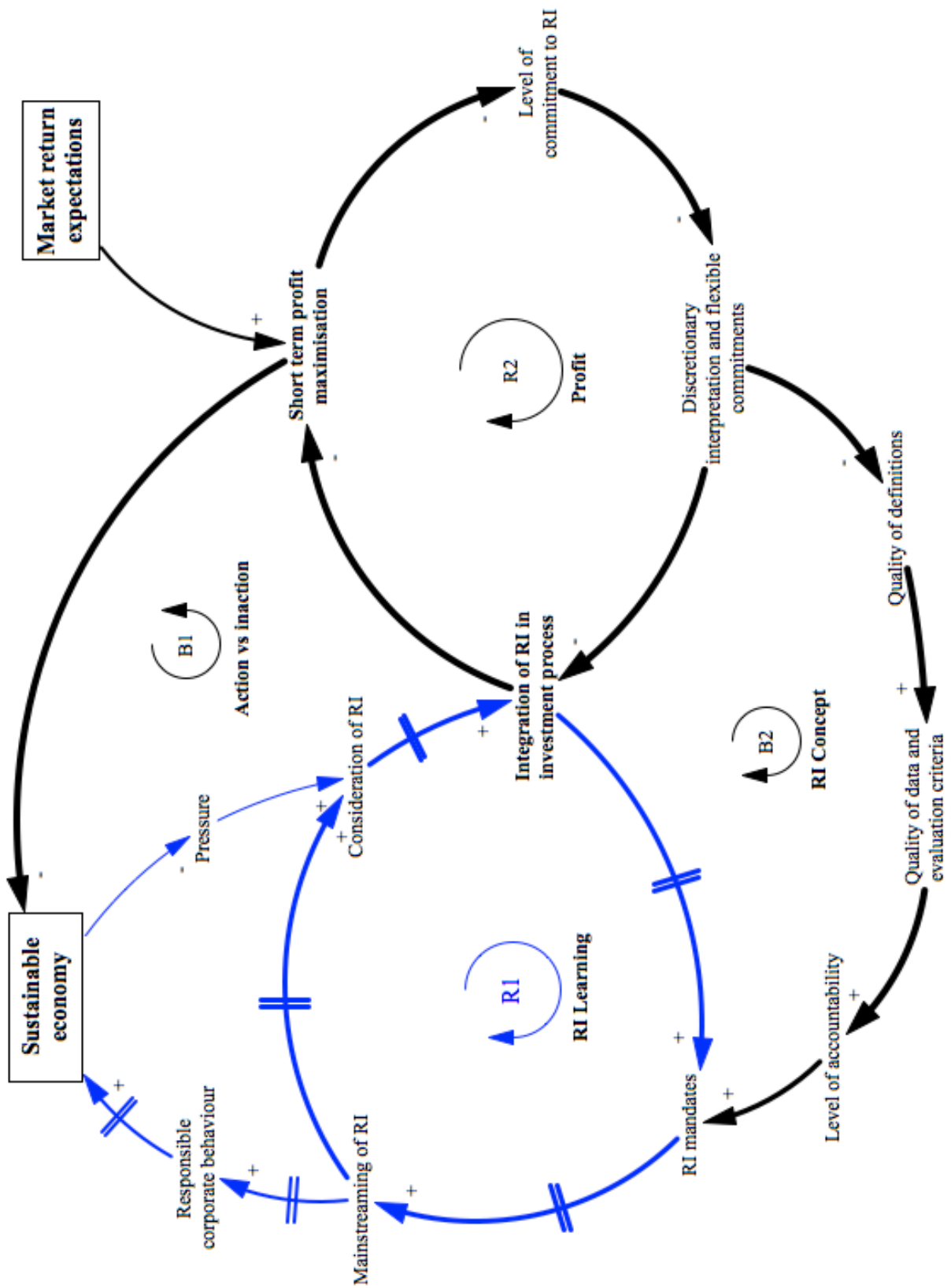


Figure 10: Causal Loop Diagram of RI's agency

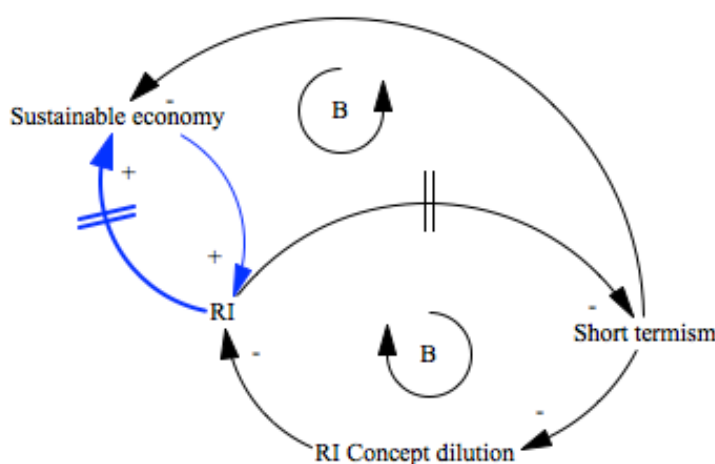
The Causal Loop diagram reveals two reinforcing feedback loops and two balancing loops:

- R1, called the RI Learning loop, shows how learning and, thereafter, mainstreaming is taking place to generate progress towards a sustainable economy. It further highlights that the influence of each variable is delayed in time. Learning, skills development and capacity building require time before they can have an effect on corporate behaviour. Notwithstanding, in the long term this positive feedback loop leads to an improvement in corporate behaviour, thus supporting a sustainable economy;
- R2, called Profit loop, shows the influence of short-term profit maximisation and current industry standard practices on the level of commitment and ultimately the level of integration of RI into investment processes. Unlike R1, R2 is not affected by delays. It is immediate. Furthermore, this short-term loop influences the system in the opposite direction to R1, steering it away from a sustainable economy. In such reinforcing processes, a small change can build on itself, meaning that the effect of every variable is amplified;
- B1, the Action vs. Inaction loop, highlights how the pressure to consider and integrate RI into investment processes is counter-balanced by short-term pressure to maximise profit and meet market return expectations. This balancing loop affects negatively and immediately the ability to reach a sustainable economy; and
- B2, the Concept loop, highlights how short term profit seeking further dilutes the RI concept and impedes on the learning and capacity building process.

#### **3.3.4 Dynamic hypothesis**

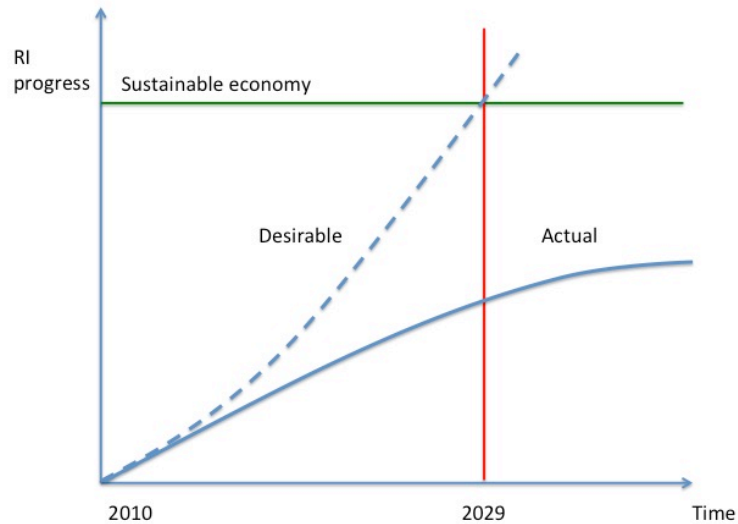
The Causal Loop Diagram represents an important step towards the articulation of a explanation or dynamic hypothesis about the observed problem behaviour (Sterman, 2000; Morecroft, 2007). The feedback structure makes clear that efforts taking place to move the investment community towards RI practices are happening at a relatively slow pace due to limitations in learning and the effect of short-term and immediate pressure from the market. The learning process is slow, and there are no influential feedbacks to support it or speed it up. Progress towards RI is subject to the mechanisms and expectations of the market. The reinforcing Profit loop determines how RI is perceived and implemented, thus limiting the range of action to what is familiar (Morecroft, 2007). The inertia embedded in this loop further acts to dilute the concept, thereby impeding further learning and capacity-building, and leads to stasis and inaction with regard to the sustainability objective.

The presence of balancing loops highlights the overall *goal seeking behaviour of the system* that is reinforcing the current equilibrium. The dynamics of change are too slow relative to the time horizon to be meaningful and the powerful feedback processes keep the state of the system nearly constant, even in the face of growing external pressure (Sterman, 2000). The slow, alternative path is no match to counteract the effects of the dominant and highly effective goal-seeking system design. The equilibrium is self-reinforcing, leading to the inertia and rigidity of the system structure (Richardson and Pugh, 1989; Sterman, 2000). This is clearly evident in the simplified Loop Diagram in Figure 11. Whilst RI can have some positive impact over time, its current implementation is unlikely to generate required meaningful changes in the available timeframe. Feedbacks are counteracting any disturbance, thereby seeking balance and stasis (Pruydt, 2013).



**Figure 11: The two balancing loops prevent RI from reaching its goal**

Going back to the *reference behaviour mode* defined earlier, instead of RI following the *desirable* evolution of an exponential curve to reach the goal of a sustainable economy, *actual* RI progress should be represented as ‘goal seeking’ curve (Sterman, 2000). As represented below, the growth of RI is likely to gradually slow down and level off to reach an equilibrium level. The equilibrium is predicted to be different from the stated goal, defined as RI supporting a sustainable economy. In the graph above, the gap between the ‘desirable’ and the ‘actual’ evolution provides a visual and dynamic representation of the problem that needs to be addressed.



**Figure 12: Desirable versus Actual evolution**

In light of the above, the dynamic hypothesis can be summarised in the three following propositions:

**Proposition 1:** The mechanisms and expectations of the market impede learning and slow down capacity building.

**Proposition 2:** The agency of RI is affected negatively by its current interpretation and implementation.

**Proposition 3:** The overall system behaviour currently prevents meaningful change to take place in the required timeframe.

In summary, viewing at RI in the context of systems' dynamics has allowed for the identification of feedback mechanisms that are not considered on traditional event-based explanations. It has further allowed the integration of time as an important variable in the problem understanding. The dynamic view that was developed provides an endogenous explanation regarding how the problem behaviour arose, is maintained and is likely to evolve over time (Sterman, 2000). The resulting propositions form the backbone of a provisional working theory, which carry important implications going forward: without intervention to modify the system behaviour, the gap between the desirable and the actual evolution of RI will widen. RI will be unable to shift investment practices in the timeframe required to support a sustainable economy.

### 3.4 Transition implications.

The propositions put forward highlight the conflicting influences affecting progress towards RI. The findings of the research corroborate the central SD proposition that “problematic situations arise from interactions among purposeful actions motivated by conflicting worldviews” (Morecroft, 2007:152). As pointed out by Checkland and Holwell (2004), it is the simultaneous interactions of many different *intentions* that generate both progress and problems. The insights resulting from the conceptualisation effort raise questions with regard to the role of market expectations and assumptions underpinning the concept of RI. They further challenge the strategies used so far to promote RI practices. Investigating these questions is necessary in order to re-define a dynamic path that can support an effective transition towards a sustainable economy. Building on the dynamic hypothesis, I will explore further the implications of each proposition in order to identify possible strategies or interventions capable of changing the systems dynamics and improving the agency of RI.

#### 3.4.1 *Conflicting intentions and the role of mental models*

Proposition 1, which states that “The mechanisms and expectations of the market impede learning and slow down capacity building”, makes apparent the conflicting intentions between, on one hand, *supporting a sustainable economy* and on the other *meeting market expectations*. However, whilst both forces influence RI, meeting market expectations has a stronger impact on the overall system behaviour.

One reason advanced for this situation is that instead of addressing the systemic cause of a problem, the proposed solution works within the boundary set by market expectations and practices. The RI movement is seeking greater accountability from the financial sector “in a manner that works largely within the existing analytical and normative framework of the financial economy” (Richardson and Cragg, 2009:27).

SD refers to this ‘framework’ as a *mental model* (Senge, 1990). Central to the discipline since its inception, mental models have been described as “collective routines or standard operating procedures, scripts for selecting possible actions, cognitive maps of a domain, typology of categorising experience, logical structures for interpretation or attribution about individuals we encounter in daily life” (Sterman, 2000:16). SD stresses how mental models affect all our decisions and our ability to learn, as most decisions and strategies are taken in the context of existing mental models (Forrester, 1961). Mental models hold strong beliefs as to how the world works and actively construct – or model – the world we see and how we understand or deal with issues (Senge, 1990).

Information feedbacks often fail to affect existing mental models, thus limiting learning capacity. Information is perceived and interpreted through filters. Measurements further introduce biases and errors. As pointed out by Albert Einstein, “Our theories determine what we measure” and thus we often selectively observe data to fit our narratives (Senge, 1990:166). Moreover, the complexity of real-world issues often surpasses our cognitive capabilities. As articulated by Herbert Simon (1978), ‘bounded rationality’ limits our ability to formulate and solve complex problems. As explained by Sterman, “Faced with the overwhelming complexity of the real world, time pressure, and limited cognitive capabilities, we are forced to fall back on rote procedures, habits, rule of thumb, and simple mental models. Although we sometimes strive to make the best decisions we can, bounded rationality means that we often systematically fall short, thus limiting our ability to learn from experience” (Sterman, 2000:26). The higher the complexity of a situation, the more people tend to rely on entrenched mental models, ignore or misinterpret feedbacks and challenge the reliability of expert evidence (Sterman, 2000; Morecroft, 2007).

The investment industry further relies on an established set of practices, tools and operating mechanisms, which perpetuate its expectations (Woods and Urwin, 2010). Industry wide practices such as discounted cash flow analysis to assess investment, standard asset allocation criteria, the use of Modern Portfolio Theory (Markowitz, 1952) or risk management processes create a bias towards the short term (Urwin, 2010; Slawinski *et al.*, 2015). These practices are further reinforced by incentive systems and the reward system of the financial intermediaries. As pointed out by Sethi, “Financial intermediaries and consultants, for the most part, are paid on the basis of the performance of their recommended investment choices. However, this performance is rarely measured in the long-term” (2005:105). Thus, the maximisation of short term returns is currently “embedded in the way financial markets are structured” (Sethi, 2005:104). Evaluation systems tend to underestimate future risks and over-estimate future rewards, especially when future risks are hard to measure and information is limited or inconsistent. Sustainability issues, temporally distant or poorly understood, are assigned less importance and urgency than short-term focused opportunities (Dutton and Webster, 1988 cited in Slawinski *et al.*, 2015). Hence the lack of quality ESG data and evaluation criteria act as an obstacle to the consideration of sustainability and creates a negative reinforcing influence encouraging short-termism (Sandberg, 2008; Richardson, 2009b; Herringer *et al.*, 2009; Urwin, 2010; Slawinski *et al.*, 2015).



Mental models, entrenched in beliefs, expectations and practices co-opt the intentions built into RI and limit the scope of change possible. Shifting the balance of influences means challenging the embedded intentions of industry practice and amending the toolset to fit the new intentions.

The findings can be summarised in the following proposition:

**Proposition 4:** The familiar assumptions embedded in mental models and operational practices perpetuate expectations and act as a lens through which RI is interpreted.

### ***3.4.2 Unresolved theoretical tensions and unchallenged behavioural norms***

The conflicting intentions and the dominant influence of market expectations are the visible manifestation of deeper and unresolved theoretical tensions between shareholder value and stakeholder theory. These tensions are reflected clearly in the debate around the interpretation of fiduciary duties.

The conventional understanding is that the fiduciary duty of investors, such as pension funds or mutual funds, is to maximise the financial benefit for the ultimate beneficiaries and to exercise prudence when managing the invested contributions (Sethi 2005; OECD 2006; Woods and Urwin, 2010; Sandberg, 2010). The influence of Milton Friedman (1970), who stated that profit maximization was the sole moral obligation of corporations, gave rise to a strict financial interpretation in line with the notion of shareholder primacy. As such, according to the Chicago law professors Langbein and Posner, the duty of prudent investing forbids the trustee “to invest for any other object than the highest return consistent with the preferred level of portfolio risk” (1980:98, cited in Sandberg, 2010:146). Stakeholder theory, on the other hand, has given rise over the last decade to a new interpretation, which acknowledges third parties potentially affected by investment decisions and values the consideration of ESG factors in investment decisions. In line with this perspective, the Freshfields report (2005), commissioned by the United Nations Environment Programme’s Finance Initiative (UNEPFI), confirms that taking ESG considerations into account is not only “compatible with the current legislative framework surrounding fiduciary duties, ... it is actually legally obligatory on many occasions” (Sandberg, 2010). Reinforcing this interpretation, some regulators and investors are increasingly making explicit mention of ‘stakeholders’ in their policies (Woods and Urwin, 2010; Sandbu, 2012).

Yet, despite the growing use of the stakeholder perspective, the interpretation of fiduciary duty remains largely biased by shareholder value and practices have not changed. The position of PRI highlights this unsettled reality by stating that signatories commit to adopt and implement the principles of RI “where consistent with [their] fiduciary responsibilities” (UNPRI, 2015). Rather than taking a categorical position, PRI



accepts that “if ‘fiduciary responsibilities’ to the investment beneficiaries demand it, other principles of responsible investment may be ignored, at least partly or temporarily” (Juhani Lehtonen, 2013:594).

Whilst recognising the moral obligation of businesses, stakeholder theory provides little guidance as to the nature of moral behaviour expected and the type of responsibility it engenders. Within the stakeholder perspective, different approaches provide different answers to the questions ‘Who is a stakeholder?’ or ‘What is the moral obligation towards stakeholders?’ or ‘How are responsibilities allocated between the various economic actors with respect to achieving public good’ (Wall and Greiling, 2014). In the context of an unclear stakeholder discourse, investors have ‘free hands’ to interpret their fiduciary duties and implement discretionary approaches to RI. The risk is that the unresolved theoretical framework perpetuates the system’s inertia by leaving unchallenged behavioural norms (Richardson, 2009a; Woods and Urwin 2010; Sievänen, 2013).

To describe the assumptions and values imbedded in behavioural norms, Donaldson and Preston used the term “normative core” (1995). This term recognised that “sometimes our assumptions and values are not explicitly stated, yet always present in the way we talk about value creation and trade” (Purnell and Freeman, 2012:110).

Making the distinction between open-core and closed-core institutions, Purnell and Freeman showed how in closed-core institutions “ethical decision-making is viewed by the institution as a separate domain from the core business of the institution” and how “the resulting blind spot stifles meaningful exchanges with stakeholders and external parties” (Purnell and Freeman, 2012:110). Investigating why the shareholder primary perpetuates itself in the banking industry even when institutions publicly recognise the importance of stakeholder value, Purnell and Freeman argue that it is *not* that the banking industry is “unwilling to consider interests beyond shareholders, but rather that it is unable given the imbedded set of beliefs and ideas currently institutionalized by the ‘fact/value dichotomy’” (2012:113).

The term *fact/value dichotomy* was coined by Hilary Putnam (2002) to describe the “false philosophical dualism” of facts and values at the heart of the shareholder primacy narrative. This dualism postulates that the realms of business and realms of ethics are separated. As such, business decisions have no moral content and, except for contractual obligations, ethical considerations must be externalised (Purnell and Freeman, 2012). This false dichotomy tends to perpetuate itself in closed-core institutions because the narrative permeates every aspect of their existence: structure, measurement tools, incentives, and even language.

“The task of overcoming the dichotomy—to those individuals invested in the institution—results in roadblocks of imagination before the conversation even starts” (Purnell and Freeman, 2012:115). The power of the narrative prevents a true exchange of ideas. From this line of argument, it becomes clear that until a reflection takes place to challenge the imbedded set of values and the current externalisation of ethics, the dynamics of change within the investment industry will remain superficial and entrenched in the dominant narrative. To overcome the fact/value dichotomy and truly engage with the stakeholder narrative, it appears critical to create an environment where ethical considerations can be discussed openly, across institutions and their stakeholders.

The findings can be summarised in the following proposition:

**Proposition 5:** The notion of shareholder value still dominates the theories, assumptions and practices, which underpin the behaviour of financial organisations.

### **3.4.3 The ethical dilemma**

The fact that the mainstreaming of RI is taking place as the concept abandons its ethical roots should therefore not come as a surprise (Viviers, 2013) and needs to be analysed in perspective with Proposition 2, which states: “The agency of RI is affected negatively by its current interpretation and implementation”.

No longer promoting ethically sound corporate behaviour, RI has “at its heart improved financial return for beneficiaries through the exploitation of ESG-related market inefficiencies” (Woods and Urwin, 2010:4). Mainstream investors are generally uncomfortable with the integration of an ethical agenda. They fear being immersed in “acrimonious and irresolvable debates about the correct ethical course” with potentially disastrous legal implications (Richardson, 2009b:607). Thornton argues, “What is considered to be ‘ethical’ in investment terms is inherently subjective, imprecise and continually changing with altered societal perspectives” (2008:419).

The situation exposes “deep fault lines between actors embedded in fundamentally different logics” (Slawinski *et al.*, 2015:12). On one hand, scientific knowledge exposes “the world’s finite resource base and the fragile ecology upon which humanity, and all other species, depends for survival” (Juhani Lehtonen, 2013:599). The climate is a transnational common and “everyone has a shared responsibility to ensure that its biophysical functions are not put at risk” Ansari *et al.*, 2013 cited in Slawinski, 2015:12). The *sustainability imperative* requires humankind to think beyond its own interests and take clear and immediate action to rearrange its economic framework (Richardson, 2009b). On the other hand, climate change and ESG issues

have been addressed using the *market logic* (Thornton *et al.*, 2012) that gives primacy to economic growth and “prizes growth in share price, wealth accumulation, keen competition, and committing investment capital” (Miller *et al.*, 2011:4). The market logic has encouraged firms to take action on sustainability issues only in so far as it contributes to “growth objectives, wealth accumulation and strategic position in the market” (Slawinski *et al.*, 2015:12).

Whilst RI and financial performance are not incompatible, especially for long-term investors, the current compartmentalisation and containment of ethical considerations limit the scope of change possible and constrain RI to an *instrumental approach*. RI is a “means to the ends of shareholder wealth” and the positive societal effects are collateral outcomes rather than the result of intrinsic intentions (Garriga and Melé 2004:52). Although the ‘business case RI’ is likely to address some environmental and social issues, it is not designed to take into account problems that are not valued by the market or whose financial materiality is distant in time (Richardson and Cragg, 2010). This situation is unlikely to change unless the framework guiding investment decisions is reinterpreted in line with sustainability imperatives (Wen, 2009).

Fundamentally, the fault line highlights the ethical and ideological divide at the heart of the sustainability debate. In 1992, in their “Warning to Humanity”, scientists called for “[a] new ethic ... towards discharging our responsibility for caring for ourselves and for the earth” (Union of Concerned Scientists, 1992 cited in Richardson, 2009b). They argued that progress toward sustainability required challenging the anthropocentric and growth-centred values at the heart of the market logic in order to keep human activities within the carrying capacity of the planet (Daly, 1993). Most current research in sustainability insists that business activities must be set in the context of *nested dependencies* with social and environmental systems (Kendall and Willard, 2015).



**Figure 13: Nested dependencies (Kendal and Willards, 2015)**

Several researchers like Richardson and Cragg (2010), Juhani Lehtonen (2013), Viviers (2013) have long pointed out the conflicting intentions at the heart of RI and argued for a renewed ethical framework. The anthropocentric and contractual ethical perspective, which guides fiduciary duty interpretation, limits investor's ability to meet long-term sustainability imperatives. The debate needs to shift away from whether RI is compliant with fiduciary duty or whether fiduciary duty should be 'stretched' to accommodate ESG considerations (Martin, 2009; Richardson, 2009a; Sandberg, 2013). Rather, the challenge is to ensure that fiduciary duty and the underlying ethical framework guiding investment decisions are consistent with RI in the context of long-term sustainability.

While the notion of 'ethical consideration' is imbued with complexity and multiple meanings, I agree with Richardson and Crag that investment decisions need to be framed by "respect for fundamental human rights and ecological, social and economic sustainability" (2010:22). Although such an ethical framework is likely to be difficult to enunciate in clear normative imperatives, internal value systems, governance framework and decision-making processes can evolve to take into account parameters consistent with society's long-term sustainability (Woods and Urwin, 2010).

Effective progress towards RI means re-negotiating the ethical framework guiding investment practices and fiduciary duties in line with sustainability knowledge and objectives. The sustainability challenges facing the world require a courageous undertaking from the investment community. As was the case during the civil rights movement, the situation requires dramatic changes in beliefs and behaviours (Sterman, 2008). Improving the agency of RI and expanding the scope of change possible implies challenging the hidden assumptions at the heart of the market logic (Juhani Lehtonen, 2013).

The above analysis can be summarised in the following proposition:

**Proposition 6:** The current ethical framework of financial institutions limits the scope of change possible and constrains RI to an *instrumental approach*.

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*The notion of "triple bottom line" seems to exert a significant influence on businesses' understanding of sustainability. The understanding of 'embedded sustainability', where the economic system is a subsystem of the social system, which is in turn a subsystem of the natural system, is absent. However, where embedded sustainability effectively leads to sustainable development (i.e. a transformation of the way we do business), the 'triple bottom line' is a way to further maximise profits by better managing risks. It remains consistent with the Friedman doctrine, and does not seek to reform the current economic system.*

*Understanding what is the end goal of RI is important. While one may argue that 'collective action' will define it over time, it is questionable whether we have the time and can take the risk of a different outcome than sustainable development. Thus, is the reason for the current business case RI to "silently sneak between the enemy's lines" and initiate discussions? Or is it to simply to improve risk management in the current economic context without taking any responsibility for any negative outcome?*

*Is RI, in its current form, fundamentally "responsible"? What is responsible about taking into account ESG to optimise risk returns? To be effective, can RI be isolated from broader ethical considerations?*

**Text Box 7: Personal memo 10 December 2014****3.4.4 The need for new institutional strategies**

The institutional environment plays a significant role in the perpetuation of the status quo (Thornton et al, 2012). By sanctioning the use of discretionary interpretations and flexible commitments, the regulatory framework de facto accepts and complies with the tenets of the market logic, leaving the narrative and ethical assumptions unchallenged. In light of Proposition 3, suggesting that the overall system behaviour currently prevents meaningful change to take place in the required timeframe, the current institutional environment should be critically assessed, its impact evaluated and new strategies investigated.

The bias of the institutional environment towards the market logic is corroborated by the 'comply or explain' approach, favoured by regulators in respect of RI. As explained by Woods and Urwin, the legislatively sanctioned approach to RI requires "to either comply and adopt aspects of sustainable investment ('comply') or provide a written explanation detailing why they have chosen not to comply and for what time period ('explain')" (2010:14). In line with industry practices, this approach allows "an alternative line of action to be

pursued subject to explanation” (Woods and Urwin, 2010:14). It assumed that progress will be gradual and that “the market is efficient and functions best with minimal governmental oversight” (Richardson, 2009a:558).

In line with the self-regulation trend, the institutional environment supports the view that “the best opportunities for generating compliance will come from collective action” (Brown, 2013:501). As argued by the World Bank “‘Collective Action’ is a collaborative and sustained process of cooperation among stakeholders. It increases the impact and credibility of individual action, brings vulnerable individual players into an alliance of like-minded organizations and levels the playing field between competitors” (2008:4). As further explained by Buchanan (1996), a collective strategy is favoured by the industry as it provides “better protection against loss of competitiveness: If the cost of contributing to the solution to a social problem is distributed fairly among competitors, none will be penalized for acting ethically” (Brown, 2013:501). In the context of a collective strategy, a ‘dialogic approach’, relying mainly on the engagements of institutional asset owners, is expected to lead to the critical evaluation of different investment options and to redirect the investment activities towards responsible businesses (Juhani Lehtonen, 2013).

However, relying mainly on such a strategy seems rather unconvincing in the context of the *urgency* to act on sustainability issues such as climate change, especially considering the ideological divide. While proponents argue that it gradually contributes to a change in expectations (Thaler, 2008 cited in Woods and Urwin, 2010), collective action is a messy and lengthy process, whose outcome is uncertain and most likely “on a smaller scale and more fragile than one would wish” (Brown, 2013:502). In such strategy, power is employed to push agendas, and any focal position is regularly contested. Self-governance compliance processes further carry risks of games played by the industry to minimise regulatory scrutiny and limit liability (Laufer, 2006, cited in Brown, 2013). Combined with regulatory uncertainty and a lack of credible policy measures on climate change and related issues, the reliance on collective action promotes confusion and poor accountability (Richardson, 2011; Viviers 2013).

As a direct consequence, RI has become what Gallie (1955) termed a ‘radically confused’ concept. Despite the alleged standardisation of the terminology through the PRI initiative, the concept is associated with multiple meanings and goals, which “actually represent a number of different and distinguishable concepts” (Woods and Urwin, 2010:3). The conceptual ambiguities are blurring both the outcome and the transition process (de Caluwé and Vermaak, 2004).

Clarifying the concept of RI represents a minimum requirement for its goals to be pursued with transparency and purpose. A clear and unambiguous concept is a pre-requisite to the generation of quality, measurable and comparable information, which firms are dependent upon to establish their strategies (de Caluwé and Vermaak, 2004; Wen, 2009; Herringer *et al.*, 2009; Woods and Urwin, 2010; Berry, 2013; De Brucker *et al.*, 2013). Conceptual clarity is also a precondition if the legal environment guiding fiduciary duties - and at the heart of effective change in investment practice - is to be reviewed in line with the sustainability imperative and if a new ethical framework is to be progressively negotiated (Sethi, 2005; Richardson, 2009a).

Providing clarity on the concept further means making its temporality explicit. Social practices that determine change are embedded in temporal realities. As argued by Sandberg and Tsoukas “The particulars that make knowledge actionable – what to do, at what time, in what context – are not included in timeless propositional statements” (2011:342 cited in Langley *et al.*, 2013). Without temporal clarity, institutions face a “decision trap” (Van Oorschot, Akkermans, Sengupta and van Wassenhove, 2013) often stretching current temporal activities at the expense of future activities (Langley *et al.*, 2013). Awareness of time can therefore shift the balance of concerns and encourage different strategies.

In the context of urgency, self-regulation mechanisms must therefore be complemented by a regulatory intervention aiming at clarifying the concept of RI in line with sustainability knowledge, objectives and timeframes and reviewing the legal framework surrounding fiduciary duty to align industry practices with societal goals (Woods and Urwin, 2010; Richardson, 2011). Institutional strategies need to take a firm and consistent stance in support of the *sustainability* imperative. Vague references to a poorly defined sustainability idea or a mention of the need to consider ESG in investment processes are not enough. Whilst the law cannot stand alone to prescribe behavioural change, it can clear obstacles and lay the founding principles from which companies, investors and service providers can reassess their assumptions, intentions and practices (de Caluwé and Vermaak, 2004). Legal systems can act to translate societal values into operational and governance frameworks (Woods and Urwin, 2010; Richardson and Cragg, 2010). Empirical research confirms that: “if we wish to encourage and continue the trend towards corporate sustainability there is a need for regulatory guidance on the governance of sustainability to improve both practice and reporting in this area” (Klettner *et al.*, 2014:162). Whilst “complicated and often hard to enforce command-and-control regulation” might not be advisable and is likely to be strongly resisted, the regulatory environment must provide clarity on the overarching sustainability goal to encourage reflections around ethics and shed light on the allocation of responsibilities amongst the various economic actors (Richardson, 2011:637). This is consistent with suggestions from reflexive law theorists, such as Gunther Teubner, who

argue for procedural reforms focused on improving clarity and transparency in order to encourage change (Richardson, 2011:637).

Overall, the objective of a regulatory intervention is to call into question the current *instrumental* approach and instead seek to promote an *embedded* approach, where “the interests, identities, values and assumptions” at the heart of any financial entity are consistent with a sustainable economy (Thornton *et al.*, 2012; Klettner *et al.*, 2014; Slawinski *et al.*, 2015:11). Regulatory clarity can provide financial firms with the means to effectively incorporate both mandatory rules and voluntary commitments into their investment framework and can further clarify responsibilities across the various actors of the financial sector (Richardson, 2009a; Wen, 2009; Woods and Urwin, 2010). As suggested by Woods and Urwin, if based on strong beliefs and a clear mission, such a framework can provide a transparent structure from which to implement and monitor RI across the investment chain (2010).

The above argument can be summarised as follows:

**Proposition 7:** Providing conceptual clarity and adapting the legal framework surrounding fiduciary duty appears as minimum institutional requirements to enable progress towards RI.

Reflecting on the transition implications, it appears that the process of change must take place at many levels at the same time (de Caluwé and Vermaak, 2004). Assumptions, theories and practices need to evolve to support the objective of a sustainable economy. However, overcoming the present status quo calls for new institutional strategies that clarify concepts and their implications across the industry whilst encouraging new operational and governance frameworks, consistent with long-term sustainability.

### 3.5 Chapter summary and conclusion

The aim of the conceptual ‘process’ framework was to gain an understanding of the dynamic influences affecting the concept and the agency of RI. In order to achieve this, the study investigated global trends in RI and assessed the level of change in the investment industry, thereby highlighting that RI falls short of generating transformative action. Taking the research to a higher level of abstraction, the framework then investigated and conceptualised the causal relationships affecting the agency and the evolution of RI over time. This allowed the formulation of a dynamic hypothesis explaining change processes and how these



affect the agency of RI. The hypothesis was then expanded on to investigate the underlying mechanisms at play and their implications in terms of institutional strategies going forward.

The overall findings can be summarised as follows:

RI, in its current implementation, is unable to shift investment practices in time to support a sustainable economy. The dynamics of change are too slow relative to the time horizon to generate meaningful transformation. The intentions embedded in the market mechanisms impede learning and slow down progress towards RI. The mental models, theories and operational practices are still dominated by the notion of shareholder value, which underpins the behaviour of financial organisations, acts as a lens through which RI is interpreted and perpetuates expectations. In this context, the absence of an ethical debate leaves behavioural norms unchallenged, thereby limiting the scope of change possible and constraining RI to an *instrumental approach*. Progress towards RI depends on reforming the institutional environment to ensure conceptual clarity and enable a legal and governance framework consistent with sustainability objectives.

The dynamic insights arising from the present conceptual process framework emphasise that time for action is running out. While some entities have engaged proactively and meaningfully in RI, many have not; they have continued to invest unsustainably and have failed to reflect upon the values and narratives at the heart their practices. By focusing on the dynamic and temporal dimension of RI, this perspective aims to contribute to a better understanding of the dynamics and the underlying processes influencing progress towards RI. More specifically, I intend for this conceptual process framework to provide a means to assess the institutional strategies employed in local contexts.

## 4 Chapter Four: Empirical Research Findings - CRISA's Agency On The Dynamics Of The South African RI Industry

### 4.1 Introduction

In light of the introduced conceptual framework and a greater understanding of the dynamics influencing institutional strategies and progress towards RI, I now set out to investigate the second research question: "What is CRISA's agency on the dynamics influencing RI in South Africa?"

The conceptual framework has made clear that the institutional environment and the type of regulatory strategies employed play an essential role in ensuring progress towards RI. South Africa is particularly interesting in this regard as, despite having a leading voluntary and regulatory framework with regard to corporate sustainability and RI, changes in investment practices amongst institutional investors and their service providers remain slow and uneven, especially when compared to their European and American counterparts (Eccles *et al.* 2007, Herringer *et al.* 2009; Viviers *et al.*, 2009; Viviers and Firer, 2013). Giamporcaro and Viviers estimate that the actual size of the RI market remains quite marginal (2014:249). Furthermore, having been the lead researcher on a recent survey commissioned by the CRISA Committee and Ernst and Young, it became clear to me that progress towards RI is tainted by major issues with regard to the quality and the consistency of data available as well as by the intentions guiding strategies.

To answer my research question, I have structured my analysis as a three-step process: the first step provides some background information by analysing the literature with regard to CRISA and the evolution of RI in South Africa. The second step consists of assessing CRISA's agency based on current public disclosure trends within the industry. In the third step, the research findings are used to position CRISA's agency amongst the main drivers and barriers of RI in South Africa.

### 4.2 Background on Responsible Investment in South Africa

The objective of this section is to contextualise the research finding that will be presented in section 4.3. To proceed, I will describe how CRISA came into existence and the Code's main characteristics, discuss some of

the dominant influences that have shaped the practice of RI in South Africa and provide an overview of the current characteristics and trends of the market.

#### **4.2.1 CRISA in context**

South Africa is the largest institutional investment market in Africa, with close to US\$500 Billion of assets under management (AUM) (Giamporcaro and Viviers, 2014). As such, South Africa has a well functioning and highly regulated financial and investment industry, which largely follows ‘developed-world’ trends, practices and innovations (World Economic Forum Global Competitiveness Report, 2011/2012).

As in the rest of the world, corporate scandals, the growing levels of social inequalities and environmental challenges have raised questions around the role of business in society and highlighted the need to promote sustainable corporate and financial practices. Against this backdrop of change, South Africa adopted a leading framework and the successive King Codes of Governance Principles have set the stage for corporate sustainability. In 2009, the King III Code allowed South Africa to become one of the first countries to require listed companies to deliver integrated reporting and explain how they take into account ESG issues (van der Ahee and Schulschenk, 2013; Steyn, 2014; Marx and Mohammadali-Haji, 2014). Recognised as an international standard of best practice, the latest King III Code unequivocally states that: “Sustainability is the primary moral and economic imperative of the 21st century and one of the most important sources of both opportunities and risks for businesses” (IoDSA, 2009:11). Corporate sustainability is described as “conducting operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. It means having regard to the impact that the business operations have on the economic life of the community in which it operates” (IoDSA, 2009; Marx and Mohammadali-Haji, 2014). As such, the King III Code promotes a stakeholder-inclusive governance approach and sets the expectation that corporate entities should report on social, environmental and economic issues and consider the triple context in which they operate (Steyn, 2014).

The principles set out in the successive King Codes of Governance Principles were further institutionalised with amendments to Regulation 28 of the Pension Funds Act 24/1956 in 2011. Following the recommendations made by the World Economic Forum (2005:10) and the Freshfields report (UNEPFI, 2005:13), the amended Regulation 28 made explicit that fiduciary duties and ‘prudent behaviour’ required the consideration of ESG factors. As of January 2012, South African pension funds are required to ‘explicitly consider’ a responsible investment approach as part of their fiduciary duty towards beneficiaries (National Treasury, 2011). Although the amended regulation falls short of defining sustainability, its preamble states

that: “Prudent investing should give appropriate consideration to any factors which may materially affect the sustainable long-term performance of a funds’ assets including factors of environmental, social and governance character” (National Treasury, 2011).

In this context, CRISA was developed as an industry initiative to support the implementation of the amended Regulation 28 and guide institutional investors and their service providers towards RI practices (IoDSA, 2013a). Under the strong leadership of the Government Employee Pension Fund (GEPF), a committee of industry representatives was formed to document RI principles and guidelines pertinent to the South African investment industry and in line with the latest King code (IoDSA, 2011). CRISA was published in July 2011 and complemented in January 2013 by a Disclosure Practice Note (IoDSA, 2013a). Published by the Institute of Directors in Southern Africa (IoDSA), CRISA is endorsed by the Principal Officers Association (POA), the Association for Savings and Investment South Africa (ASISA), the Financial Services Board (FSB) and the Johannesburg Stock Exchange (JSE). Formalising South Africa’s approach to RI, the launch of CRISA made South Africa the second country in the world, after the UK, to formally encourage RI. As expressed in the ‘Purpose’ of CRISA, “Read together, the King Code and CRISA provide a framework that relates to the function of all role players in the overall governance system, including boards of companies, institutional shareholders, their service providers and the ultimate beneficiaries” (IoDSA, 2011:7).

CRISA promotes transparency and the consideration of ESG factors in investment decisions. Strongly inspired by the PRI initiative, CRISA is structured around 5 principles (detailed in Figure 14) and focused on promoting public disclosure of policies and practices (IoDSA, 2011). A voluntary approach is used to encourage all entities to implement the prescribed principles on a ‘apply or explain’ basis and encourage best practice

**The Five CRISA Principles:**

1. Incorporate RI into decision-making.
2. Demonstrate Active Ownership.
3. Consider a collaborative approach to promote acceptance.
4. Manage conflicts of interest.
5. Ensure transparency on CRISA implementation and disclosure of policies.

conduct by shareholders and service providers (IoDSA, 2011). Market forces are expected to encourage self-regulation. Whilst CRISA applies directly to the institutional investor as the asset owner who has fiduciary duties towards ultimate beneficiaries, “it is intended that the principles and practice recommendations contained in CRISA also apply to service providers and the manner in which they execute their mandates (IoDSA, 2011:7). However, it is the institutional investor who bears final accountability for the application of CRISA.

**Figure 14: CRISA's five principles**

Unlike its global counterpart the PRI, and contrary to what has been mentioned in previous academic research (Giamporcaro and Viviers, 2014:244, African Investing For Impact Barometer, 2014:2), an entity does not sign up to become a 'CRISA signatory'. All institutional investors and their service providers operating in the South Africa investment market are expected to apply the five CRISA principles, disclose their RI policies and related practices as described in the CRISA Disclosure Practice Note, or explain why they have elected not to do so (IoDSA, 2011; IoDSA, 2013a). Unlike the PRI, CRISA does not provide a reporting format for entities to complete, and compliance information is not centrally available. Institutional investors and their service providers are invited to disclose their RI policies and practices publicly, either on their website or in the annual reports.

CRISA can be described as an investor-driven governance network (IGN) and attests of "the emergence of a new model of private, non-state-based governance, also known as business self-regulation" (MacLeod and Park, 2011:57). This institutional arrangement relies on the drive from businesses with minimal involvement from governmental actors. Participating entities recognise the benefits of acting collectively, thereby leveraging their financial power to change corporate behaviour for the long-term benefit of the industry. Similar in purpose to that of a transnational advocacy networks like the PRI, the collaborative effort of an IGN like CRISA focuses on framing the discourse and promoting acceptance of new norms or considerations (MacLeod and Park, 2011).

Although CRISA does not prescribe or advocate any specific RI strategy, it states: "Such an approach will in the long-term be in the interest of ultimate beneficiaries as part of the delivery of superior risk-adjusted returns on investment that has been done cognisant of the environmental and socio-economic context" (IoDSA, 2011:7). CRISA further provides a definition of sustainability, in line with the latest King III Code. As such, CRISA's definition of sustainability states: "In order to avoid any misunderstanding in CRISA, the terminology "sustainability" and "ESG" are used in order to indicate an understanding of governance in its wider sense, encompassing behaviour that supports sustainable development. Sustainability means the ability of a company to meet existing needs without compromising the ability of future generations to meet their needs. Sustainability includes managing the impact that business has on the life of the community, the broader economy and the natural environment in which it operates. It also includes the reverse, namely considering the effect that society, the economy and the environment have on business strategy. Sustainability includes economic and ESG considerations" (IoDSA, 2011:7).

Regulation 28 and CRISA tie local investors to the principles set out in the latest King III Code and together they provide a strong institutional foundation to support progress towards RI in South Africa (Giamporcaro and Viviers, 2014). This leading regulatory and voluntary framework provides both a justification and the means – through integrated reporting and appropriate disclosure - to promote industry best practices with regard to corporate sustainability (van der Ahee and Schulschenk, 2013; Steyn, 2014; Marx and Mohammadali-Haji, 2014). Given that the pension industry represents about half of all assets under management and that the amended Regulation 28 mandates this industry to consider RI, the joint regulatory and voluntary framework has the potential to rapidly exert a substantial pressure on the flow of local investments (Giamporcaro, 2014). As reported by Viviers and Firer (2013:219), if certain institutional investors have argued in the past that progress towards RI was constrained by the lack of enabling regulatory framework, this argument appears obsolete. On the contrary, South Africa presents as a country with a leading framework to guide corporate sustainability and RI.

#### **4.2.2 Major influences shaping the South African RI industry**

Although the institutionalisation of RI as a recommended investment approach was formalised in South Africa with the amendment to Regulation 28 and the publication of CRISA, the local RI industry has been shaped by a diversity of influences, including by the country's specific historical context, certain local initiatives and specific global trends.

Whilst the origin of RI in South Africa can be traced back to 1992 and the anti-apartheid movement, a major influence shaping RI thereafter can be attributed to the strong developmental and transformative investment agenda of the post-apartheid government. According to Viviers *et al.*, Unity Incorporation was one of the first RI investor in South Africa (2009). Co-founded in June 1992 by labour unions, this investment group used their pension funds to raise awareness around labour issues in the companies in which they invested. After the first democratic election of 1994, the Reconstruction and Development Programme (RDP) strongly influenced the establishment of funds supporting infrastructure improvement and Black Economic Empowerment (BEE) (Viviers *et al.*, 2009; 27four, 2015). To date, this historical context continues to have a major effect on the understanding and definition of RI in South Africa and a certain level of confusion persists between BEE and RI activities (Leeman, 2005). For certain South African authors, BEE and more recently Broad-Based Black Economic Empowerment (B-BBEE) (Act No. 53 of 2003) form an integral component of RI “as it represents a “social” consideration along with other social, environmental and corporate governance (ESG) concerns” (Viviers *et al.*, 2009:4). Given South Africa's status as an emerging economy and considering its specific socio-political history, it should come as no surprise that social and developmental considerations

feature predominantly in the current institutional demand for RI funds (Viviers, 2014:742). Research by Giamporcaro and Pretorius confirms that around 80% of RI assets focus on a social developmental agenda (2012:15).

The historical context is also held partly responsible for the significantly smaller attention given to environmental concerns in the South African RI landscape. As such, Giamporcaro and Pretorius confirm findings by Eccles *et al.* advancing that institutional demand— whilst generally very low in South Africa for RI product and strategies - “is almost non-existent for environmental driven approaches” (Eccles *et al.*, 2012; Giamporcaro and Pretorius, 2012:14). This situation reflects a very different reality and state of concerns compared to the European and American RI market, whose reasonably high growth rates could be partly credited for the considerable demand for environmental themed funds (Giamporcaro and Pretorius, 2012:2). Giamporcaro and Pretorius further argue that until the more pressing developmental problems are addressed, environmental issues are likely to be perceived as incidental (2012:1; Viviers, 2014). It is yet unclear how the growing global concerns around environmental sustainability and climate change are going to influence local political, corporate and financial leaders and guide the choice of development path for South Africa (Giamporcaro and Pretorius, 2012:15).

Beyond the effects of the historical socio-political circumstances of the country, some local initiatives and certain global trends have further shaped the understanding and implementation of RI.

An important local initiative is the establishment by the Johannesburg Stock Exchange (JSE) of its SRI index in 2004 (Giamporcaro and Viviers, 2014). This index evaluates – on a voluntary basis - listed companies using a range of ESG criteria. Whilst any entity listed on the JSE All Share index is eligible, a minimum score in terms of relative environmental, social and governance performance is required to be included in the SRI index. Companies are rated according to their category of activities and measured relative to their own stated practices and targets against a framework designed in consultation with local businesses (JSE SRI Index, 2013; Giamporcaro and Viviers, 2014). Evaluation criteria focus on the direct environmental or social footprint of a given entity and evaluation reports are not released publicly (JSE SRI Index, 2013).

Following trends in Europe and America, the SRI index is now tracked by certain fund managers and serves as a basis for local RI products (Giamporcaro and Viviers, 2014). According to Giamporcaro and Viviers, the index has led to a level of standardisation of the RI vocabulary and influenced the industry’s perception of RI products (2014). They explain: “What was previously referred to as ‘BEE funds’ or ‘infrastructure funds’

started to be classified under the SRI banner as funds tracking the JSE's SRI Index" (Giamporcaro and Viviers, 2014:256). The general lack of reliable local ESG data (Herringer *et al.*, 2009) has further made the JSE SRI Index a predominant assessment tool for the local fund managers. As such, its structure and operating criteria are likely to affect the practical reality of RI in South Africa. Whilst JSE's SRI Index has been a welcome initiative and is steadily growing, the easy criteria for inclusion and the lack of transparency puts the index at risk of being used as a marketing tool rather than a real sustainability assessment and tracking instrument (Wen 2009; Richardson 2009). In this respect, it is worthwhile to note that in 2012, 21% of all companies listed on the JSE were included in the JSE SRI index (Viviers, 2014).

Global forces have also modelled the local understanding and implementation of RI. Research by local experts identify the PRI initiative, Islamic finance and Impact investing as three primary influences (Eccles *et al.*, 2007; Herringer *et al.*, 2009; Viviers *et al.*, 2009; Viviers, 2014; Giamporcaro and Viviers, 2014). The launch of the PRI initiative in 2006 and the subsequent creation of a PRI network in South Africa in 2009 contributed to a significant rise in awareness around RI principles and the business case for RI strategies (Crotty, 2011). The largest pension fund in South Africa, the Government Employee Pension Fund (GEPF), became a PRI signatory in 2007 and led numerous local asset managers to join the PRI network in the hope of winning investment mandate with the GEPF (Crotty, 2011; Giamporcaro and Viviers, 2014). Under the leadership of the GEPF, the PRI initiative guided the vision and vocabulary at the heart of CRISA and the amended Regulation 28, promoting the consideration of ESG to improve long-term financial returns and aligning fiduciary duty interpretation with the Freshfields report (UNEPFI, 2005).

Another global trend, the worldwide growth in Islamic financing, was met in South Africa by a small but strong Muslim community and led the JSE to launch two Shari'ah indices in 2008 (Patel, 2012). Whilst most Shari'ah funds in South Africa (76.8%) do not make public the investment criteria they used, it is understood that they are following Islamic laws (Viviers, 2014:747). As such, Shari'ah funds generally exclude "companies associated with alcohol, gambling, pornography, non-Halaal foodstuffs (such as pork), tobacco, firearms, weapons and entertainment" (Herringer *et al.*, 2009:13). Shari'ah funds also generally exclude from their investment universe financial firms or companies with high interest income or high levels of gearing. Giamporcaro and Viviers argue that a main reason for the rise of Shari'ah funds within the local RI landscape is their alignment with social and developmental agendas, which guide current institutional demand for RI funds (2014:256). Since 2008, Shari'ah funds have multiplied and are considered by local experts as a small but "distinct local feature" of what constitutes RI in South Africa (Giamporcaro and Viviers, 2014).



Finally, academic research also mentions the rise in impact investing (sometimes referred to as targeted or caused-based investing) as shaping the local RI market (Herringer *et al.*, 2009; Viviers *et al.*, 2009; Giamporcaro and Viviers, 2014; Viviers, 2014). Impact investing has been described as proactively investing in unlisted securities, particularly in emerging markets, in order to create a positive social impact (Giamporcaro and Viviers, 2014:248). According to the latest African Investing For Impact Barometer published in 2014, impact investing represents 16% of assets under management in the South African private equity space (R29bn). Viviers further points out that “almost half of all active funds in South Africa (48.5%) employ an impact investing strategy” (2014:749). Besides the growing interest showed by the private equity market for enterprise development, Viviers ascribes the rise of impact investing in South Africa to the country’s unique historical context and the desire amongst the investment industry “to address the imbalances of the past and contribute to socio-economic growth in the country” (2014:749). Again, the focus is strongly on social and developmental themes, even though this sector is likely to lead to an increased support for environmental projects (Giamporcaro, 2014; Viviers, 2014). However, it is also important to note that impact investing is mainly used in the private equity sector. Institutional investors and asset managers have only made a very limited use of this strategy (estimated 1%), and their operating principles sometimes limit their ability to do so (African Investing For Impact Barometer, 2014; Giamporcaro and Viviers, 2014). For this reason, the present study, whilst acknowledging this trend, will not include private equity related impact investing numbers into its scope of RI.

#### **4.2.3 State of current practices**

The ‘melting-pot’ of influences, both local and global, shaping the understanding and implementation of RI in South Africa, has resulted in what Giamporcaro and Viviers have called a ‘glocalised’ concept (2014). They explain that: “definition, strategies, activities and investment products [...] are constantly evolving under the influence of local and external pressures and various stakeholders’ interests, as well as the positioning of the SRI institutional field” (2014:255). Whilst the convergence of local and global influences is to be expected, especially in an emerging economy, the specific and ever changing RI landscape in South Africa renders the scoping of RI – and, therefore, its measurement - extremely difficult. Blurring even further the lines of an already ‘radically confused’ concept (Gallie, 1955), this situation raises the question of legitimacy and accepted scope of RI in South Africa.

In this context, recent academic research findings regarding the size of the market and main practices are confusing and appear to contradict each other. Giamporcaro and Viviers have recently advanced that the RI market in South Africa is “indeed very marginal compared to mainstream investments” (2014:250),

confirming earlier findings by Eccles *et al.* (2007), Viviers, *et al.* (2009), Herringer *et al.* (2009) and Giamporcaro and Pretorius (2012). However, the African Investing For Impact Barometer reports that RI is becoming a “significant part of the South African investment industry” (African Investing For Impact Barometer, 2014:1). The African Investing For Impact Barometer estimates the percentage of money committed to RI by the asset management industry at ZAR 514 Billion (2014). According to the same report, 28 asset managers (AM) hold a combined 132 funds classified as RI or Shari’ah funds. Notwithstanding, the report offers a confusing image of the RI landscape. On one hand it states that out of the ZAR 514 Billion committed to RI, 86% of funds describe their strategy as ‘traditional investing’ and only 13% describe it as ‘responsible investing’ (the remaining 1% described it as ‘Impact investing’). On the other hand, the report advances that 98% of the RI asset manager’s funds (estimated at ZAR 514 Billion) are reported to invest according to RI principles (described as either Broad or Core RI) and 2% are Shari’ah compliant (African Investing For Impact Barometer, 2014:1). It is therefore unclear whether this report estimates the size of the market to be equal to ZAR 514 Billion (36% of the total AUM by AM surveyed) or only to 13% of this amount, and thus ZAR 66 Billion (just under 5% of the total AUM by AM). The later conclusion would appear more in line with earlier findings.

It is clear, however, that “it remains difficult to obtain information on the actual depth and breadth” of RI practices (African Investing For Impact Barometer, 2014:2). Whilst funds might declare to adopt an RI approach to their practices, only few provide details on the specific strategies and criteria employed (Viviers, 2014). Viviers, therefore, reports: “Although infrastructure development is the most frequently mentioned consideration, almost half of these funds do not specify the nature of the investment which they target” (2014:751). With regard to environmental criteria, most funds (67%) making mention of environmental concerns “merely evaluate companies based on ‘sound’ environmental practices” without providing details on the evaluation criteria (Viviers, 2014:750). Generally, the lack of standard definition and evaluation criteria has been recognised as a major impediment to the growth and measurement of RI (Herringer *et al.*, 2009).

Notwithstanding, another challenge holding back RI in South Africa has been identified as the shortage of skills with regard to ESG knowledge in the industry. Herringer *et al.* pointed out that: “insufficient and inadequate human capital and skills” were a major challenge for the development of RI (2009). The lack of skills affects asset managers in their ability to integrate ESG consideration in their investment analysis (Herringer *et al.*, 2009). In this context and to further provide for the limited availability of independent research and ESG data, 25% of RI funds just mimic the composition of the JSE SRI index. The lack of

knowledge also limits institutional investors' capacity to engage with RI strategies and review management mandates accordingly (Giamporcaro and Viviers, 2014). The situation seriously constrains the growth of RI, making the education of trustees a priority for the industry. As such, the Sustainable Returns for Pensions and Society initiative, a partnership between the Principal Officers Association (POA) and the International Finance Corporation (IFC), launched in 2013 a Responsible Investment and Ownership Guide for Pension Funds in South Africa. The guide offers a step-by-step plan to facilitate the implementation of RI strategies (POA, 2013). Such initiatives aim at filling the gap and creating a basis from which RI can expand (Giamporcaro and Viviers, 2014; POA, 2013).

Before concluding on this overview of the South African RI landscape, two other characteristics of the local market are worth noting. First, Viviers advances that no RI funds in South Africa have selected a 'best-in-sector' approach (2014). This is noteworthy as such a strategy, combining positive and negative screens, has been perceived as specifically well adapted to a developing economy (Baue, 2002 cited in Viviers, 2014:740) and having a potential to yield high returns within a limited investment universe (Statman and Glushkov, 2009 cited in Viviers 2014:750). This contrasts with the situation in Europe, where this strategy is widely adopted (EUROSIF, 2010). The second characteristic is the emergence of shareholder activism and engagement strategies (Giamporcaro and Viviers, 2014; African Investing For Impact Barometer, 2014). Although still in its infancy and dominated by informal negotiations, this approach is being used by a growing number of funds and asset managers (Viviers, 2014:749). The influence of CRISA and PRI – with their focus on disclosing proxy voting records - is expected to encourage the use of this strategy going forward (Viviers, 2014:750).

From the information above, it appears that academic studies provide an emerging but still incomplete picture of the RI trend in South Africa. The 'glocalised' RI concept is still searching for a common accepted definition, and its reach in the South African investment market appears both rudimentary and difficult to measure. In this context, the intention is that CRISA and its supporting regulatory framework will drive a more formalised and substantial approach to RI.

### **4.3 Assessing CRISA's agency**

Having contextualised the emergence of CRISA and provided some background on the RI industry, the second step of my analysis focused on evaluating CRISA's agency on the South African investment market by reviewing publicly disclosed information. The analysis aimed at quantifying and qualifying progress towards

RI by confronting the publicly disclosed information to the guidelines provided by the CRISA Disclosure Practice Note published in 2013.

The disclosed information is considered in terms of (1) compliance with CRISA's disclosure framework, and in terms of (2) quality and consistency with CRISA's objectives.

#### **4.3.1 Compliance with CRISA's disclosure framework**

The evaluation followed the provisions made in the three sections or 'elements' of CRISA's 'Framework for Disclosure'. Compliance was evaluated based on (1) the disclosure of policies and mandates (2) the disclosure of responsible ownership practices and (3) the comprehensive disclosure of the implementation of CRISA's five principles.

The analysis was carried out across all types and categories of institutions, as specified in **Error! Reference source not found.**, described in Research Methods: Quantitative data collection and analysis. The results presented provide an overview of current industry practices, revealing category differences and identifying where improvements have taken place over the three years considered.

##### **4.3.1.1 Disclosure of policies**

CRISA's Framework for disclosure recommends institutions to publish three policies (IoDSA, 2013a):

- A sustainability policy – explaining how sustainability considerations are incorporated into investment decision-making processes;
- An ownership policy – describing how ownership responsibilities are fulfilled (including proxy voting); and
- A conflict of interest policy – pertaining to how conflicts of interests are identified, prevented or managed.

The study revealed that in 2015, just under 50% of all entities surveyed publish some information with regard to the three recommended policies. This is considerable as it represents nearly 10% more than in 2013 – where 40% institutions published some elements of the recommended policies. However, as can be seen in Figure 15, this average number hides major differences between categories of institutions. As in 2013, the most compliant institutions are large financial institutions and asset managers. Pension funds perform poorly and asset consultants do not offer any form of disclosure.

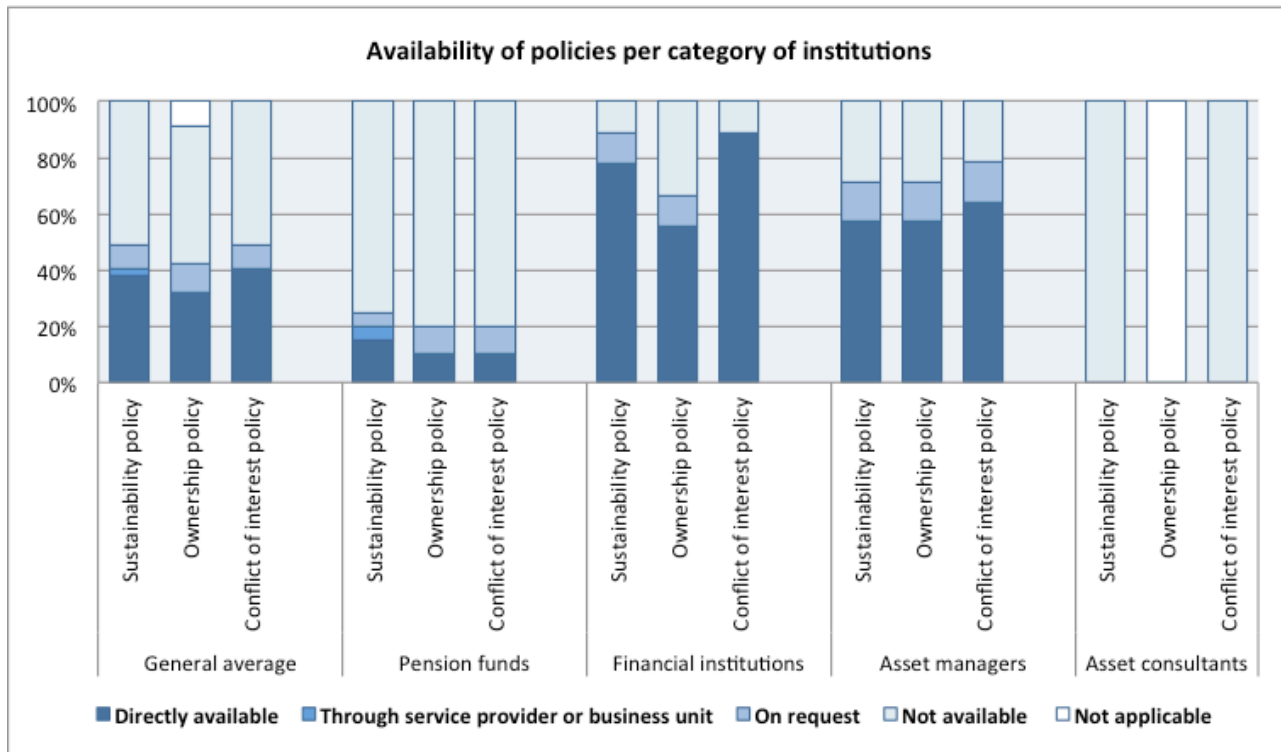
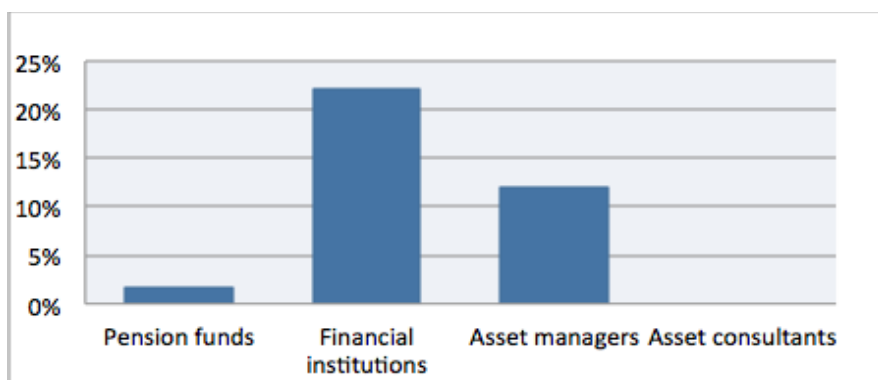


Figure 15: Availability of policies per category of institution in 2015

As showed in Figure 16, improvements in the last three years can be mainly attributed to large financial institutions (avg. 22% increase) and asset managers (avg. 12%. increase). These entities were already performing better than average in 2013 and have therefore continued to improve on their disclosure levels. Changes have not been significant in the pension fund sector (avg. 2%) and completely absent amongst asset consultants. This is concerning as these two sectors were already lagging behind other industry sectors in 2013. More significantly, pension funds, as asset owners mandated by Regulation 28 to explicitly consider an RI approach, bear final accountability for the application of CRISA and could therefore have been expected to lead the trend.



**Figure 16: 2013 -2015 Per category improvements in the disclosure of policies**

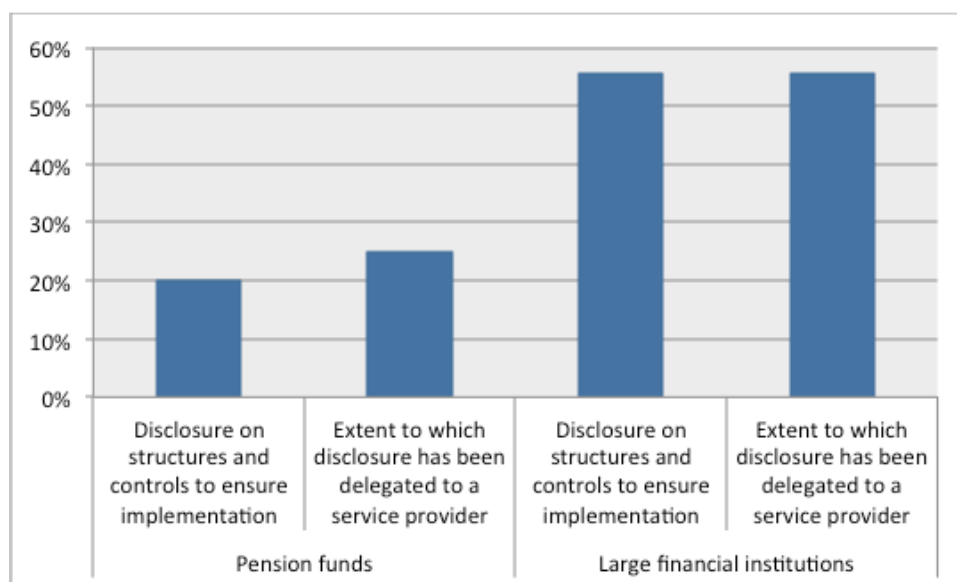
The framework further prescribes some minimum disclosure requirements with regard to investment mandates, when the investment activities and decisions of institutional investors are delegated to a service provider: “Policies should also provide stakeholders with information on the governance structures and controls that are in place to ensure effective implementation” (IoDSA, 2013a). More details are provided in Figure 17.

In this regard, the study revealed that an average of 35% of institutional investors provide some details on the mandates and operational controls in place to ensure the implementation of RI strategies by the service providers. This amounts to 56% of large financial institutions and just above 20% of pension funds, as described in Figure 18.

“Where investment activities and decisions are delegated to a service provider by mandate, the institutional investor is required to, at a minimum, disclose:

- The extent to which disclosure (or aspects thereof) has been delegated to a service provider;
- Details of its mandate to the service provider; and
- Details of the processes and procedures on how it selects and monitors application by its service provider(s) of CRISA in respect of those investment decisions and activities that have been delegated via the mandate”.

**Figure 17: Minimum disclosure requirements for institutional investors (IoDSA, 2013a)**

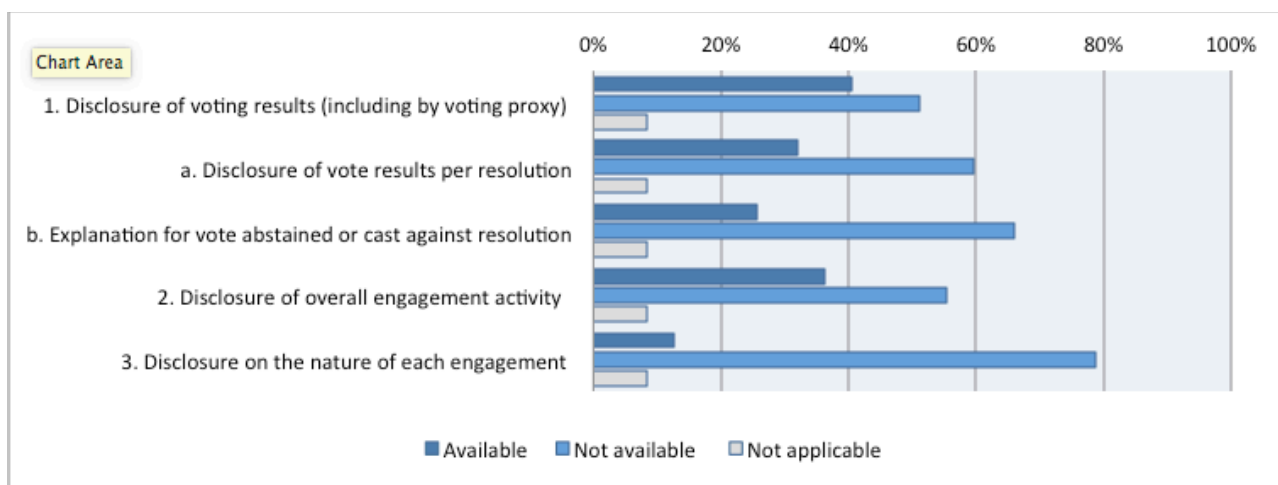


**Figure 18: Disclosures of mandates by pension funds and large financial institutions in 2015**

This finding highlights some noticeable improvements by the pension fund industry. In 2013, less than 10% of pension funds provided any details on their mandates to service providers. Whilst this percentage is still low for an industry that has fiduciary duties towards the ultimate beneficiaries, disclosures have nonetheless doubled, and the improvement is therefore not negligible. Furthermore, when considering assets under management (AUM) (versus the number of pension funds), the disclosure regarding mandates now covers close to 75% of funds managed by the pension fund industry. This increased from 65% in 2013. The reason behind this significant amount is that some of the largest funds in terms of AUM have adopted RI strategy and improved their disclosure compliance. A large number of smaller funds in terms of AUM appear to be struggling to comply with the disclosure requirements.

#### *4.3.1.2 Disclosure of responsible ownership practices*

With regard to Element 2 of the Disclosure Practice note, the percentage of entities disclosing proxy-voting results is rather encouraging. Point 1 of Figure 19 indicates that 40% of institutional investors and service providers disclose their voting results, the majority directly on their website and about 5% in the annual report. This is slightly better than in 2013 (4% on average). However, information is often limited to a summary, and only 25% to 30% of institutions provide per resolution details or explanations.



**Figure 19: Disclosure of proxy voting and engagement activity in 2015**

The general average further hides large discrepancies between different categories of institutions. As such in 2015, 26% of pension funds disclose their proxy voting results, up from 20% in 2013. With regard to large financial institutions and asset managers, these two categories have improved their disclosure levels by 11% and 14% respectively since 2013. As in 2013, asset managers provide the best levels of disclosure with 57% of entities disclosing their proxy voting results.

As pointed out by point 2. in Figure 19, about 30% of institutions disclose their overall engagement activities. This percentage is similar to 2013 results. Only large financial institutions and asset managers have slightly improved on this item. However, the disclosure on the nature of each engagement (point 3. in figure 20) has remained very low at 11%. No improvements have been recorded for the period.

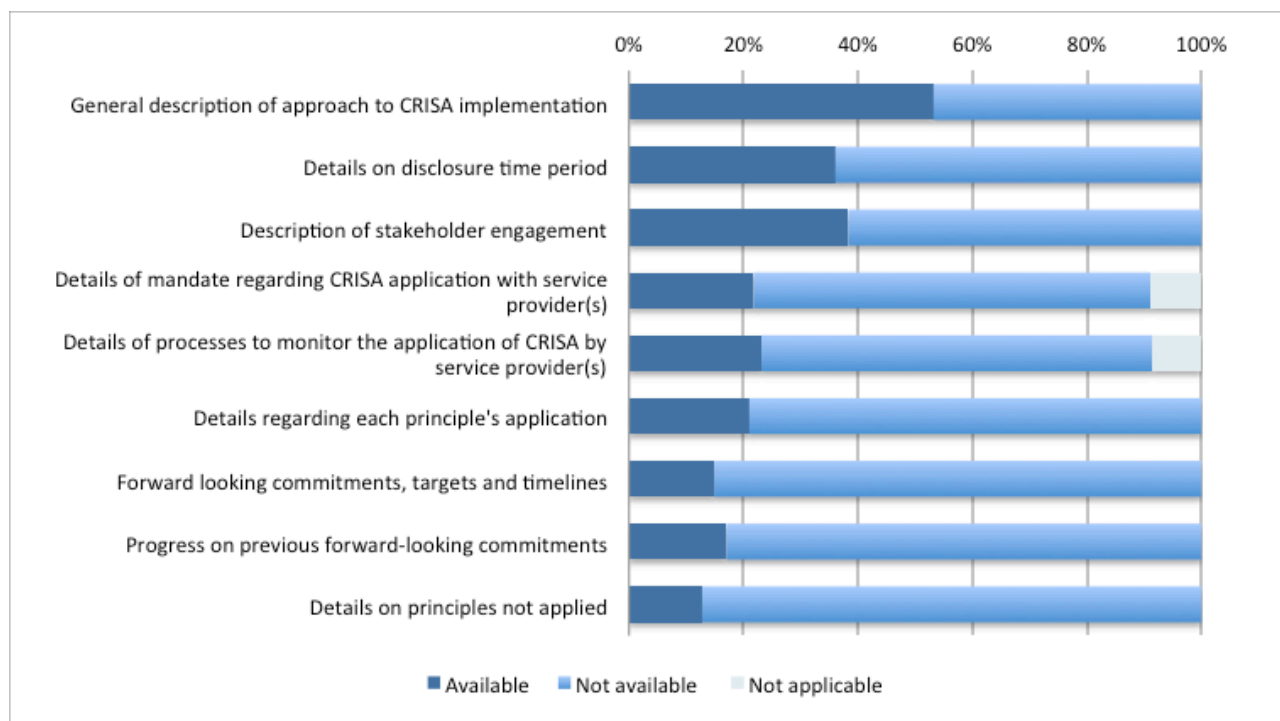
For the purpose of this research, the principle of active ownership was considered 'not applicable' to asset consultants.

#### 4.3.1.3 Comprehensive disclosure of CRISA implementation

An institutional investor or a service provider is required to "at least once a year, fully and publicly disclose to what extent it applies this Code" (IoDSA, 2011). This disclosure should be provided in the integrated annual report or in the responsible investment report of the institutional investor or its service providers (IoDSA, 2013a).



Whilst close to 50% of entities provide a general description of their approach to CRISA's implementation, a much smaller percentage provides details on mandates, commitments, progress or reasons for not applying certain principles. This is in line with 2013 findings. The only noticeable difference is a slight increase in the description of stakeholder engagement. The findings are summarised in Figure 20.



**Figure 20: Comprehensive disclosure of CRISA's implementation in 2015**

Large financial institutions and asset managers account for most of the disclosures. Only 30% of pension funds provide a general description of their approach to CRISA's implementation in their annual report and, on average less, than 10% provide details on the implementation of mandates, commitments, progress or reasons for not applying certain principles.

#### 4.3.1.4 Summary of the quantitative assessment

Overall, the quantitative assessment of CRISA's application between 2013 and 2015 revealed a growing level of compliance with CRISA's disclosure framework. However, whilst these findings are encouraging, the assessment also revealed varying practices and levels of accountability across types and categories of institutions. Large financial institutions and asset managers have made the most significant progress. Pension funds are still generally lagging behind the trend, making nonetheless some non-negligible

improvements to their disclosures (especially when AUM are considered). Asset consultants made no progress in their overall disclosure level during the considered period.

It is important to note that improvements to disclosures between 2013 and 2015 mostly came from the same entities. Organisations that already provided some level of disclosure in 2013 have broadened the scope of their disclosure in 2014 and 2015. In this context, some institutions are emerging as RI leaders. RI features as an integral part of their positioning and disclosures are easily accessible. However, there were very few 'newcomers' to the disclosure trend. More precisely, there were 20 entities providing some form of disclosure on CRISA in 2013, 1 additional entity in 2014 and 2 new entities in 2015. Encouragingly, the 3 newcomers were pension funds. Altogether, there are now 23 entities (48%) publicly acknowledging CRISA and providing some form of disclosure.

**Memo: 14 August 2015 4:20 pm**

*Leaders are reinforcing their lead. There is more consistency amongst leaders in the way their disclose information.*

*Amongst Institutional Investors (Asset Owners), the percentage disclosing information is probably not bigger (no new websites). However, most of them use Asset Managers as administrators. These generally provide good disclosure. The key is in the mandate and in the advisory role. Unfortunately information on control structures remain limited*

*Top leaders like GEPF could do more to show 'how to' disclose (ex: section of their website with all relevant information gathered and easily accessible). The information is there but one must search for it.*

*Reporting on company engagement is generally improving.*

*The information publicly available from Asset Consultants has not changed. Have they experienced more pressure from their clients? The industry? It is hard to tell. I will need to investigate during interviews.*

**Text Box 8: Personal memo 14 August 2015**

Finally, disclosures on monitoring and control structures in place to ensure adequate implementation of RI strategies remain limited, especially in the pension fund sector. It is important to remember that it is the mandate between the asset owner and the asset manager that determines the integration of RI in investment practice. Whilst asset managers generally provide the best disclosure levels, it remains unclear

how the high level of disclosure affects the governance and implementation of awarded mandates. Asset managers do not drive the process of RI integration; they can only position themselves with the relevant skills and capabilities. The determining factor is asset owners allocating capital to RI strategies. As asset managers do not disclose publicly whose assets they manage and which mandates they have been awarded, it is unclear how much of the AUM are managed according to RI. Should the mandate not specifically prescribe an RI strategy, funds are likely to be managed according to traditional investment objectives, irrespective of what the asset manager's website advertises.

#### **4.3.2 Quality of information and depth of RI integration**

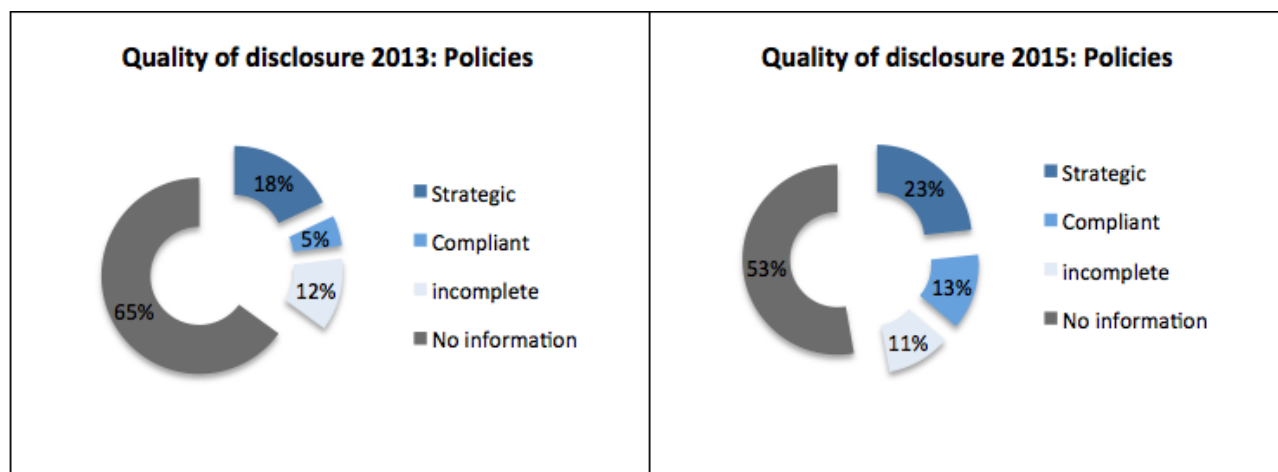
To gain insights on how RI approaches have been integrated into investment strategies, the quantitative evaluation was complemented by an analysis of the quality of the documents provided by disclosing entities. The following section highlights significant characteristics concerning the information disclosed, namely: (1) a great diversity in the disclosure quality, (2) the poor comparability of data, and (3) the general lack of transparency and a diversity of approaches.

##### *4.3.2.1 Diversity in the disclosure quality*

For the purpose of the research, disclosures were categorised and interpreted as either '*strategic*', '*compliant*', '*incomplete*' or not available. *Strategic* means that the information provided is seen as in line with the guidelines and expectations set by CRISA. The information offered communicates that an RI approach is integrated at a strategic operational level. Disclosures are comprehensive and broadly covered. *Compliant* reflects a 'tick-in-box' attitude where basic information is provided in a way that does not demonstrate a commitment to RI strategies. In this instance, the emphasis of the RI approach is on ensuring the 'financial sustainability' of the entity itself and no intention of changes to investment practices are indicated. *Incomplete* indicates cases for which only partial and extremely limited information was made available. In such instances, information indicated an acknowledgement of RI and was interpreted in the present research as the beginning of a process to consider its integration.

Overall, the quality of document provided varies greatly amongst entities disclosing information. To illustrate the diversity of disclosures, in 2015, 23% of information provided with regard to policy documents could be categorised as strategic, 13% as compliant, 11% as incomplete, whilst 53% of surveyed entities did not provide information. This means that out of the 47% of entities disclosing on their policies, about half seem to integrate RI at a strategic operational level, a little more than a quarter applied a 'minimum compliance' approach and the remaining quarter indicated an acknowledgement but no commitment to RI. The

distribution amongst the different categories of information is slightly different from the 2013 findings. The growth in policy disclosures is shared between strategic and compliant approaches. The level of incomplete information is stable. Figure 21 summarises the differences in quality of policy disclosure between 2013 and 2015.



**Figure 21: Quality of policy disclosures in 2013 and 2015**

This information places some shade on initial findings related to the availability of information. On average, only about half of information disclosed is considered qualitatively in line with CRISA's guidelines. Furthermore, the general average hides significant differences amongst categories. As such, asset managers generally provide the most comprehensive information, closely followed by large financial institutions. Pension funds lag far behind and information disclosed by asset consultants is either non-existent or incomplete. Relative category performances for 2015 are unchanged compared to 2013 findings.

The study revealed that disclosures generally lack depth. Shortcomings are specifically felt regarding monitoring and control structures in place to ensure the adequate implementation of RI strategies. Limitations also appear strongly when it comes to providing details on how each principle is applied or not, commitments taken and measurements in place. Less than 10% of entities made any public disclosure of their achievements, targets or failures to comply. The lack of transparency on methodologies, objectives and timeframes leads to a perception of limited RI integration and low levels of accountability, even by the best disclosing entities.

#### 4.3.2.2 *Poor comparability of data*

The assessment was rendered difficult by language, content and format inconsistencies. The situation is similar to what was observed in 2013.

Terms such as ‘responsible’, ‘ethical’ or ‘sustainable’ are used with various intentions and meaning. RI generally features amongst other ‘sustainability’ issues and is often confused with the direct ecological or social impact of organisations. As such, some investors position themselves as ‘responsible’ because they follow the Global Reporting Initiative (GRI) guidelines and disclose their direct carbon footprint or the paper and water consumption of their offices. Others mention funding a selection of community projects or allocating funds to a foundation as ‘investing responsibly’. Some indicate their inclusion in the JSE SRI index or their fight against corruption as a measure of their responsible approach to business and investment practices. Compliance with all legislation and fraud prevention is a theme running strongly across sustainability and responsible investment reports. Whilst valuable in their own rights, many of the practices included in disclosures are not directly comparable and many have little to do with RI.

##### ***Memo 11 August 2015 11am***

*Observations regarding RI disclosures made by large financial institutions in their Integrated Report:*

- *Definite trend towards GRI reporting and listing on JSE SRI index;*
- *Sustainability as monitoring of direct impact: green building, water and energy consumption;*
- *Indirect consequences of activities (through investments choices) are generally overlooked;*
- *Definite growth in use of term “Stakeholder” ... but narrow definition. Mostly limited to current customers, shareholders, suppliers, and employees;*
- *Increase in the establishment of ethics committees – but generally limited to preventing fraud and ensuring compliance;*
- *No mention of ‘E’ or ‘S’ in the ‘risk management’ section of annual reports; and*
- *General strong presentation of ‘governance’ management*
  - *Prevention of fraud*
  - *Compliance with all legislations*

##### **Text Box 9: Personal memo 11 August 2015**

There is no prescribed format for the reporting of information and relevant information is hard to locate, compare and interpret. As such, a sustainability policy can be anything from a two-page document to a short paragraph. Only two entities provided a quality document addressing ‘Element 3: Comprehensive disclosure

of CRISA implementation'. All other disclosing entities provided incomplete information amalgamated with other issues or achievements in their sustainability or integrated reports. Except for one pension fund, no other entity in this category provided details regarding their approach to RI. Whilst CRISA states that "the disclosures by the institutional investor, as asset owner, and its service provider should when read together cover the complete disclosure framework" (IoDSA, 2013a), it must be pointed out that finding the relevant information across the diversity of participants and medium is difficult and weakens any disclosure attempt. Information is hard to track down, especially as most entities do not provide a dedicated section on their website or in their sustainability report for RI or CRISA disclosures. The only exception concerns proxy-voting results, which are provided comprehensively either in the form of a summary or directly made available by date or per invested company.

As per the 2013 findings, 20% of surveyed institutions claim to be "CRISA signatories" or "CRISA compliant" whilst failing to provide any further disclosure. This highlights a poor understanding of processes and expectations. In such cases, CRISA is used instrumentally as a marketing or positioning tool, with neither not depth substance. The ambiguous use of language and related terms is confusing and misleading.

#### 4.3.2.3 *Lack of transparency and diversity of approaches*

The market is characterised by a general lack of transparency and consistency with regard to definitions, the use of discretionary standards and a diversity of undefined RI approaches.

Only two institutions were found to use CRISA's definitions of sustainability and RI. All other disclosing entities either did not provide a definition or developed their own version of the concepts. As such, several disclosing entities used the word 'sustainability' to mean the long-term financial performance and viability of their organisation. In this context, it was difficult to compare the RI investment universe used by entities. Despite CRISA's efforts to formalisation definition and concepts, little change has been observed in the market and the situation remains similar to what Herringer *et al.* detailed in 2009.

Furthermore, disclosed proxy-voting results indicated that the integration of ESG factors is most generally limited to Governance (G) related issues. There are only few reported resolutions or votes on social (S) factors and even less on environmental (E) factors. Only three entities were found to make a public reference to climate change either on their website or in their sustainability report. This is in line with earlier findings by Giamporcaro and Pretorius (2009) and more recent research by Viviers (2014).

The situation results in a diversity of unspecified approaches to RI and a blurred understanding of concepts. RI approaches overlap and merge with other concepts and activities, such as 'good corporate governance', Corporate Social Responsibility (CSR), B-BBEE funding, and Shari'ah investments. One can only assume – without a clear statement or any details - that the different concepts all form part of RI. Only three entities made clear that they apply an RI strategy across their investments and asset classes and gave a succinct indication of how this was done.

The context of poor rigour and black-box definition compromises the credibility of information provided by disclosing entity and makes any attempt to measure the impact of RI a random guess.

#### *4.3.2.4 Summary of initial findings*

The analysis of RI related disclosures revealed that CRISA's influence is inconsistent across institutions and generally lacks depth. While disclosure trends appear at first encouraging, they mask major differences between entities and hide issues with regard the quality, consistency, comparability and reliability of information disclosed. Approaches to RI are generally unclear and discretionary. The lack of standardised practices leaves too much room for interpretation and status quo. In this context, it is unclear how market forces are expected to drive accountability in the investment market and if CRISA, together with its supporting regulatory framework, are effectively driving a more formalised and substantial approach to RI.

To conclude on this section, the second step of the analysis process reveals that the 'comply or explain' approach that is being used, combined with a lack of enforced definitions and standards, appears to deliver results, which are erratic and difficult to measure.

## **4.4 Drivers and barriers to progress**

Having assessed CRISA's agency based on current public disclosure trends within the industry, the third step of my analysis aimed at positioning CRISA's agency amongst the main drivers and barriers of RI in South Africa.

To this effect, the assessment of publicly disclosed information as detailed in section 4.3 provided a baseline that was presented to industry professionals to discuss RI trends in the South African market and identify drivers and barriers to RI progress in South Africa. The feedback was gathered through semi-structured

interviews and expert reviews whilst additional information was generated from personal observations, as detailed in Chapter 2, section 2.3.2 and 2.3.3. The analysis of the data revealed the following themes representing drivers and barriers influencing progress toward RI in South Africa:

#### **4.4.1 Drivers**

Four main drivers towards RI were identified during the analysis and can be summarised as follows: (i) the essential role of leaders, (ii) the influence of the PRI, (iii) the importance of capacity building and collaborations, and (iv) the growing levels of disclosures.

##### *4.4.1.1 The role of leaders*

Respondents highlighted both the role of specific entities - which use their influence to mainstream RI and drive acceptance of CRISA - and the role of pioneering individuals inside organisations, who are putting RI on the agenda and driving organisational changes.

Across categories, some institutions are emerging as RI leaders. These entities are investing resources to understand how the sustainability challenge affects their business model and operational practices. Setting new standards and market expectations, these leaders are seen as changing the competitive landscape and demonstrate a real intention to develop new tools or generate new research to further the implementation of RI. Most of these organisations were instrumental in the development of CRISA and are now actively involved in promoting the acceptance of its principles.

One of the entities fulfilling this function is the Government Employee Pension Fund (GEPF). The largest pension fund in Africa with close to 1.6 trillion assets under management as of March 2014, the GEPF has been leading by example, implementing an integrated approach to active ownership and promoting RI practices across the industry. The first South African asset owner to be a PRI signatory and also a founding member of the CRISA Committee, the GEPF actively integrates ESG concerns into investment analysis as a way to manage and preserve the long term value of its investment, in line with its fiduciary obligations towards members and CRISA's guidelines. To achieve this, the GEPF has established an ESG Working Committee with its main asset manager, the Public Investment Corporation (PIC) to coordinate efforts: ensure alignment of voting positions, decide on engagement strategies and develop ESG assessment instruments. As such, a joint venture was established with Stellenbosch University's Centre for Corporate Governance in Africa to develop an ESG assessment matrix, which guides formal and informal engagement strategy.



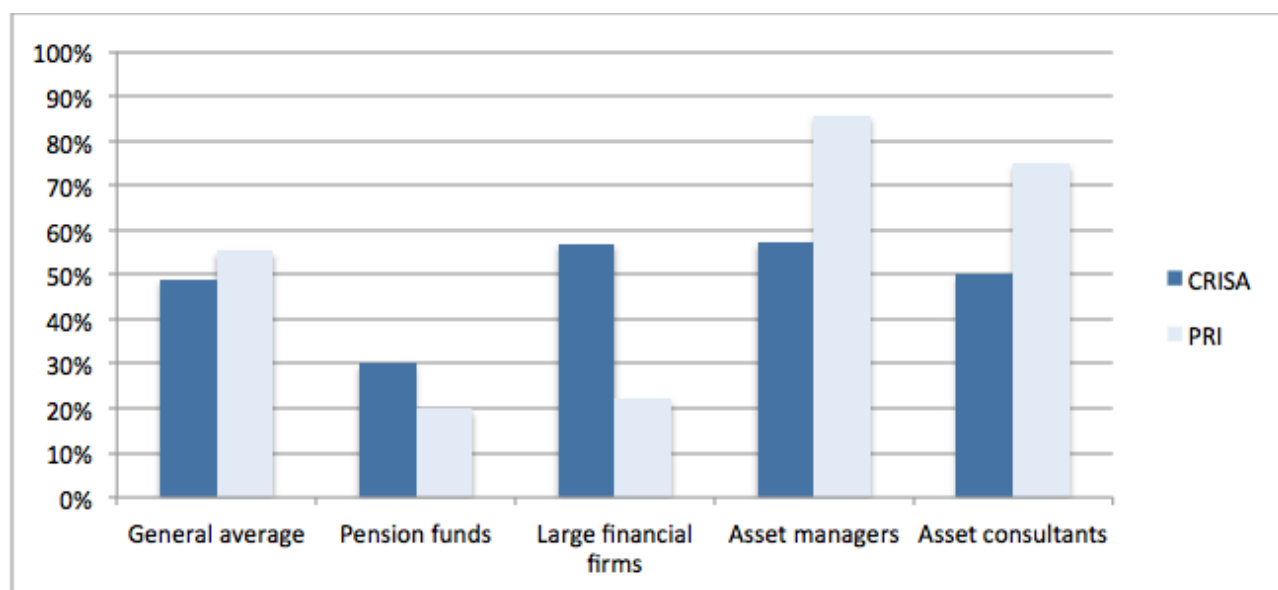
Beyond demonstrating how active ownership can be implemented by pensions funds, the GEPF has been a main participant in industry initiatives aiming at mainstreaming RI, raising awareness of ESG issues and providing guidance on the integration of RI strategies. A leading force behind the Sustainable Returns for Pension Funds initiative and the Emerging Market Disclosure Project, instrumental in bringing a PRI conference to South Africa in 2013, the GEPF actively participates in an array of other ESG-related initiatives or collaborations, such as the Carbon Disclosure Project, the Water Disclosure Project, the International Integrated Reporting Committee Pilot Programme or the Global Real Estate Sustainability Benchmark, to name a few. Demonstrating on-going efforts to improve its integration of RI strategies and the quality of its CRISA disclosures, the GEPF is acting as a guide to the industry; putting pressure on asset owners to follow its lead and encouraging asset managers to build capacity and ensure their readiness to support RI strategies.

This finding supports Sethi's argument, that leading organisations "play a critical role in (a) identifying the important SRI-based attributes on which data should be collected, and, (b) in bringing together individuals and groups, notably the academic community, to create measures by which such data should be collected in a manner that its quality and objectivity is assured" (2005:109). Driving demand for RI strategies, these leaders stimulate practice development and knowledge creation.

Respondents also highlighted the essential role of individuals, who within their organisation act as pioneers spearheading processes of change and championing the availability of disclosures. The language of sustainability is often foreign to financial practitioners and their immediate considerations. ESG advocates thus pioneer the cultural shift by asking key questions and encouraging a debate around sustainability issues. They call attention to the fact that ESG trends must be factored into new product development and challenge investment practices to consider RI strategies. The internal processes of building awareness and capacity are often slow and challenging. Jon Duncan, Old Mutual Investment Group's Head of Sustainable Research and Engagement, confirms that company-wide debates take time and cannot be dictated or fast tracked (IoDSA, 2013b). However, building consensus through discussions and progressive alignment appears as a critical step for organisations to come to terms with concepts and enable the future implementation of RI strategies. Individual RI leaders play a critical role in initiating and supporting the process of capacity building by feeding data at all levels of their organisation and creating strategic internal networks of influence.

#### 4.4.1.2 The influence of the PRI

The PRI's influence preceded CRISA's and to a large extent is shaping the expectations and practice of RI in South Africa. First, it is important to note that CRISA's design and terminology were significantly influenced by the PRI. Beyond this influence, there are currently in South Africa more PRI signatories than organisations recognising CRISA. If 47% of institutions follow, to some extent, the CRISA disclosure framework, on average 57% of surveyed institutions are signatories to the PRI. This is illustrated in Figure 22. The percentage is boosted by the high number of asset managers and asset consultants that have signed the PRI. As such, from the list of surveyed institutions, 86% of asset managers are signatories to the PRI, and 100% of asset consultants are PRI signatories. However, only 20% of surveyed asset owners (pension funds or large financial institutions) are signatory to the PRI. At the time of writing, only 4 pension funds and 2 large financial institutions are signatory as asset owners. All other signatories have signed as service providers.



**Figure 22: Percentage of CRISA and PRI signatories in 2015**

Whilst many service providers became signatories to the PRI to qualify for certain mandates rather than as a result of a commitment to sustainability, respondents indicated that the PRI often represented a first critical step towards further thinking and integration of ESG factors into investment analysis. For RI leaders inside organisations, the formal and public process represented by the signature of the PRI principles preceded open discussions regarding RI and disclosure requirements. The self-regulated nature of the disclosures recommendations and the absence of sanctions converged to make it relatively easy to engage in the process. This is in line with previous local and international research findings, which have advanced that the

“non-prescriptive nature” of the PRI has been instrumental in its success (Richardson, 2009a; Herringer et al., 2009:17). It is important to note that signatories to the PRI do not need to have an RI product offering. Research by Giamporcaro and Viviers (2014) indicated that in 2012, only 24 out of the 30 asset managers that are signatories to the PRI offered any RI products. In most cases, CRISA disclosures took place as a second step, to comply with local regulatory guidelines. Large financial institutions are no exception to this trend, as most of them signed the PRI as asset managers and are now evaluating how the principles apply to them as asset owners.

Respondents further indicated that the PRI’s business-case approach is central to their understanding of RI and implementation CRISA. The notion of ‘risk-adjusted performances’ is in-line with broader investment return objectives and, unlike ethical considerations, fits with the language of the industry. “Accommodating rather than radically challenging the financial sector” (Richardson, 2009b:616), the PRI is establishing itself locally as a benchmark for the RI sector. The ring fencing of ESG consideration to financially material issues and the flexible implementation requirements extends into their CRISA disclosure practice.

Finally, it was mentioned that the high numbers of asset managers that are signatories to the PRI create a pool of demand for ESG research. Over the last few years, this has boosted the supply and availability of both local and international ESG themed research. Whilst still lagging behind requirements, such research puts RI into context and increases – even if moderately – the time horizon considered by analysts and fund managers. By shifting the type of data that must be taken into account, ESG research encourages organisations to add new skills to their operations and hire a new generation of professionals that are familiar with both financial and ESG terminology. Whilst the process is slow and operates largely within an unchanged analytical framework, most respondents felt that this could act as a foundation to the normalisation of ESG consideration in investment processes and thus to the mainstreaming of RI practices.

#### *4.4.1.3 Collaborating for capacity building*

The interviews identified that access to information and building internal capacity were essential starting points to facilitate the uptake of RI practices and encourage transparency through disclosures. Industry players need to access, develop and integrate new knowledge regarding ESG factors before they can understand how these affect their products and/or investment activities. Organisations must work on internal readiness before they can fully engage towards RI and deepen their disclosures.

In this context, respondents were not surprised to see improvements in CRISA disclosures coming mainly from organisations broadening their scope of disclosure between 2013 and 2015 as opposed to newcomers. As organisations progressively build capacity, they adapt their organisational structures, skills, knowledge and expectations to meet the RI challenge. Senior management develops awareness of the issues. They are more supportive and more perceptive of how practices and behaviours need to evolve. In one particular case, the ESG team had grown in three years from one person to a team of four, including a very senior and experienced sustainability executive. The team was publishing a quarterly internal newsletter, thus contributing to a deeper reach into the business. Such organisations are entering a new phase of engagement with RI, whereby they can call on external expertise to build new knowledge and instruments to implement RI approaches more broadly. These organisations are ready to engage deeper into the disclosure requirements of CRISA because they have a better understanding of RI and sustainability issues.

With similar objectives as the joint venture set up between the GEPF, PIC and Stellenbosch University's Centre for Corporate Governance in Africa, other organisations are now collaborating with academic structures such as the University of Cape Town Graduate School of Business (UCT GSB) or the Cambridge Institute for Sustainability in the UK. By doing so, these organisations are ensuring a systemic integration of ESG concerns into their long-term strategies, thereby improving their assessment capabilities of ESG factors and enabling the emergence of products and ideas that capture or address sustainability trends. In this context, one respondent indicated that his organisation was now following a "Required by Science" transition process, whilst modelling and benchmarking progress.

Whilst this phenomenon is encouraging and indicates a deeper engagement with RI, it also sheds light on two parallel processes taking place in the investment market. On one side, a core group of leaders are gradually moving ahead, contributing to a change in expectations and using their power to push the RI agenda according to their understanding of the concept. On the other, the majority of entities remain anchored in their established practices and act to water down changes taking place in the industry. As few entities will move alone, the game of influence at play risks slowing down transformational changes until the majority of the industry is ready (or forced) to engage with RI practices. This specifically risks affecting the potential for collaboration amongst entities.

#### *4.4.1.4 Disclosures of RI practices*

The growing visibility of RI terminology and disclosures across the various reporting mediums of companies is also driving progress. RI is becoming integral to the investment landscape. Even when the information

disclosed is incomplete or misleading, the widespread use of the terms positions RI as a relevant approach to investment practices. The competitive pressure to conform leads to progress – if not in substance – in the number of new entities making RI statement and hopefully initiating the process of capacity building. The asset management industry is a testimony to this phenomenon and the high number of entities that are now disclosing according to PRI or CRISA is a direct result of the market pressure.

The next step is for disclosure on RI to form part of the standard due diligence processes used by asset owners to select asset consultants and asset managers. RI disclosures and practices can then guide the relationships between institutional investors and their service providers. If today, most asset owners do not yet formally monitor the reporting of policies, voting and engagement practices, the progressive increase in institutional investors' awareness of Regulation 28 and its implications is likely to accelerate the disclosure trend and constrain service providers to substantiate their approach to RI. In this context, industry-led initiatives such as the development of the 'Responsible Investment and Ownership Guide for Asset Owner' by the Sustainable Returns Project are seen as vital to promote change.

Within the set of drivers, respondents felt that CRISA's main influence was on disclosure level. Its agency to inspire leaders or on capacity building is perceived as limited and weaker than the PRI.

#### **4.4.2 Barriers**

Whilst the emerging trends driving acceptance and integration of RI are encouraging, improvements are constrained by several factors. The analysis identified five factors, which affect negatively progress towards RI and limit CRISA's agency. These included (i) the lack of definitions and standards, (ii) the limited institutional incentives to engage in RI (iii) the uncommitted role of service providers, (iv) the short-term bias of the industry and a disconnection from sustainability challenges, and (v) a fear of commitment.

##### *4.4.2.1 Lack of definitions and standards*

The general lack of standards and clear criteria defining what forms part of RI reinforces the feeling of a 'melting-pot' concept (Giamporcaro and Viviers, 2014) used more as a marketing tool than an instrument for sustainability. The "vague, boilerplate statements" do not clarify methodologies behind RI practices nor do they provide any insights into the quality of implementation (Richardson, 2011:628). What forms part of RI and what is excluded is left at the discretion of each financial institution, and the final beneficiary is left guessing. Furthermore, in most cases, the concept of RI appears unrelated to the concept of sustainability,

as defined by the latest King III report or CRISA. A small minority of entities demonstrate a real engagement and a true reflection with regard to the challenge of long-term sustainability.

As it was clear during the second phase of the research and the analysis of public disclosures, the lack of firm definitions and standards drives an appearance of progress towards RI. Moreover, such progress is substantially very questionable. Each entity is free to claim unverifiable achievements, and use RI instrumentally without any constraints in terms of accountability.

As previously pointed out, academics tend to assume that B-BBEE and Shari'ah funds form part of RI in South Africa. However, there is no audit regarding how these funds fit within or are compatible with other sustainability objectives. Certain B-BBEE projects – giving priority to job creation – could be highly controversial from an environmental perspective. Yet, they might be positioned or counted as RI funds. Giamporcaro and Viviers have mentioned the debate around shale gas fracking in the Karoo as an example of the ambivalence of RI in South Africa and its consequences (2014). There are no minimum requirements defining what is acceptable or not within an RI context. As such, ESG factors appear evaluated separately from one another and not integrated in a 'nested' understanding of economic sustainability. Focusing on either of these factors seems to be 'good enough' to qualify as an RI fund or an RI strategy. As such, a high carbon and water intensive initiative could nevertheless be considered 'responsible' because it focuses on infrastructure development. Furthermore, respondents reported that generally governance considerations are well factored into investment process in South Africa. However, environmental and social factors remain under-integrated in analysis.

Whilst research has pointed out that the lack of normative standards and sustainability indicators should come as no surprise in the formative stages of a new concept (Sethi, 2005), this context of customised interpretation leaves existing investment practices and behavioural norms unchallenged. Investment decisions remain driven by conventional performance expectations (Crotty, 2013). RI and related definitions are designed to fit the requirements of a 'business-as-usual' framework, and ESG integration is a mere way of improving financial competitiveness and meeting rising return expectations. In this context, effective change in investment practices appears marginal and any assessment is, by nature, subjective. Definitions, practices and objectives are not comparable, and the potential for change is limited by the absence of accountability.

It must be noted that the general lack of comprehensive and standardised methods for reporting ESG factors further hinders progress towards a more formalised approach to RI, by limiting the availability of quality data. As pointed by Steyn, although sustainability reporting has improved over the last decade, especially with the Global Reporting Initiative (GRI), information provided by listed and unlisted companies remains at large uneven, fragmented and difficult to verify (2014). Whilst the quality of data related to governance is reported to be of quality, respondents were generally very negative about the quality of environmental (E) and social (S) data. This situation limits the systematic and consistent integration of E and S data in investment frameworks and limits the potential for dedicated ESG themed funds. One respondent indicated that, in the South African context, focusing on G provided the most reliable 'entry point' for the creation of RI funds. As an anecdote, 'E' or 'S' were not mentioned in the 'risk management' section of any of the annual reports surveyed.

#### 4.4.2.2 *Limited institutional incentives to engage in RI*

For many respondents, the effective uptake of RI practices was limited by the relatively small genuine demand from asset owners, and specifically from pension funds (except the GEPF).

Asset owners create the institutional and commercial incentive that drives the change in the investment industry. Initiatives like CRISA or the PRI have been designed for and apply in the first instance to institutional investors, whilst Regulation 28 applies only to pension funds. However, asset owners have been much slower to integrate, monitor and disclose on responsible investing practices than anticipated – thus putting limited pressure on the investment chain to modify investment practices.

In this regard, respondents pointed out that the South African legal framework surrounding RI, which rests on the amendment to Regulation 28, provides only a limited institutional incentive for asset owners to engage in RI. Whilst clarifying that ESG integration is compatible with fiduciary duty, the South African legal framework (only applicable to pension funds) remains tentative and inscribed in conventional investment practices. Regulation 28 supplies only a vague reference to RI and sustainability, and falls short of aligning industry practices with a clear societal goal. It "supports the adoption of a responsible investment approach" but falls short of defining it. Similarly, it refers to "the sustainable long-term performance of a fund's assets" without referring to sustainability. Leaving open the door for selective interpretation, the revised prudential guidelines for the retirement fund industry promote a restricted RI concept and a compliant/legal attitude. Entrenched in modern portfolio theory language and conventional asset allocation criteria, Regulation 28 frames RI as a means to "earn adequate risk adjusted returns" (National Treasury, 2011). As such, pension

funds and their service providers need to demonstrate that they consider – to the extent that they judge valuable - the materiality of ESG factors with respect to financial performance. The amended Regulation 28 is silent regarding the integration of issues that are not directly correlated to financial performance and makes no reference to social or environmental returns.

In this context, the South African regulatory environment – whilst leading in many respects - does not provide a baseline, from which asset owners (and by extension, service providers) can reassess their assumptions, intentions and practices in line with a revised societal goal. Established in continuity of existing practices, Regulation 28 only broadens some considerations to improve the industry's risk management without trying to challenge the industry's operational framework. The additional voluntary framework's guidelines, aspirational, subject to further interpretation and without any reference to a prescribed timeframe, can only have a very progressive impact on the transformation of investment practices. Many smaller funds appear still unaware of the implications of the change to regulation 28.

As identified by previous research (Viviers, 2014), this situation is rendered even more difficult by the general lack of interest, awareness and education of pension fund trustees and members around RI strategies. As advanced by certain respondents, many pension funds have limited resources available for research or education and their trustees struggle to integrate RI requirements and communicate adequately with members around ESG issues. Members - who for the most part have a passive attitude towards investment strategies - are mostly unaware of issues related to sustainability and suspicious of the RI concept. This confirms earlier findings by Viviers, Kruger and Venter (2012) and Reddy (2011).

#### *4.4.2.3 The uncommitted role of service providers*

Many of the listed requirements in CRISA or the PRI are not directly applicable to service providers (asset managers and asset consultants), hence putting little pressure on these market players to effectively change investment practices. Disclosure requirements have been designed to address the practices of asset owners and apply only by extension to service providers, to guide them in their effort to build capacity and ensure readiness to implement the RI strategies of asset owners.

Respondents have pointed out that asset managers are only accountable in so far as determined by their mandate signed with the asset owners and therefore tend to adapt to the market's demand. Until clearly mandated to consider RI, asset managers are likely to leave their practices unchanged. Unfortunately, the interviews indicated that ESG mandates were not common. Asset managers' commitment to RI were often



limited to the use of an ‘integration approach’: ESG factors are integrated into traditional investment strategies. In this strategy, ESG factors are used discretionarily for both stock picking and selling in order to “take advantage of the market through under-analysed themes” (EUROSIF, 2005:28). The objective remains to deliver alpha return. Engagement strategies were used mainly to address governance issues proactively.

In the case of asset consultants, the applicability of CRISA or the PRI appears even more limited. These institutions fall outside most current disclosure requirements and generally only provide – if at all - a brief description of their approach to RI. Whilst this group of financial actors plays a key role in advising institutional investors, no details are available with regard to how RI is integrated into the advice, the research or any other services they provide to asset owners. There is no transparency regarding due-diligence questionnaires used for the selection for asset managers. No information is provided regarding the on-going management and monitoring of asset managers on behalf of asset owners. Whilst asset consultants are in a strategic position accelerate change, to guide institutional investors and put pressure on asset managers to build capacity towards RI, there is no evidence demonstrating any commitment to do so.

For several respondents, the concern was heightened by the fact that the line was increasingly blurred between the responsibility of asset owners and asset managers, asset managers and asset consultants, as they perform work that is conventionally assigned to the other. The respondents pointed out that service providers – and especially asset consultants - exert an increasingly high level of influence on the allocation and ownership of funds. In this context, the chain of accountability has become unclear and it is difficult to identify who is ultimately responsible to final beneficiaries and society at large.

Uncompelled to change by asset owners and driven by conventional performance expectations, service providers are perpetuating traditional investment practices.

#### *4.4.2.4 Short term bias and disconnection from sustainability challenges*

Effective progress towards RI is further slowed down by the conflict between short-term imperatives and long-term objectives.

While RI benefits are experienced mostly over the long term, the market is still characterised by a focus on quarterly performances. Relayed by the media and monitored by consultants, the focus on short-term performances drives return expectations of asset owners, pension fund trustees and final beneficiaries alike.

The focus of the industry remains to deliver 'outperforming' financial results compared to the sectors' benchmarks.

Confirming findings by Viviers (2013), respondents feared that reducing the investment universe could reduce portfolio diversification and lead to lower financial returns. Most felt that the number of securities available in South Africa was too small to allow for well-performing positive or negative screening strategies. In this context, and except if specifically mandated, the most preferred strategy with regard to RI was the use of an integrated approach. Within this framework, ESG issues were factored into analysis as temporary impediments. They were not taken account into the discounted cash flow analysis or the calculation of the net-present value of a company, but rather used to identify short-term opportunities or risks. The merit of considering the long-term effect of ESG factors was viewed as debatable and deemed generally unreliable by certain interviewees. The idea of integrating ESG issues into the calculation of the long-term value of companies was perceived as distorting the analysis. A particular example of ESG integration given to me by one of the respondent is symptomatic of this interpretation of ESG integration: *"Lonmin is a great example of the value of ESG integration into investment analysis. We believe that following the social unrest that took place, the Lonmin stock has been oversold. Taking into account ESG is enabling us to identify this stock as a buying opportunity"*.

This finding is significant, as it indicates that in many instances RI and ESG analysis are not used to judge the behaviour of corporates and put pressure on these entities to act responsibly. ESG integration is used as a tool to maximise short-term opportunities or reduce near term risks. This approach to RI defeats its main benefit, which is to lengthen the time horizon considered by the investment community and promote long-term investment strategies in line with sustainability. In this context, RI serves existing short-term practices and is unconcerned by the promotion of responsible corporate behaviour. This application of RI, whilst on the rise and accepted by the industry as genuine, appears disconnected from the intentions set out in CRISA and the King III report.

It generally appears that RI is not integrated in an overall reflection around sustainability challenges, the need to modify economic development trends and the urgency to act on climate change. Whilst timeframes and clear commitments to sustainability are generally avoided in publicly disclosed information, discussions with respondents further indicated that – apart from a few exceptions - company wide debate on sustainability and the role of the financial industry were not taking place. When confronted with the latest IPCC information regarding the need to transition to a low carbon economy within the next 5 to 15 years

(2014), most respondents were uncomfortable and indicated that RI was not used in this context. In these circumstances, it is unclear how CRISA acts to fulfil its purpose and support the application of King III principles around sustainability; that is, to ensure that corporates consider the triple context in which they operate and operate “in a manner that meets existing needs without compromising the ability of future generations to meet their needs” (IoDSA, 2009; Steyn, 2014).

#### 4.4.2.5 *Fear of commitment and absence of urgency*

The feedback gathered during expert reviews and the presentation of recommendations clearly indicated uneasiness towards firm commitments.

The discussions indicated that there were no dedicated resources and limited funds available within the industry to facilitate the uptake of RI practices. Whilst CRISA could have been a pole of influence, the organisation had very limited budget and there was no dedicated personnel to drive the process. The organisation depended on voluntary contributions from the industry, which did not provide for the organisation of events, regular research, tailored training programmes, newsletters or the creation of a dedicated website. During reviews and the presentation of recommendations, many ideas were debated; these include: publishing a financial industry index to rate RI policies, practices and disclosures; releasing a bi-annual newsletter to increase visibility, media coverage and public acknowledgment of good practices, innovative products or leading figures; or identifying leaders in each category of institutions in a ‘Name and Fame’ event to highlight exemplars and encourage improvements. All of these possibilities were put to rest because of the lack of funds and the absence of dedicated resources.

The representatives of the industry showed reluctance in coordinating learning effort and collaborating towards industry wide capacity building. There was limited interest in expanding the work done by the Sustainable Returns for Pension Funds and Society initiative with the “Guide for Pension funds in South Africa” and to create an online resource centre accessible to all industry players; where all initiatives, guides, templates and other relevant information would be available to the South Africa investment industry. There was, further, quite a strong opposition to the idea of facilitating a common platform for the understanding and integration of ESG knowledge. The idea of creating an online resource centre to share information and facilitate individual and collective engagement on critical issues was strongly resisted. The discussions made clear that ESG related information was proprietary information, and its integration was considered a ‘competitive advantage’. Thus, sharing information went against general market pressure and competitive mechanisms.

The need to improve reporting and definition standards was not considered urgent and could not take place before industry readiness. Participants acknowledged that there would be value in building from the PRI experience in terms of reporting and in clarifying key terminology used in CRISA. They recognised that there was some confusion in the industry between CRISA and the PRI, with many institutions declaring to be ‘CRISA signatories’. An alignment with the PRI process would create more consistency, reduce confusion and could facilitate the tracking of progress. Participants further confirmed that clear definitions and consistent reporting formats were important to facilitate meaningful communication and offer opportunities to build clarity and consensus around the objectives and purpose of RI and CRISA. Discussions indicated a consensus around the need to structure and channel the information provided by disclosing entities. However, these concerns were considered ‘long-term’. Most participants felt that reporting and definition issues could only be addressed at a later stage, with a greater maturity of the South African RI industry.

Finally, it is important to note that there was great uneasiness when any references were made to timelines and goals in terms of RI adoption by the industry. Whilst all participants were individual RI leaders within their own organisation, they unanimously indicated that creating a competitive pressure to adopt RI at a greater pace was unrealistic in the context of current market practices and expectations.

#### **4.5 Chapter summary and conclusion**

The aim of this chapter was to seek an answer to my second research question “What is CRISA’s agency on the dynamics influencing RI in South Africa”? To answer this research question, I structured my analysis as a three-step process: the first step analysed the literature with regard to CRISA and the evolution of RI in South Africa. The second step assessed CRISA’s agency based on publicly disclosed information from a representative industry sample of 47 entities. In the third step, I used the research findings to position CRISA’s agency amongst the main drivers and barriers of RI in South Africa.

The literature pointed out that RI is still in its infancy in South Africa. The concept is searching for meaning, influenced by historical factors and difficult to scope (Herringer et al, 2012; Giamporcaro and Viviers, 2014). The publication of CRISA’s voluntary guidelines by the industry intended to drive a more formalised and substantial approach to RI (IoDSA, 2013a). CRISA aimed at complementing and supporting the emerging regulatory framework in place, thereby guiding institutional investors and their service providers in the application of the amended Regulation28 (IoDSA, 2013a).

However, the assessment of publicly disclosed information over three years revealed that, whilst putting RI on the agenda, CRISA's agency is inconsistent and difficult to qualify, thus leading to only slow progress. Following the initial uptake, there are now few 'newcomers' to the process of disclosure. Improvements mostly come from entities that were already disclosing in 2013 and have improved on the information provided. When positioned within the range of drivers and barriers to RI in South Africa, CRISA's influence appears to have yielded little effective change in terms of behaviour and practices.

The dialogic and flexible 'comply or explain' approach, whilst driving an appearance of success, seems to conceal the urgency and the imperative nature of sustainability issues. With limited budget, resources and influential power, CRISA's agency is unable to drive clear commitments towards RI in South Africa. As a result, the current institutional strategy is failing to challenge the underlying logic guiding investment practices, leaving the industry largely unchanged.

## 5 Chapter Five: Implications, Conclusion and Recommendations

In the preceding two chapters, I sought to answer two different questions:

1. What are the underlying dynamics influencing progress towards RI?
2. What is CRISA's agency on the dynamics influencing RI in South Africa?

In this final chapter, I confront the theoretical propositions generated in chapter three with the empirical findings outlined in chapter four to formulate an explanation of CRISA's agency within the dynamics influencing progress towards RI in South Africa. I then conclude and make recommendations with regard to possible points of intervention to accelerate change within the industry.

### 5.1 Practical implications of theoretical propositions

In chapter three, I developed seven theoretical propositions, which suggested that the current implementation of RI would be unable to shift investment practices in time to support a sustainable economy. The conceptual model pointed out that the dynamics of change were too slow relative to the time horizon to generate meaningful transformation. Furthermore, the institutional strategies used limited the scope of change possible by constraining RI to an instrumental approach.

I will now discuss the relevance of each theoretical proposition in the context of the South African investment industry and consider the practical implications.

**Proposition 1:** *The mechanisms and expectations of the market impede learning and slow down capacity building.*

In chapter three, I identified that the efforts taking place to move the investment community towards RI practices were happening at a relatively slow pace. The feedback structure embedded in the system dynamics constrains and slows down the learning processes of various role players. The mechanisms and expectations of the market focus the industry's efforts on delivering short-term returns. There were, further, no influential feedbacks to support learning and speed up capacity building.

I found that the empirical data outlined in chapter four clearly supported this proposition. The South African investment industry's expectations, in terms of profit levels and quarterly returns, remain largely unchanged. The intentions guiding behaviours are dominated by the need to meet market expectations, and sustainability is not a core concern. Only governance issues sometimes influence investment considerations. Regulation 28 and CRISA have been designed in continuity with current practices and work within the industry's operational framework.

The findings suggest that ESG integration in South Africa is not a part of a learning cycle integrated in a broader reassessment of industry practices. From a supply side, analysts integrate ESG data as a means to maximise profit opportunities and deliver alpha returns. The objective of delivering excess return relative to market benchmarks constrains the scope of change and learning opportunities. In the present context, learning and capacity building depends largely on the progressive influence of individual leaders within organisations. On the demand side, the conventional performance expectations of asset owners perpetuate the status quo. The general lack of awareness and education among pension fund trustees regarding RI and the mostly passive attitude of members with regard to investment strategies further limit the pressure towards meaningful change in the industry.

***Proposition 2:*** *The agency of RI is affected negatively by its current interpretation and implementation.*

The conceptual model showed that RI in its current interpretation and implementation was no match to counteract the effects of the dominant and highly effective goal-seeking system design. The equilibrium is self-reinforcing, hence leading to the inertia and rigidity of the system structure (Richardson and Pugh, 1989; Sterman, 2000). I identified that whilst RI could have some positive impact over time, its current implementation was unlikely to generate the meaningful changes in the 10 to 15 years timeframe prescribed by international climate and sustainability experts (IPCC, 2014).

The analysis of empirical data revealed that the 'business case' approach, applied to a 'melting-pot' concept (Giamporcaro and Viviers, 2014) and used discretionarily by the industry was highly unfavourable to effective progress and meaningful change in South Africa. The focus on financial materiality in the consideration of ESG leaves industry practices unchallenged. Strategies used, such as 'integration', merge seamlessly into the current operating framework and contribute to the short-term focus of the industry. More importantly, the current interpretation of RI in South Africa is leading to a lack of professionalism in the implementation of the concept, which profoundly affects the credibility of statements put forward by

financial institutions – even leaders. The discretionary interpretations, the diversity in the quality of information provided, the poor comparability of data and the lack of transparency blur the concept to the extent of disconnecting it from its *raison d'être*. In this context, attempts to measure effective progress are largely subjective and efforts to scope the industry are unreliable.

The evaluation of PRI transparency reports published annually by South African signatory entities shows that there are often no supporting documents available and many hyperlinks are broken or incorrect. Statements are made, which cannot be substantiated because no definition is provided and no information can easily be verified. Therefore, the business case approach combined with the language and definition inconsistencies and the lack of reporting format converged to sanction an instrumental use of RI for the purpose of marketing or short-term profit seeking.

***Proposition 3:*** *The overall system behaviour currently prevents meaningful change to take place in the required timeframe.*

The conceptual framework revealed that actual progress towards RI followed what systems dynamics refers to as a 'goal seeking' curve, rather than the desired 'exponential curve'. This means that the growth of RI is likely to gradually slow down and level off to reach an equilibrium level. The equilibrium is predicted to be different from the stated goal, defined as RI supporting a sustainable economy.

The empirical findings regarding the uptake of RI by the South African investment industry are very representative of this proposition. After the initial period of interest in RI, a clear decrease in disclosure trends can be observed, with only few new entities making reference to RI. It is mainly the existing RI leaders who are confirming their lead, thus expanding on their knowledge and publicly disclosed information. Even within this market segment, interviews revealed that the overall approach towards RI was constrained by several factors. This includes the lack of industry readiness, the poor reliability of E and S data, the limited internal awareness regarding sustainability issues, and the need to fit within short-term performance expectations.

When asked whether the current progress towards RI would be sufficient to allow a transition to a carbon neutral economy within 10 to 15 years, all respondents indicated that this would be highly unlikely. Respondents pointed out that core sustainability issues such as climate change were generally not yet integrated into RI. The current focus is mainly on governance issues, justified by the lack of quality E and S



data. The further lack of urgency with regard to clarifying definitions and reporting format contributes to the maintenance of the status quo and the temporal disconnection between the practice of RI and its purpose.

There would be value in testing this proposition with further research, especially using SD to map the specific South African context and identify the local feedback mechanisms and their temporal consequences.

***Proposition 4:*** *The familiar assumptions embedded in mental models and operational practices perpetuate expectations and act as a lens through which RI is interpreted.*

This proposition advanced that the normative framework of the financial economy, referred to as a ‘mental model’ (Senge, 1990), remains entrenched in the conventional beliefs, expectations and practices of the financial industry. Information is perceived and interpreted through filters, which co-opt the intentions built into responsible investment and limit the scope of change possible.

Whilst this proposition requires further investigation in the South African context, empirical findings point to the relevance of this proposition. Instruments used to assess possible investments continue to create a bias towards the short term. The integration of ESG factors in the investment analysis process generally does not affect the calculation of net present values, standard asset allocation criteria, or risk management processes. ESG factors appear relevant to the industry in terms of their short-term materiality rather than as indicators of long-term value. Moreover, the role of consultants and managers is left unchallenged, and their performance is rarely measured in the long-term. Thus the maximisation of short-term returns remains embedded in the way investment markets are structured. RI has been framed to fit the requirements of a ‘business-as-usual’ framework.

***Proposition 5:*** *The notion of shareholder value still dominates the theories, assumptions and practices, which underpin the behaviour of financial organisations.*

In this proposition, I advanced that despite the growing use of the stakeholder perspective, the interpretation of fiduciary duty remains largely biased by shareholder value and practices have not changed. The power of the narrative prevents a true reflection from taking place.

My analysis of annual reports and the outcome of certain interviews clearly pointed to a growth in use of the term “stakeholder”. However, the definition of the term "stakeholder" is generally limited to current

customers, shareholders, suppliers, and employees, and applies to the direct operational impacts of the financial institution. The impact of investment choices on the wider communities is generally not taken into account by investors. Certain RI leaders make reference to the positive impact of themed investment projects (mostly through debt instruments). Others mention ‘engagements strategies’ with the boards of investee companies as a way to manage the impact of their investments (bearing in mind that most reported engagements deal with governance issues only). The majority of entities use what could be called a ‘restorative’ approach, by engaging in targeted social responsibility projects or sponsoring community empowerment ideas.

It is further clear that what dominates fiduciary obligations is the generation of financial return for immediate beneficiaries. The notion of a duty towards future generations of beneficiaries or the community at large was largely absent. Whether the language refers to stakeholders or not, the overarching objective remains to deliver outperforming financial results compared to the sectors’ benchmarks. The consideration of E, S or G factors is deemed relevant only in so far as it contributes to the enhancement of short to medium term performances. Sustainability, as defined by the Brundland report (WCED, 1987) or outlined in the King III report (IoDSA, 2009), is a by-product rather than a core concern of the industry. Only certain RI leaders have initiated company wide debates and sought external advice to integrate long-term sustainability issues.

Overall, I feel that the dynamics of change within the investment industry remain superficial and entrenched in the dominant narrative. The *fact/value dichotomy* (Putnam, 2002) and the resulting blind spot are very present in the South African investment landscape. The industry publicly uses the language of stakeholder value; yet in practice appears unable to shift away from an effective focus on shareholder value. For the industry to truly engage with the stakeholder narrative, I found that it was critical to create an environment where long-term sustainability considerations can be discussed openly, across institutions and their stakeholders.

***Proposition 6:*** *The current ethical framework of financial institutions limits the scope of change possible and constrains RI to an instrumental approach.*

With this proposition, I concurred with several authors, who claim that the mainstreaming of RI globally is taking place as the concept abandons its ethical roots (Richardson, 2009; Viviers, 2013). RI has “at its heart improved financial return for beneficiaries through the exploitation of ESG-related market inefficiencies”

(Woods and Urwin, 2010:4). The positive societal effects are collateral outcomes rather than the result of intrinsic intentions.

Publicly available information and information gathered during interviews indicate that the current ethical framework of South African financial institutions is dominated by 'legal compliance' approach. In line with contractarian moral theory, investors submit to regulations and normative requirements but do not extend their ethical considerations to sustainability imperatives. Ethics committees commit to preventing fraud and ensuring compliance to Regulation 28 or other imperative rules. The core functions of investment practices are not concerned about evaluating the moral acceptability of corporate actions. Thus, RI in its current implementation in South Africa is largely disconnected from corporate social responsibility (CSR), and the financial industry does not act as a catalyst for change. The ethical considerations are managed, somehow, separately from everyday activities and compartmentalised from the core business of financial institutions.

The evidence suggests that RI in South Africa is largely concerned with improving risk management in the current economic context. The idea of taking responsibility for the possible negative environmental or social outcomes of investment choices is mostly absent. The focus on governance – whilst justified by the lack of quality E and S data - is quite revealing of the ethical framework guiding investment decision. Investee companies that can demonstrate compliance to laws and regulations are deemed responsible. E and S factors are used instrumentally to refine investment analysis by signalling risks or opportunities in order to generate adequate risk adjusted returns.

***Proposition 7: Providing conceptual clarity and adapting the legal framework surrounding fiduciary duty appears as minimum institutional requirements to enable progress towards RI.***

The last proposition challenged the role of institutional strategies. It advanced that to enable transformative change, self-regulation mechanisms must be complemented by a regulatory framework, which clarifies the concept of RI in line with sustainability knowledge, objectives and timeframes, and aligns fiduciary duty with long-term societal goals (Woods and Urwin, 2010; Richardson, 2011). To expand the scope of change possible, institutional strategies must take a firm and consistent stance in support of the sustainability imperative.

The South African situation provides significant insights regarding the importance of conceptual clarity and the extent to which regulatory interventions must go in order to generate effective change. Whilst

pioneering by making explicit that the integration of ESG factors in investment analysis is consistent with fiduciary duties, the regulatory framework falls short of defining what is RI and how it relates to sustainability. On the contrary, Regulation 28 refers to “sustainable long-term performance” and sets the guidelines for ESG consideration within a context of conventional risk management and asset allocation criteria. Regulators are concerned with the materiality of ESG factors with regard to financial performances, not with aligning industry practices with long-term societal goals.

Hence, the current regulatory framework does not set the stage for a transition towards a sustainable economy. The regulatory intervention stands in continuity with current practices. It merely acknowledges a new set of risks arising from the socio-economic and environmental context and stipulates that such risks must be taken into account. The ‘how’ and ‘why’ ESG factors must be considered are reduced to their financial significance with no reference to a large societal context and long-term goal. To use the arguments advanced by Sandberg and Tsoukas “The particulars that make knowledge actionable – what to do, at what time, in what context – are not included” (2011:342 cited in Langley *et al.*, 2013). The language of stakeholder value is also absent and there is no reference to the expectation of a moral behaviour on behalf of institutional investors. The legislator currently shows no concern for third parties potentially affected by investment decisions. Very much in line with the notion of shareholder value, the integration of ESG factors is used to generate “returns suitable for the fund’s specific member profile” (National Treasury, 2011). By leaving the fiduciary duties inscribed in shareholder value and constrained to the financial sphere, the legal framework positions ESG integration as an added tool to generate the required financial performance.

In this context, a voluntary initiative like CRISA has no foundation from which to exert pressure and initiate an expectation of change. Instead, the collective strategy used by the industry is promoting confusion and poor accountability. In the present context, the ‘comply or explain’ approach is disconnected from any temporal reality and used discretionarily by financial organisations, mostly as a means to ensure legal compliance, thus leaving industry practices largely unchanged. Far from creating a competitive pressure to comply with high RI standards, CRISA’s influence is limited to the disclosure of poorly qualified and unsubstantiated practices. The appearance of progress post 2011 is misleading because actual trends are difficult to substantiate.

In light of the above, the observed lack of change in market practices and the poor progress made towards RI in South Africa should come as no surprise. They are a direct result and a fair reflection of the intentions at the heart of the current regulatory framework, whether prescribed or voluntary. Vague references to

contradicting definitions of sustainability or a mention of the need to consider ESG in investment processes is not enough to generate change. Without needing to be prescriptive and complicated, the legal system must lay the founding principles from which investors and service providers can reassess their ethical assumptions, intentions and practices. In doing so, the regulatory framework would act to translate societal values into operational and governance frameworks. It would provide financial firms with the means to effectively incorporate both mandatory rules and voluntary commitments into their investment framework. It would serve as a basis from which to clarify responsibilities across the various actors of the financial sector.

## **5.2 Summary of findings and conclusion**

My research explored the system dynamics and underlying processes influencing progress towards RI in order to answer the following two interrelated questions: “What are the underlying dynamics influencing progress towards RI?” and “What is CRISA’s agency on the dynamics influencing RI in South Africa”? The objective of the research was to gain an understanding of the dynamics at play within the industry in order to formulate a explanation of CRISA’ agency on progress towards RI in South Africa.

To answer my first research question and gain theoretical insights into the problem, I built a conceptual framework. Drawing on the discipline of Systems Dynamics (SD) and integrating a temporal dimension, I analysed the concept of RI in the context of a dynamic approach. The resulting conceptual ‘process’ framework showed how RI, in its current implementation, would be unable to shift investment practices in time to support a sustainable economy. The feedback structure indicated that the current equilibrium is self-reinforcing, hence leading to the inertia and rigidity of the system. The dynamics of change are too slow relative to the time horizon to generate a meaningful transformation. Drawing attention to the role of intentions and mental models, the conceptual process framework challenged the theories, assumptions and practices underlying the behavioural norms of the investment industry and called for new institutional strategies to encourage an ideological framework consistent with a sustainable economy.

To answer my second research question, I gathered background information on the evolution of RI in South Africa, before investigating the influence of the regulatory framework in place using empirical data spanning over a period of three years. My empirical findings were consistent with and confirm the outcome of the conceptual framework. The findings indicated that CRISA’s agency to modify the investment practices of institutional investors and their service providers in South Africa is limited, slow and difficult to substantiate. While some disclosure trends appeared encouraging, these mask major issues with regard the quality,

consistency, comparability and reliability of data available. Except for a few leaders, the industry was characterised by an instrumental and discretionary approach to RI, which yielded little effective change in terms of behaviour and practices. The dialogic and flexible ‘comply or explain’ approach appeared to conceal the urgency and the imperative nature of sustainability issues, thereby failing to challenge the underlying logic guiding investment practices. CRISA’s agency to promote RI was further limited by a lack of funds and dedicated resources. As a result, the current regulatory framework, supported in law by Regulation 28 and in practice by CRISA, does not set the stage for a transition towards a sustainable economy, but rather stands in continuity with current practices.

I conclude my research by arguing that the current South African regulatory framework falls short of supporting effective progress towards RI in South Africa. To initiate transformative change, the institutional environment must provide conceptual clarity and take a firm and consistent stance in support of the sustainability imperative. Until such time, CRISA’s agency within the dynamics of change towards RI in South Africa is likely to remain limited, inconsistent and temporarily disconnected from the problems it tries to address. I concur with Niels Eccles that, in its current form and implementation, “there is nothing inherently or inevitably ‘responsible’ about egoist investment and that the aversion to behaving ethically amongst institutional investors must be challenged and not swept under a carpet of rhetoric” (2011:415).

As humanity faces a defining moment, the opposing forces of urgency and uncertainty are blurring the ability to act. Locked in a reality and unable to fully comprehend the future, the path to transition is unclear and challenging. While some entities have engaged proactively and meaningfully in RI, many have not; they continue to invest unsustainably and are avoiding reflecting upon the values and narratives at the heart of their practices. However, dynamic insights emphasise that time for action is running out. By integrating a dynamic and temporal dimension to the understanding of RI, I hope this process study heightens a sense of urgency and makes further research more actionable.

### **5.3 Recommendations and opportunity for further research**

The findings of my research have helped to conceptualise certain points of intervention and provide opportunity for further research.

To help the South African industry reassess their practices and engage more substantially with RI, I make the following recommendations:

1. There would be value in clarifying the concept of RI and how it relates to sustainability. Currently the concept is associated with multiple meanings and goals, blurring its outcome and the transition process. A clear and unambiguous concept is a pre-requisite to the generation of quality, measurable and comparable information. Providing clarity on the concept further means making it temporally explicit. Awareness of time can shift the balance of concerns and encourage different strategies. In line with this suggestion, the standardisation of reporting format could greatly improve the accountability of financial institutions and provide greater transparency in the allocation of responsibilities amongst the various economic actors.
2. Institutional strategies need to take a firm and consistent stance in support of the *sustainability* imperative. The urgency of the present situation should prompt the adaptation of regulatory environments in line with scientific knowledge and a framing of financial activities in the context of *nested dependencies* with social and environmental systems. Legal systems can act to translate societal values into operational and governance frameworks. They can serve as a benchmark for the renegotiation of the ethical framework guiding investment practices and fiduciary duties in line with sustainability knowledge and objectives, in a manner that is consistent with stakeholder value. This appears as a pre-requisite for improving the agency of voluntary initiatives and self-regulation mechanisms, thus giving them the means to reach into the practice of organisations with a consistent and unavoidable message.

The often-expressed discourse of development versus environmental and / or social responsibilities should come as no excuse for the present situation. As I outlined in the introduction, South Africa's National Strategy for Sustainable Development and Action Plan (NSSD 1) supports a transition to a low-carbon and sustainable economy stating that "South Africa aspires to be a sustainable, economically prosperous and self-reliant nation state that safeguards its democracy by meeting the fundamental human needs of its people, by managing its limited ecological resources responsibly for current and future generations, and by advancing efficient and effective integrated planning and governance through national, regional and global collaboration" (Department of Environmental Affairs, 2011). As argued by Shrivastava *et al.*, this statement indicates an "acceptance of the idea that the objectives of economic growth and development planning need to be situated within the framework of a transition" towards a sustainable economy (2014:23). The voluntary and regulatory

framework thus should act as a benchmark from which changes in investment strategies and capital flows can take place.

3. Conditional to the above, there would be value in institutionalising CRISA and providing it with dedicated funds and resources. For greater agency, CRISA should be constituted into an organisation and have predictable funding available at its disposal to coordinate efforts towards RI. CRISA should have the financial and human means to organise events and training programs, centralise knowledge and report on a single platform, commission independent research and feed the industry with improved ESG knowledge. As a self-regulated industry body, CRISA should be provided with the means to perform its function on a predictable basis.

In terms of future research, there would be value in confronting the macro perspective developed in this thesis with a micro perspective, investigating the extent to which RI leaders (organisations or individuals) are embedding an integrative logic to their sustainability commitment. Valuable insight could be generated by examining what influences are guiding change; i.e. who are the actual 'players'/'actors'? What are actors pushing for? What motivates them? What are they trying to achieve? What values and narratives are at the heart of their practices? What is holding them back? What reference points inspire them? Beyond institutional strategies, future research could investigate what other influences can be drawn upon to accelerate change within the industry and guide a transformational process. Such insights could help support the design of institutional and corporate strategies aiming at promoting transformational change within investment practices.

#### **5.4 Contributions**

Whilst existing research on RI have investigated a wide variety of aspects of the concept, its practice and its reach, there has been little inquiry into the underlying dynamics at play, their embedded temporal implications and the impacts of institutional strategies employed to promote RI. Furthermore, to date there has been limited academic research in South Africa on the agency of local institutional strategies to generate progress towards RI. In this context, my research makes several contributions to the corporate and financial sustainability literature, and assists in the conceptualisation of possible points of intervention to drive transformational change in the South African investment industry.



Firstly, the present research approach differs from those used in other investigations by developing a *process* study of the concept of RI. Analysing how and why phenomena emerge, develop and/or terminate over time, a process study explicitly incorporates time and the temporal progression of activities as elements of explanation that matter highly. Given the urgency to address sustainability and climate issues, analysing the efficiency of RI in the context of time gave rise to a new understanding of its agency. From this perspective, RI appears temporally and substantially disconnected from the problem it tries to address. As timeless propositions do not make knowledge actionable, the researcher calls for further RI research to be grounded in a temporal reality (Langley *et al.*, 2013).

Secondly, there has been limited investigation of RI using Systems Dynamics (SD) modelling. Using a feedback approach goes beyond the linear event-based analysis, which fails to take into account the feedback mechanisms influencing the outcome of decisions. It has further allowed the integration of time as an important variable in the problem articulation. The dynamic view that was developed in this study provides an endogenous explanation regarding how the problem behaviour arose, is maintained and is likely to evolve over time. The conceptual model highlights that without an intervention to modify the system behaviour, RI will be unable to shift investment practices in the next 10 to 15 years to support a sustainable economy.

Thirdly, the insights resulting from the SD analysis highlight the importance of learning processes and assumptions underpinning the concept of RI. The findings in this study further challenge the strategies used so far to promote RI practices, thus prompting to reflect on the path to transition. Although some research have addressed learning, values and strategies in the dynamic context of time and complexity, few - if any - have focused on the financial industry and its role in promoting a sustainable economy. This study highlighted that the dynamics of change in the systems behaviour need to be faster and more effective whilst the opposing influences need to be confronted. Drawing attention to the importance and effects of mental models, the findings warn against the natural tendency to fall back on familiar assumptions and misinterpret feedbacks. To bring about effective change implies challenging the theories, assumptions and practices underlying intentions. In particular, the findings emphasise the need to confront ethical beliefs and challenge the institutional environment, which perpetuates confusion and conceals the urgency of the situation (Purnell and Freeman, 2012). Overcoming the present status quo calls for reviewing institutional strategies in order to encourage the emergence of a new corporate ideological framework consistent with a nested approach to sustainability (Kendall and Willard, 2015).

Finally, the present research supports the transition to sustainable development in South Africa. The dynamic perspective applied to the South African context provides valuable insights regarding the agency of current local institutional strategies. The findings identified that despite the leading voluntary and regulatory framework, the South African investment industry has recorded little change in behavioural norms and operational standards. Amongst others, the main reasons advanced for this shortfall are the lack of conceptual clarity and the lack of institutional commitment towards sustainability. Pointing to possible points of intervention, the findings of the research should prompt South African regulators to reassess the legal framework in line with clear societal goals, and to align their RI approach to the generation of long-term stakeholder value. This is a prerequisite for change, providing the necessarily foundations to improve the agency of voluntary regulatory initiatives such as CRISA and to act as a benchmark from which financial institutions can reassess their beliefs and operational framework.

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## 7 Appendices

### Appendix A: List of surveyed institutions

Websites, Annual reports and Sustainability Reports – when available - were consulted for the following entities:

#### *Pension funds*

1. GEPP
2. ESKOM
3. SA RAF
4. EIPF
5. Sentinel
6. Transnet PF
7. MIPF
8. PPS
9. MIFA
10. Municipal Gratuity Fund
11. SALA
12. Telkom retirement Fund
13. Standard Bank
14. Sasol
15. Mineworkers Provident Fund
16. FNB Pension Fund
17. ABSA Pension Fund
18. Alexander Forbes Retirement Fund
19. Central Retirement Annuity Fund
20. Lifestyle Retirement annuity Fund

#### *Large financial institutions (other asset owners)*

1. Old Mutual
2. SANLAM
3. MMI
4. Liberty
5. Investec Group
6. Allan Gray Group
7. Alexander Forbes Group
8. ABSA
9. RMB First Rand

***Asset managers***

1. PIC
2. Investment solutions
3. Coronation
4. Taqyanta Asset Managers
5. Momentum
6. Stanlib
7. Prudential Portfolio Managers
8. SIM
9. OMIGSA
10. Foord Asset Management
11. Kagiso
12. Allan Gray Ltd
13. ABSA ASSET MANAGEMENT (PTY) LTD
14. Investec Asset management

***Asset consultants***

1. Riscura
2. Towers Watson
3. Fiduciary Solutions
4. Alexander Forbes Financial Services

**Appendix B: Size of Asset Under Management (AUM)**

<b>Top 20 Pension funds</b>	in ZAR Billion of AUM in 2013 Considering <u>or</u> integrating RI <sup>2</sup>	
• GEPF	1592	1592
• ESKOM	92,7	92,7
• SA RAF	95,7	
• EIPF	65,6	
• Sentinel	72,5	72,5
• Transnet PF	52,2	52,2
• MIPF	36,7	
• PPS	32,3	
• MIFA	22,8	
• Mine Employee Pension Fund	21,7	
• Municipal Gratuity Fund	15,1	
• SALA	10,9	
• Telkom retirement Fund	36	
• Standard Bank	29,8	
• Sasol	33,3	
• Lifestyle Retirement Annuity and Preservation Funds	64,2	
• FNB Pension Fund	22,1	
• ABSA Pension Fund	23,5	
• Alexander Forbes Retirement Fund (provident and pension)	41,9	
• Momentum Retirement Annuity Fund	35,3	
• Central retirement annuity fund	84,3	84,3
	<b>2480,6</b>	<b>1893,7</b>

Source: FSB. 2013. *Annual Report of the Registrar of Pension Funds to the Minister of Finance.*

<sup>2</sup> Own estimation based on publicly disclosed information of financial institutions, which either disclose according to CRISA or the UN PRI.

<b>Top 14 asset managers</b>	In ZAR Billion of AUM in 2014 Considering <u>or</u> integrating RI <sup>3</sup>	
• PIC	1600	1600
• Investment solutions	321	321
• Coronation*	636	636
• TAQUANTA ASSET MANAGERS	90	
• Momentum asset managers + Managers of Managers	179	179
• Stanlib	551	551
• Prudential Portfolio Managers	203	203
• SIM	446	446
• OMIGSA	574	574
• Foord	136	
• Kagiso	71	71
• Allan Gray Asset Management	462	462
• ABSA ASSET MANAGEMENT (PTY) LTD	104	104
• Investec asset management	505	505
	<b>5878</b>	<b>5652</b>
		96%

Source: Alexander Forbes. 2014. *The Manager Watch™ Survey of Retirement Fund Investment*.

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<sup>3</sup> Own estimation based on publicly disclosed information of financial institutions, which either disclose according to CRISA or the UN PRI.

**Appendix C: List of interviewees**

<b>Title</b>	<b>Company</b>	<b>Category of institution</b>
ESG Manager	GEPF	Pension Fund
Head of Group Corporate Affairs	Sanlam Group	Large financial institution
Head of Sustainability Research and Engagement	Old Mutual Investment Group	Asset manager
Head of ESG Research	Prudential Investment Managers	Asset manager
Head of Consulting	Riscura	Asset consultant

## Appendix D: Data Matrix

CRISA Matrix			
Rating			
A	Availability of info (factual and objective) - Compliance with framework for disclosure 1 = On the website, 2 = In Annual, 3 = RI Report, 4 = Through service provider, 5 = On request, 6 = Not available		
I	Integration of RI and consistency of practices with policies (Subjective assessment) 7 = Strong (strategic), 8 = Technical (compliance), 9 = Minimal (incomplete), 10 = Policy and disclosure consistency, 11 = Lack of policy and disclosure consistency, 12 = Not applicable, 13 = No information available to make assessment		
Questions		Identification of answers	
1.	<b>POLICY DISCLOSURE</b>	Availability	Integration
1.1	Policy on the incorporation of sustainability considerations into investment processes (analysis and activities)	A1	I1
1.2	Policy on ownership responsibilities	A2	I2
1.3	Policy on Conflict of Interest	A3	I3
1.4	Disclosure on governance structures and controls to ensure effective implementation, including annual policy review	A4	I4
1.5	Extent to which disclosure has been delegated to a service provider	A5	I5
2.	<b>RESPONSIBLE OWNERSHIP PRACTICES DISCLOSURE</b>		
2.1	Disclosure of voting results (including by voting proxy) and as per CRISA Disclosure Practice Note	A6	I6
2.2	Consistency with proxy voting policy	A7	I7
2.3	Implementation of good practice (general evaluation)	A8	I8
2.3.1	Direct disclosure of vote results per resolution	A9	I9
2.3.3	Whether the vote cast by the institutional investor or its service provider was against or where it obtained from voting	A10	I10
2.3.4	Explanation of the reasons where it obtained or a vote was cast against the proposed resolution	A11	I11
2.3.5	Whether the meeting was attended by the institutional investor or whether voting took place by proxy	A12	I12
2.4	Disclosure of overall engagement activity	A13	I13
2.5	Consistency of disclosure with responsible ownership policy	A14	I14
2.6	Frequency of disclosure (should be bi-annual)	A15	I15
2.7	Disclosure regarding the nature of each engagement	A16	I16
3.	<b>ANNUAL CRISA IMPLEMENTATION DISCLOSURE</b>		
3.1	General description of approach to CRISA implementation	A17	I17
3.2	Details on disclosure time period	A18	I18
3.3	Description of stakeholder engagement	A19	I19
3.4	Details of mandate regarding CRISA application with service providers	A20	I20
3.5	Details for processes or procedures in place to monitor the application of CRISA by service provider(s).	A21	I21
3.6	Principle application: (General evaluation)	A22	I22
3.6.1	Principle 1 Description of practical application & scope of application (Incorporate RI into decision making)	A23	I23
	Principle 2 Description of practical application & scope of application (Promote active ownership)	A24	I24
	Principle 3 Description of practical application & scope of application (Collaborative approach to acceptance)	A25	I25
	Principle 4 Description of practical application & scope of application (Conflict of Interest)	A26	I26
	Principle 5 Description of practical application & scope of application (Transparent about the content of their policies)	A27	I27
3.6.2	Description of monitoring actions - qualitative and quantitative	A28	I28
3.6.3	Forward looking commitments, including KPIs, targets and timelines	A29	I29
3.6.4	Progress on previous forward-looking commitments (most likely absent given effective date of CRISA)	A30	I30
3.7	Principles not applied:	A31	I31
3.7.1	Background information and context informing decision	A32	I32
3.7.2	Reasons for not applying / applying differently	A33	I33
3.7.3	Mitigating factors to manage risk from limited or absent application	A34	I34



## Appendix E: Example of interview questions

Example of questions in a first interview with an asset manager

### General questions

- What have been the main drivers to consider ESG and improve disclosure?
  - Has CRISA or the PRI been a major influence?
  - Do you face pressure from asset consultants? i.e. in their due diligence process?
  - Do you feel peer/market pressure to consider RI strategy?
  - Is RI part of your overall strategy mix to address overall market related risks?
  - Is the adoption of RI expected to improved financial performances?
- The amendment to Regulation 28 broadens the interpretation of fiduciary duty to include ESG consideration: what impact has this amendment had on your investment strategy or that of your institutional clients?
  - Are you experiencing increased pressures from asset owners to consider RI?
  - Are mandates changing and being more specific about RI?
- Do you integrated RI across asset classes / across mandates or only when mandated to do so and according to mandate specifications?
- Has your product offering evolved to incorporate RI?

### Internal factors

- How would you rate your level of internal readiness/ capacity for ESG integration compared to last year? And how is your organisation building capacity?
- How is RI perceived in your organization? Is it feared that engaging RI could hurt financial returns or the general financial performances of your organisation?
- What are the main challenges towards implementing RI strategies, considering both external and internal dynamics?
- Are there specific costs associated with RI and how are these managed?
- How would you rate the quality/reliability of ESG data or research available? What could improve this?
- What are your organisation's next steps / actions to promote RI and improve disclosure?
- The literature advocates the development of a sustainable investing framework to facilitate the implementation of RI strategies. Has your firm developed such a framework (Investment beliefs, mission clarity, monitoring process, values, governance framework)?

### RI Strategies

- When considering ESG – do you place as much emphasis on the 3 components (environmental, social or governance) or do you find it easier to primarily focus on one of them? Do you find that in South Africa there is less institutional concern for the environment?

- Have you participated in any active engagement activities specifically relating to environmental or to social factors?
- What are the dominant RI strategies employed in your organisation (ex: Best of sector screening, Index investment, negative screening, integration, formal or informal activism)?

### **Market related**

- Have performance expectations and investment timeframes changed, i.e. extended?
- How is the market pressure for short-term profit maximisation affecting RI strategies and ESG integration?
- What is the time horizon of the majority of your investments? Is RI extending this horizon?
- What type of measure/initiative would level the playing field on RI in your specific industry?
- Do you find that the knowledge base of the industry around these issues is growing? Can you give me examples?
- Do you view the lack of clear definition associated with the concept of RI as a problem? How does your organization determine what forms part of RI (do you include Shari'ah?, B-BBEE? etc.)

### **Sustainability**

- How would you rate your organisation's knowledge of sustainability issues and what it means in terms of change?
- In the context of sustainability, do you personally think a 'comply or explain' approach is appropriate/ effective to promote change in the industry?
- The IPCC, in its last report, indicates that we have a 5 to 15 year window to transition to a low carbon economy and keep the world average temperature below a 2 degree Celsius increase, after which the costs associated with climate change and uncertainty levels escalate exponentially:
  - How is this affecting your organisations' strategy – vision, products, investments and organisation?
  - To what extent do you think RI, in its current form, can enable this transition?
  - What conditions would be required for the financial sector to act as a catalyst for change?
- Would you qualify your organisation's approach towards sustainability as instrumental/ superficial or embedded into the core values of the firm?
- Would you say that ESG and climate risks are adequately priced into stocks?

## Appendix F: Extract from NVIVO® – coding of stakeholders

### Stakeholders

	Level of influence	Main driver - influential factor	Worldview	Timeframe	Type of influence	Quality of influence
<b>Strategic influence</b> Service providers\Asset consultants	High	Incentive structure	Current economic system and reductionist worldview	Current effect	Negative influence on progress	Detrimental to RI
<b>Direct influence</b> Service providers	High	Incentive structure	Current economic system and reductionist worldview	Current effect	Negative influence on progress	Detrimental to RI
Asset managers	High	Incentive structure	Unassigned	Current effect	Unassigned	Risk of greenwashing
Younger generation of financial analysts and fund managers	Medium	Incentive structure	Current economic system and reductionist worldview	Current effect	Negative influence on progress	Detrimental to RI
Younger generation of analysts	High	Cognitive element	Soft sustainability - eco modernisation	Delayed effect	Positive influence on progress	Effectiveness in dealing with issues
Asset owners\Institutional investors are highly influential	High	Unassigned	Unassigned	Long lasting effect	Unassigned	Unassigned
Asset owners\Large financial institutions	High	Unassigned	Current economic system and reductionist worldview	Long lasting effect	Unassigned	Unassigned
Asset owners\Long term investors have natural alignment with RI	High	Cognitive element	Unassigned	Long lasting effect	Positive influence on progress	Effectiveness in dealing with issues
Main RI investors\Activist shareholders	Medium	Cognitive element	Soft sustainability - eco modernisation	Current effect	Positive influence on progress	Mainstreaming
climate interested investors (CI)	Low	Cognitive element	Hard sustainability - systems understanding	Long lasting effect	Positive influence on progress	Effectiveness in dealing with issues
Public and media	Medium	Cognitive element	Soft sustainability - eco modernisation	Current effect	Positive influence on progress	Effectiveness in dealing with issues
Sustainability rating agencies	Medium	Cognitive element	Soft sustainability - eco modernisation	Current effect	Positive influence on progress	Mainstreaming
Consumers and individual investors	Low	Values	Unassigned	Current effect	Unassigned	Unassigned
<b>Indirect influence</b> Advocacy networks\“investor-driven governance networks” (IGNs)	Low	Unassigned	Soft sustainability - eco modernisation	Delayed effect	Positive influence on progress	Mainstreaming
Advocacy networks\Transnational advocacy networks (TANs)	Low	Unassigned	Soft sustainability - eco modernisation	Delayed effect	Positive influence on progress	Mainstreaming
NGOs and civil society networks	Low	Cognitive element	Hard sustainability - systems understanding	Delayed effect	Positive influence on progress	Effectiveness in dealing with issues
Advocacy networks	Medium	Unassigned	Soft sustainability - eco modernisation	Delayed effect	Positive influence on progress	Mainstreaming
Advocacy networks\UN PRI	High	Unassigned	Soft sustainability - eco modernisation	Delayed effect	Positive influence on progress	Mainstreaming
future generations						
<b>Feedback mechanism</b> RI\Who\Profile of RI retail investor	Medium	Cognitive element	Soft sustainability - eco modernisation	Current effect	Mainstreaming	Reinforcing

### Stakeholder analysis

Participants	Level of influence	Interest in RI	Role in the system	Key element
Institutional investors				
Public pension funds	High	Medium	Anchor for progress	
Private pension funds	Medium	Low		
Large financial institutions	High	Low	Problem participants - key to progress	
Service providers				
Asset manager	High	Medium	Anchor for progress	
Current generation of financial analysts and fund managers	High	Low	Problem participants - key to progress	
Younger generation of analysts	Low	High		
Asset consultants	High	Low	Problem participants - key to progress	
Individual investors / Consumers	Low	Medium		
NGO	Low	High		
Advocacy networks - Others	Low	High		
Advocacy networks - PRI	High	High	Anchor for progress	The driving force
Media	High	Low	Problem participants - key to progress	
Civil society	Low	Low		
Future generations	Low	High		
Sustainability rating agencies	Medium	High		
Governments	High	Medium	Anchor for progress	
Academic network	High	Low	Problem participants - key to progress	

## Appendix G: Extract from NVIVO® – coding of RI defining elements

Defining elements of RI	Main driver - influential factor	Worldview	Effect	Type of influence	Nature
RI-How SRI strategies engage in shareholder activism	Accountability	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\conflict resolution between stakeholder	Cognitive element	Soft sustainability - eco modernisation	Helping to understand	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\informed by stakeholder theory	Cognitive element	Soft sustainability - eco modernisation	Helping to understand	Mainstreaming RI	Practical implementation
Theoretical framework	Incentive structure	Current economic system and reductionist worldview	Helping to understand	Limiting growth of RI	Theoretical contribution
RI-How\Approaches to RI	Incentive structure	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Approaches
RI-How\Approaches to RI\Strategic approach to ESG integration	Incentive structure	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-How\Approaches to RI\Targeted approach to ESG integration	Incentive structure	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-How\Practice of RI\Cost of RI funds	Incentive structure	Unassigned	Point of contention	Limiting growth of RI	Practical implementation
RI-How SRI strategies	Incentive structure	Unassigned	Helping to implement	Mainstreaming RI	Approaches
RI-How SRI strategies\Best of sector screening	Incentive structure	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-How SRI strategies\Integration	Incentive structure	Current economic system and reductionist worldview	Helping to implement	Mainstreaming RI	Practical implementation
RI-How\Suggestions to grow SRI	Incentive structure	Unassigned	Helping to implement	Mainstreaming RI	Suggestions
RI-Why Reasons to adopt a responsible behaviour\connection with financial performance	Incentive structure	Current economic system and reductionist worldview	Helping to understand	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\improve competitiveness	Incentive structure	Soft sustainability - eco modernisation	Helping to understand	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\institutional characteristics	Incentive structure	Unassigned	Helping to understand	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\Managing reputation risks	Incentive structure	Current economic system and reductionist worldview	Helping to understand	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\Reducing risks	Incentive structure	Current economic system and reductionist worldview	Helping to understand	Mainstreaming RI	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\RI to manage risks	Incentive structure	Unassigned	Helping to understand	Unassigned	Point of discussion
RI-Why SRI fund performance	Incentive structure	Unassigned	Helping to understand	Unassigned	Practical implementation
RI-How SRI strategies\indexes and other databases	Market needs	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Approaches
RI-How SRI strategies\plurality of approaches	Market needs	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-How SRI strategies\positive screening	Market needs	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-How SRI strategies\SRI funds	Market needs	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-What\What is SRI - definition\degree of standardisation of the concept	Market needs	Soft sustainability - eco modernisation	Helping to grow	Mainstreaming RI	Suggestions
RI-What\Size of RI market	Market needs	Unassigned	Helping to understand	Unassigned	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\Distinction from ethical investor	Market needs	Soft sustainability - eco modernisation	Helping to understand	Mainstreaming RI	Practical implementation
South Africa\Size of RI market in SA	Market needs	Unassigned	Helping to understand	Unassigned	Practical implementation
RI-Why Reasons to adopt a responsible behaviour\Low minimum requirements	Public pressure	Current economic system and reductionist worldview	Helping to understand	Mainstreaming RI	Practical implementation
RI-How\Practice of RI\Applies to both investment and credit practices	Unassigned	Current economic system and reductionist worldview	Helping to implement	Mainstreaming RI	Practical implementation
RI-How\Practice of RI\diversity of SRI practice across countries	Unassigned	Unassigned	Helping to implement	Mainstreaming RI	Approaches
RI-How SRI strategies\Classification of strategies	Unassigned	Unassigned	Helping to understand	Unassigned	Approaches
RI-What\Type to RI	Unassigned	Unassigned	Adding confusion	Unassigned	Approaches
RI-Why Reasons to adopt a responsible behaviour	Values	Unassigned	Helping to understand	Unassigned	Point of discussion
RI-How\Practice of RI\Challenges of implementation	Values	Soft sustainability - eco modernisation	Point of contention	Limiting growth of RI	Unassigned
RI-How SRI strategies\Impact investment	Values	Soft sustainability - eco modernisation	Helping to implement	Mainstreaming RI	Practical implementation
RI-How SRI strategies\Negative screening	Values	Soft sustainability - eco modernisation	Helping to implement	Traditional and more constraining approach	Practical implementation
RI-How SRI strategies\Top issues considered	Values	Soft sustainability - eco modernisation	Helping to understand	Unassigned	Top issues
RI-What\Type to RI\Business case RI	Values	Soft sustainability - eco modernisation	Helping to understand	Mainstreaming RI	Approaches
RI-What\Type to RI\Ethics RI	Values	Hard sustainability - systems understanding	Helping to implement	Traditional and more constraining approach	Approaches
RI-What\Type to RI\Evolution of RI	Values	Unassigned	Adding confusion	Mainstreaming RI	Approaches
RI-What\What is SRI - definition	Values	Unassigned	Point of contention	Limiting growth of RI	Top issues
RI-What\What is SRI - definition\ambiguities associated with the con	Values	Unassigned	Point of contention	Limiting growth of RI	Top issues
RI-What\What is SRI - definition\Termological ambiguities associated with the con	Values	Unassigned	Adding confusion	Limiting growth of RI	Point of discussion
RI-What\What is SRI - definition\essentially contested concept', or whether it is mere	Values	Unassigned	Adding confusion	Limiting growth of RI	Point of discussion
RI-Why\Goal of SRI	Values	Unassigned	Point of contention	Unassigned	Point of discussion