Informing Responsible Investment Practices through Environmental, Social and Governance Analysis:

A Perspective from South African Broad-Based Black Economic Empowerment and Transformation Disclosure

by

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Declaration

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Abstract

This research aims to provide greater insight into responsible investment (RI) practices in South Africa and abroad. Specifically, the research aims to contribute to the fields of sustainability and RI, explore best practices and frameworks informing RI practices, to highlight the obstacles to RI in South Africa, to explore the disclosure of a purposefully selected sample of Johannesburg Stock Exchange (JSE) listed companies, and to improve the disclosure of listed companies in South Africa in order to inform the process of environmental, social and governance (ESG) inclusion in investment decision-making.

The need for this research stems from the limited body of literature which is available on RI practices in South Africa including good stakeholder engagement and the understanding or interpreting of ESG data. The need for the research is further driven by the fact that, other than publications dealing with levels of Broad-Based Black Economic Empowerment (B-BBEE) compliance, there is little deeper analysis on transformation towards improved ESG performance across listed companies that investors can draw on to inform engagement with these companies. In particular, this is the case for the Top 100 listed companies on the JSE. There is also little research that highlights financial, reputational and license to operate risks resulting from transformation towards improved ESG performance.

The objectives are to increase RI awareness amongst institutional investors like the Government Employees Pension Fund (GEPF) to include ESG consideration in the decision-making process by selecting only those companies actively progressing in the ESG fields; and to prompt companies to focus efforts on ESG disclosure with the aim of improving their disclosure.

A literature review was utilised to investigate the RI practices in South Africa, the obstacles to RI, and how these obstacles could contribute to a disconnect between ESG disclosure and ESG consideration in investment decisions. This study focuses on two of the most pertinent obstacles to RI as identified in the literature, that is the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market. An evaluation matrix was utilised to provide greater insight into the ESG disclosure of South African companies (covering the top 40 JSE listed companies for 2013), with specific emphasis on key aspects of social performance, namely B-BBEE and transformation.

The main findings of this research indicated that the analysis of the impact of ESG issues on company performance is problematic when companies are selective in their ESG disclosure; disclosure is a pre-requisite for quality performance analysis; and the approach to, and absence of,

disclosure highlights investment risks that cannot be evaluated. An analysis of the top 40 JSE listed companies' disclosure was completed to provide a view of the companies' approach, disclosure and related risks around B-BBEE and transformation.

Among the group of top-tier performing companies, forty-six per cent listed the topic of transformation and B-BBEE as material issues/strategic objectives and extensive information was provided addressing all B-BBEE elements. These companies expanded on plans to address transformation and B-BBEE within the company as responsible corporate citizens. Eighty-three per cent of companies produced integrated reports and seventy-one per cent produced sustainability reports. Verified B-BBEE certificates (eighty-eight per cent of companies) and scorecards (twelve per cent of companies) were publically available on a listed company level. GRI disclosure indexes were available for fifty-four per cent of companies and the companies reported, in addition to other GRI indicators, on all of the LA and HR GRI indicators selected for this study.

All of the bottom-tier performing companies briefly mentioned the topic of transformation and/or B-BBEE in their company reports or websites while providing little or no context. Seventy-five per cent of these companies publically disclosed their B-BBEE certificates, however no scorecards were available. No GRI disclosure indexes were available; however, the companies reported on some of the LA or HR GRI indicators.

The companies in the B-BBEE non-disclosure group did not mention the topic of transformation and/or B-BBEE in their reports or on their websites. Thirty-three per cent of companies produce integrated reports and sixty-six per cent produced sustainability reports. No B-BBEE certificates or scorecards were publically available; however, one company disclosed its verified detailed ownership scorecard on its website. Only eight per cent of companies disclosed a GRI disclosure indexes and reported on the LA or HR GRI indicators selected for this study.

Opsomming

Hierdie navorsing poog om insig rakende verantwoordelike beleggingspraktyke in Suid-Afrika en in die buiteland te voorsien. Die navorsing is spesifiek daarop gemik om ‘n bydrae te lewer tot die veld van volhoubaarheid en verantwoordelike belegging, om beste praktyke en raamwerke wat verantwoordelike belegging belig te verken, om die struikelblokke tot verantwoordelike belegging in Suid-Afrika uit te lig, om die openbaarmaking van ’n doelbewuste geselekteerde steekproef van maatskappye gelys op die Johannesburgse Effektebeurs (JE) te verken, en om die openbaarmaking van gelyste maatskappye in Suid-Afrika te verbeter ten einde die proses van omgewings-, sosiale, en korporatiewe beheer (OSK) in beleggingbesluitneming te belig.

Die behoefte aan hierdie navorsing het ontstaan uit die beperkte literatuur rakende verantwoordelike beleggingspraktyke in Suid-Afrika; insluitende behoorlike betrokkenheid van belanghebbendes en die begrip of interpretering van OSK-data. Die behoefte aan die navorsing word voorts gedryf deur die feit dat, anders as publikasies wat handel met gehoorgewing aan Breë-Basis Swart Ekonomiese Bemagtiging (B-BSEB), is daar min diepere ontleding van transformasie vir verbeterde OSK-prestasie in gelyste maatskappye wat beleggers kan gebruik om gesprekke rondom betrokkenheid met hierdie maatskappye te voer. Dit is veral die geval vir die Top-100 gelyste maatskappye op die JE. Daar is ook min navorsing wat finansiële, reputasie-, en lisensie-om-te-hanteer-risiko’s beklemtoon wat ontstaan uit transformasie vir verbeterde OSK-prestasie.

Die oorhoofse doel van hierdie studie is tweevoudig; om verantwoordelike beleggingsbewustheid onder institusionele beleggers soos die Regeringwerkerspensioenfonds te verhoog om OSK-inagneming by die besluitnemingsproses in te sluit deur slegs die maatskappye te kies wat aktief in die OSK-velde vorder; en om maatskappye aan te spoor om hul OSK-openbaarmakingspogings te fokus op die doel om hul openbaarmaking te verbeter.

’n Literatuuroorsig is gebruik om die verantwoordelike beleggingspraktyke in Suid-Afrika te ondersoek; asook die struikelblokke tot verantwoordelike belegging; en hoe hierdie struikelblokke kan bydra tot ’n skeiding tussen OSK-openbaarmaking en OSK-inagneming in beleggingsbesluite. Hierdie studie fokus op twee van die mees pertinente struikelblokke tot verantwoordelike belegging soos geïdentifiseer in die literatuuroorsig; naamlik 1) die kwalitatiewe aard, swak gehalte, en teenstrydighede; en 2) onvolledige en nie-openbaarmaking van OSK-data wat in die mark beskikbaar is.

‘n Evalueringsmatriks is gebruik om insig rakende die OSK-openbaarmaking van Suid-Afrikaanse maatskappye (die Top-40 JE-gelyste maatskappye vir 2013) te voorsien, met spesifieke klem op die sleutelaspekte van sosiale prestasie, naamlik B-BSEB en breëre transformasie.

Die hoofbevindinge van hierdie navorsing het aangedui dat die ontleding van die impak van OSK-kwessies op prestasie problematies is wanneer maatskappye selektief is in hul OSK-openbaarmaking; openbaarmaking ’n voorvereiste is vir gehalteprestasieontleding; en die benadering tot, en tekort aan, openbaarmaking beleggingsrisiko’s wat nie geëvalueer kan word nie beklemtoon. ’n Ontleding van die top-40 JE-gelyste maatskappye se openbaarmaking is onderneem om ‘n oorsig te verskaf van die maatskappye se benadering, openbaarmaking, en verwante risiko’s rakende B-BSEB en transformasie.

Onder die groep beste presterende maatskappye (24 maatskappye) is bevind dat ses-en-veertig persent die onderwerpe van transformasie en B-BSEB gelys het as materiële sake/strategiese doelwitte. Die maatskappye het uitgebrei op hul planne om transformasie en B-BSEB binne die maatskappye as verantwoordelike korporatiewe burgers aan te spreek. Drie-en-tagtig persent van die maatskappye het geïntegreerde verslae en een-en-seventig persent het volhoubaarheidsverslae geproduseer. Omvattende inligting is voorsien wat al die B-BSEB-elemente aanspreek en geldige B-BSEB-sertifikate (agt-en-tagtig persent) en -telkaarte (twaalf persent) van hierdie gelyste maatskappye is openlik beskikbaar. ’n Globale Verslaggewingsinisiatief (GVI)-openbaarmakingsindeks is beskikbaar vir vier-en-vyftig persent van die maatskappye waar verslag gelewer word oor die GVI-aanwysers, asook alle arbeidspraktyke en ordentlike werk en menseregte-GVI-aanwysers wat vir hierdie studie gekies is.

Die groep laagste presterende maatskappye (B-BSEB-bydraer vlakke 5-8) het bestaan uit vier maatskappye en die navorsing het bevind dat die onderwerp van transformasie en/of B-BSEB genoem word in al die maatskappy se verslae of op die maatskappye se webwerwe, wat slegs na wetlike toegewendheid of wetlike vereistes verwys. Vyf-en-sewentig persent van die maatskappye se B-BSEB-sertifikate is beskikbaar, maar geen B-BSEB telkaarte is beskikbaar nie. Geen GVI-openbaarmakingsindekse is beskikbaar nie, maar die maatskappye het egter aangedui dat hulle slegs verslag lewer oor sommige arbeidspraktyke en ordentlike werk en menseregte-GVI-aanwysers.

Die maatskappye met geen B-BSEB-openbaarmaking het bestaan uit 12 maatskappye en die navorsing het getoon dat transformasie en/of B-BSEB nie in die maatskappye se verslae of op hul webwerwe genoem word nie. Geen B-BSEB-sertifikate of -telkaarte van hierdie gelyste maatskappye is openlik beskikbaar nie, en slegs agt persent van die maatskappye het GVI-openbaarmakingsindekse beskikbaar gestel waar hulle oor sommige van die arbeidspraktyke en ordentlike werk of menseregte-GVI-aanwysers verslag lewer.

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Table of Contents

List of Abbreviations

The use of abbreviations and acronyms has generally been avoided, except where the relevant abbreviations are well known and the use of the full name would clutter the text. Abbreviations and acronyms commonly used are:

AFS	annual financial statements
AM	asset manager
AO	active ownership
B-BBEE	Broad-Based Black Economic Empowerment
B-BBEE Act	Broad-Based Black Economic Empowerment Act 2003
CFA	Chartered Financial Analyst
CRISA	Code for Responsible Investment in South Africa
CSI	corporate social investment
CSR	corporate social responsibility
CWC	Committee on Workers' Capital
DBCCA	DB Climate Change Advisors
DJSI	Dow Jones Sustainability Index
DTI	Department of Trade and Industry
DWCPD	Department of Women, Children and People with Disabilities
E&Y	Ernst & Young
EIRIS	Ethical Investment Research Services
EGSEE	environmental, governance, social, ethical and economic
EN	Environmental GRI indicators
EMDP	Emerging Markets Disclosure Project
ESG	environmental, social and governance
FTSE	Financial Times Stock Exchange
GEAR	Growth, Employment and Redistribution
GEPF	Government Employees Pension Fund
GDP	gross domestic product
GRI	Global Reporting Initiative
GSIA	Global Sustainable Investment Alliance
HIV/AIDS	Human Immunodeficiency Virus infection / Acquired Immunodeficiency Syndrome
HR	human rights GRI indicators
IFAC	International Federation of Accountants
IFC	International Finance Corporation

ILO	Institute for Local Government
IOS	International Organization for Standardization
IRBA	Independent Regulatory Board for Auditors
JSE SRI	Johannesburg Stock Exchange Socially Responsible Investment
King III	King Code of Governance Principles for South Africa III
LA	Labour practices and decent work GRI indicators
N/A	not applicable
NDP	National Development Plan
NESRI	National Economic & Social Rights Initiative
NPC	National Planning Commission
OECD	The Organisation for Economic Co-operation and Development
PIC	Public Investment Corporation
POA	Principle Officers Association
PRI	Principles for Responsible Investment
RDP	Reconstruction and Development Plan
REP	responsible equity portfolio
RI	responsible investment
SANAS	South African National Accreditation System
SRI	socially responsible insurance
UN	United Nations
UNEP	United Nations Environment Programme
UNEP FI	United Nations Environment Programme Finance Initiative
UNISA	University of South Africa
UNGC	United Nations Global Compact
UNPRI	United Nations Principles for Responsible Investment

The term ‘African’ as used in this paper means ‘black African’ and is not intended to imply that South Africans of other races have any less claim to being Africans. Since the term ‘non-white’ is still widely regarded as offensive, this study uses ‘black’ as the collective term for African, Coloured and Indian people according to the definition of ‘black people’ as per the Broad-Based Black Economic Empowerment (B-BBEE) Codes of Good Practice supporting the Broad-Based Black Economic Empowerment Act 2003 (B-BBEE Act). Other studies sometimes use ‘black’ to refer to African people only.

List of Figures

List of Tables

Chapter 1: Introduction and Overview

1. Introduction and background to this study

Responsible Investment (RI) is a continually growing and changing space that encompasses institutional investors, asset managers and financial service providers (Renneboog, Horst, Ter & Zhang, 2008; Macpherson, 2014). In the investment industry, RI considerations are more common today as they are increasingly being applied in investment decisions (Gitman, Chorn & Fargo, 2009; Bertrand, 2011; Macpherson, 2014). It has been roughly nine years since the Principles for Responsible Investment (PRI) were launched by the United Nations (UN) Secretary-General in 2006, three years since South Africa formalised its approach to RI in 2011 with the Code for Responsible Investment in South Africa (CRISA) and since the revised version of Regulation 28 of the Pension Fund Act was promulgated prescribing RI principles in South Africa.

RI, in broad terms, requires that an institutional investor evaluate the performance of a business not based on profits alone but also considering its environmental, social and governance (ESG) impact when making investment decisions (Gitman *et al.*, 2009). It is, therefore, important for institutional investors to implement a RI model with clear policies and processes to guide and integrate ESG considerations into investment decisions (UNEP FI, 2005; Bertrand, 2011). ESG issues can be global or local in nature and will differ from company to company. Some of the pertinent South African ESG issues include energy security, water security and access to water, labour relations, inequality, unemployment, lack of quality education and skills, poverty, corruption and misallocation of national funds, business ethics, and poor governance (NPC, 2012). To expand on the social issues particularly relevant in a South African context, the following are included in the National Development Plan (NDP): poverty, inequality, and unemployment (NPC, 2012).

This study examines transformation and a subset of transformation namely Broad-Based Black Economic Empowerment (B-BBEE) in a South African context. Globally, the concept of transformation within a company is understood and communicated as diversity, which entails gender equality, health and safety, as well as other minority issues. As a social component within the ESG sphere in South Africa, transformation refers to B-BBEE, a legislative tool implemented by the Department of Trade and Industry (DTI) in 2003, which primarily aims to shift patterns of ownership of capital and the control of capital to black people[1] (Republic of South Africa. 2012a; SPII, 2012).

[1] The collective term for African, Coloured and Indian people according to the definition of 'black people' in the B-BBEE Codes of Good Practice supporting the B-BBEE Act No. 53 of 2003.

For the purpose of this study, 'transformation' refers to the contribution made by a company to bring about equality[2] and ensure diversity with respect to race or ethnic group, gender, age, occupational level and other minority rights issues within its company structure (Republic of South Africa, 1998a; Republic of South Africa, 1998b; Republic of South Africa, 2003; NPC, 2012; GRI, 2013).

This study aims to contribute to both the sustainability and the responsible investment research fields. These fields are included in the RI landscape in South Africa, with ESG issues in the social sphere being particularly topical to South Africa. There is a limited body of literature on responsible investment, including good stakeholder engagement and the understanding or interpretation of ESG data, making specific reference to South Africa. Specifically, no in-depth research on the disconnect between ESG disclosure by companies and the ESG considerations of institutional investors has been done in South Africa. Academic interest in the field of RI mostly focuses on studies of the financial performance of RI funds (the link between the inclusion of ESG issues into decision-making and the financial performance of those funds).

2. Rationale for this study

2.1. The importance of environmental, social and governance considerations in investment decision-making

There is an increased focus on ESG issues in response to global sustainability challenges such as waste, energy constraints, economic and financial crises, social inequalities, poverty, unethical governance, corruption, B-BBEE in South Africa, water scarcity, withering biodiversity and climate change compared to a few decades ago (Schulschenk and Van der Ahee, 2013; Ceres and Blackrock, 2015). In addition, many stakeholders are demanding more comprehensive information on what business is currently doing and planning for the future regarding issues other than profitability (Elkington, 1998). Besides the heightened global awareness of sustainability issues, ESG factors are increasingly considered as investors, analysts, businesses and society realise that profitability alone is no longer the only investment criterion (UNEP FI, UNISA & Noah Financial Innovation (Pty) Ltd, 2007). More pressure is therefore placed on companies to report on positive and negative contributions to these ESG issues and to integrate ESG policies into the core strategy of the business to have a positive effect on long-term performance. Another drive behind ESG consideration is the direct link to financial performance as the scarcity and prices of environmental and social inputs escalate (Gitman *et al.*, 2009). Companies listed on the Johannesburg Stock Exchange (JSE) are compelled to report on ESG issues, however, it is questionable whether

[2] Equality refers to race or ethnic group, gender, age, occupational level and other minority rights issues when inequality exists within a company. For example, company employees will not be discriminated against when salary adjustments or promotions are considered.

institutional investors are taking the information produced into account when deciding where to invest funds (GRI, 2013).

Institutional investors are increasingly recognising that sustainability concerns threaten to change the competitive landscape across whole industries and markets, and that they have a vested interest in requiring that companies improve their corporate reporting so that the ESG issues can be better understood and contextualised (Ceres, 2015). Institutional investors, such as pension funds, insurance companies, trade unions and religious organisations, manage funds on behalf of clients and are different to individual investors (also referred to as retail or private investors). According to Van der Velden and Van Buul (2012), pension funds can only move towards sustainable long-term investing whilst fulfilling their fiduciary responsibilities when they understand what the ESG issues are and how to include them in their investment decision-making process. In addition, long-term investment risks and opportunities can be better understood through the lens provided by ESG disclosure (Gray and Niklasson, 2013). Thus, it is equally as important for companies to produce valid ESG data, as it is for institutional investors to be able to interpret and use the information to make informed decisions.

2.2. Limited research available on the disconnect between environmental, social and governance disclosure and environmental, social and governance consideration in investment decisions

Annually, companies produce and publish ESG data in the form of annual financial statements, sustainable development reports, integrated reports, annual reports, transformation reports, B-BBEE certificates, and so on, most of which are available in the public domain. Companies can become members or signatories to various bodies, such as the United Nations Principles for Responsible Investment (UNPRI), the CRISA, the Global Reporting Initiative (GRI), the Committee on Workers' Capital (CWC), and so on, which may or may not require their signatories to publish reports. These reports contain financial and non-financial information that tells a story about a company's performance. According to the CFA Institute (2008) and Ceres (2015), companies' narrative disclosure can include decision-useful information reflecting the company's current response to sustainability concerns and preparedness for likely future risks.

It is important for institutional investors to understand the particular return on investment and risk implications associated with the transformation agenda and the challenges experienced by companies operating in South Africa (CFA Institute, 2008; SAICA, 2012). The dominant diversity and transformation drivers that impact companies are B-BBEE; the Employment Equity Act 1998; the Skills Development Act 1998; and the Women Empowerment and Gender Equality Bill (DWCPD, 2013). In addition, transformation performance needs to align to global best practice around diversity performance as set out in frameworks such as the GRI (SAICA, 2012).

Obstacles exist between companies' disclosure of ESG information and institutional investors' understanding, interpretation and ultimately investment decision-making based thereon (UNEP FI *et al.*, 2007; Viviers, Kruger & Venter, 2009; Mia, 2011; IFAC, 2012; Schulschenk & Van der Ahee, 2013). Analysts and service providers can assist in this process by researching and interpreting the public ESG disclosure and presenting it to institutional investors with the aim of achieving enlightened investment decision-making in the best interests of beneficiaries.

2.3. South African institutional investors' size and power advantages

Institutional investors' roles as change agents and engaged shareholders are vitally important and cannot be overstressed as the majority (approximately 70% in certain countries) of corporate securities are owned by them (Viviers *et al.*, 2012). Fund mandates, which stipulate the investment preferences and rules of a client, guide the actions of institutional investors (Viviers *et al.*, 2012). As representatives of asset owners, institutional investors have a fiduciary duty to manage and invest large amounts of money which requires careful consideration to ensure that investments are made in the best interests of the fund beneficiaries (Viviers, Bosch, Smit & Buijs, 2009; Viviers *et al.*, 2012; POA, 2013). In addition, as institutional investors have "long-term investment horizons and clear gains to make from ensuring their present investment decisions are beneficial to long-term sustainable economic growth (UNEP FI *et al.* 2007:3)", the consideration of the social and environmental consequences of their investments is particularly pressingly relevant (UNEP FI *et al.*, 2007).

However, institutional investors do not seem to pay enough attention to one of the biggest drivers of change, namely sustainability and especially ESG issues (McKnett, 2013). Reckless behaviour such as this can jeopardise future long-term returns (McKnett, 2013). The larger the investor, the more profound the difference made by a change in investment approach. Thus institutional investors, such as pension funds, foundations and endowments have the capital capacity to make significant changes in the investment landscape and according to McKnett (2013) they should allocate most of their resources to companies working the hardest at solving sustainability issues.

According to the Principle Officers Association (POA) (2013), South Africa's retirement industry is one of the largest in the world and a leader in global best practice in retirement fund governance. Pensioners will be directly affected by the decisions of the country's pension funds (POA, 2013). The size of these large retirement funds ensures that unprecedented power can be exercised when investing in socially responsible funds with long-term benefits for pensioners. The Government

Employees Pension Fund (GEPF) is Africa's largest pension fund with more than 1.2 million active members, in excess of 300 000 pensioners and beneficiaries, and assets worth more than R1 trillion (Viviers *et al.*, 2012; GEPF, 2013). The Public Investment Corporation (PIC), which invests the GEPF's funds, is one of the largest investment managers in Africa (Yortt, 2009; PIC, 2014). The PIC is wholly owned by the South African government and is the only asset manager that serves South Africa's public sector taking care of the investment needs of about 35 public sector pension, provident, social security, development and guardian funds (PIC, 2014). According to Cameron (2006), Viviers *et al.* (2009) and Viviers *et al.*, (2012), the GEPF indicated that its financial power will be used to force corporate South Africa to shape up in areas of good governance, social responsibility and environmental protection. Viviers *et al.* (2009) and Viviers *et al.* (2009:7) further state that "the GEPF has the potential to exert enormous influence on corporate decision-making in South Africa as it controls almost half of the total retirement savings of the country".

2.4. Beneficiaries of funds could suffer great losses

The ultimate beneficiaries of the funds managed by institutional investors such as the GEPF are those individuals who invest money to be managed on their behalf. These individuals therefore will have to absorb great losses if funds are invested irresponsibly[3] (Ceres and Blackrock, 2015). In most cases these individuals' "… pensions are their sole source of income post retirement" (Abdurahman, 2015:16). Endorsing the before-mentioned view, Ceres and Blackrock (2015) state that investors' responsibilities include looking after the long-term financial needs of the fund beneficiaries who depend on receiving their retirement income. Gitman *et al.* (2009:17) state that "institutional investors often represent government employees, teachers and academics, unions, or medical practitioners, who may be predisposed to considering broader societal and environmental issues". Thus, by practicing responsible investment, the capital of the fund beneficiaries can be protected and increased (Ceres and Blackrock, 2015).

3. Problem statement and research question

The literature reviewed on RI, both global and on South Africa, suggests that many barriers exist hampering the practice of RI. Obstacles to RI hinder the integration of ESG factors into investment decision-making. This study focused on the following obstacles to RI, namely the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market. These obstacles could cause a disconnect between ESG disclosure by companies and ESG consideration and inclusion by institutional investors. For the purposes of this research, 'disconnect' refers to the lack of communication or agreement and an inability for two or more parties,

[3] The environment, economy and various other stakeholders will also suffer losses of different kinds.

in this case institutional investors and companies, to agree or to understand each other. This study explores a disconnect from a company perspective as the ESG data producer. Company disclosure standards are compiled and published in the form of legislative documents, best practices and frameworks based on research and consultation with companies, investors and other users of company disclosures. Therefore, a deviation of these disclosure standards could indicate a lack of communication or agreement and an inability for institutional investors and companies to agree or to understand each other. As a result, ESG issues might not be included in investors' decision-making processes. An extensive range of ESG issues exists globally making it impossible to conduct in-depth research on each issue within the environmental, social and governance pockets, thus it was decided to focus on the topical social issue of transformation with B-BBEE as a subset within the South African context.[4]

The broad problem relates to the obstacles to RI in South Africa and the disconnect between ESG disclosure by companies and ESG consideration and inclusion by institutional investors. This problem is broadly framed as: 'Obstacles to RI, namely the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market, combined with a general lack of understanding of ESG issues and impacts, leads to a failure to adequately interpret, incorporate and integrate ESG factors into investment decision-making.'

More specifically, when companies are selective in ESG disclosure it makes the analysis of the impact of ESG issues on company performance problematic causing challenges to the understanding and interpretation of the available ESG data, and potentially resulting in ESG factors not being integrated into investment decision-making. This study aims to assess disclosure that is a pre-requisite for quality performance analysis and how the approach to, and absence of, disclosure highlights investment risks that cannot be evaluated. This problem is researched by exploring B-BBEE and transformation disclosure within South African listed companies to determine the nature of the disclosure (whether it is qualitative or quantitative in nature) as well as the availability, quality, and consistency of the disclosure.

The refined research question is formulated as follows:
'Could the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of B-BBEE and transformation disclosure within South African listed companies prevent institutional investors from understanding and interpreting that disclosure?'

[4] The focus on a social issue within a South African context is justified and explained in the introduction and background of Chapter 3.

The refined research question encapsulates the following sub-questions that this study aims to answer:

- Sub-question 1: What are the obstacles to RI, from the reviewed literature, that hinder the integration of ESG factors into investment decision-making?
- Sub-question 2: What are the specific obstacles to ESG disclosure by companies and ESG consideration and inclusion by investors in RI literature?
- Sub-question 3: Could these specific obstacles – the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market – cause a disconnect between ESG disclosure by companies and ESG consideration and inclusion by institutional investors?
- Sub-question 4: Could ESG analysis based on complete and consistent disclosure inform RI practices as it pertains to incorporating ESG issues?
- Sub-question 5: Does an analysis of B-BBEE and transformation disclosure in South African listed companies using an evaluation matrix indicate lack of disclosure?
- Sub-question 6: Could an analysis of the current disclosure and its shortcomings improve B-BBEE and transformation disclosure of South African listed companies?
- Sub-question 7: How does the JSE top 40, top-tier, bottom-tier and other companies' B-BBEE and transformation disclosure compare according to the Likert Scale?
- Sub-question 8: Which areas of the JSE top 40 companies' B-BBEE and transformation disclosure are incomplete and not disclosed?
- Sub-question 9: Could an analysis of one component within the ESG sphere be applicable to all ESG components?

In the next section the above research questions are broken down into the primary and secondary objectives.

4. Research objectives

The research objectives stemming from the research sub-questions formulated in the previous section are discussed below. The research aims to contribute to the fields of investment and sustainability particularly in the South African context.

The primary objectives of this study are to:

- identify the obstacles to RI that are hindering the integration of ESG factors into investment decision-making from the reviewed literature;
- explore whether the obstacles to RI could contribute to a disconnect between ESG disclosure by companies and ESG consideration and inclusion by institutional investors;

- explore whether ESG analysis based on complete and consistent disclosure could inform RI practice as it pertains to incorporating ESG issues;
- study South African listed companies' B-BBEE and transformation disclosure by making use of an evaluation matrix; and
- analyse the JSE Top 40 Top-Tier, Bottom-Tier and Other companies' B-BBEE and transformation disclosure according to a developed Likert Scale.

The secondary objectives of this study are to:

- understand the specific obstacles to ESG disclosure by companies and ESG consideration and inclusion by investors as they pertain to the investment industry in South Africa identified in RI literature;
- study the social component of ESG and specific factors relevant in a South African context, namely B-BBEE and transformation disclosure of listed companies;
- improve B-BBEE and transformation disclosure of South African listed companies' by studying the current disclosure and its shortcomings;
- identify the areas of the JSE Top 40 companies' B-BBEE and transformation disclosure that are incomplete and not disclosed; and
- consider how the evaluation matrix utilised in this study might be useful in investigating other ESG issues.

The overarching research approach and design are presented in the next section.

5. Overarching research approach and design

The detailed research approach and design are discussed in Chapter 2 and Chapter 3 respectively.

Chapter 2 makes use of a non-empirical study asking descriptive, theoretical, and conceptual questions. An exploratory review of all identified literature was undertaken in order to identify the relevant existing literature and collate the results of the literature reviewed on RI practices and ESG factors in the investment industry in South Africa and abroad. Data gathering methods include sampling, the application of inclusion and exclusion criteria, and data extraction. The major themes that emerged are discussed in Chapter 2.

Chapter 3 analysed the B-BBEE and transformation disclosure by the top 40 JSE listed companies by empirically testing the disclosure through a content analysis of the online content, reports and certificates of the companies selected for review based on the evaluation matrix (as discussed in Chapter 3). The empirical study makes use of a mixed research design gathering hybrid data from company information available in the public domain. The mixed research design comprises a content and comparative study asking exploratory and descriptive questions. The population is defined as listed companies in South Africa, the sample as JSE listed companies and the purposeful sample chosen as the top 40 JSE listed companies. Data gathering methods include purposeful sampling, E-research and content analysis. Qualitative data analysis methods include narrative and content analysis as well as coding. Quantitative data analysis methods include the evaluation matrix based on the Likert Scale. The Likert Scale is discussed in Chapter 3.

6. Delimitations of the overall study

The delimitations of this study define the parameters of the investigation into;

- RI practices and the legislation and best practices informing RI practices;
- the obstacles to RI practices; and
- the public B-BBEE and transformation disclosure of listed companies on the JSE.

The literature that will not be extensively reviewed includes studies on global RI practices; environmental and governance components within the ESG sphere; individual investors investment practices; aspects of RI besides ESG integration, such as stakeholder engagement and proxy voting; and the other obstacles to RI that were identified through reviewing the literature.

The population that will not be studied includes the remaining 393 companies listed on the JSE Main Board in 2013 as well as unlisted companies in South Africa. The JSE top 40 companies[5] constitute 87.11% of the JSE top 100 according to market capital; and 82.89% of the JSE Main Board for 2013. The supposition was that most top listed companies that have the resources and influence to effect changes sooner were expected to take the lead on high profile issues by being compliant to a large degree and would disclose their compliance.

Multiple bottom line performance and reporting including environmental, governance, social, ethical and economic (EGSEE)[6] is widely discussed in literature globally and thus it is important to ask whether only considering ESG factors is sufficient (Brockett and Rezaee, 2012). For the purpose of this study, the focus will be placed on ESG factors while ethical and economic factors will not be discussed in detail.

[5] Refer to Annexure A: Companies ranked by total market capital at 31 December 2013 in ZAR.

[6] Economic (in most cases referred to as financial) performance, which will increasingly include an organisation's wider impact on the economy – recognising that profitability, growth and job creation lead to compensation and benefits for families and tax generation for governments (IFAC, 2012). Ethical components refer to morality and fairness in behaviour, actions, policies and practices taking place within a business context (Carroll and Buchholtz, 2014).

An extensive range of ESG issues exists globally making it impossible to conduct in-depth research on each issue within the environmental, social and governance pockets, thus it was decided to focus on the topical social issue of transformation with B-BBEE as a subset within the South African context.

When aiming to accelerate the RI process, it is necessary to first establish where the problems lie regarding non-compliance with existing policies, codes and frameworks – whether in the form of uninformed investors or the weak structures in place. For the purposes of the research, the assumption has been made that the policies in place are in fact good and well-structured, thus the issues pertaining to a lack of disclosure and non-disclosure by companies will be addressed.

7. Key terms and concepts

The key terms and concepts used in this study are listed below.

Active engagement	is the "practice of exercising ownership rights through engagement and voting practices" (UNEP FI *et al.*, 2007:54).
Acquisition debt	means the "debts of (a) black participants incurred in financing their purchase of their equity instruments in the Measured Entity; and (b) juristic persons or trusts found in the chain of ownership between the eventual black participants and the Measured Entity for the same purpose as those in (a)" (Republic of South Africa, 2012b:1)
Asset manager	is defined as an organisation or individual appointed and responsible for managing the assets of the asset owner.
Asset owner	refers to an organisation whose assets are being managed by an external asset manager.
B-BBEE Codes of Good Practice	"are to be applied in the development, evaluation and monitoring of B-BBEE charters, initiatives, transactions and other implementation mechanisms. The Codes contain basic principles and essential considerations, and provide guidance in the form of explanatory material" (Republic of South Africa. 2012a:2). The Amended Codes were gazetted in 2013.
B-BBEE Act	is a legislative framework for the transformation of South Africa's economy that "aims to address inequalities resulting from the systematic exclusion of the majority of South Africans from

	meaningful participation in the economy" (Republic of South Africa. 2012a:4).
B-BBEE Industry Sector Codes	were developed and published as industry specific opposed to the Generic Codes that are applicable to all sectors.
Beneficiary	is a person eligible to receive a benefit after the death of a member or other benefit recipient (UNEP FI, 2005).
Benefits	"A pension is a form of 'post-employment benefit', that is, a benefit an employee receives after their service to the agency ends. Other forms of such benefits can include health insurance and other health-related benefits provided to former employees" (ILO, 2013:25).
Black people	as defined in the B-BBEE Act 2003, this term refers to "Africans, Coloureds and Indians who are South African citizens. For avoidance of doubt, this term does not include juristic persons or any form of Enterprise other than a sole proprietor. Making reference to this definition, 'black women' means black people who are women, and 'black designated groups' means black people who are also workers, youth, people with disabilities or people living in rural areas" (Republic of South Africa, 2003:4).
Board of trustees	can be defined as a panel of individuals that holds or administers property or assets for the benefit of a third party. Trustees often have a fiduciary responsibility to the trust beneficiaries (Investopedia, 2015).
Clean tech investing	includes a focus on aspects such as "energy efficiency, pollution control, renewable energy, sustainable transport, and waste and water management" (Krosinsky and Robins, 2008:xxiii).
Code of conduct	refers to the "internal code of conduct developed by a company by which it expects its directors, managers and employees to behave" (Kotsantonis *et al.*, 2014:42).
Company or investee company	can be defined as a company in which an institutional investor invests or considers investing as a shareholder.
Contribution	can be defined as the amount (percentage of an employee's salary or wage) that a company contributes to a pension or provident fund on behalf of an employee.
Corporate philanthropy	can be defined as the "voluntary giving of wealth by corporations to charitable causes with no explicit expectation of any return" (UNEP FI *et al.*, 2007:53).

Corporate social investment (CSI)	is the "laying out of money or capital by a company in the enterprise of broader social development with the expectation of some form of return" (UNEP FI *et al.*, 2007:53).
Disconnect	refers to the lack of communication or agreement and an inability for two or more parties, in this case institutional investors and companies, to agree or to understand each other.
Divestment	takes place when "companies are sold from a fund portfolio because they no longer meet the ESG criteria for that fund, or for purely financial reasons" (GSIA, 2014:29).
Employment equity	promotes the "equal opportunity and fair treatment in employment through the elimination of unfair discrimination; and implementing affirmative action measures to redress the disadvantages in employment experienced by designated groups, to ensure their equitable representation in all occupational categories and levels in the workforce" (Republic of South Africa, 1998a:12).
Engagement	refers to "interactions between the investor and current or potential investees (which may be companies, governments, municipalities, etc.) on ESG issues. Engagements are undertaken to influence (or identify the need to influence) ESG practices and/or improve ESG disclosure" (UNPRI, 2013a:9).
Environmental, social and governance (ESG)	can be separately defined as environmental issues relating to the quality and functioning of the natural environment and natural systems; social issues relating to the rights, well-being and interests of people and communities; and governance issues relating to the governance of companies and other investee entities (UNPRI, 2013a:4).
ESG incorporation	is covered in Principle 1 of the PRI. Throughout the Reporting Framework, ESG incorporation is referred to as the review and use of ESG information in the investment decision-making process. The Reporting Framework addresses four ways in which ESG incorporation can be done, namely "screening, sustainability themed investment (also referred to as environmentally and socially themed investment), integration of ESG issues, or a combination of the above" (UNPRI, 2013a:6).
ESG integration	is the "systematic and explicit inclusion by investment managers of environmental, social and governance factors into traditional financial analysis" (UNPRI, 2013a:6).

Ethical investing	is an investment style determined by the "value-system of the key investment decision-maker" (Krosinsky and Robins, 2008:xxiii).
Gender equality	can be defined as the "full and equal enjoyment of rights and freedoms, and equal access to resources, opportunities and outcomes, by women, men, girls and boys" (DWCPD, 2013:3).
Global Reporting Initiative (GRI) indicators	are disclosure requirements set out under the GRI's comprehensive sustainability reporting framework currently in its fourth iteration. The GRI sustainability reporting framework provides metrics and methods for measuring and reporting sustainability-related impacts and performance that is widely used around the world (GRI, 2013:3).
Impact investing	makes reference to "targeted investments, typically made in private markets, aimed at solving social or environmental problems. Impact investing includes community investing, where capital is specifically directed to traditionally underserved individuals or communities, or financing that is provided to businesses with a clear social or environmental purpose" (GSIA, 2014:29).
Institutional investor	is an organisation that "pools and invests large sums of money into securities, property and various investment assets normally with the aim of creating value in the long term" (GSIA, 2014:29). The primary purpose is to invest its assets or those held in trust by it for others. Examples of institutional investors include pension funds, investment companies, universities, and banks.
Integrated Reporting	is a "holistic and integrated representation of the company's performance in terms of the value that it has generated within the triple context of the economy, society and natural environment" (IODSA, 2011:9).
Investor	is an individual or organisation that invests money into securities, property and various investment assets normally with the aim of making a profit in the short term. This study will focus on institutional investors as opposed to individual investors. Refer to *institutional investor*.
Investment decision-making processes	"… refers to research, analysis and other processes that lead to a decision to make or retain an investment (i.e. to buy, sell or hold a security), or to commit capital to an unlisted fund or other asset.

	(Proxy) voting decisions and engagement activities are not classified as investment decisions …" (UNPRI, 2013a:6).
King Report or King Code	refers the 'King Report on Governance for South Africa', and the 'King Code of Governance Principles' (IODSA, 2009).
Mandate	is defined as the "arrangement between an institutional investor and its service provider whereby the service provider makes investment decisions or performs investment activities for and on behalf of the institutional investor" (IODSA, 2011:9).
Material aspects	are those that "reflect the organization's significant economic, environmental and social impacts; or that substantively influence the assessments and decisions of stakeholders. To determine if an Aspect is material, qualitative analysis, quantitative assessment and discussion are needed" (GRI, 2013:7).
Organisation	is a concept that is used interchangeably when referred to a business, company, enterprise and entity. This study is focused on listed companies; therefore, the concept 'company' will be used.
Ownership deal	is a transaction involving shareholding of the Measured Entity or an entity higher up in the ownership structure through which rights of ownership (economic interest and/or voting rights) are transferred to the benefit of black people as defined in the B-BBEE Act (2003).
Ownership initiative	is an initiative that improves a Measured Entity's performance under the Ownership element of the B-BBEE Codes. This initiative typically includes ownership deals, sale of asset transactions, flow-through black ownership from mandated investments, and/or equity equivalency initiatives. It specifically excludes continued recognition as envisaged by the B-BBEE Codes of Good Practice.
(Proxy) voting and shareholder resolutions	respectively refer to "voting on management and/or shareholder resolutions as well as filing shareholder resolutions" (UNPRI, 2013a:9).
Readily available	refers to the availability of information on the website of a company or in a report published on the website.
Responsible investing	The following definitions are all applicable to this study: An investment approach "adopted by institutional investors to start taking ESG factors into account in pursuit of their fiduciary duties to clients and beneficiaries" (Krosinsky and Robins, 2008:xxiii).

	"Investment that incorporates an active consideration of ESG issues into investment decision-making and ownership … where ESG issues are considered on the basis of their financial materiality." (UNEP FI *et al.*, 2007:7) "Investment approach that incorporates environmental, social and governance criteria into investment analysis based on the belief that ESG issues are a driver of financial returns. Integration denotes a wide range of activities, from the use of one or two ESG criteria in a specific product to the incorporation of ESG criteria in all valuation models across an entire firm." (Gitman *et al.*, 2009:4)
Screening of investments	mainly involves three types of screening: • "Negative/exclusionary screening: The exclusion from a fund or portfolio of certain sectors, companies or practices based on specific ESG criteria. • Positive/best-in-class screening: Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers. • Norms-based screening: Screening of investments against minimum standards of business practice based on international norms" (GSIA, 2014:4).
Service provider	can be defined as an organisation rendering a service to another organisation at a fee. In the context of this study, the services rendered would mostly be of a financial nature. "Those who act under mandate of the institutional investor in respect of any of the investment decisions and investment activities dealt with in CRISA, including asset and fund managers and consultants" (IODSA, 2011:9).
Shareholders	are individuals or organisations holding shares in a company and are therefore entitled to receive dividends when the company declares dividends from profit made in a financial year.
Social investing	"seeks financial and social returns, investment that has an impact on others" (Krosinsky and Robins, 2008:xxiii).
Stakeholders	can be defined as "those who reasonably have a legitimate expectation to be engaged with or to receive information from the institutional investor or its service providers on the grounds that

	they are affected by the investment activities and investment decisions of the institutional investor or its service providers" (IODSA, 2011:9). These stakeholders include all parties influenced by and having an influence on a company's activities in different ways, for example suppliers, the government, employees, clients, etc. (including *shareholders*).
Sustainability	is the "ability of a company to conduct its operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs" (UN, 1987:15). "Sustainability includes managing the impact that the business has on the life of the community, the broader economy and the natural environment in which it operates. It also includes the converse, namely considering the effect that the society, the economy and the environment have on business strategy" (IODSA, 2011:9).
Sustainable investing	is an approach "driven by long-term economic, environmental and social risks and opportunities facing the global economy" (Krosinsky and Robins, 2008:xxiii).
Sustainability report	is "a report published by a company or organisation about the economic, environmental and social impacts caused by its everyday activities. A sustainability report also presents the organisation's values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy" (GRI, 2013:9).
Transformation	refers to the contribution made by a company to bring about equality and ensuring diversity with respect to race/ethnic group, gender, age, occupational level and other minority rights issues.
Transparent	refers to "documents and reports that are easy to understand or recognise, balanced, complete, obvious, candid, open, frank, relevant and accessible to stakeholders" (IODSA, 2011:9).
Ultimate beneficiaries	are those "end-beneficiaries or underlying investors such as the individual savers or pension fund members to whom institutional investors owe their duties, including the individual retirement fund beneficiaries and the individuals in whose names on whose behalf unit trusts and policies are held" (IODSA, 2011:9).
Unemployed persons	"are those (aged 15-64 years) who a) were not employed in the reference week; and b) actively looked for work or tried to start a business in the four weeks preceding the survey interview; and c)

	were available for work, i.e. would have been able to start work or a business in the reference week; or d) had not actively looked for work in the past four weeks but had a job or business to start at a definite date in the future and were available" (Stats SA, 2014b:xxiv).

8. Layout and structure

The rest of the paper is structured as follows:

- Chapter 2 provides background to RI practices and discusses the global and local best practices and legislation informing RI. The chapter continues to explores the obstacles to RI and how these obstacles could contribute to a disconnect between ESG disclosure and ESG consideration in investment decisions.
- Chapter 3 provides background to pertinent social issues in South Africa and critically analyses the current best practices informing B-BBEE and transformation in South Africa. It further analyses South African B-BBEE and transformation disclosure in JSE listed companies.
- Chapter 4 will discuss the conclusions and recommendations reached through this study.

Chapter 2: Responsible Investment and its Obstacles: The Disconnect between Environmental, Social and Governance Disclosure and Environmental, Social and Governance Consideration in Investment Decisions

1. Introduction and background to responsible investment

1.1. Background to responsible investment

Since 1987, academic literature has referred to a wide variety of names and descriptions for investment practices that gave consideration to ESG factors (Eccles & Viviers, 2011). The most common names include socially responsible investment (SRI) (Rosen & Sandler, 1991; Abramson & Chung, 2000; Statman, 2008); ethical investment (Irvine, 1987; Mackenzie, 1998; Schwartz, Tamari and Schwab, 2007; Viviers, 2007) and social investment (Dunfee, 2003; Cox, Brammer and Millington, 2007). In recent years, the terms responsible investment (Dembinski, Bonvin, Dommen & Monnet, 2003; Thamotheram And Wildsmith, 2007; Viviers, Bosch, Smit & Buijs, 2009a) and sustainability or sustainable investment (Weber, 2005; Koellner, Sangwon, Weber, Moser & Scholz, 2007) emerged. Apart from the most common names in literature, the following ambiguous names also made an appearance: “community investing; environmentally responsible investing; faith-based investing; mission-based or mission-related investing; moral investing; social choice investing; green investing; red investing; white investing, and so on” (Eccles and Viviers, 2011:2).

Between 1994 and 2004, authors such as Sparkes (1994); Cowton (1998); Sparkes (2001); Sparkes & Cowton (2004), frequently published work on the meaning and clarification of the names and concepts used in the investment sphere. The overarching suggestion was to define ethical investment as “investment carried out on behalf of values-based organisations such as churches and charities” (Sparkes, 2001:199) and SRI as investment where the “key distinguishing feature lies in its combination of social and environmental goals with financial objectives of achieving a return on invested capital approaching that of the market” (Sparkes, 2001:201). The new term, RI, was mainly introduced by the United Nations Principles for Responsible Investment (UNPRI) as “investment practices that integrate a consideration of ESG issues with the primary purpose of delivering higher-risk-adjusted financial returns” (Eccles & Viviers, 2011:2). Following the rapid growth of an RI industry, academic interest in this type of investment has emerged (Renneboog *et al.*, 2008).

An adaptation the time line developed by DB Climate Change Advisors (2012) showing the evolution of sustainable investing is shown in Figure 2.1 below. This time line supports the before mentioned paragraphs by visually illustrating the most common names and descriptions used for investment practices that gave consideration to ESG factors.

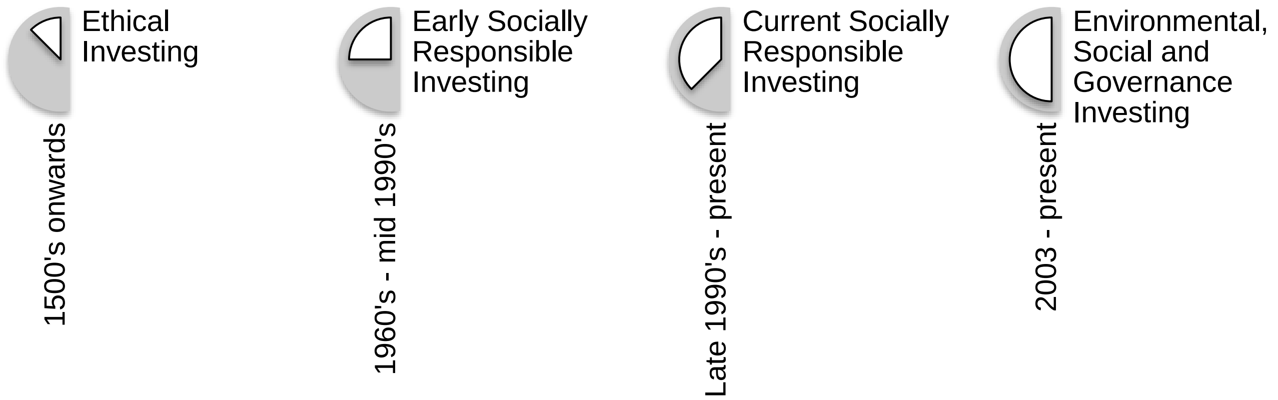


Figure 2.1: Evolution of sustainable investing

Source: Adapted from DB Climate Change Advisors (2012:18)

SRI is often used as a generic term covering sustainable, responsible, socially responsible, ethical, environmental, social investments and any other investment process that integrates financial analysis with the influence of ESG issues (DB Climate Change Advisors, 2012; GSIA, 2014). For the purposes of this study, the term 'responsible investment' will be used consistently.[7]

Various events and crises have heightened the world's awareness of sustainability issues and over the last decade the concept of RI emerged (GRI, KPMG, UNEP & USB, 2010; Schulschenk & Van der Ahee, 2013). Today RI is a continually growing and changing space that encompasses institutional investors, asset managers and financial service providers (Renneboog *et al.*, 2008). RI, in broad terms, requires that an institutional investor evaluate the performance of a business not based on profits alone, but also considering ESG impact when making investment decisions (Gitman *et al.*, 2009). In other words this investment approach explicitly acknowledges the integration of ESG considerations – which are believed to be material and might be affecting the investment industry – when making investment decisions (Eccles and Viviers, 2011). ESG issues can be global or local in nature and will differ from business to business. Some of the pertinent South African ESG issues include B-BBEE, energy security, water security and access to water, labour relations, unemployment, corruption, business ethics and climate change, to name a few (Viviers *et al.*, 2012).

[7] The choice of the term "responsible investment" is informed by the UNPRI's prominent role in promoting RI internationally and in South Africa.

1.2. Environmental, social and governance consideration in investment decision-making

Positive responses are increasing with reference to investments creating value for the environment and society in addition to providing good financial returns (Bilbao-Terol, Arenas-Parra & Cañal-Fernández, 2010). The increased positive responses have contributed to the growth of RI practices. ESG factors are increasingly considered as investors, analysts, businesses and society realise that profitability alone is no longer the only investment criterion (UNEP FI *et al.*, 2007). Another drive behind ESG consideration is the direct link to financial performance as the scarcity and prices of environmental and social inputs escalate (Gitman *et al.*, 2009). Supporting this view, in recent years an increasing number of academics and industry experts have come to believe that key ESG developments can influence long-term financial performance significantly (Macpherson, 2014).

A common problem arising when social and environmental considerations are taken into account is how to quantify and summarise the non-financial information for presentation to investors (Bilbao-Terol *et al.*, 2010). Bilbao-Terol *et al.* (2010:111) states that "environmental, ethical or social impacts contain great imprecision and vagueness due to their nature and the available information on the performance of companies". According to the IODSA (2011), "value" is no longer purely a financial concept and investors are required to consider factors that impact long-term sustainability in addition to monetary benefits. In addition to concern for profitability companies are also expected to take social and environmental factors into account. A research paper published by the UNEP FI *et al.* (2007) states that the movement from conventional SRI thinking to a greater focus on the financial materiality of ESG issues will likely become more effective with movement towards integrating the issues into the heart of mainstream investment practices. FutureGrowth Asset Management (2011) stated that ESG can only progress to the next level if all industry stakeholders collaborate effectively in pursuing the same goal of ESG inclusion in mainstream investing in South Africa.

Environmental factors refer to energy consumption, water availability, waste management and pollution. Environmental risks are created by operational decisions, carbon emissions, climate change effects, pollution, waste disposal, renewable energy, and resource depletion (Eccles & Viviers, 2011; Bloomberg, 2013). Environmental performance relates to resource consumption in delivering products and services (IFAC, 2012). "Environmental challenges pose a potential risk for investors, as environmental externalities can result in significant economic losses, while repairing environmental damage such as air and water pollution can generate considerable fiscal costs. Adequate investments towards preventing environmental problems limit such potential liabilities." (Schieler, 2015:6)

Social factors include human capital, employee engagement, innovation capacity and supply chain management, labour and human rights. Social risks arise from corporate policies and practices in the fields of human resources, supply chain, discrimination, political contributions, diversity, human rights, and community relations (Eccles & Viviers, 2011; DB Climate Change Advisors, 2012; Bloomberg, 2013). Social performance refers to the impact an organisation has on people and social issues (including both employees and the wider community) (IFAC, 2012). “A weak social climate dominated by labour unrest, extreme inequality, or other social tensions is another potential investment risk. A delicate social climate can easily result in violent turmoil, disrupting important economic activity such as manufacturing or trade and/or paralyse policymaking. Strong social cohesion, on the other hand, supports orderly conflict resolution and facilitates the implementation of necessary reforms, thus contributing towards sustainable economic development.” (Schieler, 2015:6)

Governance refers to the oversight exercised by an organisation’s board and investors. Governance risks can stem from flaws in corporate governance policies, cumulative voting, executive compensation, shareholder’s rights, takeover defence, staggered boards and independent directors (Bloomberg, 2013). The governance dimension includes “… a country’s institutional framework, regulatory quality, rule of law, government efficiency, central bank independence and political stability, among other factors. Civil liberties, internal conflict and corruption also reflect a country’s governance profile.” (Schieler, 2015:6)

ESG incorporation is covered in Principle 1 of the UNPRI where it is referred to as the review and use of ESG information in the investment decision-making process (UNPRI, 2013a). The reporting framework addresses four ways in which ESG incorporation can be done, namely screening, sustainability themed investment (also referred to as environmentally and socially themed investment), integration of ESG issues, and a combination of the before mentioned (Viviers *et al.*, 2012; UNPRI, 2013a). In other words, ESG integration strategies are the RI strategies applied by investors to select the companies which are considered for investment.

1.3. Responsible investment strategies

Active ownership (AO), as a sub set of RI, is concerned with how the asset owner or asset manager is involved with the ESG performance of companies while invested in that entity (Ceres & Blackrock, 2015). The involvement of an asset owner with a company refers to the investment strategy followed by the asset owner. Ideally, the objectives of active owners are to keep their interest in a company, while influencing it to meet its corporate responsibilities (Ceres and Blackrock, 2015). The opposing strategy to engagement and influence is divestment which could take place if the active owners’ efforts to bring about change fail or are disregarded (Ceres & Blackrock, 2015).

Social campaigns like the anti-war and the anti-racist movements have aimed to create awareness among investors of the social consequences of investments since the 1960's. Today, issues like environmental protection, human rights, and labour relations are more frequently integrated into RI investment screening (Renneboog *et al.*, 2008). Therefore, RI refers to investors including financial analysis and sustainability considerations, such as traditional SRI approaches like moral or ethical investment philosophies, into decision-making (UNEP FI *et al.*, 2007).

Figure 2.2 below visually provides a broad overview of the prominent investment strategies that are discussed in this section.

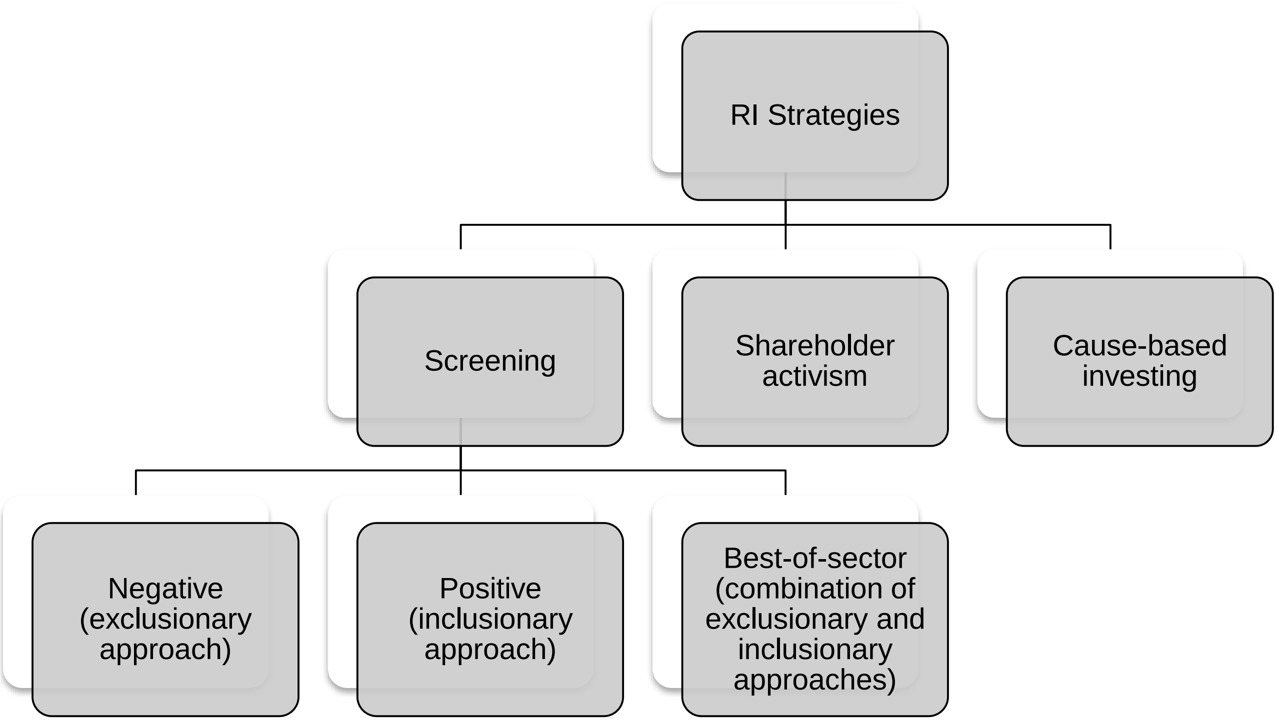


Figure 2.2: An overview of RI strategies

Source: Adapted from Viviers (2007:5) and Viviers *et al.* (2009:4)

Negative and positive screening are some of the oldest methods applied in the rating process of social responsibility (Viviers, 2007; Renneboog *et al.*, 2008; Herringer, Firer & Viviers, 2009; Bilbao-Terol *et al.*, 2010). Negative screening involves the exclusion of companies participating in particular activities, for example the manufacture of weapons, tobacco, pornography or cosmetics tested on animals (Herringer *et al.*, 2009; Viviers *et al.*, 2009; Bilbao-Terol *et al.*, 2010). Negative screening also involves excluding businesses not complying with particular norms related to international labour, human rights and environmental conventions (Bilbao-Terol *et al.*, 2010). Three strategies explored by Nagy, Cogan & Sinnreich (2013) include the 'ESG worst-in-class exclusion' which is similar to negative screening, a 'simple ESG tilt' where stocks with high current ESG ratings are over-weighted, and 'ESG momentum' where stocks that have improved ESG ratings during the past 12 months are over-weighted and stocks that have decreased ESG ratings underweighted.

The second approach, positive screening, specifically includes businesses with positive social performance records, for example good labour relations, community involvement, and superior environmental performance records (Viviers, 2007; Renneboog *et al.*, 2008; Herringer *et al.*, 2009; Viviers *et al.*, 2009; Bilbao-Terol *et al.*, 2010). A modern screening method is the "best-in-class" approach where businesses in different sectors are compared based on an integrated approach and those outperforming their peers are identified (Renneboog *et al.*, 2008; Herringer *et al.*, 2009; Viviers *et al.*, 2009). This approach involves engagements with businesses through direct dialogue and voting rights at annual general meetings (AGM).

Supporting the investment strategies described in the paragraphs above, Table 2.1 below provides detailed summaries of the core and broad investment strategies.

Table 2.1: Core versus broad investment strategies

Core investment strategies	**Broad investment strategies**
Ethical exclusions … [are] exclusions where more than two negative criteria/filters are applied (as opposed to just tobacco or weapons for example)."	"Simple screening [is] an approach that excludes given sectors or companies from a fund if involved in certain activities based on specific criteria, such as arms manufacture, publication of pornography, animal testing etc. If the exclusion approach is based on more than two criteria, it is considered to be an 'ethical exclusion'."
"Positive screening [comprises] the selection within a given investment universe, of stocks of companies that perform best against a defined set of ESG criteria, including Best-in-Class or SRI theme funds for instance."	"Norms-based screening [is the] negative screening of companies according to their compliance with international standards and norms such as issued by the [Organisation for Economic Co-operation and Development] (OECD), [Institute for Local Government] (ILO), UN, UNICEF, etc. If norms-based screening is clearly based on more than two negative criteria (for instance, compliance with

	the 10 principles of the Global Compact), it is considered to be an 'ethical exclusion'."
"Best-in-class [is an] approach where the leading companies with regard to ESG criteria from each individual sector or sector group are identified and included in the portfolio (a subset of positive screening)" (GSIA, 2014).	"Engagement [involves] a long-term process of dialogue with companies which seeks to influence company behaviour in relation to their social, ethical and environmental practices."
"SRI themed funds [such as] thematic funds may focus on sectors such as water or energy, or issues such as the transition to sustainable development and a low carbon economy" . To be considered SRI, a theme fund must show an explicit SRI motivation. Taking into account ESG considerations in the fund construction process. This approach requires the existence of specific mechanisms, such as the involvement of SRI expertise in stock analysis selection, the application of an ESG screen, or the management of the product by the SRI team (a subset of positive screening)."	"Integration [is] the explicit inclusion by asset managers of ESG risk into traditional financial analysis. Corporate Governance risk should be limited here to the interface between governance and social and environmental issues."

Source: Adapted from Herringer *et al.* (2009:14)

In addition to the most prominent investment strategies discussed above, other strategies, methods and processes have been suggested and explored:

- Viviers (2007) and Viviers *et al.* (2009) discuss cause-based investing where a particular ESG cause is supported through investment. This approach is said to have powerful and visible impacts on the economy as jobs are created and infrastructure needs addressed (Viviers *et al.*, 2009). Even though cause-based investors generally seek financial returns similar to market rates, some investors might accept lower returns in order to support a particular cause (Viviers *et al.*, 2009).
- Bilbao-Terol *et al.* (2010:110) suggest a "method that can be used to define a measure of the ethical performance of the mutual funds that follow a SRI approach – we present an index called 'SRI-Attractiveness' that summarises the social, environmental and ethical performance of each SRI-fund for a particular investor".
- Van der Velden & Van Buul (2012) elaborate on a responsible equity portfolio (REP) investment process where the strategy includes long-term financial return, ESG integration

and active ownership. The REP investment process allows for investment in companies with poor ESG performance as long as targets have been set for improvement and engagement (Van der Velden & Van Buul, 2012). In other words the REP strategy will not allow investment in companies with outstanding financial performance but no possibility for engagement around ESG inclusion (Van der Velden & Van Buul, 2012). The REP investment process has four steps namely, screening, due diligence, investment and lastly, active ownership and monitoring (Van der Velden & Van Buul, 2012).

RI strategies are voluntarily chosen and applied by investors where the adherence to legislation and frameworks informing the investment industry is compulsory. The most prominent global and local legislation, frameworks and best practices informing RI practices are discussed in the next section.

1.4. Global and local legislation, frameworks and best practices informing responsible investment practices

Over the years, legislation and frameworks emerged with the aim of mitigating and regulating the investment industry locally and globally. Among the first to emerge was the GRI. Started in 1997 and becoming independent in 2002, it represents global best practice on sustainability reporting frameworks and enjoys strategic partnerships with the United Nations Environment Programme (UNEP), the United Nations (UN) Global Compact, the OECD, the International Organization for Standardization (IOS) and others. The GRI indicators are disclosure requirements set out under the GRI's comprehensive sustainability reporting framework currently in its fourth iteration (GRI, 2013). The GRI sustainability reporting framework provides metrics and methods for measuring and reporting sustainability-related impacts and performance that is widely used around the world (Ohlhoff, 2008).

The UN Global Compact, first released in May 1999, is a global corporate citizenship framework for businesses and companies aiming to align to ten universally accepted principles in the areas of human rights, labour, the environment and anti-corruption (UNEP 2003; Ohlhoff, 2008). The ten principles of the UN Global Compact are listed in Table 2.2 below.

Table 2.2: Ten principles of the UN Global Compact

Human Rights	
Principle 1	"Businesses should support and respect the protection of internationally proclaimed human rights within their sphere of influence; and
Principle 2	make sure they are not complicit in human rights abuses."

Labour Principle 3 Principle 4 Principle 5 Principle 6	“Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced and compulsory labour; the effective abolition of child labour; and eliminate discrimination in respect of employment and occupation.”
Environment Principle 7 Principle 8 Principle 9	“Business should support a precautionary approach to environmental challenges; undertake initiatives to promote greater environmental responsibility; and encourage the development and diffusion of environmentally friendly technologies.”
Transparency and Anti-corruption Principle 10	“Businesses should work against corruption in all its forms, including extortion and bribery.”

Source: UNGC (2014:11)

In 1994, South Africa embarked on a journey towards democracy with clear goals to redress past economic, political and social inequalities by attempting to ensure that previously disadvantaged groups would be provided with access to possessions, opportunities for the ownership of assets, economic rights, government services and education (Republic of South Africa, 2003; Ponte, Roberts & Van Sittert, 2007; Kim, 2010; Jeffery, 2014). It was necessary to provide a comprehensive framework for the transformation of the South African economy and thus in 2003 the B-BBEE Act was promulgated. The essence of the Act is to “advance economic transformation and enhance the economic participation of black people in the South African economy” (Republic of South Africa, 2003:4). In 2007, the B-BBEE Codes of Good Practice were gazetted as an implementation framework for B-BBEE policy and legislation (Republic of South Africa. 2012a).

The 1994 King Report on Corporate governance (King I) was the first corporate governance code developed aiming to place South Africa at the forefront of governance internationally, followed by the King II report published in 2002 (Yortt, 2009). Companies were prompted to report on how their operations both positively and negatively impacted on the economic life of the community in which they operated; and how the company intends to enhance those positive aspects and eliminate or improve the negative aspects in the year ahead (IODSA, 2009). The King III Code of Governance

Principles was published in 2009 recommending integrated reporting in line with the GRI's Sustainability reporting guidelines which aim to help reporters prepare sustainability reports and to make robust and purposeful sustainability reporting standard practice (Solomon and Maroun, 2012; GRI, 2013).

The Financial Sector Charter was created in accordance with Section 12 of the B-BBEE Act. The Financial Sector Code encourages participants to "actively promote a transformed, vibrant and globally competitive financial sector that reflects the demographics of South Africa, and which contributes to the establishment of an equitable society by providing accessible financial services to black people and by directing investment into targeted sectors of the economy" (Republic of South Africa, 2012c:5).

The Johannesburg Stock Exchange Socially Responsible Investment (JSE SRI) Index[8] was introduced in 2004 in response to debates regarding global sustainability focusing particularly on South Africa. As a pioneering initiative, the index draws attention to RI in emerging markets like South Africa and recognises the effort made by listed companies to incorporate sustainability principles into their everyday business practices (Ohlhoff, 2008; Yortt, 2009; JSE, 2014). The index uses the triple bottom line philosophy, which includes the environment, society and the economy with governance as the foundation, to assess companies on their policy, management, performance and reporting (JSE, 2014). The SRI Index series has evolved considerably since it was launched in 2004. The measurement is conducted against a holistic set of ESG and related sustainability concerns including a fourth area of climate change (JSE, 2014). Whether a company will be included in the index is determined through an aggregation methodology in relation to the indicators based on analysis of company information made publically available (JSE, 2014).

In 2006, the six principles for RI, developed by a group of the world's largest institutional investors were launched. The UN-supported PRI Initiative is an international network of investors working together to put the principles into practice (UNEP FI & UN Global Compact, 2013). Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these ESG issues into their investment decision-making and ownership practices (Bertrand, 2011; UNEP FI & UN Global Compact, 2013). The six principles of the UNPRI are listed below.

1. "We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.

[8] The criteria for listing on the SRI Index were initially determined by the JSE after consultation with the JSE SRI Index Advisory Committee.

4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles" (UNEP FI and UN Global Compact, 2013:2).

The Companies Act 2008 came into effect in May 2011 and South Africa formalised its approach to RI in the same year when the CRISA was published. CRISA "gives guidance on how the institutional investor should execute investment analysis and investment activities and exercise rights so as to promote sound governance" (IODSA, 2011:3). There are five key principles:

1. "An institutional investor should incorporate sustainability considerations, including environmental, social and governance, into its investment analysis and investment activities as part of the delivery of superior risk-adjusted returns to the ultimate beneficiaries.
2. An institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities.
3. Where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors.
4. An institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur.
5. Institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments" (IODSA, 2011:3).

In 2011, the revised version of Regulation 28 was issued under the Pension Funds Act 1956 limiting the extent to which retirement funds may invest in particular assets or in particular asset classes (Republic of South Africa, 1956). The main purpose is to protect the members' retirement provision from the effects of poorly diversified investment portfolios by limiting the maximum exposure to more risky asset classes, making sure that no unnecessary risks are taken with retirement money (Republic of South Africa, 1956). In effect, implying that retirement funds' investment policy statements should now clearly define how ESG criteria and disclosure will be applied and integrated (Bertrand, 2011).

The UNEP-FI Principles for Sustainable Insurance (UNEP-FI PSI) were launched in 2012 as a voluntary framework for the global insurance industry to address ESG risks and opportunities (UNEP FI, 2012). The four principles are:

1. "Incorporate ESG data into decision-making.

2. Raise awareness, manage risk, and develop solutions.
3. Promote action on ESG issues.
4. Disclose progress on implementation" (UNEP FI, 2012).

Even though RI and corporate governance guidelines are largely voluntary in South Africa, RI seems to be moving from niche to mainstream (Visser, 2010; Bertrand, 2011; Macpherson, 2014). New trends in investor demands show an approach that attempts to include ESG factors into investment decisions (IFAC, 2012; Macpherson, 2014). However, despite the abundance of frameworks and legislative processes in place to govern and inform RI practices, there is still a lot of talk and little action, too much box-ticking, too few examples of ESG considerations embedded into investment decision-making strategies, and many mainstream portfolio managers still label ESG issues as irrelevant (UNEP FI and UN Global Compact, 2013).

The body of literature on responsible investment making specific reference to South Africa, including good stakeholder engagement and the understanding or interpreting of ESG data, is limited (Mtshazo, 2008). The available literature highlights some of the obstacles hindering the ESG integration process. The rest of Chapter 2 will explore the obstacles to RI and how these obstacles could contribute to a disconnect between ESG disclosure and ESG consideration in investment decisions.

2. Methodology and methods

The key questions of this study are the following:

- What are the obstacles to RI, from the reviewed literature, that hinder the integration of ESG factors into investment decision-making?
- What are the specific obstacles to ESG disclosure by companies and ESG consideration and inclusion by investors in RI literature?
- Could these specific obstacles – the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market – cause a disconnect between ESG disclosure by companies and ESG consideration and inclusion by institutional investors?

This research is aimed at institutional investors and companies in South Africa. The relevance of the research to institutional investors and companies is that it will highlight the obstacles to RI practices in South Africa that could lead to a disconnect between ESG disclosure by companies and ESG consideration and inclusion by investors. For the purposes of this research, 'disconnect' refers to the lack of communication or agreement and an inability for two or more parties, in this case institutional investors and companies, to agree or to understand each other. This study explores a disconnect from a company perspective as the ESG data producer. Minimising or eliminating the disconnect is important as selective ESG disclosure by companies makes analysis of the impact of ESG issues on company performance problematic. This study aims to assess disclosure that is a pre-requisite for quality performance analysis. The approach to and absence of disclosure highlights investment risks that cannot be evaluated.

An exploratory review of all identified literature was undertaken in order to identify the relevant existing literature and collate the results of the literature reviewed on RI practices and ESG factors in the investment industry in South Africa and abroad. In addition to peer-reviewed journal articles, a number of sources outside the quality scholarly literature databases were reviewed. This approach encompassed searching for relevant primary data, grouping and organising the data by theme, critically analysing the data and combining the information effectively, and re-analysing the findings presented in the sources reviewed.

The primary data includes a variety of sources such as peer-reviewed journal articles, company and industry reports, books, local and international best practices and legislation, theses and dissertations by students at South African and international academic institutions, conference proceedings, reference materials, presentations, and newspaper and magazine articles. A sample of relevant literature was strategically chosen to be relevant to the research questions.

Data gathering methods included sampling, the application of inclusion and exclusion criteria, and data extraction. The inclusion and exclusion criteria defined the parameters of this study. Sources were identified by applying the following search strategy:

- The sample of relevant literature included RI in South Africa and abroad, in addition focusing on ESG factors in the investment industry particularly B-BBEE and transformation as social issues in the South African context.
- The search terms included ‘responsible investment’; ‘environmental, social and governance’; ‘transformation’; ‘B-BBEE’; and ‘listed company disclosure’, among others.
- A time frame of ten years was applied, namely 1995–2015, making exceptions in a limited number of cases.
- Sources that could not be located in English were excluded.

The first major theme that emerged is the importance and relevance of ESG considerations in investment decision-making as highlighted by studies on RI in South Africa. The second is the myriad of existing and available global and local legislation, frameworks and best practices on RI. The legislation, frameworks and best practices are of value as RI is still an emerging field in many developing countries and therefore practices and best practices are mostly adopted from developed countries. The third theme that emerged is the obstacles to RI and the part it plays in the disconnect between ESG performance disclosure provided by business and the ESG performance considered by investors.

The next sections are structured as follows:

- Section 3 identifies and analyses the obstacles to RI from studies on South African RI practices. The following obstacles were identified as areas of relevance for the rest of this study, namely the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market.
- Section 4 explores the correlation between the above mentioned obstacles and a disconnect between ESG disclosure provided by business and ESG disclosure considered by institutional investors.
- Section 5 provides a summary and conclusions to Chapter 2.

3. Analysis of the obstacles to responsible investment in South Africa: studies on South African responsible investment practices

3.1. Introduction

Studies on responsible investment, good stakeholder engagement and the understanding or interpreting of ESG data, making specific reference to South Africa, include;

- an investigation by the UNEP FI, UNISA and Noah Financial Innovation (Pty) Ltd (2007:3) on "how the South African investment community integrates sustainable development and particularly ESG issues in investment decision-making";
- an emerging markets investor survey where the Ethical Investment Research Services (EIRIS) (2009) identified obstacles to responsible investment in emerging markets;
- Viviers *et al.* (2009:3) researching "the RI sector in South Africa making reference to the definition, characteristics, size, nature and obstacles thereof";
- Mia (2011) identifying some of the main obstacles in the way of sustainable investment;
- the International Finance Corporation (IFC), SinCo & Riscura (2011:2) that studied the sustainable investment practices in Sub-Saharan Africa by analysing investment practitioner views of "sustainable investment in private equity and asset management in South Africa, Nigeria and Kenya";
- an emerging markets report by Brewer (2012) who surveyed global investors in order to assess the level of investment in emerging countries and the ESG challenges that are considered key issues;

- the International Federation of Accountants (IFAC) (2012:2) that asked the question: “to what extent are investors using ESG info?”;
- Schulschenk & Van der Ahee (2013:1) published a research report presenting the “latest insights and trends in responsible investment in South Africa”; and
- Macpherson (2014) who notes that ESG data and information has become more mainstream and listed three main drivers that have led to a greater availability of ESG information, namely increased regulation, ESG networks, and mainstream data providers.

In an international study conducted by Gitman *et al.* (2009) titled *ESG in the Mainstream: The Role for Companies and Investors in ESG Integration*, barriers to full ESG integration into investment decision-making are discussed.

3.2. The obstacles to responsible investment identified in South African studies

The first obstacle to RI is the confusion around the meaning of RI and what it entails. In a study conducted by the UNEP FI *et al.* in 2007, with the aim of understanding why RI integration was not enthusiastically attempted by investors, some barriers, drivers and enablers of RI were identified. Participants in this study comprised the following groups: pension funds, asset managers and investment advisory service providers. The study revealed that general awareness of RI was 82% in the case of investment advisory service providers, 79% among asset managers, and a noticeably lower 53% among principal officers of pension funds (UNEP FI *et al.*, 2007). In addition, the study notes that a significant amount of confusion was apparent around the meaning of RI among pension fund managers. Echoing the before mentioned, Herringer *et al.* (2009) found that the issue around the definition of SRI was seen as an obstruction for investors and asset management companies attempting to fully understand the sector and take it forward. Accoding to Viviers *et al.* (2009:12), an obstacle to RI is a lack of definition of RI in a South African context. Mia (2011) noted that sustainable investment was lumped with ethical investment in the investment community and caused confusion around what RI entails.

The second obstacle to RI as identified in the literature is the belief that RI means increased risk and reduced returns. One of the barriers to RI identified by the participants in a UNEP FI study is a lack of evidence that RI is associated with improved financial returns (UNEP FI *et al.*, 2007:39–40). In contrast to the before mentioned, Herringer *et al.* (2009) note that the most important consideration for investors was identified as the risk adjusted performance of SRI funds as a growing body of evidence suggests that it is on par with conventional funds. Therefore, the negative perceptions among institutional investors need to be challenged. Supporting the findings of the UNEP FI study, negative perceptions around RI fund performance was identified by Viviers *et al.* (2009:12) as a barrier to RI. The lack of evidence to support the notion that ESG factors will increase financial returns was further noted by the IFC et al. (2011:63) as obstacle to RI. Mia (2011) notes that a negative perception of risk-adjusted returns that responsible investment can deliver exists in the market.

Thirdly, the short-termism in financial and investment markets stifles the long term view RI takes. According a study by the UNEP FI *et al.* (2007:39–40), the short-term nature of financial and non-financial reporting that needs to fit the long-term returns from RI causes problems. Gitman *et al.* (2009:23) support this view by stating that the continual focus on the short term hinders the demonstration of long-term value. The IFC et al. (2011:63) stresses both the before mentioned findings in that the short-term nature of financial reporting conflicts with the expected long-term returns of RI. Mia (2011) states that the inherent, short-term, competitive and comparative nature of the investment business model (short-termism encouraged as it is rewarded in the investment community) proves to be a barrier to RI.

The fiduciary responsibility of investors was identified as a fourth obstacle to RI. The UNEP FI et al. (2007:39–40) and IFC et al. (2011:63) found that the fiduciary responsibility of investors is a barrier to RI. Further both the UNEP FI and IFC state that advisors discourage ESG in investment. Mia (2011) echoes the before mentioned by stating that investors do not see the need to include ESG considerations in investment decisions and feel that the inclusion of ESG factors would violate fiduciary duty and mandate responsibility. Regarding the last mentioned, investors might feel that by focusing on sustainability aspects (ESG) they will not fulfil their primary responsibility towards beneficiaries that entails generating the greatest possible financial returns (Mia, 2011). This idea of reduced financial returns was discussed above as a second obstacle. Not fulfilling a responsibility to beneficiaries can be combined with the fear of having their responsibility solely dictated by sustainable investment (Mia, 2011).

A fifth barrier to RI is the lack of expertise and skills among RI advisors and analysts. The UNEP FI *et al.* (2007:39–40) found that a lack of the necessary expertise and appropriately skilled advisors were identified as obstacles to RI. Herringer *et al.* (2009) note that as South Africa is already challenged with a skills shortage, the financial and ESG sectors are no different. Given the long-term nature of SRI investments, retention and transfer of skills over the duration of investments proved to be a further challenge (Herringer *et al.*, 2009). Both Viviers *et al.* (2009:12) and the IFC et al. (2011:63) make mention of a lack of RI expertise among local asset managers and investment analysts. Mia (2011) identified a shortage of investment staff with the necessary skills to make responsible investment decisions as an obstacle to RI. A further obstacle identified by Mia (2011) is the retention and transfer of ESG skills and Gitman *et al.* (2009:23) makes mention of the weak investor capacity in the market.

A sixth barrier to RI as identified in the literature is the lack of appropriate benchmarks (Viviers *et al.*, 2009:12). The IFC *et al.* (2011:63) asked investors, asset owners and managers, and stakeholders to identify the barriers to ESG in investment that will be most relevant in Sub-Saharan in the next few years and the most important emerged as the inability to evaluate investment target ESG-related performance. Supporting the before mentioned, Mia (2011) identified a lack of appropriate benchmarks as barrier to RI. Schulschenk & Van der Ahee (2013) embarked on a study – *The State of Responsible Investment in South Africa* – with the aim of investigating whether investors consider ESG information when making investment decisions (specifically in the South African context). According to the study, the lack of ESG measurement tools remains the greatest barrier to considering ESG issues followed by uncertain levels of accountability (Schulschenk & Van der Ahee, 2013). Investors have difficulty in interpreting and understanding the available ESG data in the market with ESG factors still ending up being labelled irrelevant whilst a passive and selective approach is followed concerning ESG integration into investment decisions (Schulschenk and Van der Ahee, 2013).

A seventh and widely mentioned obstacles is the incomplete and non-disclosure of ESG data available in the market. The UNEP FI *et al.* (2007:39–40) found that pension funds identified “inadequate information for evaluation of ESG performance” as a key barrier. An interesting finding is that principal officers of pension funds identified the “lack of adequate information to evaluate investment target ESG performance as the most important barrier” (UNEP FI *et al.*, 2007:43). An emerging markets investor survey report titled *An Analysis of Responsible Investment in Emerging Markets* by EIRIS (2009) identified obstacles to responsible investment in emerging markets. The main challenge indicated by 70% of survey respondents is a lack of company ESG disclosure. The international study by Gitman *et al.* (2009:23) listed barriers to full ESG integration of which one is a lack of quality ESG data. The lack of education and information on sustainable investment was listed by the IFC et al. (2011:63) as barrier. Acquiring and assessing ESG information is considered to be more resource intensive than audited financial information – “the difficulty of acquiring consistent, comparable, audited information remains a significant hurdle to integrated analysis” (UNPRI, 2013b:6). An emerging markets report by Brewer (2012) surveyed global investors in order to assess the level of investment in emerging countries and the ESG challenges that are considered key issues. The key challenge identified by respondents as an important barrier is a lack of company ESG disclosure (Brewer, 2012). To elaborate on the major concerns among investors, the study indicated that the poor quality and inconsistency of ESG data available in the market is listed as a recurring issue in addition to the difficulty of finding and accessing information (Schulschenk & Van der Ahee, 2013). Another main concern with ESG data was its quality and that it is difficult to express in monetary terms (Schulschenk & Van der Ahee, 2013).

A further obstacle to RI is the view that RI is too costly to implement (UNEP FI *et al.*, 2007:39–40). Both the IFC et al. (2011:63) and Mia (2011) confirm the view that ESG in investment is too costly to implement referring to the cost of obtaining and analysing ESG data.

Lastly, various other obstacles were listed and mentioned in studies. These obstacles will be mentioned below but does not form part of the focus of this study. In a study conducted by EIRIS (2009:15–16), 51% of survey respondents indicated that the challenge of different corporate cultures was a barrier generally referring to the lack of emerging market companies mitigating its ESG risks. Other barriers that influence company engagement include language, idiomatic, and cultural differences. Supporting the before mentioned, Brewer (2012) identified challenges that include errors in translation of company reports due to a language barrier and the inconsistencies between the reporting of a company's activities in its home county versus other countries, the regulatory environment, the corporate culture and access to local markets, resource scarcity, and issues around shareholder rights. Schulschenk and Van der Ahee (2013) made reference to dissimilar formats, content, understanding and approach to the integration of ESG factors as well as misleading language. Gitman *et al.* (2009:23) found that the business value of sustainability is not integrated into investor communications.

In summary, the main obstacles to RI as identified in the above mentioned studies are listed in Table 2.3 below.

Table 2.3: The main obstacles to RI as identified in the literature study

No.	Obstacle Description	Source(s)
1.	A lack of adequate information to evaluate investment target ESG related performance.	UNEP FI *et al.* (2007:39–40) IFC *et al.* (2011:63)
2.	A lack of company ESG disclosure.	EIRIS (2009:15–16) Brewer (2012)
3.	A lack of definition of RI in a South African context and a lack of appropriate benchmarks.	Herringer *et al.* (2009) Viviers *et al.* (2009:12) Mia (2011:6)

4.	The qualitative nature of ESG issues, followed by the lack of measurement tools.	Schulschenk and Van der Ahee (2013)
5.	The poor quality and inconsistency of ESG data available in the market (dissimilar formats, content, understanding and approach to the integration of ESG factors).	Gitman *et al.* (2009:23) Schulschenk and Van der Ahee (2013)
6.	The difficulty of acquiring consistent, comparable, audited information remains a significant hurdle to integrated analysis.	UNPRI (2013b:6)

This study will focus on the following obstacles to RI, namely the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market. Chapter 3 will explore the relevance of the obstacles by analysing the disclosure of the Top 40 listed companies on the JSE. The motivation for selecting the specific obstacles is that:

- quantitative information has been disclosed by companies for centuries where qualitative information was not considered to be objective and hard to interpret, hence the importance of transparent and readily available qualitative information;
- a company's disclosure – website and reports – is a reflection of its business values and practices and the public domain is often the first and only way wherein stakeholders such as institutional investors can obtain information about the company;
- incomplete ESG data and the non-disclosure thereof is within a company's control; and
- as disclosure is a pre-requisite for quality performance analysis, selective ESG disclosure makes the analysis of the impact of ESG issues on company performance problematic and highlights investment risks that cannot be evaluated.

4. Exploration of the disconnect between environmental, social and governance disclosure and environmental, social and governance consideration in investment decisions

This section will explore the possible disconnect between ESG disclosure by companies and ESG consideration by investors as a result of the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market. As quantitative information has been used to make investment decisions for centuries, qualitative information is considered less objective and harder to interpret. The poor quality and inconsistency can be attributed to an interpretation of sustainability and other non-financial information disclosure indicators. Incomplete and non-disclosure of ESG data could be the result of both a skewed understanding of sustainability and other non-financial information disclosure indicators, and non-compliance as compliance is not mandatory.

4.1. Listed company disclosure: availability of information in the public domain

One of the most historic developments in progress towards informed markets and a sustainable global economy is the practice of sustainability reporting (GRI *et al.*, 2010). With companies having pursued the main goal of making profit for centuries, sustainability reporting was introduced in an attempt to prompt companies to conduct business more responsibly, including reporting on a company's economic, social and environmental vision, plans, challenges, and achievements (Dawkins & Ngunjiri, 2008; GRI *et al.*, 2010; Visser *et al.*, 2010). However, according to Visser *et al.* (2010), it seems as though a tick-box approach has been followed instead of making genuine attempts to conduct business more responsibly. Corporate social responsibility (CSR) appeared to be limited to once-off isolated actions whereby businesses attempted to be seen as good corporate citizens (Visser *et al.*, 2010).

A more integrated approach to finance and sustainability performance was suggested in 2009 and many businesses started producing integrated reports which aimed to provide the reader with an integrated view of the business where sustainability has become a part of the core business, and not merely a side-line issue (IODSA, 2009; King, 2015). According to Ljungkvist (2015:10) integrated reporting is important to investors because it links sustainability topics to financial information and the company's overall business strategy. When a company incorporates ESG exposures into its long-term strategic planning and adequately communicate these factors and strategies, its stakeholders are able to better understand and communicate the issues affecting their common future as a more comprehensive picture of the company's prospective value is available (CFA Institute, 2008; Dawkins & Ngunjiri, 2008; GRI *et al.*, 2010; Ljungkvist, 2015).

Ljungkvist (2015) states that the lack of transparency, comparability and financial relevance are some of the key concerns in the process of integrating sustainability issues into investment analysis. The CFA Institute (2008), the IIRC (2015) and Pearse (2015) are in agreement with the view expressed by the GRI *et al.* (2010) that:

> Transparency about the sustainability of organisational activities is of interest to a diverse range of parties, including businesses, employees, non-governmental organisations, investors, accountants and others. Sustainability reports can be used for benchmarking and assessing sustainability performance with regard to existing regulatory frameworks; demonstrating how the company influences and is influenced by expectations about

sustainable development; and comparing performance within an organisation and between different organisations over time. (GRI *et al.*, 2010:10)

Companies that are non-compliant to national laws or have irresponsible ESG policies and practices are considered to be risks in an investment portfolio. Often however, the facts about non-compliance or lack of licenses are not disclosed. Listed companies annually disclose information on their websites and in their annual reports which are generally available in the public domain.

Table 2.4 below lists reasons for and against mandatory and voluntary approaches to reporting as encouraged by various stakeholders such as regulators, company management, governments and non-profit groups, among others.

Table 2.4: Reasons for and against mandatory and voluntary approaches to reporting

	Reasons for	**Reasons against**
Mandatory approaches to reporting	Changing the corporate culture – leaders will continue to innovate above minimum requirements	Knowledge gap between regulators and industry
	Incompleteness of voluntary reports	One size does not fit all
	Comparability	Inflexibility in the face of change and complexity
	Non-disclosure of negative performance	Lack of incentive for innovation
	Legal certainty	Constraints on efficiency and competitiveness
	Market failures – theory of regulation	
	Reduction of non-diversifiable market risk free rider problem	
	Cost savings	
	Standardisation	

	Equal treatment of investors	
Voluntary approaches to reporting	Flexibility	Conflicts of interest
	Proximity	Inadequate sanctions
	Compliance	Under-enforcement
	Collective interest of industry	Global competition
		Insufficient resources

Source: GRI *et al.* (2010:8)

According to the UNPRI (2013b), the question of whether high quality integrated analysis of ESG information is possible should be replaced with discussions around structure, utilisation, resourcing and payment. Supporting the positive statement on high quality integrated ESG analysis, Roy (2012:4) notes that "ESG data has become more mainstream" and lists "two main drivers [that] have led to a greater availability of ESG information". These drivers are increased regulation and more mainstream ESG data providers that are entering the market. Supporting this view, Gitman *et al.* (2009:20) note that "the availability of ESG data through third-party providers seems to be increasing … [as these service providers gather] data from public sources and through company surveys and interviews …".

Herringer *et al.* (2009) suggest that companies need to be further educated on their role in society which would lead to companies being more ESG conscious to ensure long-term sustainability. The UNEP FI and WBCSD (2010) hosted an international workshop series where investors, companies and stakeholders participated in discussions around translating ESG into sustainable business value. The key findings from the workshops indicated that asset managers require companies to disclose how their operations and performance are influenced by ESG factors; state and show what the connection is between ESG factors and the financial materiality thereof; illustrate that ESG can be used to reduce volatility; disclose information in a comparative way as ESG is only relevant if it can be compared to a competitor, past performance, or new market development; improve corporate measurement, monitoring and reporting of environmental issues; and report on social inequities and employee remunerations in the workplace as these issues are acutely material in South Africa" (UNEP FI & WBCSD, 2010:9).

The actions suggested by Gitman *et al.* (2009) for companies include gaining familiarity with ESG; identifying financially material issues; developing a proactive strategy for communicating on ESG. Ljungkvist (2015) states that the main objective of companies should be to deliver relevant information to institutional investors in an accessible format to ensure that their sustainability story is effectively told.

4.2. Institutional investors environmental, social and governance consideration and inclusion in investment decision-making

A growing sense exists among institutional investors that ESG factors are becoming more material to the financial success of businesses (Gitman *et al.*, 2009; Bertrand, 2011; Roy, 2012; Ceres & Blackrock, 2015). Ljungkvist (2015:14) notes that “institutional investors are increasingly starting to look at ways of investing their money with a more long-term and sustainable outlook, increasing demand for standardized, accessible data”. In a case where an institutional investor applies a RI strategy that considers ESG factors when making investment decisions, ESG risks can be highlighted; and companies that have more effective risk management and are likely to be more profitable in the long run, can be identified (Van Dijk *et al.*, 2012; Ellsworth and Spalding, 2013). Greenwald (2015:20) states that “not only is sustainability integration important to identify long-term opportunities, it can also be used to identify long-term sustainability risks”.

In a study conducted by the UNEP FI in 2007, with the aim of understanding why RI integration was not enthusiastically attempted by investors, enablers of RI were identified. The RI enablers identified by participants are training provided on RI; RI benchmarks such as the JSE SRI, Financial Times Stock Exchange (FTSE) 4GOOD, Dow Jones Sustainability Index (DJSI); co-operative initiatives; collaboration with civil society organisations; and facilitated industry conversations (UNEP FI *et al.*, 2007:39–40).

The UNEP FI and WBCSD (2010) hosted an international workshop series where investors, companies and stakeholders participated in discussions around translating ESG into sustainable business value. The key findings from the workshops indicated that investors need to clearly communicate to all stakeholders which ESG information is needed for mainstream investment analysis; address the investment community’s misconceptions and perceptions around the material ESG issues within sectors and companies; enquire about companies forward-looking reporting and the role of ESG issues in risk management and market opportunities; collectively decide on the measurement, standardisation and disclosure of material ESG issues; and explore new tools that can assist asset owners and managers (UNEP FI and WBCSD, 2010:13).

The actions suggested for institutional investors are to increase ESG familiarity and influence companies to embed it in their company culture; include ESG into investment objectives, mandates and contracts; demonstrate interest in ESG disclosure; closely monitor legislation on ESG issues;

and secure senior-level commitment in the investment community (Gitman *et al.*, 2009; FutureGrowth Asset Management, 2011).

A study undertaken by the IFAC in 2012 which asked the question *to what extent are investors using ESG info?* – made it clear that ESG data is increasingly being used as institutional investors are beginning to understand the importance of integrating ESG factors into decision-making as they will have an impact on the long-term performance of a portfolio (IFAC, 2012). According to IFAC, four factors support the above statement. These factors are the number of investors that are UNPRI signatories, the increasing number of ESG resolution shareholder proposals, the belief that ESG integration can create long-term value for shareholders, and the performance of portfolios incorporating ESG factors that outperform their peers (IFAC, 2012:3). The investment approaches used to incorporate ESG factors are listed below.

- Institutional investors seem to be moving towards engagement and dialogue as opposed to strict inclusionary and exclusionary approaches, which can lead to even greater consideration of ESG factors in investment decision-making.
- Institutional investors have indicated that short-term performance is not as important as the management of long-term risks by sacrificing the first for the latter.
- ESG factors are included into the decision-making process due to institutional investors' compliance attitudes.
- Due to the complex nature, inconsistency and insufficiencies of ESG disclosure by companies, some investors will have no consideration or inclusion of ESG issues into the decision-making process (IFAC, 2012:3).

Most traditional investors are interested in information and disclosure related to the financial impact of ESG factors which can be assessed in terms of cash flows, earnings, cost of capital and asset values. Therefore, the focus needs to shift toward material ESG factors relating to the drivers of competitive advantage and sustainable value creation of an organisation (IFAC, 2012).

Schulschenk & Van der Ahee (2013) embarked on a study – *The State of Responsible Investment in South Africa* – with the aim of investigating whether investors consider ESG information when making investment decisions (specifically in the South African context). The results of the study revealed that 84% of investors consider ESG issues when making investment decisions and 46% of eventual decisions are often (and 12% always) influenced by ESG issues (Schulschenk and Van der Ahee, 2013). Motivations for including ESG issues in investment decisions include being responsible corporate citizens, adhering to frameworks such as the UNPRI and CRISA, and the possibility of greater financial returns (Schulschenk and Van der Ahee, 2013). Nevertheless, the study revealed that the extent to which ESG issues were considered in decision-making might appear promising

(Schulschenk and Van der Ahee, 2013). Investors disclosed that available benchmarks or indicators were considered as follows, 69% considered the B-BBEE scores; 68% non-financial information in integrated reports; 59% the JSE SRI index (Schulschenk and Van der Ahee, 2013).

Principle 4 of the UNPRI states that investors "… will promote the acceptance and implementation of the six Principles within the investment industry" (UNEP FI and UN Global Compact, 2013)." Ceres & Blackrock (2015) support the view of Bertrand (2011:2) that "institutional investors … have the ability to influence and encourage … sound governance principles and practices [within investee companies] by virtue of their share ownership and rights". In addition, investors also have a responsibility to influence companies to invest responsibly. RI principles also encourage participation in elevating ESG concerns and reporting on the implementation of RI principles. It is important for investors to implement a RI model with clear policies and processes to guide and integrate ESG considerations in investment decisions (UNEP FI, 2005; Bertrand, 2011).

5. Summary and conclusion: The obstacles to RI contributing to the disconnect between environmental, social and governance disclosure and environmental, social and governance consideration in investment decisions

A literature review was utilised to investigate the RI practices in South Africa; the obstacles to RI; and how these obstacles could contribute to a disconnect between ESG disclosure and ESG consideration in investment decisions. RI implies that institutional investors evaluate the performance of a company not based on profits alone but also consider ESG issues when making investment decisions. International RI Guideline principles are best captured in works by UNPRI, UNEP FI, and the UN Global Compact. Nationally, legislative instruments like CRISA and Regulation 28 of the Pension Fund Act prescribe the principles of RI in South Africa. The integration of ESG issues into investment decisions is "a growing discipline that offers opportunities for long-term value creation both for investors and society as a whole" (Macpherson, 2014:1).

Institutional investors play a vital role in the South African economy as they stimulate economic growth, business activity and employment (UNEP FI *et al.*, 2007). Even though investment decision-making continues to be primarily driven by making instant short-term profits, institutional investors are starting to consider the social and environmental consequences of their investments. Supporting this view, Gitman *et al.* (2009); Macpherson (2014); Freyman, Collins & Barton (2015) state that RI considerations are more common today seeing that they are increasingly being applied in investment decisions as institutional investors are progressively becoming aware that today's economy will be shaped by powerful forces such as population growth, rising energy demand, protection of human rights, climate change and declining freshwater resources.

The increased awareness of ESG factors among institutional investors led to the rapid growth of RI globally (Renneboog *et al.*, 2008). A wide range of factors – including among others, global warming, corporate responsibility, and governance issues – contributed to the creation and growth of awareness among governments, companies and institutional investors. By investing sustainably institutional investors are doing two things, firstly creating insurance that reduces risk to the planet and economy and secondly, performance is not sacrificed in the short term (McKnett, 2013). According to Renneboog *et al.* (2008), RI is expected to continue growing at a rapid pace given the positive regulatory environment and growing social awareness of institutional investors.

Institutional investors practicing RI expect companies to pay attention to environmental and social aspects in addition to profit maximisation. As investors make decisions on whether or not to adopt RI practices, company management decides on sustainability strategies. Companies adopt CSR practices for various reasons, such as pressure from social and environmental lobbyists, inherent culture of managers and employees in favour of CSR, improved reputation and higher firm value, elimination of competition in the market, and so on (Renneboog *et al.*, 2007). According to Ljungkvist (2015) the main objective of companies should be to deliver relevant information to institutional investors in an accessible format to ensure that their sustainability story is effectively told.

However, pre-set ideas and industry issues are still blockages for RI. UNEP FI *et al.* (2007) concludes from its study that while an understanding exists that ESG issues are vital for long-term value creation, the evidence of the incorporation of ESG considerations into mainstream investment activities is scarce. The causes of hesitant behaviour and lack of enthusiasm for RI can be attributed to a variety of obstacles hindering the ESG integration process. The obstacles contributing to the scarcity of RI practices in South Africa explored in this study are the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market. These obstacles contribute to a disconnect between investors and companies in the investment industry. When companies are selective in their ESG disclosure it makes analysis of the impact of ESG issues on company performance problematic.

Chapter 3 will explore the relevance of the obstacles by analysing the disclosure of the Top 40 listed companies on the JSE. This study aims to assess disclosure that is a pre-requisite for quality performance analysis and that the approach to, and absence of, disclosure highlights investment risks that cannot be evaluated.

Chapter 3: Environmental, Social and Governance Analysis: A Perspective from South African Broad-Based Black Economic Empowerment and Transformation Disclosure

1. Introduction and background: "Social" in South Africa

The planet and economy each face numerous unavoidable challenges which are inextricably connected. These challenges include an abundance of waste and pollution, energy constraints, economic and financial crises, social inequalities, poverty, unethical governance, corruption, water scarcity, biodiversity loss and climate change (Zaulochnaya-Brouwer, 2011). Sandham & Pisani (2006) note that within a development context, 'social' is one of the most difficult words to define as it has such a broad range of interpretations and meanings that it is often used in a rather vague way. In an attempt to define the concept of "social" within an ESG context as well as in a developing country context, the following definitions were considered:

The UNPRI describe social issues as "issues relating to the rights, well-being and interests of people and communities. These include: human rights, labour standards in the supply chain, child, slave and bonded labour, workplace health and safety, freedom of association and freedom of expression, human capital management and employee relations; diversity; relations with local communities, activities in conflict zones, health and access to medicine, HIV/AIDS, consumer protection; and controversial weapons" (UNPRI, 2013a:4). According to the International Association for Impact Assessment (IAIA) (2003:4), social impacts include "demographic changes, job issues, financial security, and impacts on family life". Burdge and Vanclay (1996:59) describe social impacts as "all social and cultural consequences to human populations of any public or private actions that alter the ways in which people live, work, play, relate to one another, organize to meet their needs, and generally cope as members of society. Cultural impacts involve changes to the norms, values, and beliefs of individuals that guide and rationalize their cognition of themselves and their society". Today's social challenges are numerous, complex, and urgent, from ageing societies and climate change, to energy efficiency and security (OECD, 2011). "Human rights are based on principles of dignity and freedom. Both are severely compromised when human beings cannot meet their fundamental needs. Economic and social rights guarantee that every person be afforded conditions under which they are able to meet their needs" (NESRI, 2015). In particular, economic and social rights include education, food, health, housing, social security and work.

For the purpose of this study, the definition of 'social' [9] within an ESG context as well as in a developing country context is "the rights, well-being and interests of people and communities and whether they are able to meet their fundamental needs".

According to an ESG country report that identifies key ESG risks in South Africa, a troubled social backdrop creates unique challenges for South African companies (Rogatschnig, Fryer & Menou, 2013). These challenges include, among others, high-income inequality, high youth unemployment and endemic poverty (Leibbrandt, Woolard, Finn & Argent, 2010; Rogatschnig *et al.*, 2013). According to the NPC (2012), Gumede (2013) and Bhorat, Hirsch, Kanbur & Ncube (2014), the continued racial imbalances existing around poverty, inequality and unemployment in South Africa continue to appear on the government's list of top priorities.

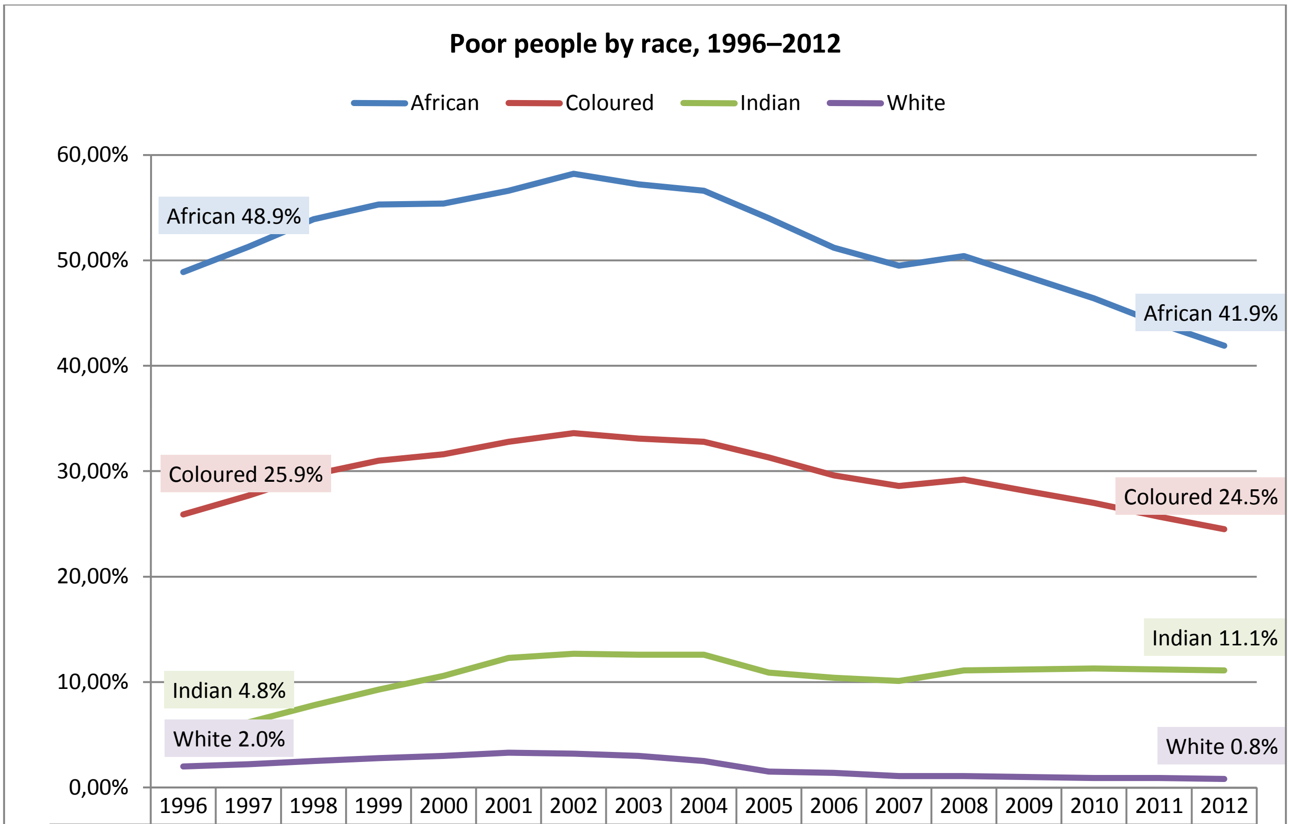
The next section will briefly reflect on poverty, inequality and unemployment in South Africa.

1.1. Poverty, inequality and unemployment

The developing world, including South Africa, face key social, economic and political developmental challenges with poverty ranking among the highest (Leibbrandt *et al.*, 2010; Stats SA, 2014). Since 1994, poverty alleviation has been a priority for the South African Government and this is reflected in the Reconstruction and Development Plan (RDP) of 1994 and reiterated in the National Development Plan (NDP) published in 2011 (Stats SA, 2014). Figure 3.1 below shows the percentage of poor people by race for 1996 to 2012. Poor people are defined as the part of the "population living below a poverty line" and a poverty line is defined as the "line drawn at a particular level of income or consumption; households/individuals whose incomes fall below a given level of the poverty line or whose consumption level is valued at less than the value of the poverty line are classified as poor" (Stats SA, 2014:73)[10].

The percentage of poor African people declined from 48.9% in 1996 to 41.9% in 2012. The percentages of poor Coloured and White people respectively decreased with 1.4% and 1.2% from 1996 to 2012. The percentage of poor Indian people increased from 4.8% in 1996 to 11.1% in 2012.

[9] For the purposes of this study, the term 'social' will be used consistently and does not exclude the definitions linked to terms such as 'socio-economic'.
[10] Refer to the report: *Poverty Trends in South Africa: An Examination of Absolute Poverty between 2006 and 2011* (Stats SA, 2014) for detailed descriptions and background to the national poverty lines.

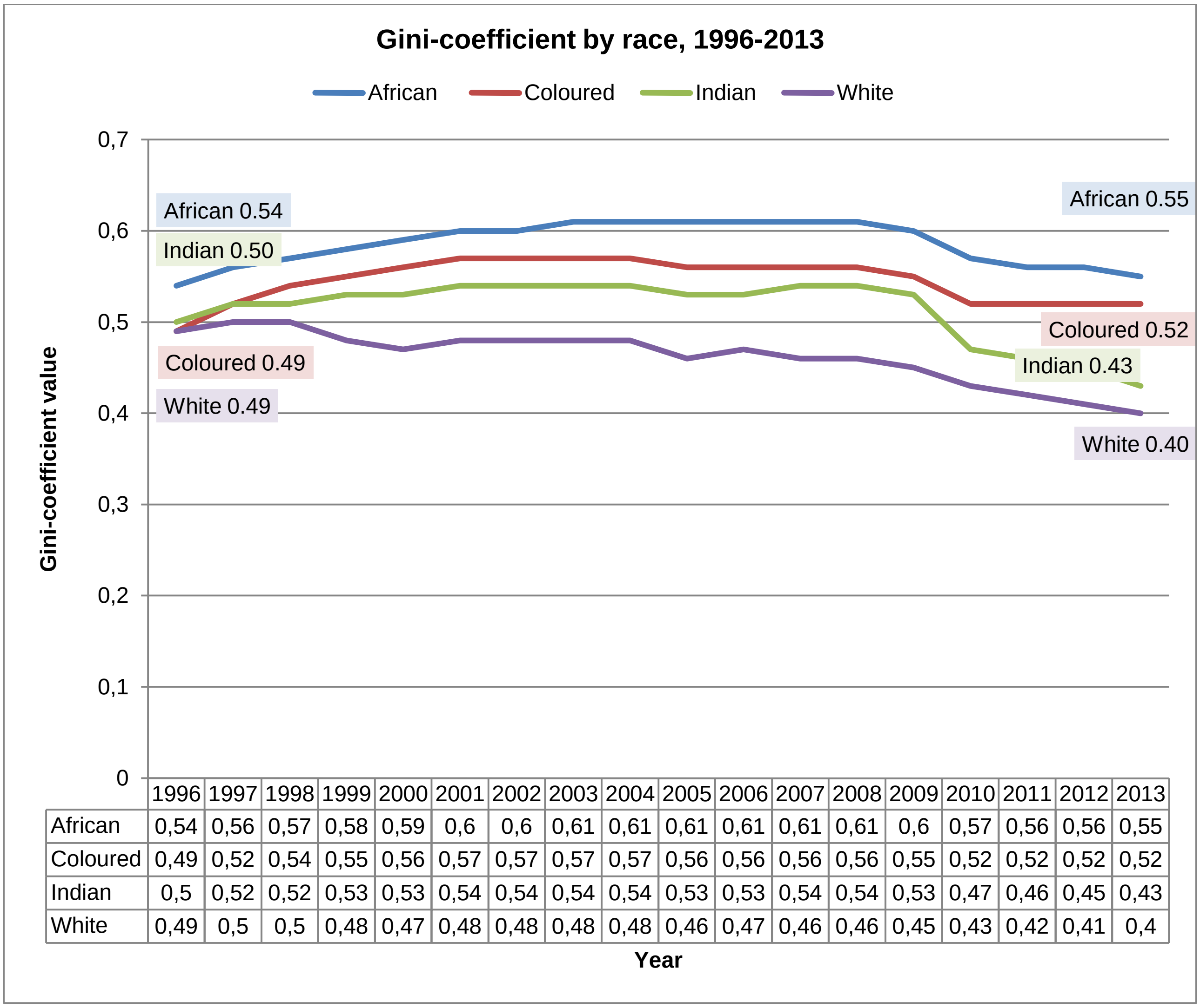


	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
African	0,489	0,513	0,539	0,553	0,554	0,566	0,582	0,572	0,566	0,54	0,512	0,495	0,504	0,484	0,464	0,44	0,419
Coloured	0,259	0,277	0,297	0,31	0,316	0,328	0,336	0,331	0,328	0,313	0,296	0,286	0,292	0,281	0,27	0,257	0,245
Indian	0,048	0,062	0,078	0,093	0,106	0,123	0,127	0,126	0,126	0,109	0,104	0,101	0,111	0,112	0,113	0,112	0,111
White	0,02	0,022	0,025	0,028	0,03	0,033	0,032	0,03	0,025	0,015	0,014	0,011	0,011	0,01	0,009	0,009	0,008

Figure 3.1: Poor people by race, 1996–2012

Source: Own calculations based on Stats SA (2014)

Inequality is measured in terms of the Gini coefficient where a value close to 1 means total inequality and a number close to zero total equality (Mbabane, 2007; Stats SA, 2014). Figure 3.2 below shows the Gini coefficient by race for 1996 to 2013. In 1996, the value for African people was the highest at 0.54 compared to the value for White people at 0.49. In 2013, the value for African people had increased while the value for White people had decreased which shows an ever greater disparity between the groups. The value for Coloured people had also increased from 0.49 in 1996 to 0.52 in 2013. In the case of Indian people, the value had decreased from 0.50 in 1996 to 0.43 in 2013.



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
African	0,54	0,56	0,57	0,58	0,59	0,6	0,6	0,61	0,61	0,61	0,61	0,61	0,61	0,6	0,57	0,56	0,56	0,55
Coloured	0,49	0,52	0,54	0,55	0,56	0,57	0,57	0,57	0,57	0,56	0,56	0,56	0,56	0,55	0,52	0,52	0,52	0,52
Indian	0,5	0,52	0,52	0,53	0,53	0,54	0,54	0,54	0,54	0,53	0,53	0,54	0,54	0,53	0,47	0,46	0,45	0,43
White	0,49	0,5	0,5	0,48	0,47	0,48	0,48	0,48	0,48	0,46	0,47	0,46	0,46	0,45	0,43	0,42	0,41	0,4

Figure 3.2: Gini-coefficient by race, 1996-2013

Source: Own calculations based on Stats SA (2014)

According to Grossett and Hills (2003), the unemployment figure in South Africa is one of the most shocking characteristics of its labour market. South Africa's rate of unemployment is high by world standards and is associated with a range of social problems such as poverty, inequality and crime. Stats SA defines unemployment as follows:

> Unemployed persons are those (aged 15-64 years) who a) were not employed in the reference week; and b) actively looked for work or tried to start a business in the four weeks preceding the survey interview; and c) were available for work, i.e. would have been able to start work or a business in the reference week; or d) had not actively looked for work in the past four weeks but had a job or business to start at a definite date in the future and were available. (Stats SA, 2014b:xxiv)

Figure 3.3 below shows that South Africa's unemployment rate increased from 20% in 1994 to 25% in 2015. Unemployment increased from 1994 to 2014 where African unemployed individuals increased with 168.93%, Coloured, Indian and White unemployed individuals with 93.78%, 42.60%, and 230.79% respectively (refer to Figure 3.4 below).

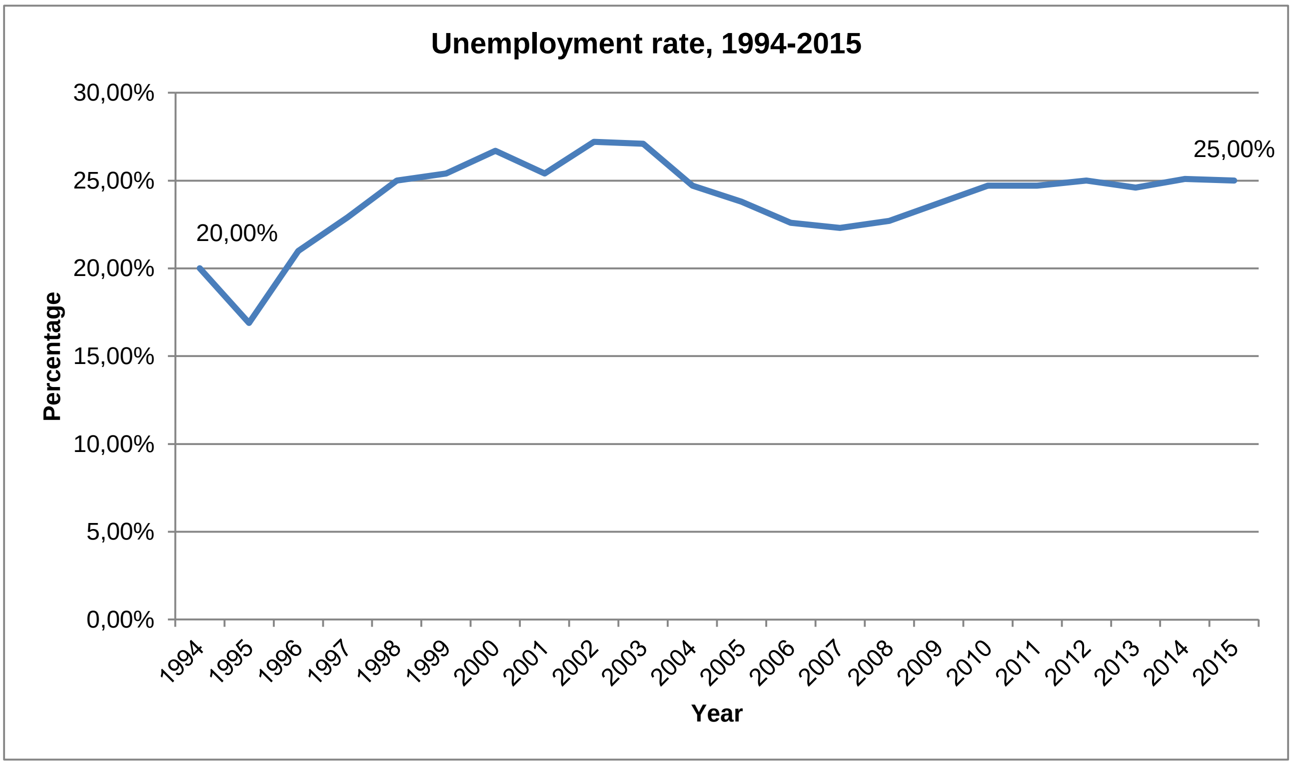


Figure 3.3: Unemployment rate 1994-2015

Source: Own calculations based on BusinessTech (2015)

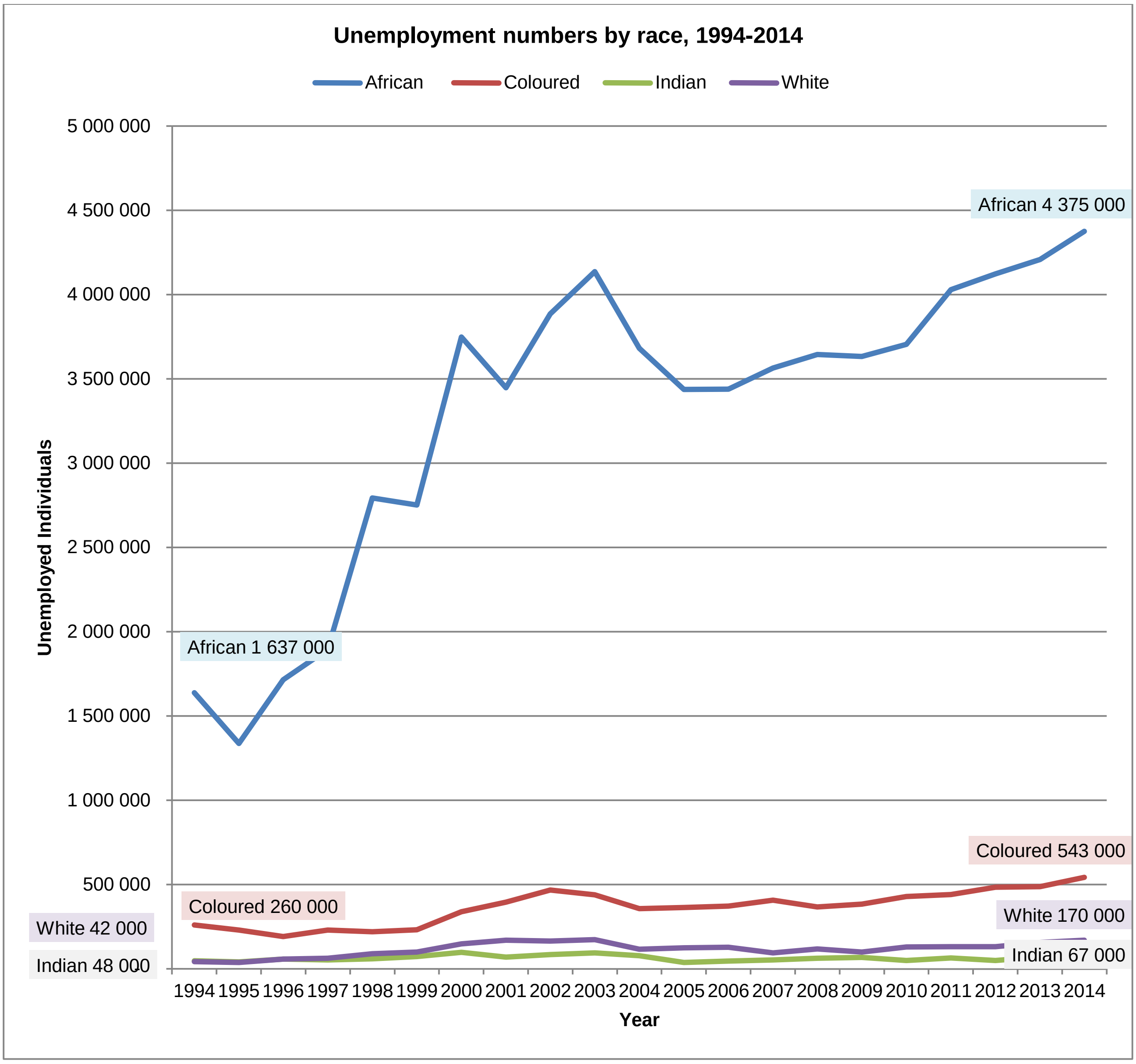


Figure 3.4: Unemployment numbers by race, 1994-2014

Source: Own calculations based on Stats SA (2014)

Since 1994, the South African Government has embarked on a journey attempting to redress the unique social inequalities the country is faced with (Mbabane, 2007; UNEP FI *et al.*, 2007, Gumede, 2013). Legislation and regulations promulgated to achieve this objective include B-BBEE which aims to transform the South African economy mainly by increasing black[11] ownership in the economy (Mphuthi, 1999; Mbabane, 2007).

[11] According to the Codes of Good Practice gazetted under the B-BBEE Act, “Black” refers to Africans, Coloured and Indians and there is strong emphasis on privileging women in economic empowerment.

This study will focus on two of the most relevant regulatory initiatives aimed at addressing socio-economic issues in the South African context, namely B-BBEE and transformation.

2. Methodology and methods

This research is relevant to investors and companies. Its relevance to institutional investors, such as the GEPF, is that it will:

- offer insight into the relevant and absolute quality of transformation disclosure available in the market;
- highlight that companies are at risk of non-performance, both from a social and financial perspective;
- indicate that incomplete disclosure limits the ability to identify non-performance of companies (including companies' contributions to national priorities) and thus hinders the incorporation of this non-performance into investment decision-making as it is an unquantified risk;
- provide investors with a clear agenda to fulfil their engagement mandate under RI and CRISA;
- provide relevant information to focus engagements with companies (active ownership); and
- allow institutional investors, such as the GEPF, to play a leadership role in setting B-BBEE and transformation disclosure expectations and show the investment industry how social issues can be incorporated into investment decision-making in a meaningful manner.

The relevance of the research to companies is that it will;

- highlight the risks of non-disclosure, both from a social and financial perspective;
- stress the importance of a company's disclosure – website and reports – as this is a reflection of its business values and practices and the public domain is often the first and only way wherein stakeholders such as institutional investors can obtain information about the company;
- indicate that incomplete disclosure limits the ability of investors to identify non-performance of companies (including companies' contributions to national priorities) and thus prevents investors from incorporating companies with good ESG performance into investment portfolios as incomplete disclosure is an unquantified risk; and
- identify areas where disclosure is lacking thus highlighting areas for improvement.

B-BBEE and transformation disclosure by the Top 40 JSE listed companies were empirically tested through a content analysis of the online content, reports and certificates of the companies selected for review based on the evaluation matrix (as discussed in Section 2.1 below). This study makes use of an exploratory design supported by a comparative and a cross-sectional design in order to obtain and analyse company information available in the public domain aiming to highlight two broad obstacles to RI, namely the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of B-BBEE and transformation disclosure available in the market. The nature of this study allows for the adoption of three complementary designs throughout the research process.

The population of this study comprises listed companies in South Africa. The sample was chosen and defined as companies, particularly the top 40, listed on the JSE in South Africa. The top 40 companies constitute a purposeful sample, which is a form of non-probability sampling where the goal is to choose a sample relevant to the research questions (Bryman and Bell, 2014). The JSE Main Board constituting 433 listed companies for the 2013 year reflected a total market capital of R9 966 billion.[12] The top 100[13] companies' market capital for 2013 is R9 483 billion[14] and the top 40 companies' market capital is R8 261 billion[15]. The top 40 companies[16] comprise 87.11% of the market capital of the top 100 for 2013. The supposition was that most top listed companies that have resources and influence to effect changes sooner were expected to take the lead on high profile issues by being compliant to a large degree and would disclose their compliance.

This study is limited to the assessment of B-BBEE and transformation disclosure available in the public domain, therefore to company reports, certificates and websites. Data gathering methods included purposeful and theoretical sampling, gathering of data for secondary analysis, E-research and content analysis. The relevant reports were available on the company websites and thus 100% coverage was obtained for the sample of 40 JSE listed companies. Companies were compared in peer groups (compiled from sector and industry groups); and according to B-BBEE contributor levels (Level 1-4 and 5-8) as well as non-disclosure. The contributor levels are determined according to the points scored per element in the B-BBEE verification process. Table 3.1 and Table 3.2 below present the mechanisms for measurement and calculation of the B-BBEE elements under the Old and Amended Codes respectively.

Table 3.1: Mechanisms for measurement and calculation of the B-BBEE elements – Old Codes

B-BBEE element	Old Codes weighting
Ownership	20 points
Management control	10 points

[12] R 9 965 994 837 103.00 at 31 December 2013 (Source: McGregor BFA).
[13] The JSE companies are ranked by total market capital on a certain date. The data used for the purposes of this research is 31 December 2013. Refer to ANNEXURE A: Companies ranked by Total Market Capital at 31 December 2013 in ZAR.
[14] R 9 483 209 682 637.00 at 31 December 2013 (Source: McGregor BFA).
[15] R 8 261 357 596 062.00 at 31 December 2013 (Source: McGregor BFA).
[16] Refer to ANNEXURE A: Companies ranked by Total Market Capital at 31 December 2013 in ZAR.

Employment equity	15 points
Skills development	15 points
Preferential procurement	20 points
Enterprise Development	15 points
Socio-Economic Development initiatives	5 points

Source: Adapted from Republic of South Africa (2012a:11)

Table 3.2: Mechanisms for measurement and calculation of the B-BBEE elements – Amended Codes

B-BBEE element	**Amended Codes[17] weighting**
Ownership	25 points
Management control (*and Employment equity*)	15 points
Skills development	20 points
Enterprise and Supplier Development	40 points
Socio-Economic Development initiatives	5 points

Source: Adapted from Republic of South Africa (2013a:11)

Table 3.3 and Table 3.4 below present the B-BBEE status of Measured Entities under the Old and Amended Codes.

Table 3.3: B-BBEE status of Measured Entities – Old Codes

B-BBEE Status	**Qualification**	**B-BBEE recognition level**
Level One Contributor	≥100 points on the Generic Scorecard	135%
Level Two Contributor	≥85 but <100 on the Generic Scorecard	125%
Level Three Contributor	≥75 but <85 on the Generic Scorecard	110%
Level Four Contributor	≥65 but <75 on the Generic Scorecard	100%
Level Five Contributor	≥55 but <65 on the Generic Scorecard	80%
Level Six Contributor	≥45 but <55 on the Generic Scorecard	60%
Level Seven Contributor	≥40 but <45 on the Generic Scorecard	50%
Level Eight Contributor	≥30 but <40 on the Generic Scorecard	10%
Non-Compliant Contributor	<30 on the Generic Scorecard	0%
Non-disclosure	*No B-BBEE disclosure*	*N/A*

Source: Adapted from Republic of South Africa (2012a:11)

[17] The Amended Codes were gazetted in 2013.

Table 3.4: B-BBEE status of Measured Entities – Amended Codes

B-BBEE Status	**Qualification**	**B-BBEE recognition level**
Level One Contributor	≥100 points on the Generic Scorecard	135%
Level Two Contributor	≥95 but <100 on the Generic Scorecard	125%
Level Three Contributor	≥90 but <95 on the Generic Scorecard	110%
Level Four Contributor	≥80 but <90 on the Generic Scorecard	100%
Level Five Contributor	≥75 but <80 on the Generic Scorecard	80%
Level Six Contributor	≥70 but <75 on the Generic Scorecard	60%
Level Seven Contributor	≥55 but <70 on the Generic Scorecard	50%
Level Eight Contributor	≥40 but <55 on the Generic Scorecard	10%
Non-Compliant Contributor	<40 on the Generic Scorecard	0%
Non-disclosure	*No B-BBEE disclosure*	*N/A*

Source: Adapted from Republic of South Africa (2013a:12)

The information analysed in this study was collected and compared from the following sources: sections in Integrated and Sustainability Reports focusing on social transformation and B-BBEE, Transformation Reports, B-BBEE Certificates, B-BBEE Scorecards, company websites, GRI disclosure index focusing on the labour practices and decent work (LA), human rights (HR), and economic sections.

As B-BBEE certificate expiry dates vary from month to month, a company's B-BBEE certificate had to be valid for the period 1 January 2013 to 31 December 2013. Companies' financial year-ends also differ from month to month therefore the company reports and financial statements that were published at the respective company's year-end in 2013 were considered. Thus the observations are limited to the historical period the researcher studied, namely 2013.

The data analysis methods for qualitative research, according to Bryman and Bell (2014), include narrative analysis where content, word usage and themes are analysed in addition to establishing the social contexts of the narrative, content analysis where printed text and documents are analysed to construct emerging themes, coding where prominent themes and patterns are identified in the data, and statistics where the patterns are summarised and analysed.

2.1. The evaluation matrix

This research provides an objective analysis of how the JSE Top 40 listed companies respectively have defined and framed their approach to transformation. The research will explore whether transformation is considered strictly as B-BBEE compliance, or is pursued strategically within the broader context of race, gender, skills development and inequality. The quality and relevance of public disclosure required to meaningfully analyse performance will also be considered. For example, the availability of disclosure around the companies' B-BBEE scorecards will be assessed. The intention was not necessarily to determine the level of compliance since companies may be internally compliant, but fail to provide sufficient information regarding compliance.

The research approach is qualitative in nature and incorporates company views on transformation and B-BBEE, compliance to and reporting on GRI indicators. In the design of the company disclosure indicators the approach taken involves B-BBEE disclosure indicators based on the requirements of the B-BBEE Codes of Good practice and on assessing transformation disclosure. Indicators were adapted from the GRI as it relates to labour practices and decent work, human rights, and economic issues.

According to Bryman and Bell (2014), a cross-sectional design comprises the collection of data on more than one case at the same time with non-manipulative variables (normally adopting a nomothetic approach generating conclusions that apply regardless of time and place). The research comprises the development of a database where companies' publically available B-BBEE and transformation information is captured. In other words, an evaluation matrix where non-manipulative variables, such as company reports and B-BBEE certificates, will be assembled to gather information on 40 companies simultaneously.

The analysis of disclosure is done according to a Likert Scale. The distinctions between the various levels of the Likert Scale are based on the availability of B-BBEE and transformation disclosure of the JSE Top 40 companies. The Likert Scale should be interpreted as follows:

- Scale 1: No disclosure – The topic of transformation and/or B-BBEE is not mentioned in the company reports or on the company website. No B-BBEE certificate or scorecard is publically available on listed company level. No GRI disclosure index is available and the company does not report on any of the LA or HR GRI indicators selected for this study.
- Scale 2: Disclosure to a lesser extent – The topic of transformation and/or B-BBEE is briefly mentioned in the company reports or on the company website with little or no context provided. B-BBEE points and/or contributor level are available in company reports or on the company website with no supporting B-BBEE certificate or scorecard. No GRI disclosure

index is available, however the company reports on a few of the LA or HR GRI indicators selected for this study.

- Scale 3: Disclosure to some extent – The topic of transformation and/or B-BBEE is mentioned in the company reports or on the company website mentioning legal compliance or legislative requirements. A B-BBEE certificate and scorecard on listed company level is only available on request. A GRI disclosure index is available; but the company indicates that it only reports on some of the LA or HR GRI indicators selected for this study.
- Scale 4: Disclosure to a large extent – The topic of transformation and/or B-BBEE is discussed in detail making reference to all B-BBEE elements highlighting the importance of transformation to the company. A B-BBEE certificate (no scorecard) on listed company level is publically available. A GRI disclosure index is available and the company reports on most of the LA or HR GRI indicators selected for this study.
- Scale 5: Substantive disclosure – The topic of transformation and B-BBEE is listed as a material issue/strategic objective to the company. The company expands on plans to address transformation and B-BBEE within the company as a responsible corporate citizen. Extensive information is provided addressing all B-BBEE elements. A B-BBEE certificate and scorecard on listed company level is publically available. A GRI disclosure index is available and the company reports on all of the LA or HR GRI indicators in addition to other GRI indicators selected for this study.

Following the interpretation of the Likert Scale, Table 3.5 below presents the exploratory and descriptive questions asked in analysing the B-BBEE and transformation disclosure of the top 40 companies on the JSE. The questions pertain to the materiality of transformation and/or B-BBEE, the company's website and published reports, company B-BBEE certificates and related information, and the availability of company information.

The first section in the evaluation matrix covers company material issues. Generally, a company would dedicate a section within one or more of its published reports to address the issues that are of importance to the company and its stakeholders. The questions asked in the table below aim to test whether a company views transformation and/or B-BBEE as material ESG issues. The second question builds on the first by testing the depth of a company's understanding of transformation and/or B-BBEE as material ESG issues. If a company merely describes transformation and/or B-BBEE by referring to the B-BBEE elements on the scorecard, it is not evidence enough the company made an effort to incorporate transformation and/or B-BBEE into their core business strategy. The before mentioned is important as the understanding and implementation of transformation and/or B-BBEE will differ from company to company. Further, the first section touches on the legislative side of B-BBEE by asking whether a company subscribes to B-BBEE, in other words, does a company have a B-BBEE certificate and detailed scorecard and on what level the certificates are issued. The last mentioned is relevant as a company with an international footprint generally only has a B-BBEE certificate on a South African company level.

The second section in the evaluation matrix covers company disclosure. This section explores the company's published reports that are publically available. Companies were initially prompted by government to produce sustainability reports to account for activities affecting the environment, its people and the communities wherein it operates. The integrated report was introduced soon after as a report which should combine profit generating activities with social and environmental activities (Brewer, 2012). As part of its listing requirements the JSE includes compliance with the King Code (Ohlhoff, 2008). The second set of questions pertains to a company's B-BBEE certificate and detailed scorecard and whether this is publically available.

Table 3.5: Evaluation matrix: Disclosure of the scope of B-BBEE and transformation indicators

Disclosure of the scope of B-BBEE and transformation indicators	Results				
	1	2	3	4	5
1. MATERIAL ISSUES					
Does the Company consider transformation and/or B-BBEE as material ESG issues? Are transformation and/or B-BBEE included in the Company's strategic objectives/imperatives?					
1.1 How is transformation defined/described in the company reports and on the website?					
Is the concept of transformation just defined as B-BBEE? Does the Company make a generic statement around the legislative requirements of B-BBEE and that the Company is aiming to be compliant? Does the Company make reference to the B-BBEE elements and how each one is being addressed?					
Does the Company provide a broader definition of transformation than merely referring to B-BBEE, such as gender equality, human rights, etc.					

1.2 Does the Company subscribe to B-BBEE?					
Does the Company have a valid verified B-BBEE certificate? Is the B-BBEE certificate issued on a listed company level? Does it include any Company subsidiaries? Is the B-BBEE certificate issued on a South African Group level?					
If the B-BBEE certificate is not publically available, is it available on request?					
1.3 Does the company disclose the impact of the Amended Codes on its business operations? The Amended B-BBEE Codes that will come into effect on 1 May 2015 will significantly reduce current compliance levels due to the rigid and focused nature thereof.					
2. DISCLOSURE					
Does the Company publish an Integrated Report? If not, is an Annual Report available?					
Does the Company publish a separate Sustainability/ Sustainable Development/Corporate Citizenship Report?					
Does the Company publish a separate Transformation report? A separate Transformation Report is not a statutory requirement, but it is considered good practice as a number of companies publish Transformation Reports.					
Does the Company publish a separate B-BBEE Report? A separate B-BBEE Report is not a statutory requirement, but it is considered good practice as a number of companies publish B-BBEE Reports.					
Does the Company disclose transformation and/or B-BBEE information on its website?					
2.1 How do companies disclose B-BBEE performance?					
Is the Company's B-BBEE level publically available on its website, published reports or B-BBEE certificate?					

Is the Company's B-BBEE certificate publically available? The B-BBEE Act requires companies to report on B-BBEE performance. If not, is it available on request?					
Does the Company publish its detailed B-BBEE scorecard per element?					
Does the Company publish a GRI disclosure index? To assess global best practice, diversity indicators of the GRI as it relates to labour practices and decent work, human rights and economic issues, will be considered.					
2.2 Is the Company's information easy to understand, complete, open, relevant and accessible to stakeholders? Is the relevant information easy to locate on the Company's website and/or available in the published reports without consulting other sources, such as conducting a Google search?					

The following sections are structured as follows:

- Section 3 discusses the B-BBEE and transformation disclosure of the top 40 JSE listed companies for 2013 by making use of an evaluation matrix that highlights the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of B-BBEE and transformation disclosure available in the market. The aim of this study is to improve disclosure practices in an attempt to improve investment decision-making.
- Section 4 provides conclusions and recommendations to this study.

3. Analysis of environmental, social and governance issues: A perspective from South African Broad-Based Black Economic Empowerment and transformation disclosure

3.1. Broad-Based Black Economic Empowerment and transformation

Transformation is a topical issue across the globe and many countries are taking part in finding and creating solutions to improve the well-being of millions of people worldwide (SPII, 2012). The OECD is one such organisation aiming at "promoting policies that will improve the economic and social well-being of people around the world" (OECD, 2014:4). More specifically in a South African context, B-

BBEE and transformation initiatives are pivotal in addressing social inequalities which still exist after the Apartheid era (Mbabane, 2007).

The Apartheid era in South Africa was characterised by the way social and economic goods were distributed to the sole benefit of white people and the prejudice of black people (Mbabane, 2007; Chipkin, 2013). The situation was maintained by denying black South Africans political and civil rights, and even formal citizenship. Writing nearly 20 years after the transition to democratic rule in 1994 Chipkin (2013:4) notes that “South Africa resembles less and less the society imagined in the Constitution, [namely] a non-racial democracy where all citizens have more or less equal access to goods and services”, despite important and positive changes to the way that many private and public goods are allocated. Chipkin (2013) also states that the majority of people in South Africa are still dependent on poor or non-existent public services whilst a small percentage of people live in luxury. Many people have to rely on the State to provide them with access to basic social services, such as electricity, clean running water, sanitation and waste removal. This state of inequality and fragmentation is frequently described as ongoing ‘social injustice’.

The prevailing legislation and best practices that inform transformation practices in South Africa are discussed below.

The Reconstruction and Development Programme (RDP) formed part of the 1994 elections and was selected as the primary socio-economic programme and viewed as the cornerstone of government development policy. The RDP documented the ANC’s strategic path towards a better life that encompasses a united, non-racial, non-sexist, democratic and prosperous society (ANC, 1994:5).

The Constitution of the Republic of South Africa (1996) was promulgated in December 1996. The Constitution is “… the supreme law of the Republic … [that aims to] heal the divisions of the past and establish a society based on democratic values, social justice and fundamental human rights; lay the foundations for a democratic and open society in which government is based on the will of the people and every citizen is equally protected by law; improve the quality of life of all citizens and free the potential of each person; and build a united and democratic South Africa able to take its rightful place as a sovereign state in the family of nations” (Republic of South Africa, 1996a:1243).

The Growth, Employment and Redistribution (GEAR) strategy was developed as a macroeconomic policy framework in 1996. GEAR represents “a strategy for rebuilding and restructuring the economy … in keeping with the goals set in the Reconstruction and Development Programme“ (Republic of South Africa, 1996b:1).

The GRI emerged in 1997 representing global best practice on sustainability reporting frameworks. The GRI indicators are disclosure requirements set out under the GRI's comprehensive sustainability reporting framework currently in its fourth iteration (GRI, 2013). The following indicators from the *General*, *Labour Practices and Decent Work* (LA) as well as the *Human Rights* (HR) categories, were consulted in this study:

- G4-10: "a. Report the total number of employees by employment contract and gender. b. Report the total number of permanent employees by employment type and gender. c. Report the total workforce by employees and supervised workers and by gender. d. Report the total workforce by region and gender." (GRI, 2013:27).
- LA1: "Total number and rates of new employee hires and employee turnover by age group, gender and region" (GRI, 2013:65).
- LA12: "Composition of governance bodies and breakdown of employees per employee category according to gender, age group, minority group membership, and other indicators of diversity" (GRI, 2013:68).
- LA13: "Ratio of basic salary and remuneration of women to men by employee category, by significant locations of operation" (GRI, 2013:68).
- HR3: "Total number of incidents of discrimination and corrective actions taken" (GRI, 2013:72).

The Employment Equity Act (1998) was gazetted in 1998 with the purpose "… to achieve equity in the workplace by promoting equal opportunity and fair treatment in employment through the elimination of unfair discrimination; and implementing affirmative action measures to redress the disadvantages in employment experienced by designated groups, to ensure their equitable representation in all occupational categories and levels in the workforce" (Republic of South Africa, 1998a:12).

In 1998, the Skills Development Act (1998) was approved with the purposes to "… develop the skills of the South African workforce; … increase the levels of investment in education and training in the labour market and to improve the return on that investment; …encourage employers to use the workplace as an active learning environment, to provide employees with the opportunities to acquire new skills, to provide opportunities for new entrants to the labour market to gain work experience, and to employ persons who find it difficult to be employed … encourage workers to participate in learnerships and other training programmes; … improve the employment prospects of persons previously disadvantaged by unfair discrimination and to redress those disadvantages through training and education; … ensure the quality of education and training in and for the workplace; … assist work-seekers to find work, retrenched workers to re-enter the labour market, and employers to find qualified employees; and … provide and regulate employment services" (Republic of South Africa, 1998b:4-5).

The Broad-Based Black Economic Empowerment Act (2003) is supported by the Codes of Good Practice (2007) and Amended Codes (2013). The B-BBEE Act is "… a legislative framework for the promotion of black economic empowerment [that promotes] ... the achievement of the constitutional right to equality, increase broad-based and effective participation of black people in the economy and promote a higher growth rate, increased employment and more equitable income distribution [and aims to] establish a national policy on broad-based black economic empowerment so as to promote the economic unity of the nation, protect the common market, and promote equal opportunity and equal access to government services" (Republic of South Africa, 2003:2). The B-BBEE Codes of Good Practice were gazetted to "… specify interpretative principles of B-BBEE; specify the application of the Codes and the basis for measurement under the Codes; … specify the elements of B-BBEE measurable under the Generic Scorecard; specify the Generic Scorecard; specify the basis for determining compliance by entities with the Codes; …" (Republic of South Africa, 2012a:8). The Amended Codes were gazetted in 2013 (Republic of South Africa, 2013a).

Each code, whether Generic or a Sector Code, such as Financial or Forestry, contains a number of elements that are linked to compliance targets (Mbabane, 2007). The elements on the Generic Scorecard are ownership, management control, employment equity, skills development, preferential procurement, enterprise development, and socio-economic development initiatives (Republic of South Africa, 2012a). The elements on the Amended Generic Scorecard are ownership, management control (*and employment equity*), skills development, enterprise and supplier development, and socio-economic development initiatives (Republic of South Africa, 2013a). The B-BBEE contributor status or level will be determined on an annual basis by an accredited verification agency following a prescribed methodology as laid out in the DTI's verification manual (Jeffery, 2014).

The Accelerated and Shared Growth Initiative for South Africa (ASGISA) replaced in the GEAR strategy in 2006 intending to "accelerate the growth of South Africa's economy, as well as accelerate wealth redistribution" (Gumede, 2013:2). As "the South African Government was mandated in 2004 to halve poverty and unemployment by 2014" (The Presidency, 2006:2), the following gross domestic product (GDP) targets for 2005 to 2009 and 2010 to 2014 respectively, namely "… an annual growth rate that averages 4,5% or higher [and] … an average growth rate of at least 6% …" (The Presidency, 2006:3).

The National Development Plan (NDP) 2030, compiled by the National Planning Commission (NPC), "aims to eliminate poverty and reduce inequality by 2030" (NPC, 2012:14). According to the NDP, economic transformation is described as follows:

> Economic transformation is about broadening opportunities for all South Africans, but particularly for the historically disadvantaged. It is about raising employment, reducing poverty and inequality, and raising standards of living and education. It includes broadening ownership and control of capital accumulation. In addition, it is about broadening access to services such banking services, mortgage loans, telecoms and broadband services, and reasonably priced retail services. It is also about equity in life chances and encompasses an ethos of inclusiveness that is presently missing. This includes equity in ownership of assets, income distribution and access to management, professions and skilled jobs. (NPC, 2012:138)

The aims of the Women Empowerment and Gender Equality Bill are to "… establish a legislative framework for the empowerment of women; to align all aspects of laws and implementation of laws relating to women empowerment, and the appointment and representation of women in decision-making positions and structures; and to provide for matters connected therewith" (Republic of South Africa, 2013b:2). These matters "… include the promotion of gender equality and the prohibition of unfair discrimination against women and the elimination of gender based violence" (Republic of South Africa, 2013b:2).

The concept of transformation is defined in this research as the contribution made by a company to bring about equality and ensure diversity with respect to race/ethnic group, gender, age, occupational level and other minority rights issues. This definition was derived from consulting a range of existing legislation and documents aiming to inform best practices in transformation in South Africa. As discussed above, the legislation and best practices consulted[18] include the RDP, ASGISA, GEAR, GRI indicators; the NDP; B-BBEE legislation and codes including the Employment Equity Act 1998; the Skills Development Act 1998; Women Empowerment and Gender Equality Bill (Republic of South Africa, 1998a; Republic of South Africa, 1998b; Republic of South Africa, 2003; NPC, 2012; Republic of South Africa, 2012a; GRI, 2013; Republic of South Africa, 2013a) .

Individuals, companies and the government have a part to play in the transformation of South Africa. Companies can play a role in a number of ways such as contributing to B-BBEE which includes increasing their black ownership; increasing the number of black people in management structures; developing the skills of black employees; procuring services from black suppliers; developing small

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[18] In addition to the above mentioned legislation and best practices, the following acts have been promulgated: Commission on Gender Equality Act (1996) and the Promotion of Equality and Prevention of Unfair Discrimination Act (2000).

black-owned businesses and contributing to socio-economic development (Republic of South Africa, 2003; Mbabane, 2007). According to Kim (2010), although B-BBEE is not legally binding, it is designed to be enforced on companies through social and profitability pressure.

3.2. Findings: Johannesburg Stock Exchange top 40 companies' Broad-Based Black Economic Empowerment and transformation disclosure

This research aims to bridge the gap between companies and their stakeholders by providing the stakeholders, such as institutional investors, with greater insight into the ESG performance of South African companies as it pertains to two key aspects of social performance, namely B-BBEE and transformation. Furthermore, this study aims to assess disclosure that is a pre-requisite for quality performance analysis. The approach to, and absence of, disclosure therefore highlights investment risks that cannot be quantified. An analysis of the top 40 JSE listed companies' disclosure was completed to provide a view of the companies' approach, disclosure and related risks around the stated issues. The group of top-tier performing companies (B-BBEE contributor level 1-4) comprised 24 companies; the bottom-tier performing group (B-BBEE contributor level 5-8) comprised 4 companies; and the other companies (B-BBEE non-disclosure) comprised 12 companies.

Table 3.6 below provides the research findings regarding the transformation and B-BBEE disclosure performance of the group of top-tier performing companies.

Table 3.6: Top-tier performing companies' B-BBEE and transformation disclosure

Top 40 JSE listed companies for 2013	No disclosure	Disclosure to a lesser extent	Disclosure to some extent	Disclosure to a large extent	Substantive disclosure
Top-tier performing companies (B-BBEE contributor level 1-4) – 24 companies					
Companies recognising B-BBEE and broader transformation/diversity as a material issue to be addressed	0% (0)	25% (6)	29% (7)	25% (6)	21% (5)
Companies for which disclosure information is easily accessible and transparent	0% (0)	4% (1)	38% (9)	50% (12)	8% (2)

Companies disclosing transformation-related information on their websites	4% (1)	4% (1)	50% (12)	21% (5)	21% (5)
Companies producing integrated reports	17% (4)	N/A	N/A	N/A	83% (20)
Companies producing sustainability reports	29% (7)	N/A	N/A	N/A	71% (17)
Companies producing separate transformation reports	92% (22)	N/A	N/A	N/A	8% (2)
Companies producing separate B-BBEE reports	92% (22)	N/A	N/A	N/A	8% (2)
Companies with valid B-BBEE certificates (SANAS/IRBA accredited agency)	13% (3)	N/A	N/A	N/A	88% (21)
Companies that have B-BBEE certificates at listed company level	50% (12)	N/A	N/A	N/A	50% (12)
Companies disclosing detailed B-BBEE scorecards	88% (21)	N/A	N/A	N/A	12% (3)
Companies reporting on the GRI Index	13% (3)	33% (8)	33% (8)	21% (5)	0% (0)

As seen in Table 3.6 above, the top-tier performing companies indicated that transformation and/or B-BBEE is a material issue or, at the very least, mentioned the legal compliance or legislative requirements it entails. Forty-six per cent of companies listed transformation and/or B-BBEE as a material issue/strategic objective and expanded on plans to address transformation and B-BBEE as responsible corporate citizens.

Fifty-eight per cent of companies' disclosure information was easily accessible and transparent on the company website and in published reports. As these companies were top B-BBEE contributors, these findings were in line with disclosure and availability expectations. Accessibility referred partly to the time spent acquiring information from a company's website and published reports[19] and transparency refers to a company's "documents and reports that are easy to understand or recognise, balanced, complete, obvious, candid, open, frank, relevant and accessible to stakeholders" (IODSA, 2011:9).

Companies were initially prompted by government to produce sustainability reports to account for activities affecting the environment, its people and the communities wherein it operates. The integrated report[20] was introduced soon after as a report which should combine profit generating activities with social and environmental activities (Brewer, 2012). As part of its listing requirements the JSE includes compliance with the King Code (Ohlhoff, 2008). Eighty-three per cent of companies produced integrated reports while the remaining seventeen per cent produced annual reports[21] and seventy-one per cent produced sustainability reports. As companies are moving towards producing one integrated report, this was in line with the expectation that the number of separate sustainability reports would be less (twenty-nine per cent) than the number of integrated reports.

Producing transformation reports is not a requirement and therefore is not compulsory for any company (listed and unlisted). However, it is deemed to be best practice as it ensures that a company spends time and effort contemplating the material issues affecting its operations and business strategy. The research found that ninety-two per cent of companies dedicated a section of their integrated or annual reports to transformation referring to the elements on the B-BBEE scorecard. Thus transformation was found to be considered as a B-BBEE side-line issue instead of a concept that permeated the entire organisation's thinking and ways of conducting business. Only eight per cent of companies produced separate transformation and B-BBEE reports.

As with transformation reports, no company (listed and unlisted) is required to publish a B-BBEE report. However, it is deemed to be best practice as it ensures that a company properly discloses its position on B-BBEE. In most cases where separate B-BBEE reports were available, the research found that the company's entire B-BBEE scorecard was disclosed providing greater clarity on its B-BBEE position. Greater disclosure of this nature will aid in investment decision-making.

Eighty-eight per cent of companies provided verified[22] valid B-BBEE certificates on their websites. Thirteen per cent of B-BBEE certificates were not publically available or had expired at the time this

[19] Difficulties in locating evidence were mainly due to poorly structured websites where the researcher had to hunt for information and eventually reverted to using Google to search for reports.
[20] An integrated report is a "holistic and integrated representation of the company's performance in terms of the value that it has generated within the triple context of the economy, society and natural environment" (IODSA, 2011:9).
[21] Thus, all companies produced either an Integrated or an Annual Report.
[22] B-BBEE Certificates need to be verified by an accredited body such as SANAS or IRBA.

study was done. Where B-BBEE certificates were not available on a company website, companies were contacted requesting B-BBEE certificates.

A B-BBEE certificate can be issued at various levels in a company. A distinction was made between certificates issued for the particular listed company as the company is registered with the JSE and others which were issued at a subsidiary level.[23] Fifty per cent of the companies in the research sample disclosed a B-BBEE certificate at listed company level.

Along with B-BBEE certificates, verification agencies provide companies with a detailed scorecard. B-BBEE certificates provide total points per element and indicate a company's contributor level whereas B-BBEE scorecards detail each element showing how the total points per element were calculated. Eighty-eight per cent of companies did not disclose B-BBEE scorecards compared to twelve per cent that disclosed their detailed scorecards.

Thirteen per cent of companies did not make a GRI disclosure index publically available, however the companies reported on a few of the LA or HR GRI indicators selected for this study in their published reports or on their websites. A GRI disclosure index was available for thirty-three per cent of companies; however, the companies indicated that they only reported on some of the LA or HR GRI indicators. Twenty-one per cent of companies produced a publically available GRI disclosure index and reported on all of the LA or HR GRI indicators in addition to other GRI indicators. As the group of companies constituted the top-tier performing companies in the JSE top 40, it was expected that they would make a GRI disclosure index publically available and would describe how they reported on the various indicators.

Table 3.7 below provides the research findings regarding the transformation and B-BBEE disclosure performance of the group of bottom-tier performing companies.

[23] A company in which the holding company has taken up more than a 51% shareholding and thus effectively owns the subsidiary company. Both holding and subsidiary companies form part of the same group.

Table 3.7: Bottom-tier performing companies B-BBEE and transformation disclosure

Top 40 JSE listed companies for 2013	No disclosure	Disclosure to a lesser extent	Disclosure to some extent	Disclosure to a large extent	Substantive disclosure
Bottom-tier performing companies (B-BBEE contributor level 5-8) – 4 companies					
Companies recognising B-BBEE and broader transformation/diversity as a material issue to be addressed	0% (0)	100% (4)	0% (0)	0% (0)	0% (0)
Companies for which disclosure information is easily accessible and transparent	0% (0)	25% (1)	50% (2)	25% (1)	0% (0)
Companies disclosing transformation-related information on their websites	0% (0)	25% (1)	75% (3)	0% (0)	0% (0)
Companies producing integrated reports	50% (2)	N/A	N/A	N/A	50% (2)
Companies producing sustainability reports	50% (2)	N/A	N/A	N/A	50% (2)
Companies producing separate transformation reports	100% (4)	N/A	N/A	N/A	0% (0)
Companies producing separate B-BBEE reports	100% (4)	N/A	N/A	N/A	0% (0)
Companies with valid B-BBEE certificates (SANAS/IRBA accredited agency)	25% (1)	N/A	N/A	N/A	75% (3)
Companies that have B-BBEE certificates at listed company level	25% (1)	N/A	N/A	N/A	75% (3)
Companies disclosing detailed B-BBEE scorecards	100% (4)	N/A	N/A	N/A	0% (0)

Companies reporting on the GRI Index	50% (2)	50% (2)	0% (0)	0% (0)	0% (0)

The entire group of bottom-tier performing companies (10% of the total purposeful sample) provided disclosure to a lesser extent. They briefly mentioned the topic of transformation and/or B-BBEE in their company reports or websites while providing little or no context. Fifty per cent of these companies' disclosure information is relatively easily accessible and transparent on the company websites and in published reports. As these companies are bottom-tier B-BBEE contributors, the fact that information was more difficult to locate was in line with expectations around the availability and transparency of disclosure.

Fifty per cent of these companies produce integrated reports and fifty per cent produced sustainability reports. No company produced a separate transformation or B-BBEE report. B-BBEE points and/ or contributor levels were available in company reports or websites with seventy-five per cent of companies disclosing supporting B-BBEE certificates on a listed company level. No company publically disclosed its detailed B-BBEE scorecard.

No GRI disclosure index was available for any of the bottom-tier performing companies; however, the companies reported on a few of the LA or HR GRI indicators selected for this study in their published reports or on their company websites.

Table 3.8 below provides the research findings regarding the transformation and B-BBEE disclosure performance of the B-BBEE non-disclosure companies.

Table 3.8: Other companies B-BBEE and transformation disclosure

Top 40 JSE listed companies for 2013	No disclosure	Disclosure to a lesser extent	Disclosure to some extent	Disclosure to a large extent	Substantive disclosure
Other companies (B-BBEE non-disclosure) – 12 companies					
Companies recognising B-BBEE and broader transformation/diversity as a material issue to be addressed	8% (1)	58% (7)	17% (2)	17% (2)	0% (0)

Companies for which disclosure information is easily accessible and transparent	0% (0)	17% (2)	50% (6)	33% (4)	0% (0)
Companies disclosing transformation-related information on their websites	0% (0)	33% (4)	58% (7)	8% (1)	0% (0)
Companies producing integrated reports	66% (8)	N/A	N/A	N/A	33% (4)
Companies producing sustainability reports	33% (4)	N/A	N/A	N/A	66% (8)
Companies producing separate transformation reports	100% (12)	N/A	N/A	N/A	0% (0)
Companies producing separate B-BBEE reports	100% (12)	N/A	N/A	N/A	0% (0)
Companies with valid B-BBEE certificates (SANAS/IRBA accredited agency)	92% (11)	N/A	N/A	N/A	8% (1)
Companies that have B-BBEE certificates at listed company level	92% (11)	N/A	N/A	N/A	8% (1)
Companies disclosing detailed B-BBEE scorecards	100% (12)	N/A	N/A	N/A	0% (0)
Companies reporting on the GRI Index	33% (4)	33% (4)	25% (3)	8% (1)	0% (0)

Fifty-eight per cent of the B-BBEE non-disclosure companies provided disclosure to a lesser extent in that the topic of transformation and/or B-BBEE is briefly mentioned in the company reports or on the company website with little or no context provided. Even though transformation and/or B-BBEE disclosure is scarce and opaque, sixty-six per cent of companies had their information easily accessible on the company website and in published reports.

B-BBEE points and/or contributor levels are available in company reports or on the company website with no supporting B-BBEE certificate or scorecard.

Thirty-three per cent of companies produce integrated reports (sixty-six per cent of companies produced annual reports) and sixty-six per cent produced sustainability reports. It appears that the companies that are B-BBEE non-disclosure are also reluctant to move towards one integrated report. No company produced a separate transformation or B-BBEE report which is expected of the B-BBEE non-disclosure group.

Ninety-two per cent of companies did not publically disclose their B-BBEE certificate. One company disclosed its verified detailed ownership scorecard on its website, but its full B-BBEE certificate was not available. No company publically disclosed its detailed B-BBEE scorecard.

For thirty-three per cent of companies, no GRI disclosure index was available and the companies do not report on any of the LA or HR GRI indicators selected for this study. Another thirty-three per cent of companies did not make a GRI disclosure index publically available, however the company reported on a few of the LA or HR GRI indicators in its published reports or on the website. A GRI disclosure index was available for twenty-five per cent of companies, but the companies indicated that they only reported on some of the LA or HR GRI indicators. Eight per cent of companies produced a publically available GRI disclosure index and reported on all of the LA or HR GRI indicators selected for this study in addition to other GRI indicators. As this is the B-BBEE non-disclosure group of companies, it was not expected that thirty-three per cent of companies would make a GRI disclosure index publically available, which is a positive. It was expected that the majority of companies (sixty-six per cent) in the B-BBEE non-disclosure group would not report on the LA or HR GRI indicators.

4. Conclusion and recommendation: Improving Broad-Based Black Economic Empowerment and transformation disclosure

The research aimed to provide greater insight into the ESG disclosure of South African companies, with specific emphasis on key aspects of social performance, namely B-BBEE and transformation. Transformation[24] (defined in this study according to the GRI, the NDP and B-BBEE legislation) in post-apartheid South Africa is a topical issue of interest to government, labour, civil society and business owners (Ponte *et al.*, 2007; Tangri & Southall, 2008; Kim, 2010; KPMG, 2013). The

[24] For the purpose of this report, transformation refers to the contribution made by a company to bring about equality and ensure diversity with respect to race/ethnic group, gender, age, occupational level and other minority rights issues.

prevailing legislation and best practices that inform transformation practices in South Africa were discussed to provide context to the unique South African landscape companies and institutional investors operate in.

An evaluation matrix analysed was utilised to explore whether transformation is considered strictly as B-BBEE compliance, or is pursued strategically within the broader context of race, gender, skills development and inequality. The need for this research is driven by the fact that other than publications on B-BBEE levels, there is little deeper analysis on transformation across listed companies; particularly for the JSE top 100 listed companies that investors can draw on to inform engagement with companies. There is also little research that highlights financial, reputational and license to operate risks within companies resulting from transformation performance. This research covered the top 40 JSE listed companies for 2013 and grouped companies according to their B-BBEE contributor levels. These groups comprised top-tier performing companies (B-BBEE contributor level 1-4), bottom-tier performing companies (B-BBEE contributor level 5-8) and other companies (B-BBEE non-disclosure).

Disclosure among the group of top-tier performing companies proved to be thorough and well documented when compared to the bottom-tier performing companies. The topic of transformation and B-BBEE was included in the companies’ material issues/strategic objectives lists and extensive information was provided addressing all B-BBEE elements. In contrast, companies in the B-BBEE non-disclosure group and the bottom-tier performing companies included limited information on transformation and B-BBEE other than making mention to the B-BBEE elements in the light of legal compliance or a legislative requirement. B-BBEE certificates and scorecards were publically available where companies are high performers and only available on request or not at all where companies have a low score. GRI disclosure indexes were available and the top-tier performing companies reported, in addition to other GRI indicators, on all of the LA and HR GRI indicators selected for this study. The bottom-tier performing and group of non-disclosure companies selectively reported on the GRI indicators selected for this study and a small number had GRI disclosure indexes publically available.

Institutional investors would easily be able to gain an understanding of a top-tier performing company’s transformation and B-BBEE standing based on its thorough public disclosure. In the case of the bottom-tier performing and group of non-disclosure companies, an institutional investor would need to spend additional time and resources to determine what these companies’ position on and understanding of transformation and B-BBEE is. In order for institutional investors to improve ESG decision-making, company disclosure needs to be easily accessible and transparent. The research concludes that improved company disclosure is a requirement for improved investor decision-making.

Chapter 4: Conclusion

1. Overall findings of this study

1.1. Chapter 2: Responsible investment and its obstacles: The disconnect between environmental, social and governance disclosure and environmental, social and governance consideration in investment decisions

This research indicates that global and local legislation, frameworks and best practices exist informing RI practices. As institutional investors have a compliance attitude towards the integration of ESG factors into decision-making, the availability of numerous legislation, frameworks and best practices is considered a positive. This research supports the findings of a study by the UNEP FI *et al.* (2007:39-40) where institutional investors agreed that more stringent legislation would be an important driver of RI as regulation would make compliance non-negotiable.

Even though RI and corporate governance guidelines are largely voluntary in South Africa, this research found that RI seems to be moving from niche to mainstream as ESG consideration is becoming increasingly important and relevant. However, despite the abundance of frameworks and legislative processes in place to govern and inform RI practices, there is still a lot of talk and little action, too much box-ticking, too few examples of ESG considerations embedded into investment decision-making strategies, and many mainstream portfolio managers still label ESG issues as irrelevant.

The research indicates that both companies and institutional investors are responsible for ESG integration. In support of the before mentioned statement:

- Gitman *et al.* (2009:25) state that “specific actions can be taken by companies and investors to respond to the barriers preventing greater ESG integration and that and ESG-based approach can be adopted”.
- Bjorn Stigson (1998) notes that sustainable development requires collaborative thinking and partnerships with other non-business organisations and it is not possible for companies to deal with or solve sustainable development issues alone.
- McKnett (2013) also adds that “companies and investors are not singularly responsible for the fate of the planet and they do not have indefinite social obligations” (McKnett, 2013:08:48).

Therefore, both companies and investors can contribute to social transformation. As companies disclose their ESG performance in their annual integrated, sustainability and transformation reports and publish them in the public domain, institutional investors need to single out the companies or organisations they wish to invest in.

The research indicates that obstacles to RI exist that hinder the integration of ESG factors into investment decision-making. The main obstacles identified in this study are a lack of adequate information to evaluate investment target ESG related performance; a lack of company ESG disclosure; a lack of definition of RI in a South African context combined with a lack of appropriate benchmarks; the qualitative nature of ESG issues, followed by the lack of measurement tools; the poor quality and inconsistency of ESG data available in the market (dissimilar formats, content, understanding and approach to the integration of ESG factors); and the difficulty of acquiring consistent, comparable, audited information that is a significant hurdle to integrated analysis.

The research indicates that the above mentioned obstacles, and specifically the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market, could contribute to a disconnect between ESG disclosure by companies and ESG consideration and inclusion by investors.

1.2. Chapter 3: Environmental, social and governance analysis: A perspective from South African Broad-Based Black Economic Empowerment and transformation disclosure

Transformation is a topical issue across the globe and many countries are taking part in finding and creating solutions to improve the well-being of millions of people worldwide (SPII, 2012). The OECD is one such organisation aiming at "promoting policies that will improve the economic and social well-being of people around the world" (OECD, 2014:4). More specifically in a South African context, B-BBEE and transformation initiatives are pivotal in addressing social inequalities which still exist after the Apartheid era (Mbabane, 2007). The research indicates, in support of the findings by Chipkin (2013:4), that "efforts to 'transform' the economy have focused on ownership and control of private, for-profit companies. In particular, black economic empowerment policies, including Broad Based Black Economic Empowerment (B-BBEE), have tried to shift patterns of ownership and control of capital". However, even though most laws and regulations restricting black people were repealed, the inequalities will remain pronounced for years to come as macro-societal changes take time to filter through a country's entire population (Mphuthi, 1999).

The research indicates that ESG analysis based on complete and consistent disclosure could inform RI practices that pertain to incorporating ESG issues. Investors need to understand whether companies are meeting set transformation and B-BBEE performance targets as non-performance against the B-BBEE Codes puts expected returns at risk over the long and short term. Incomplete disclosure limits their ability to identify non-performance and incorporate that into investment decision-making (unquantified risk), and also limits the ability to determine their contribution to national priorities, legislation and best practices. Companies need to understand that selective ESG disclosure makes the analysis of the impact of ESG issues on company performance problematic. This study aimed to assess disclosure that is a pre-requisite for quality performance analysis and that the approach to, and absence of, disclosure highlights investment risks that cannot be evaluated. According to Viviers *et al.* (2012), many responsible investors still find information in company reports insufficient for decision-making purposes.

The research indicates that B-BBEE and transformation disclosure of South African listed companies' falls short at present in that it could be 1) of poor quality and inconsistent, and 2) incomplete and lacking. The research indicates that listed companies' ESG disclosure is generally readily available in the public domain and that the majority of Top 40 companies acknowledge that B-BBEE and transformation are material social issues that should be addressed by the company as a corporate citizen. The research further indicates that B-BBEE verification levels are generally disclosed, however detailed B-BBEE scorecards at listed company level are not available for the majority of companies studied.

Among the group of top-tier performing companies, forty-six per cent listed the topic of transformation and B-BBEE as material issues/strategic objectives and extensive information was provided addressing all B-BBEE elements. These companies expanded on plans to address transformation and B-BBEE within the company as responsible corporate citizens. All of the bottom-tier performing companies briefly mentioned the topic of transformation and/or B-BBEE in their company reports or websites while providing little or no context. The companies in the B-BBEE non-disclosure group did not mention the topic of transformation and/or B-BBEE in their reports or on their websites.

Eighty-three per cent of top-tier performing companies produced integrated reports and seventy-one per cent produced sustainability reports. Fifty per cent of the bottom-tier performing companies produced integrated reports and the other half produced sustainability reports. Thirty-three per cent of B-BBEE non-disclosure group companies produce integrated reports and sixty-six per cent produced sustainability reports.

Verified B-BBEE certificates (eighty-eight per cent of companies) and scorecards (twelve per cent of companies) were publically available on a listed company level in the case of the top-tier performing companies. Seventy-five per cent of the bottom-tier performing companies publically disclosed their B-BBEE certificates, however no scorecards were available. No B-BBEE certificates or scorecards were publically available, but one company in the B-BBEE non-disclosure group disclosed its verified detailed ownership scorecard on its website.

GRI disclosure indexes were available for fifty-four per cent of top-tier performing companies, none for the bottom-tier performing companies and for only eight per cent of companies in the B-BBEE non-disclosure group.

As the findings from Chapter 2 indicates that the 1) qualitative nature, poor quality and inconsistency; and 2) incomplete and non-disclosure of ESG data available in the market, could contribute to a disconnect between ESG disclosure by companies and ESG consideration and inclusion by investors; this research concludes that meaningful ESG information will ensure better investment decision-making, greater benefit for the fund beneficiaries and stimulate active ownership in the investment industry in South Africa.

2. Critique of this study and its contributions

The limitations and challenges, as well as the contributions of this study are discussed in this section.

When aiming to accelerate the RI process, it is necessary to first establish where the problems lie regarding non-compliance with existing policies, codes and frameworks – whether in the form of uninformed investors or the weak structures in place. For the purposes of the research, the assumption has been made that the policies in place are in fact good and well-structured, thus the issues pertaining to a lack of disclosure and non-disclosure by companies will be addressed. This study contributes to a well-informed view of the B-BBEE and transformation disclosure in the South African listed company environment.

The poor quality and inconsistency of the ESG data produced and presented to the market complicates the way the available amount of ESG is calculated as most of the data is not relevant or reliable. This study contributes to highlighting the best practices, legislation and frameworks available that inform global and local RI practices. As companies become more aware and start reporting in accordance with the best practices, legislation and frameworks, the available ESG data will become more consistent and of better quality.

South African institutional investors might not yet be interested in investing in a responsible and sustainable manner and would prefer to focus on higher returns than the inclusion of ESG factors into policies and decisions. This study contributes to discussing the importance of ESG consideration in investment decision-making and provides an overview of various RI strategies available to institutional investors which will ensure financial returns in addition to ESG considerations.

As all information was obtained from the public domain, access to information was not a fundamental issue throughout the research process. However, many listed companies did not publish their B-BBEE certificates on their websites or elsewhere online as it is not a legislative requirement to make this information publically available. Therefore, the companies may be internally compliant, even though their information is not disclosed in the public domain. In these cases, companies were contacted inquiring about their B-BBEE compliance. It was found that some companies with low contributor levels did not have B-BBEE certificates publically available and refused to provide them for the purposes of this study. These companies were included in the B-BBEE non-disclosure group.

The group of companies in the mining sector posed a challenge as the mining companies included in the sample did not have B-BBEE certificates available as they choose to subscribe only to the Mining Charter that has targets and elements that differ from the Generic Sector Codes.

3. Recommendations for further research

The areas for future research that have been identified through this study will be discussed below.

A study of the transformation and B-BBEE disclosure of the remaining 393 companies listed on the JSE as well as unlisted companies in South Africa would be of value. This will provide a broader view, in terms of the number of companies and not the total market capitalisation value, of larger and smaller company disclosure around transformation and B-BBEE.

A study of the impact that South African listed and unlisted companies' B-BBEE and transformation performance can have for institutional investors would be insightful. As disclosure and performance are not one in the same, it would be interesting to see how a company's performance on B-BBEE and transformation compliments or contradicts the disclosure around the stated issues.

A number of studies of the impact that South African companies' environmental and governance issues can have for investors could be done due to the multitude of issues within each of the social, environmental and governance spheres. This research recommends that the evaluation matrix be utilised in other studies to investigate various ESG disclosures.

Numerous studies could be done exploring the other RI obstacles between companies and investors in South Africa and abroad as identified in the literature study.

A comparative study can be conducted in other developing and developed countries. This study can be repeated in other countries by making use of a similar evaluation matrix for a variety of ESG issues. Findings from the studies in developing countries will allow for comparison with the South African experience and developed country study findings can be utilised as benchmarks.

A purposeful study would be exploring the role of intermediaries such as analysts or service providers in interpreting and translating ESG data produced by companies in order to make it more useful to investors.

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Annexure A: Johannesburg Stock Exchange Main Board Listed Companies on 31 December 2013

2013			
Listing	**JSE Code**	**Company Name**[25]	**Market Capital (ZAR)**
1	BTI	BRITISH AMERICAN TOB PLC	1 134 346 918 488.30
2	SAB	SABMILLER PLC	883 114 708 508.81
3	GLN	GLENCORE XSTRATA PLC	723 518 768 170.30
4	BIL	BHP BILLITON PLC	685 288 293 643.20
5	CFR	COMPAGNIE FIN RICHEMONT	543 506 400 000.00
6	NPN	NASPERS LTD -N-	441 463 945 332.24
7	MTN	MTN GROUP LTD	395 168 172 985.60
8	SOL	SASOL LIMITED	332 063 955 776.00
9	AGL	ANGLO AMERICAN PLC	315 231 172 013.34
10	SBK	STANDARD BANK GROUP LTD	208 038 576 419.52
11	FSR	FIRSTRAND LTD	195 862 094 275.86
12	VOD	VODACOM GROUP LTD	195 398 119 280.00
13	OML	OLD MUTUAL PLC	161 551 794 913.26
14	KIO	KUMBA IRON ORE LTD	140 110 619 549.74
15	APN	ASPEN PHARMACARE HLDGS L	124 524 145 463.15
16	BGA	BARCLAYS AFRICA GRP LTD	112 089 594 777.38
17	SLM	SANLAM LIMITED	110 040 000 000.00

[25] Company names as reflected on the JSE Main Board.

2013			
Listing	**JSE Code**	**Company Name**[25]	**Market Capital (ZAR)**
18	AMS	ANGLO AMERICAN PLAT LTD	107 333 390 628.00
19	NED	NEDBANK GROUP LTD	106 178 618 911.51
20	REM	REMGRO LTD	98 626 805 850.00
21	SHP	SHOPRITE HOLDINGS LTD	92 605 046 358.00
22	SHF	STEINHOFF INT HLDGS LTD	91 122 501 164.80
23	BVT	BIDVEST LTD	87 747 741 740.36
24	IMP	IMPALA PLATINUM HLGS LTD	76 497 927 396.00
25	RMH	RMB HOLDINGS LTD	65 926 540 280.60
26	MNP	MONDI PLC	64 267 140 875.00
27	WHL	WOOLWORTHS HOLDINGS LTD	63 854 777 089.74
28	MDC	MEDICLINIC INTERNAT LTD	62 848 756 700.00
29	EXX	EXXARO RESOURCES LTD	52 105 805 977.50
30	ITU	INTU PROPERTIES PLC	51 828 068 207.22
31	TBS	TIGER BRANDS LTD	51 101 033 513.04
32	DSY	DISCOVERY LTD	49 302 970 087.00
33	ANG	ANGLOGOLD ASHANTI LIMITED	49 280 539 773.60
34	ASR	ASSORE LTD	48 304 022 000.00
35	GRT	GROWTHPOINT PROP LTD	46 753 559 314.35
36	INP	INVESTEC PLC	45 180 245 475.40
37	LHC	LIFE HEALTHC GRP HLDGS L	43 637 322 232.50

2013			
Listing	**JSE Code**	**Company Name[25]**	**Market Capital (ZAR)**
38	CCO	CAPITAL&COUNTIES PROP PL	41 873 857 870.00
39	IPL	IMPERIAL HOLDINGS LTD	41 571 306 216.00
40	MPC	MR PRICE GROUP LTD	40 515 957 747.10
41	RMI	RAND MERCHANT INS HLDGS	39 831 304 556.26
42	ARI	AFRICAN RAINBOW MIN LTD	39 825 762 806.73
43	MMI	MMI HOLDINGS LIMITED	39 716 033 610.00
44	REI	REINET INV SOC ANON	39 188 257 200.00
45	NTC	NETCARE LIMITED	37 718 464 104.30
46	TRU	TRUWORTHS INT LTD	35 564 937 625.60
47	LBH	LIBERTY HOLDINGS LTD	34 687 727 607.60
48	TSH	TSOGO SUN HOLDINGS LTD	31 733 611 458.04
49	LON	LONMIN PLC	30 224 347 225.92
50	DST	DISTELL GROUP LTD	29 827 751 249.32
51	RDF	REDEFINE PROPERTIES LTD	29 634 940 295.85
52	MSM	MASSMART HOLDINGS LTD	29 413 933 281.12
53	CML	CORONATION FUND MNGRS LD	28 298 747 351.80
54	NPK	NAMPAK LTD	28 062 142 288.20
55	BAT	BRAIT SE	26 621 581 597.08
56	GFI	GOLD FIELDS LIMITED	25 419 386 114.82
57	PIK	PIK N PAY STORES LTD	25 187 231 540.03

2013			
Listing	**JSE Code**	**Company Name[25]**	**Market Capital (ZAR)**
58	CPI	CAPITEC BANK HLDGS LTD	23 566 910 178.00
59	SPP	THE SPAR GROUP LTD	23 078 685 989.71
60	BAW	BARLOWORLD LTD	22 419 617 991.57
61	SNT	SANTAM LIMITED	22 133 986 496.82
62	TFG	THE FOSCHINI GROUP LIMIT	21 589 991 501.50
63	PFG	PIONEER FOODS GROUP LTD	20 923 895 482.50
64	INL	INVESTEC LTD	20 801 346 572.08
65	MND	MONDI LTD	20 520 202 384.00
66	AVI	AVI LTD	19 582 152 513.84
67	HYP	HYPROP INV LTD	18 640 714 329.96
68	PPC	PPC LIMITED	18 391 433 706.24
69	PSG	PSG GROUP LTD	17 663 784 173.25
70	ABL	AFRICAN BANK INV LTD	17 562 790 791.00
71	SAP	SAPPI LTD	17 169 259 731.33
72	CLS	CLICKS GROUP LTD	17 167 337 402.04
73	GND	GRINDROD LTD	16 929 566 548.52
74	CPL	CAPITAL PROPERTY FUND	16 921 565 517.87
75	HCI	HOSKEN CONS INV LTD	16 781 711 380.00
76	NEP	NEW EUROPE PROP INV PLC	16 361 493 437.64
77	RES	RESILIENT PROP INC FUND	16 250 984 478.00

2013			
Listing	**JSE Code**	**Company Name[25]**	**Market Capital (ZAR)**
78	ACL	ARCELORMITTAL SA LIMITED	16 051 534 273.32
79	NHM	NORTHAM PLATINUM LTD	16 011 227 866.50
80	AFE	AECI LIMITED	15 872 405 897.80
81	TKG	TELKOM SA SOC LTD	14 373 635 584.80
82	RLO	REUNERT LTD	13 765 540 656.90
83	OMN	OMNIA HOLDINGS LTD	13 649 696 980.25
84	ILV	ILLOVO SUGAR LTD	12 765 876 548.04
85	AIP	ADCOCK INGRAM HLDGS LTD	12 580 138 479.20
86	TON	TONGAAT HULETT LTD	12 353 243 490.00
87	TRE	TRENCOR LTD	12 212 380 718.67
88	MUR	MURRAY & ROBERTS HLDGS	11 918 927 962.40
89	PWK	PIK N PAY HOLDINGS LTD	11 878 921 817.46
90	HAR	HARMONY GOLD MINING COMPANY LTD	11 432 605 810.56
91	ATT	ATTACQ LIMITED	11 063 793 122.95
92	RCL	RCL FOODS LIMITED	10 882 652 748.52
93	RPL	REDEFINE INTERNATIONAL P	10 790 021 494.36
94	SUI	SUN INTERNATIONAL LTD	10 715 614 529.95
95	AEG	AVENG GROUP LIMITED	10 443 762 618.63
96	DTC	DATATEC LTD	10 182 419 680.25
97	OCE	OCEANA GROUP LTD	9 844 174 290.52

2013			
Listing	**JSE Code**	**Company Name[25]**	**Market Capital (ZAR)**
98	RBP	ROYAL BAFOKENG PLATINUM	9 765 647 648.40
99	WBO	WILSON BAYLY HLM-OVC LTD	9 636 000 000.00
100	FBR	FAMOUS BRANDS LTD	9 426 046 476.30