Addressing the participation gap in institutional investment: an assessment framework and preliminary results

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Chapter

Introduction

This chapter shows how fiduciary duty and the governance quality of investment can be understood using a stakeholder-based approach. In the past, stakeholders were effectively passive economic actors, who were supposed to just sit back and reap rewards. This view is increasingly being challenged by the assertion that large investors should care about governance as well as economic outcomes, and have both a right and a responsibility to ensure that assets are managed in a way that is socially and environmentally beneficial for all stakeholders. Contemporary governance theory argues for a wider understanding of stakeholders, which, in the case of investment, encompasses both financial and nonfinancial interests. This chapter examines the changing nature of “stakeholderism,” and explores its tensions and contradictions, using responsible investment as a case study. A survey of stakeholders involved in responsible investment follows. The results reveal interesting views about the governance quality of some central aspects of the sector’s architecture, and thus provide useful learning points for institutional investment and fiduciary duty in general.

Changing conceptions of stakeholder rights and responsibilities

It has been argued that developments in institutional governance in the wake of the 1992 Rio “Earth” Summit, with its emphasis on sustainable development, necessitate a fundamental rethink of what constitutes a “stakeholder” in investment that claims to be truly “responsible.” The definition has become far more all-encompassing, and now includes non-governmental organizations (NGOs, sometime also referred to as civil society or civil society organizations – CSOs), the general public and local communities, unions, private business, ethical shareholder groups and small shareholders, as well as traditional interests such as governments, regulatory authorities and large-scale investors (Cadman 2011a). If it is accepted that the investment community is made up of a wide range of participants, from traditional “internal” interests (e.g., banks, financial advisors and asset managers) to “external” groups in civil society, and that these interests all have a “stake” in investment activities, it is necessary to look beyond “corporate” governance as a means of determining the legitimacy of current financial practice (Cadman 2011b).

A well-established literature suggests that a stakeholder-based approach can be useful in understanding the governance quality of institutional investment and fiduciary duty (Donaldson and Preston 1995; Hamilton and Erikson 2010). In the past, certain stakeholders – for example, pension funds – were not seen as central to investment decisions; this is now changing. The “universal owner” hypothesis argues that such large investors, who have a stronger role in global economic activity than individual shareholders, are more concerned with minimizing investor risk than with making a quick profit (Hawley and Williams 2000). Hence, such investors pay more attention to matters of
Addressing the participation gap in institutional investment

The participation gap in institutional investment is a significant issue. The efforts of NGOs to change the behavior of companies have, for example, resulted in improvements in the human rights record of certain companies, or led them to address issues such as climate change. Indeed, it has been suggested that improved social and environmental performance can boost financial success. External parties such as NGOs may not yet have legally enforceable claims, but trustees may nevertheless have the mandate to take third-party interests into account (Richardson 2010). Thus, responsible investment has the potential to provide lessons for investment practice more generally. Given the evolving relations between internal and external stakeholders, it is necessary to recast the analytical basis on which the quality of investment governance is evaluated.

**Background to the development of responsible investment**

“Responsible investment” can be understood as investment practices that deliver sustainable returns in economic, social and environmental terms. Although related to the older concept of corporate social responsibly (CSR), with its historical links to human rights and the struggle for racial equality in countries such as South Africa, CSR is more closely tied to the discourse of sustainable development as it has emerged over the past two decades. Since the UN Conference on Environment and Development (UNCED) in 1992, sustainable development has been promoted through a range of global public–private initiatives, including the Global Compact, initiated in 2000. UNCED was central to the development and promotion of voluntary methods of environmental problem solving as an alternative to governmental regulation (Clapp 2005). Such methods are implemented through a range of private sector, market-based mechanisms, such as emissions trading and ecolabelling (Jordan et al 2005; Falkner 2003). Through these mechanisms, a range of actors – state, civic and business – have come together in a series of multi-scalar, multi-stakeholder initiatives that are “ conducive to inclusive development” (Utting and Marques 2010: 17).

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governance, and have become active around corporate behavior and investment practices (Yaron 2003). This engagement is leading to changes in corporate behavior, as companies seek to sell themselves to responsible investors by demonstrating their environmental or social credentials. In 2005, the influential Freshfields Report argued that responsible investors could go so far as to instruct trustees to make investment decisions on environmental or social grounds, rather than strictly on financial grounds (Freshfields Bruckhaus Deringer 2005). This has had legal repercussions, because there is now some uncertainty as to whether instructions that supersede financial considerations are contrary to fiduciary duty; determinations in different jurisdictions have gone either way. As a result of these developments, commentators are beginning to prefer the term “fiduciary responsibility” to “fiduciary duty” (Richardson 2010).

Regardless of the legal issues, institutional investors and shareholders are increasingly becoming involved in the decision-making that underpins investment activities, and influencing the deliberations made by financial planners and advisors. Civil society interests, most notably NGOs, are also playing an increasing role (Ransome and Sampford 2010). Yet the role afforded to such parties is generally a passive one of being consulted about investment decisions, rather than one of active participation; thus, they are considered important only in so far as they provide knowledge that is material to such decisions. Engagement, in the sense discussed above, is usually nonexistent or indirect; and creates, in terms of internal and external interests, what is referred to in public policy as a participation gap (Fiorino 1996).

Mitchell et al.’s theory of stakeholder salience explains stakeholder relations within an organization in terms of power (extent of influence), legitimacy (degree of status or acceptance) and urgency (ability to initiate a response) (Mitchell et al. 1997). This theory helps to explain why external interests are generally considered less salient to investment decisions than internal interests, but it does not provide any suggestions as to how to address this participation gap. An examination of developments in the sphere of corporate governance can shed some light on the incipient social relationships in contemporary investment practice. The efforts of NGOs to change the behavior of companies has, for example, resulted in improvements in the human rights record of certain companies, or led them to address issues such as climate change. Indeed, it has been suggested that improved social and environmental performance can boost financial success. External parties such as NGOs may not yet have legally enforceable claims, but trustees may nevertheless have the mandate to take third-party interests into account (Richardson 2010). Thus, responsible investment has the potential to provide lessons for investment practice more generally. Given the evolving relations between internal and external stakeholders, it is necessary to recast the analytical basis on which the quality of investment governance is evaluated.
In 1999, the World Bank and the Organisation for Economic Co-operation and Development cofounded the Global Corporate Governance Forum (GCGF) as a facility of the International Finance Corporation. The aim of the GCGF is to encourage companies to invest and behave in a socially responsible manner (Global Corporate Governance Forum 2010). Between 2003 and 2005, the United Nations Environment Programme Finance Initiative engaged with the UN Global Compact and investment industry representatives to create a global body to promote sustainable financial practices: the Principles for Responsible Investment (PRI) (Global Compact and UNEP FI 2009a). The PRI initiative is aimed at integrating environmental and social governance (ESG) issues into financial management (Global Compact and UNEP FI 2009b). The principles cover the elements required for reporting on environmental and social performance, referred to as “sustainability reporting” (UNEP FI 2009a). Such reporting functions within a context of transparency about economic, social and environmental impacts, and is a “fundamental component in effective stakeholder relations, investment decisions, and other market relations” (Global Reporting Initiative 2008: 1). These elements were identified and developed between 2003 and 2005, in collaboration with the Global Reporting Initiative, and built on the 2002 social performance indicators of SPI Finance. Environmental reporting concerns elements such as materials, energy, water, biodiversity, emissions, compliance and transport. Social reporting covers four subthemes: labor and work practices, human rights, society and product responsibility. Economic reporting is also included; it concerns such issues as financial performance, market presence, indirect economic impacts and investment in the community. In each type of reporting, activities are reported against a series of performance indicators (ibid.). Such initiatives are understood as examples of “soft” law, based around “aspirational voluntary declarations of intent” (UNEP FI 2009b). Here, compliance occurs in the context of self-regulation against standards that concern such areas of corporate activity as accountability, responsibility and implementation (Clapp 2005).

As a financial product, responsible investment is governed by a plethora of initiatives that have arisen in the absence of any formal global system. Various models are available for determining the social and environmental sustainability of investments; however, with no consistent rules or standards, there is an urgent need for some level of consolidation (Waddock 2008; Whitman 2005). The problem of competing approaches to evaluating sustainability is evident in this sector. For example, there is an evolving debate over which method is best for screening “responsible” enterprises for their investment potential. Some companies use negative screens (e.g., no alcohol, tobacco or firearms), some use positive screens (best-in-class), and others simply screen on the basis of the degree to which a company engages and involves multi-stakeholders (UNEP FI and Mercer 2007). Hence, overall, there is uncertainty about the legitimacy of the evaluation methods being used and the entities being evaluated.

Analytical perspective on evaluating governance quality

This chapter contends that the term “stakeholders” now covers a diverse set of interests that collectively shape the institutions with which they interact. This interpretation allows for a more integrative conception than is possible in more strictly neo-utilitarian theory, in which “stake” effectively relates to “stock.” Such developments require new approaches to evaluating the frameworks through which governance is legitimated; for example, universal ownership can be extended to include interests traditionally seen as peripheral to business practice. Traditional economic preferences for maximizing shareholder returns are now increasingly being supplemented by recognition of ESG (Hawley and Williams 2005). This results in a move away from traditional practices of corporate governance, and allows for a more ethical and less functionalist model for determining governance quality (Ruggie 1998). NGOs and other stakeholders are increasingly demanding governance systems that have a wider focus than those found in traditional “top-down” institutions. The trend towards greater levels of multi-stakeholder collaboration is generating new partnerships between businesses, NGOs and governments,
and is creating new services and products (Global Corporate Governance Forum and International Finance Corporation undated). Emergent contemporary social initiatives and movements focused on the environment are triggering more inclusive forms of governance based on the “dynamic interplay between civil society, business and public sector over the issue of corporate social responsibility” (Ruggie 2003: 95). It is now possible to speak of a “new corporate governance” within finance that includes a focus on environmentally and socially oriented values (Hilb 2009).

Commentators and theorists are preoccupied by various issues concerning the quality and legitimacy of this “new” approach to governance, whether in the responsible investment sector or more broadly within the arena of sustainable development. Institutional arrangements – that is, the mechanisms of governance that underpin the interactions between stakeholders – have a bearing on governance quality (Koenig-Archibugi 2006: 24). These arrangements most commonly refer to interest representation, aspects of responsible organizational behavior, decision-making and implementation. The foremost issue is organizational responsibility, usually understood in terms of accountability and transparency, both internally and externally to the public at large (Garten 1999; Hawley and Williams 2005; Detomasi 2006; Waddock 2008; UNGC and GCGF 2009). Another significant issue is the representation of different stakeholder interests within a given institutional context. The discussion is largely about issues of inclusiveness and equality, focusing particularly on whether all interests enjoy the levels of influence and access to resources currently enjoyed by economic interests (Jänicke 1992; Stiglitz 2003; Kerwer 2006; Koenig-Archibugi 2006; Global Corporate Governance Forum and International Finance Corporation undated). A third concern is decision-making, particularly the presence or absence of institutional democracy, and the methods by which agreements are reached and disputes are settled (Ostrom 1990; van Vliet 1993; Jänicke 1996; Meidinger 2006; Bebchuk and Hamdani 2009). The fourth major issue is effective implementation, which has been identified as relating to both the behavioral and problem-solving abilities of an institution (Skjærseth et al. 2006). In the context of responsible investment, behavioral change refers specifically to changing behavior around financial market activities, to lead to environmentally and socially sustainable outcomes. The problem that responsible investment seeks to address is the negative externalities (e.g., deforestation) associated with unsustainable investment. Given the inherently dynamic nature of social and ecological systems (and related markets), there is an implicit need for resilience in the face of changing external circumstances, such as climate change or market conditions (Folke et al. 2005). Another component of effective implementation is durability; in the context of responsible fiduciary activity, this refers to long-term investment practices that are based on environmentally and socially sustainable practices. Although emphasis is placed on social and environmental viability, implicit in this understanding is the recognition that an activity that is not economically viable will not be durable.

Previous work has brought these concerns about governance quality into a coherent analytical approach to evaluating sustainable development and, in particular, responsible investment (Cadman 2011a, 2011b, 2011c). A framework for evaluating the quality of governance of responsible investment, using a series of principles, criteria and indicators (PC&I) is presented here. The use of PC&I was popularized by UNCED, and has been generally applied to the sustainable development of natural resources. The approach has now spread to different fields, including stakeholder engagement in the corporate sector (Accountability 2005).

A problem common to studies of institutional governance is that the arrangements investigated are usually not tackled holistically; they tend to reflect the disciplines of the scholars researching governance quality, or to be drawn from professional organizations that provide governance-related services. For example, there is a current focus (almost an obsession) on accountability and transparency, with organizations devoted to providing advice or services concerning these arrangements, to the exclusion of other key governance arrangements. Alternatively, scholars and organizations studying governance may look at a variety of arrangements through the lens of one particular attribute, making evaluation somewhat confusing. A more comprehensive analytical approach understands governance on the basis of two central organizing
principles: structure and process (Pierre and Peters 2000: 14). It has recently been suggested that contemporary institutional “new” governance systems, with their emphasis on collaboration, are more appropriately conceived of in terms of structure as it relates to stakeholder participation (“participation as structure”), and process in terms of the arrangements for stakeholder deliberation (“deliberation as process”) (Cadman 2011c: 4–5). In this conception, participation and deliberation are “physical” aspects of institutional design – the extent to which institutional design facilitates participation and deliberation determines the effectiveness of its governance. It is the interactions within a given institution rather than the institution per se that determine governance quality, and ultimately, institutional legitimacy, as expressed in Figure 35.1.

Two normative values are attributed to the principles underpinning participation and deliberation: participation should be meaningful (i.e., stakeholder engagement is real, not tokenistic) and deliberation should be productive (i.e., produce genuine outcomes). These two principles are expressed through related criteria (i.e., categories associated with the relevant principle) and indicators (i.e., points of reference for measurement). Principles and criteria are usually difficult to measure; therefore, they are linked to indicators for determining the state of the governance system in question. Such indicators can provide either quantitative or qualitative information. Placing PC&I within a hierarchical framework ensures that a consistent analysis can occur at the appropriate level (Lammerts van Bueren and Blom 1997). Without such a hierarchy, some elements may be given undue attention (e.g., accountability and transparency, as has been discussed), and others that are of fundamental importance may be overlooked. For example, there is no point in focusing on inclusiveness if there is no meaningful stakeholder participation.

Implicit in this framework is the assumption that accountability and transparency, for example, are indicators of the degree of responsible organizational behavior; in turn, such behavior is one aspect of (hopefully genuine) participation. An organization that is neither transparent nor accountable is not behaving responsibly, and stakeholder participation is meaningless (since the entity in question is not answerable to stakeholders, and its actions are not visible to them). If this were the case with a given share portfolio, for example, it would be difficult to assert that the service provider (e.g., an asset manager or trustee) could really be considered a “responsible” investor.

![Figure 35.1 Theoretical model for evaluating institutional governance quality (Cadman 2011c: 5 – adapted. Reproduced with permission of Palgrave Macmillan.)](image-url)
Two criteria are associated with participation: **interest representation** and **organizational responsibility**. Interest representation is almost universally linked to three aspects of “good” governance: **inclusiveness**, concerning the breadth of those interests that participate within the governance system and the degree to which their issues are taken into consideration; **equality**, demonstrating the quality of the relationship among stakeholders; and **resources**, referring to the economic, technical or institutional capacity of a particular participant or group to have their interests addressed by system.

Organizational responsibility, as referred to above, consists of two indicators: **accountability** and **transparency**. These indicators are usually linked in the literature, and concern the degree to which stakeholder organizations or groups within the institution (and indeed, the institution itself) can be called to account internally (by shareholders, the board, other organizations and so on) and externally (by the public at large.) Transparency concerns the visibility of behavior, and the extent to which actions are open to scrutiny by other actors within the institution and beyond, and to the public at large. Consequently, the internal and external aspects of these two indicators are discussed separately in the results section.

The criteria connected to deliberation are **decision-making** and **implementation**. Decision-making is associated with three indicators: **democracy**, which concerns whether a system functions in a manner that is procedurally fair to those involved, rather than any particular type of institutional democracy; **agreement**, which refers to the methods used to reach decisions (e.g., casting of ballots, show of hands or consensus); and **dispute settlement**, which demonstrates that the system is able to manage conflict or handle disagreements in situations where no agreement can be reached or a decision is challenged. Implementation is associated with a further three indicators: **behavior change**, which signifies whether the agreements reached or substantive outcomes generated actually result in changed behavior (e.g., in the case of responsible investment, an example could be microfinance resulting in the empowerment of women); **problem-solving**, which is discrete from behavior change, and concerns the extent to which the problem the institution was created to address is actually addressed (e.g., whether emissions trading actually reduces emissions); and **durability**, which refers to adaptability, flexibility and longevity of the solution to the problem (e.g., that an emissions trading scheme does not collapse after a few years due to issues such as lack of interest, corruption or poor design). Table 35.1 summarizes these PC&I.

Together, PC&I may be used as the basis for standards that serve as a reference for monitoring, reporting and evaluation (Lammerts van Beuren and Blom 1997). Standards determine how the substantive outcomes of a given system are formulated and applied, thereby delivering both legitimacy
(which can also be equated to effectiveness) and quality (Kooiman 1993).

**Methodology**

Using the analytical framework outlined above, a survey of stakeholders was developed to provide some insights into perceptions regarding the governance quality of various aspects of responsible investment among participants in the sector. The research was undertaken with the assistance of the PRI, which provided advice on what it thought were some of the most important aspects of the responsible investment “universe.” The stakeholders contacted were sourced from two distinct groups. The largest group was from the Database of Contacts in the Field of Socially Responsible Investment, which is prepared annually by Emerging Markets ESG. The 2010 list comprised approximately 1,500 named individuals and companies. A second group was sourced from the Responsible Investment Association of Australia (RIAA) website, which in 2010 had a published list of 134 members.

The survey was conducted online, using the internet tool Survey Monkey. It was anonymous, and was divided into two sections. The first section comprised a preliminary demographic survey designed to get a general feel for the makeup of stakeholders in the investment sector. Seventy-three respondents completed this section. Survey respondents were asked to select from a revised list of categories under the headings shown in the “Type” column of Table 35.2. The financial institutions were further asked to identify themselves as either institutional investors (thirteen respondents) or “other” (eleven). Those who selected “other” identified as consultant (two respondents), connector for social investors and social entrepreneurs (one), financial planner (five), financial adviser (three), financial service (one), industry body (one), issuer (one), network (one), not for profit trust/foundation (one) and proxy agent (one).

Respondents indicated that they were active on a range of levels: international (thirty), regional (eight), national (twenty-four), state/provincial (four), local (four) and other (three). Geographical spread was largely from developed countries (sixty-eight versus five from developing countries), with the highest number of respondents was from Western Europe (twenty-eight), followed by Australasia (twenty-seven) and North America (twelve), with none from Latin America.

The second section of the survey comprised questions about perceptions of the governance quality of the sector, based on the eleven indicators of Table 35.1. The indicators “accountability” and “transparency” were expanded to allow respondents to take internal and external considerations into account, as shown in Table 35.3.

On the advice of PRI, the responsible investment “universe” was broken down into a number of specific subsectors to allow for a more comprehensive analysis. The subsectors of responsible investment identified for the purposes of comprehensive analysis were: services and products (responsible investment goods available in the market); sustainable investment organizations (associations representing the views of members); government regulation (i.e., state-based regulatory mechanisms); PRI (to provide an anecdotal perspective on a single organization active in the responsible investment space); and other reporting frameworks (i.e., nonstate and nonfinancial).

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1 www.emergingmarketsesg.net.
2 www.responsibleinvestment.org.
voluntary mechanisms). The intention here was to see whether any of these subsectors was viewed more or less favorably by respondents. Perceptions of the governance of the responsible investment sector were evaluated using the eleven indicators in Table 35.1. Respondents were asked to rate each of the indicators using a one to five-point (Likert) scale of “very low,” “low,” “medium,” “high” and “very high.” Likert scales are used to assess respondents through structured questions in which respondents specify their level of perception on a given statement. The average of all respondents’ ratings captures the collective perception per question (Burns and Burns 2008). The language used for choices within the survey was designed to address perceptions of governance quality (from “very high” to “very low”) rather than agreement or disagreement. “Low” and “very low” are not strictly negative positions, but in the context of governance quality they can be interpreted as such. The overall average value of “medium” represents a neutral perception on the indicators. The ratings at the indicator scale were aggregated under the relevant criterion; in turn, the relevant criteria were combined to provide a result at the principle level. These principle-level results were summed to provide an overall “quality score” out of sixty-five.

Opportunities for qualitative comment were also provided for each indicator, and respondents had the option of adding further general comments at the end of the survey. The results from the surveys were analyzed using Statistical Package for the Social Sciences (SPSS).

There are shortcomings associated with online surveys. Such surveys generally have much lower participation rates than other forms of survey technique (Van Selm and Jankowski 2006). In many developing countries, the internet is unreliable and subject to frequent interruptions, due to power shortages. Also, the survey questions related to the indicators of Table 35.1 were compulsory. This approach to obtaining statistically relevant results can result in a high drop-off rate. The survey could also take more than an hour to complete if stakeholders felt the need to provide extensive comments, which may also have led to incomplete responses. In our survey, thirty-four respondents commenced the second section, but only twenty-seven (i.e. 37 percent of the original seventy-three) completed it. Compulsory questions can increase the degree of ownership of the survey by respondents, and result in higher quality responses; nevertheless, the “science” of online surveys is still evolving (Manfreda et al. 2002).

Table 35.3 List of survey questions following the indicators of Table 35.1.

<table>
<thead>
<tr>
<th>Question</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you think responsible investment includes, or takes into consideration, the issues and concerns that are most important to you?</td>
<td>Perceptions of the governance of the responsible investment sector were evaluated using the eleven indicators in Table 35.1. Respondents were asked to rate each of the indicators using a one to five-point (Likert) scale of “very low,” “low,” “medium,” “high” and “very high.” Likert scales are used to assess respondents through structured questions in which respondents specify their level of perception on a given statement. The average of all respondents’ ratings captures the collective perception per question (Burns and Burns 2008). The language used for choices within the survey was designed to address perceptions of governance quality (from “very high” to “very low”) rather than agreement or disagreement. “Low” and “very low” are not strictly negative positions, but in the context of governance quality they can be interpreted as such. The overall average value of “medium” represents a neutral perception on the indicators. The ratings at the indicator scale were aggregated under the relevant criterion; in turn, the relevant criteria were combined to provide a result at the principle level. These principle-level results were summed to provide an overall “quality score” out of sixty-five. Opportunities for qualitative comment were also provided for each indicator, and respondents had the option of adding further general comments at the end of the survey. The results from the surveys were analyzed using Statistical Package for the Social Sciences (SPSS). There are shortcomings associated with online surveys. Such surveys generally have much lower participation rates than other forms of survey technique (Van Selm and Jankowski 2006). In many developing countries, the internet is unreliable and subject to frequent interruptions, due to power shortages. Also, the survey questions related to the indicators of Table 35.1 were compulsory. This approach to obtaining statistically relevant results can result in a high drop-off rate. The survey could also take more than an hour to complete if stakeholders felt the need to provide extensive comments, which may also have led to incomplete responses. In our survey, thirty-four respondents commenced the second section, but only twenty-seven (i.e. 37 percent of the original seventy-three) completed it. Compulsory questions can increase the degree of ownership of the survey by respondents, and result in higher quality responses; nevertheless, the “science” of online surveys is still evolving (Manfreda et al. 2002).</td>
</tr>
</tbody>
</table>
Preliminary results and discussion

The comprehensive results across all eleven indicators, and their associated criteria and principles, are given in Table 35.4. It should be stressed, however, that a survey of this type is largely anecdotal, for a number of reasons. With such a small cohort of respondents, the survey cannot purport to be a definitive representation of views across such a large pool of potential participants. Also, the survey does not wholly reproduce the large cross-section of interest groups, institutions and other multi-stakeholders who make up the responsible investment sector. Finally, those who responded to the survey did not specify whether they were speaking on behalf of their particular organization or as individuals; rather, they provided their own unique perceptions. Low numbers of respondents can also produce “outlier” effects, whereby a few respondents giving a score of “very high” or “very low” can overly influence the results. In addition, many of the respondents were from Australasia, which may also have influenced the results. Thus, the survey cannot be used to make any definitive claims about the governance quality of responsible investment as a whole, nor about perceptions from a given organizational viewpoint (institutional investor contra financial planner, for example). Consequently, the results presented are tentative and mainly useful for exploratory discussion only. Nevertheless, a few interesting observations can still be made, which it is hoped will encourage others to further investigate the perceptions of stakeholders directly or indirectly involved in, or affected by, institutional investment.

Looking at the average total for responsible investment as a whole, and for each of the identified subsectors, all passed with relatively similar

Table 35.4 Survey of stakeholder perceptions of governance the quality of responsible investment by subsectors.

<table>
<thead>
<tr>
<th>Subsector</th>
<th>Meaningful participation</th>
<th>Organizational responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Inclusiveness</td>
<td>Equality</td>
</tr>
<tr>
<td>Services and products (27)</td>
<td>3.2</td>
<td>3.1</td>
</tr>
<tr>
<td>Sustainable investment organisations (27)</td>
<td>3.7</td>
<td>3.4</td>
</tr>
<tr>
<td>Government regulation (27)</td>
<td>2.8</td>
<td>2.6</td>
</tr>
<tr>
<td>Principles for Responsible Investment (27)</td>
<td>3.2</td>
<td>3.3</td>
</tr>
<tr>
<td>Other frameworks (27)</td>
<td>3.1</td>
<td>2.9</td>
</tr>
<tr>
<td>Average</td>
<td>3.2</td>
<td>3.1</td>
</tr>
</tbody>
</table>
Addressing the participation gap in institutional investment

The weakest performer was government regulation, while sustainable investment organizations were the strongest. This may indicate that respondents have more confidence in the ability of the representative associations within responsible investment to govern the sector than of government; but this is speculative. The PRI performs relatively well, and outperforms other reporting frameworks; however, the somewhat nebulous nature of “other frameworks” does not yield sufficient information to comment further. It is worth noting that the governance quality of the services and products offered by responsible investment were also looked on relatively favorably. At the principle level, all subsectors passed. Once again, government regulation did not perform as well as other subsectors, and only just passed the principle of productive deliberation. At the criterion level, respondents’ perceptions about government regulation become more pronounced. In this regard, decision-making and interest representation failed. No other subsectors failed any of the criteria. These trends are reflected at the indicator level. Governmental regulation failed two indicators – resources and dispute settlement. The sustainable investment organizations achieved the highest single score for any indicator (inclusiveness). This level of performance was repeated across most other indicators, but PRI was rated highest for its degree of internal transparency and its contribution to behavioral change. There are some indicators across all subsectors that are also worth commenting on. Resources, agreement, dispute settlement and problem-solving were the lowest performing indicators, with resources being the lowest of these. Of further interest is the consistent rating of the internal and external aspects of accountability and transparency. In both instances, it appears that respondents felt that all the sectors

<table>
<thead>
<tr>
<th>Principle score</th>
<th>Democracy</th>
<th>Agreement</th>
<th>Dispute settlement</th>
<th>Criterion score</th>
<th>Behavior</th>
<th>Problem solving</th>
<th>Durability</th>
<th>Criterion score</th>
<th>Principle Score</th>
<th>Total (out of 65)</th>
</tr>
</thead>
<tbody>
<tr>
<td>21.4</td>
<td>3.0</td>
<td>2.8</td>
<td>2.7</td>
<td>8.5</td>
<td>3.2</td>
<td>3.0</td>
<td>3.1</td>
<td>9.3</td>
<td>17.8</td>
<td>39.2</td>
</tr>
<tr>
<td>23.1</td>
<td>3.4</td>
<td>3.1</td>
<td>2.9</td>
<td>9.4</td>
<td>3.2</td>
<td>3.0</td>
<td>3.1</td>
<td>9.3</td>
<td>18.7</td>
<td>41.8</td>
</tr>
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<td>2.7</td>
<td>2.3</td>
<td>2.6</td>
<td>7.6</td>
<td>3.0</td>
<td>2.5</td>
<td>2.6</td>
<td>8.1</td>
<td>15.7</td>
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<td>3.0</td>
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<td>9.1</td>
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<td>2.8</td>
<td>8.8</td>
<td>3.0</td>
<td>2.7</td>
<td>2.9</td>
<td>8.6</td>
<td>17.4</td>
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<td>2.8</td>
<td>2.8</td>
<td>8.7</td>
<td>3.1</td>
<td>2.8</td>
<td>3.0</td>
<td>8.9</td>
<td>17.6</td>
<td>38.9</td>
</tr>
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of responsible investment were less accountable and transparent to the public than they were to their own internal interests.

The comments from individual respondents make for interesting reading. Despite the high rating for inclusiveness overall, one respondent who identified as “professional organization” commented about “losing faith” and being “not sure” that either individuals or organizations went “deep enough” in taking issues and concerns into account; most individuals or organizations, the respondent felt, were “superficial.” One company respondent provided an alternative perspective, pointing to the extent to which some companies had established “links” to “NGOs like Amnesty International.” A financial adviser was particularly negative about the level of equality between the interests involved in responsible investment associations, commenting that “money talks and within organizations the ‘power’ follows the money. So fund managers will dominate RI associations because they can fund the running of that group, with hard or soft dollar support.” With regard to accountability, two respondents were of the opinion that the general public had little interest in responsible investment. Looking beyond responsible investment as a sector to investment more generally, one institutional investor commented that “Lack of accountability on RI [responsible investment] by the investment industry is a major bug bear and risk for the industry.” In terms of transparency and the general public, one financial adviser commented that:

In the finance area of RI the need for transparency is extreme through government regulation, codes of ethics of financial associations, etc. However, there is always room for people to take advantage of the public. The government should be transparent, but I have found that the RI industry (especially alternative energy and technology) get badly treated by governments.

Few comments concerned either democracy or agreement, although one respondent who self-identified as a “small sustainability consultancy” felt that the way agreements were reached within the responsible investment sector placed it “a long way ahead of other businesses.” In terms of dispute settlement, thirteen respondents noted that they had been involved in dispute settlement, and eight were of the view that these disputes had been settled effectively. A number of substantive comments were made concerning the indicator of behavior change. One professional association member made the observation that “Compared with conventional investment RI plays a huge role in changing behavior.” Another company representative commented that:

Because of the lack of transparency often the role played in changing behavior is behind closed doors, which means in effect both the organizations who are not impacting change (and just have a marketing campaign saying they do) are placed in the same category as those who are impacting change.

Another financial adviser explored the links between governmental regulation, personal action and behavior change:

It is really either government regulation as a macro change or behavioral change. But the regulations are scattered and some changes are unintentional. It is only at the one-to-one level that the real changes happen. Where people understand what their money is doing and then amend their ways accordingly.

Comments about the problem-solving capacity of responsible investment related to concerns about a “lack of means” according to one professional association respondent, but two other respondents saw responsible investment as a better performer than others, with one financial adviser stating that “RI looks further into peoples’ needs and makes them confront what they really want.” No comments were provided about the durability of responsible investment.

Conclusions

This chapter has looked at the development of the responsible investment sector, its relationship to the emerging concept of environmental and social governance, and the degree to which responsible investment can be seen as contributing to sustainable development. The transition of global financial markets towards investment models that incorporate environmental and social dimensions is now
well underway. The previous assumption that governance quality was based on fiduciary duty alone has given way to recognition of the need for greater fiduciary responsibility. Such responsibility brings with it a need to facilitate more meaningful engagement of external parties in investment decisions. Even if external parties are still seen as less salient in terms of power, there is growing recognition that their needs are legitimate and urgent. Both stakeholder engagement and stakeholder analysis need to be expanded to fit these developments. Here, there are some lessons to be learned from responsible investment, which is ahead of conventional investment practices and has notions of fiduciary duty that are far more socially and environmentally encompassing. At this stage, the contribution of responsible investment to improving social and environmental performance is evident, but based on preliminary investigation of the perspectives of some stakeholders from within the sector, there is still a way to go.

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