2 Responsible Investment and the Claim of Corporate Change

“... socially responsible investing practices are not merely discretionary and desirable activities; they are a necessary imperative, which both the corporations and public pension funds, and other large institutional holders, will ignore at serious peril to themselves.”

(Sethi, 2005)

As mentioned in the introduction, responsible investment is a widely discussed link between the stock market and CSR (Scholtens, 2006). It provides the mechanisms through which public shareholders can exert influence on corporate behaviour and is thus the focus of our study. We start this chapter by providing the reader with some terms and definitions relevant for the study of responsible investment, and giving insight into the history and the key actors involved. We proceed by identifying four different approaches of how to practice responsible investment, before we then clarify the link to CSR.

2.1 The Phenomenon of Responsible Investment

2.1.1 Introduction and Definitions

When it comes to defining responsible investment, we can witness a jungle of diverse labels; we find different labels for the same activity, or same labels for different activities. There is widespread confusion about the various expressions used to describe responsible investment (Sparkes and Cowton, 2004, p. 46; Sullivan and Mackenzie, 2006, p. 14). The main objective of this section is therefore to provide a clear definition of how we understand responsible investment and how it relates to CSR.
In short, we define responsible investment as the integration of environmental, social and governance (ESG) considerations into (a) the investment analysis and portfolio selection processes, and/or (b) ownership policies and practices such as the use of voting rights, while at the same time maintaining a reasonable financial return.

Similar definitions, but with varying accentuations, can be found in Renneboog and colleagues (2008), Sparkes (2002), Sparkes and Cowton (2004), and Sullivan and Mackenzie (2006). Thus, responsible investment on the equity side affects two fundamental decision-making processes. First, it is concerned with the identification and the assessment of prospective investment opportunities (Scholtens, 2006), which we summarize as entry decision. Second, it affects the so-called loyalty decision, a theoretical concept brought forward by the economist Hirschman (1970). Applied to the stock market, Hirschman elaborated on the question whether an investor should use his ‘voice’ to influence companies in their way of using the fund, or ‘exit’, i.e. divest in case of a conflict of interests among investor and management.

In general, responsible investment combines two basic objectives or claims: Financial return and social good (Sparkes, 2002). This twofold aim rests on the following assumptions: First, responsible investors believe in the business case of corporate ESG activities, claiming that in the short run, responsible investment funds will show a similar performance to conventional funds, while in the long run they will even bring superior financial returns. Second, responsible investors believe that based on their investment decisions they have the right and the ability to change corporate behaviour towards a stronger notion of social responsibility, thus ‘making a difference’ (Haigh and Hazelton, 2004; Rivoli, 2003; Smith, 2005). The combination of both, financial return and social good is the key characteristic of responsible investment: it “distinguishes [...] responsible investment from ordinary investment (which shares the first goal but is indifferent to the second), from [...] activism (which

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31 Instead of ESG, some authors prefer to speak of social, environmental and ethical (SEE) issues. While SEE strengthens the ethical dimension of responsible investment, ESG emerged out of an attempt to include the corporate governance debate into the responsible investment movement. However, in academic and practitioner literature both concepts are often used interchangeably.

32 With our definition we closely follow the Principles for Responsible Investment (PRI), an investor initiative to promote socially responsible behaviour. We will come back to this initiative at a later stage of the study.