BE SOCIAL, MAKE PROFIT!

Responsible Investment, Emerging Markets, and the Financial-Social Nexus

By

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EXECUTIVE SUMMARY

The following report details research carried out by the University of Maastricht Graduate School of Governance in cooperation with the FMO (the Netherlands Development Finance Company; *Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V*). The research was commissioned to coincide with the celebration of FMO's 40th year of operations, an occasion that the FMO has used to highlight the contribution that Dutch firms have made and continue to make toward realising new investment management techniques that honour the maxim "Be Social, Make Profit".

The reasoning behind this notion of "Be Social, Make Profit", is simple: making investments in long-term, sustainable, and conscientious ventures (and in sustainable and conscientious ways) is not only socially responsible, it is financially responsible as well. An investment's productivity and profit-generating potential is not dictated solely by short-term pressures, and when selection criteria relating to the sustainability of an investment venture are incorporated into portfolio management, the investment itself may have a longer and more productive lifespan. Guided by this reasoning the research began as a means of reaching the ultimate objective of evaluating how Dutch-incorporated financial firms incorporate "social" perspectives, objectives, and strategies into investment management techniques that honour the spirit of financial return. In the process the research also sought a meaning for "social", particularly in the context of investments made in emerging markets. To fulfil these goals, the research engaged firms across the financial sector in surveys and in-depth interviews. These data collection tools have enabled the assessment of the current field of actors with investment portfolios and strategies similar to that of FMO, the evaluation of the manifestation of "social" investment attitudes in actual investment strategies, and the evaluation of the willingness displayed on behalf of the surveyed actors to modify their risk appetites/risk aversion to ensure social returns.

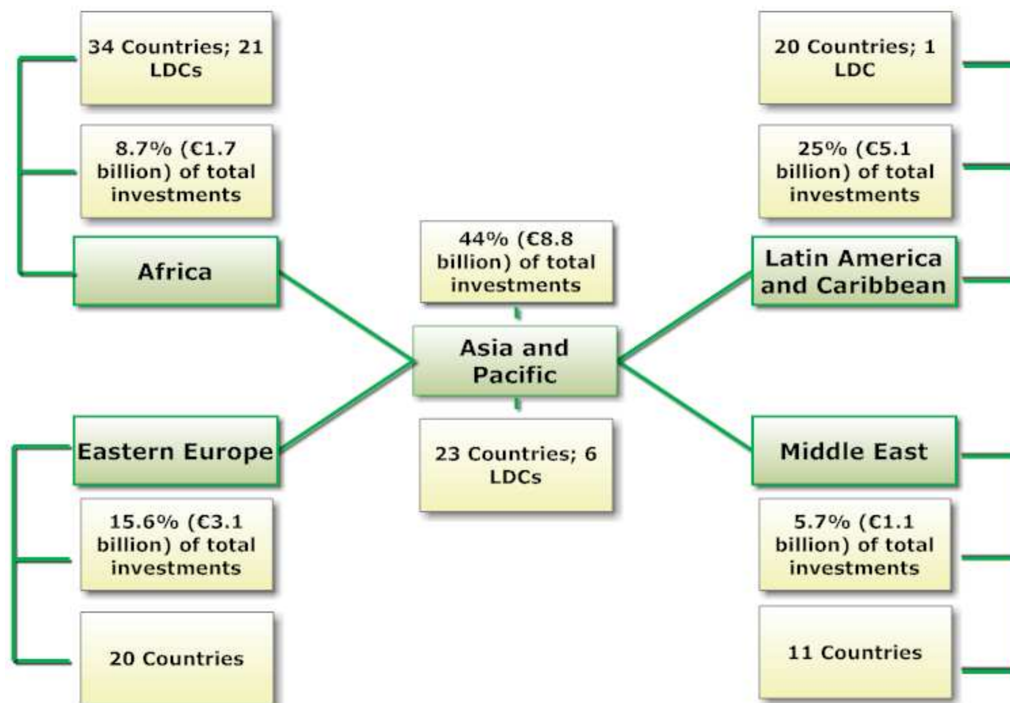
While the body of this report details the data collected among twenty Dutch-incorporated financial institutions, the discussion of the research and its results is prefaced by a brief overview of socially-responsible investing that provides the appropriate context for analysis. This overview includes explanation of the concept of socially-responsible investment; an explanation of how socially-responsible investment and environmental, social, and governance (ESG) criteria are integrated into the management practises of investors, and description of the current socially-

responsible investment context in Europe and the Netherlands. The current research is then introduced in SECTION 3.

The current study, which relied upon a mixed qualitative/quantitative methodology involving data collection via surveys, in-depth interviews, and desk research, engaged a wide range of Dutch financial institutions that invest in emerging markets. The participant pool was comprised of twenty institutions representing asset/investment management firms, commercial and investment banks, microfinance institutions and community development banks, pension funds, venture capital firms, and insurance providers. The asset/investment management respondents also represented approximately 85 institutional clients, which increased the data available about Dutch investors with investments in emerging markets.

One of the research's primary goals was to uncover the dimensions of the capital stream moving between the Netherlands and emerging markets, and the data provided by surveys and in-depth interviews provided the following insights:

- Approximately €30 billion is invested by respondents in emerging markets.
- Among respondents who were able to disclose information about their emerging market investment portfolios as disaggregated by region, the Asia and Pacific region received the greatest volume of investments at approximately 44 percent of the total emerging market capital pool. The Latin America and Caribbean region accounted for 26 percent of the total volume of emerging market investments; Eastern Europe received 16 percent of all funds. Africa received just nine percent of the total emerging market capital pool while the Middle East received the least at six percent.
- Regional investments can be broken down in the following way:



- The volume of capital moving to emerging markets via trade from the surveyed respondents alone amounted to more than five times Dutch official development aid in the same period.[2] While ODA has certainly targeted least developed countries more strategically and with greater capital, the capital moving through trade has a wider geographic distribution and greater capital volume capacity.

- The FMO is a significant contributor to the stream of capital moving to emerging markets: at €4.2 billion in investments to emerging markets, the FMO contributes the third largest amount among all respondents and provides the largest amount among non-asset/investment management firms.

In addition to "mapping" the capital flow, the research uncovered a number of recurring and underlying themes that characterise the current state of responsible investment among the respondents. These themes and trends reflect wider global trends as well as trends connected to the current state of growth of the responsible investment movement in the Netherlands. These trends show that:

[2] Organisations for Economic Cooperation and Development (OECD), Development Cooperation Directorate. 2009. "Aid at a Glance: Netherlands." <http://www.oecd.org/dataoecd/42/7/44285089.gif>

- The terminology used by investors to discuss the incorporation of (socially) responsible investment strategies and criteria into their decision-making processes is shifting away from use of the term "social". This has been accompanied by reconceptualisation of the term "socially responsible investment" toward a more inclusive definition that may be indicative of "green washing" but may signal wider acceptance of (S)RI across the financial sector.

- Mainstreaming of responsible investment concerns and strategies is a gradual process, one which affects each type of financial institution differently. While greater awareness of responsible investment concerns may be encouraged within a firm by one passionate individual, a sort of "peer pressure" effect occurs: as firms begin to incorporate responsible investment concerns into their business practises, the level of competition among firms to become more "social" seems to occur.

- Financial firms are increasingly offering ESG-themed investment vehicles to tap into the growing responsible investment movement, and these vehicles are being offered to both institutional and retail clients. This wider availability of financial services and tools has a positive effect in engaging asset owners across a variety of levels in the responsible investment movement.

- The mainstreaming of responsible investment norms into the business practises of financial institutions is selective: while many financial institutions are making progress toward developing and implementing responsible investment strategies, such strategies may not always be deployed across the entire financial group but may be implemented only in an isolated business segment where they can be fostered and monitored without risk to the greater financial group as a whole. Integration is thus deep rather than wide.

- The current financial crisis has played an enormous role in encouraging sustainability-focused, long-term investment strategies that tap into the greater growth potential and risk-return ratio offered by emerging markets.

- Investors increasingly view the incorporation of responsible investment criteria into investment decisions as a way to control and mitigate risk, and most think that in the long-term there may be a neutral or even positive effect of such criteria on returns.

- Responsible investing is increasingly being seen as a valuable business opportunity, and the contribution to private sector development in emerging markets is commonly viewed as a way to generate dual financial/social returns.

- The incorporation of environmental, social, and governance criteria into investment decisions is no longer viewed as a threat to meeting fiduciary responsibility; instead, it is now more commonly viewed as a way of meeting such obligations.

The themes and trends noted throughout the research process allowed the formulation of recommendations that can be considered for encouraging more comprehensive mainstreaming of responsible investment practises among Dutch financial institutions. While the recommendations often reflect institution-specific constraints and concerns, they do highlight major gaps identified in the current support of responsible investment initiatives. The recommendations are thus to:

- Improve availability of and access to comprehensive, detailed information about companies functioning in emerging markets. This availability should entail the formation of cooperative knowledge networks in which resources can be pooled and mobilised among investors who, due to size and financing constraints, find the transition to responsible investment to be difficult and costly.

- Increase the dissemination of information provided by initiatives such as the Emerging Markets Disclosure Project and the United Nations Principles for Responsible Investment. This dissemination process can provide more explicit guidance about *how* businesses of varying sizes and capital capacities can embed responsible investment criteria into everyday business operations.

- Design initiatives and networks that are better tailored to the needs of small and medium-sized investors.

- Encourage the development of indices that are more responsive to the constraints and sector-specific concerns of a greater variety of investors.

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LIST OF ABBREVIATIONS

EM: Emerging markets. As used in the following report, emerging markets can include any of the 22 countries defined by the MSCI Barra Index as well as any of the 25 frontier market countries, unless otherwise noted.

ESG: Environmental, social, and governance.

EuroSif: European Sustainable Investment Forum.

GRI: Global Reporting Initiative.

PPP: People, planet, profit. Also referred to as the "triple bottom-line approach".

RI: Responsible investment. This term is often used as an attempt to neutralise perceived ethical, moral, or political implications of the term "social" and is increasingly preferred among financial sector actors who wish to incorporate ESG concerns into portfolio management.

SIF: Social Investment Forum

SRI: Socially responsible investment; this acronym is often used to denote investments or investing that incorporates ESG concerns to at least some degree. As noted by EuroSif (2008), the term can also be used to express "Sustainable and Responsible Investment."

UNPRI: United Nations Principles for Responsible Investment.

SROI: Social Return on Investment Analysis

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1. Introduction

The following report details research carried out by the University of Maastricht Graduate School of Governance in cooperation with the FMO (the Netherlands Development Finance Company; *Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V*). The research was commissioned by to coincide with the celebration of FMO's 40th year of operations. To commemorate the event, the FMO seized upon the occasion as an opportunity to highlight the contribution that Dutch firms have made and continue to make toward realising new investment management techniques that honour the maxim “Be Social, Make Profit”.

“Be Social, Make Profit”, the theme chosen for the FMO's anniversary congress, embodies a principle that the FMO itself has operationalised in its investment management strategy. The reasoning behind this notion is simple: making investments in long-term, sustainable, and conscientious ventures (and in sustainable and conscientious ways) is not only socially responsible; it is financially responsible as well. An investment's productivity and profit-generating potential is not dictated solely by short-term pressures, and when selection criteria relating to the sustainability of an investment venture are incorporated into portfolio management, the investment itself may have a longer and more productive lifespan.

Guided by the statement “Be Social, Make Profit”, the research began as a means of reaching the ultimate objective of evaluating how Dutch-incorporated financial firms incorporate “social” perspectives, objectives, and strategies into investment management techniques that honour the spirit of financial return. In the process the research also sought a meaning for “social”, particularly in the context of investments made in emerging markets. To fulfil these goals, the research engaged firms across the financial sector in surveys and in-depth interviews. These data collection tools enabled the assessment of the current field of actors with investment portfolios and strategies similar to that of FMO, enabled the evaluation of the manifestation of “social” investment attitudes in actual investment strategies, and enabled the evaluation of the willingness displayed on behalf of the surveyed actors to modify their risk appetites/risk aversion to ensure social returns.

Before the discussion of the research and its results can take place, a brief overview of socially-responsible investing must be provided to appropriately frame the context expanded upon by the study. In **SECTION 1** the concept of socially-responsible investment and its implications for different types of financial actors will be discussed. An explanation of how the integration of socially-responsible investment and environmental, social, and governance (ESG) criteria into the management practises of responsible investors can occur will then be provided. This will be followed by a description of the current socially-

responsible investment context in Europe and the Netherlands. This assessment will enable the discussion of the current research, which will be introduced in **SECTION 3.** The research's methodology will first be explained followed by an assessment of the quantitative results, after which the qualitative data collected will be discussed. Following this discussion a brief summary of the results and recommendations for future studies will be provided.

1.2. Defining the concept

In recent years ***socially responsible investing*** or investment (SRI) has grown in the financial world to become a globally-embraced, mainstream finance practice (Louche and Lydenberg, 2006; Haigh and Hazelton, 2004).The modern forms of SRI, which are characterized in Europe by a shift from the embodiment of pure moral concerns in investment strategies toward the integration of societal preoccupations with financial and commercial benefits via investment, first emerged in the 1970s and 1980s. Responsible investing has come to place increasing emphasis on the need to ensure that the investment process is used as a means to change and improve the behaviour of companies on environmental, social and governance issues (Louche and Lydenberg, 2006).

The growth of the SRI movement can be partly attributed to increased media attention toward corporate scandals in financial services and to the changes in regulation regarding the disclosure of social, environmental, and governance information. These factors have led to a growing demand for social responsibility and accountability on behalf of all types of investors, from within both retail and institutional sectors (Martin, 2009; Bakshi, 2006). Responsible investing began as the initiative of singular investors, and over time it has picked up strongly within the financial services industry. Recent European Sustainable Investment Forum (Eurosif) reports have shown that this trend has occurred across Europe, with SRI not only adopted by ethical funds but also increasingly by major pension funds and other large institutional investors. The concept of SRI as a mainstream strategy has been legitimized by an increasing number of global SRI stock indices that provide benchmarks for evaluation of investment performance. Dillenburg et al (2003) make reference to the fact that the socially responsible investment industry is slowly changing, and a shift is gradually taking place from a screening approach toward a more comprehensive approach that seeks to affect corporate behaviour by engagement and integration. The shift is most noted in the global indexing initiatives, such as the benchmark initiatives of SAM (Sustainable Asset Management) Group and Dow Jones. While considering these developing trends and dynamics of SRI ratings, it is important to keep in mind that socially responsible investors apply criteria differently, and there is a great deal of heterogeneity not only within application of SRI criteria but in the very definition of such investments (Sandberg, *et. al.*, 2009).

Socially responsible investment is an evolving concept for which there are various definitions that differ widely in their respective context and meaning. Notwithstanding these definitional ambiguities, SRI can be understood as an *umbrella* concept that in fact incorporates various investment criteria that are taken into account when considering investment decisions. Moreover, it is important to note that SRI as a concept is continuously evolving, and greater specifications will develop as it matures and embraces larger groups of investors with diverse needs, particularly in terms of reconciling economic risks (Sethi, 2005).

Four levels can be identified in which heterogeneity of socially responsible investment can be observed (Sandberg et al, 2009). Such heterogeneity spans terminological, definitional, strategic, and practical areas. Understanding of SRI can also differ widely in terms of definitional, strategic (how the criteria should be integrated in the investment process) and practical (how such strategies are translated into investment criteria in practice) characteristics. Socially-responsible investment within the context of the United States tends to lead to a more value-driven definition of the field; the European approach can be distinguished as being more pragmatic, particularly because SRI is an activity often driven by institutional investors that place equal importance on social, environmental and financial aspects (Louche and Lydenberg, 2006; Sandberg et al, 2009).

As has been assessed in a previous study's analysis of the different signatories of the UNPRI (United Nations Principles for Responsible Investment) in terms of the differences in SRI terminology and focus, regional differences in perceptions largely explain the lack of semantic clarity (Sandberg et al, 2009). A review of the literature reveals that the most common term used to denote investments that integrate environmental, social, and governance concerns in the investment process is "socially-responsible investing or investment" (Sandberg et al, 2009). Nevertheless, it must also be noted that there are other existing terms that are often used to encompass such investments, such as ethical investing or investment, social investment, and responsible investing. A point of interest highlighted by Sandberg et al (2009) that is also reflected in this study of Dutch financial investors is the fact there is growing preference among European financial investors for the term ***responsible investment***. This shift toward terms and strategies that are more mainstream and neutral may suggest an emphasis on the primacy of financial considerations. Responsible investing may be defined as the integration of ESG considerations into investment decision-making as an effort to better manage the risk-return ratio, and while such a process may involve "social" drivers and components, financial reasons remain of primary interest (Sandberg et al, 2009). The terminological preference also reflects a certain degree of reluctance with regard to placing too much emphasis on the social dimension relative to environmental and financial aspects (Sandberg et al, 2009).

It is precisely due to the fact that each investor may have a different idea of ethical or socially-responsible investments that there is a need for clear reporting procedures with regard to investments (Michelson et al (2004).

1.3. Reluctance with SRI

Reluctance to incorporate socially-responsible investment strategies among pension funds, for example, is often attributed to the uncertainty in the type of financial yields that can be expected, particularly as there remains a lack of clarity as to whether SRI is, in fact, in the best interest of beneficiaries (Sandberg et al, 2009). In terms of the current debate surrounding the need for greater SRI acknowledgement and incorporation of SRI/ESG criteria into investment practices, there are two central issues that are the focus of attention of critics: fiduciary responsibility and financial returns of socially responsible investments.

In addition to these two widely acknowledged areas of concern, two additional issues on the legitimacy and appropriateness of investments are added by Sethi (2005) when considering long-term impacts of ESG factors. These issues relate to the types of SRI-based investments to be included and the ability to make changes in investment portfolios. The first issue refers to the idea that just as not all non-SRI investment choices are considered appropriate in terms of the risk-reward profile, the same logic applies for SRI investments. The issue of integration of changes in the portfolio is particularly encountered by institutional investors such as pension funds due to the fact that they often hold large pools of capital that may restrict the freedom of such funds to simply move in and out of individual stocks without risking a destabilization in the affected security's prices. The underlying meaning for other financial investors is that investors should strive to improve their returns in line with macro-economic factors that impact the general health of the economy (Sethi, 2005).

Fiduciary liability is challenging, and failure to meet fiduciary duties and responsibilities may result from two processes. Failure to meet fiduciary obligations may occur because of failure to maximize shareholder return, regardless of the ethical and moral nature of the investments. That failure may also result from failure to consider the enforcement of human rights and environmental laws and norms, however (Martin, 2009). The main shortcoming of current approaches to maximizing returns is in the fact that they are essentially focused on short-term returns within the current context and structure of financial markets. Other shortcomings may result from the issue of quality of returns, the questionable independence and objectivity of financial intermediaries and consultants that rely on the reward system, and the bias that results from the performance evaluation systems that may underestimate future risks and over-estimate future rewards (Sethi, 2005). The financial crisis clearly exposed the inherent weaknesses of the remuneration system used by banks, which encouraged excessive risk-taking and were dependent on an

assessment of short-term performance that failed to account for long-term risks (Eurosif, 2009). Taking this into account, it should be apparent that competitive and self-regulating markets have structural problems that have serious implications for the entire system of financial markets (Sethi, 2005).

1.4. Behaviour and motivations of socially responsible investors

While socially-responsible investors may be concerned for the creation of a just and sustainable society, their decision to incorporate ESG concerns and criteria as part of their responsibilities and daily investment practices should not be interpreted as an act of charity or an attempt to assuage a guilty conscience. Socially -responsible investors derive utility from both financial and non-financial characteristics of their investments (Glac, 2008). Investors derive returns on investments that lead to the creation of a healthy and wealthy society–adding to the overall fundamental value of the marketplace and inherently creating spill over effects that surpass the added value created solely by the marketplace (Lydenberg, 2007). Therefore, although socially responsible investors may have a higher acceptance for return differentials between conventional and screened investments, the majority of socially-responsible investors seem to be as interested in attaining high financial performance of their investments just as much as any other investor (Glac, 2008; Lyndenberg, 2007). Moreover, although non-SR investors may solely emphasize the economic requirements of investing when they explain their investment behaviour, they, too, seem to place importance on non-economic aspects of their investments (Glac, 2008; McLachlan and Gardner, 2004).

In terms of the financial performance of SRI-based investments, there is growing evidence that suggests that SRI-based funds' performance, for example, does not display significant differences compared to similarly-placed funds and certain benchmarks (Sethi, 2005; Benson et al, 2006; Cortez et al, 2008). Socially-responsible investments account for criteria and responsibilities that in fact complement the prevailing financial criteria of measuring returns, which are essentially short-term oriented and have a bias toward understating long-term trends. Looking into a longer time horizon, Michelson et al (2004) argue that higher financial returns occur because of the adoption of social-screening practices that may in turn serve as a signal to investors, given the focus on sustainability and management quality, that socially-responsible firms are expected to embrace. Moreover, conventional portfolio theory also recognizes that the exposure to risk of an investor can be reduced by means of diversification without any reduction in terms of financial returns. As explained by Schroeder (2004), "From the point of view of portfolio theory, a restricted investment universe should result in a lower risk-adjusted return" (p. 123). This implies that given that traditional SRI investment opportunities are a subset of the total investment universe, traditional investment funds should be able to use the same investment strategy as any SRI fund. Traditional investors can thus still benefit from diversification by including socially-responsible investments into their portfolios

(Michelson et al, 2004). Studies dating back as early as 1972 show that even though SRI funds only use a subset of the full investment universe, they do not under-perform when compared to average traditionally-managed funds.

2. European SRI Context

2.1. Expressions and Practice

Despite the fact that SRI should be framed with common purposes and goals, its development has differed substantially over the past three decades between the United States and Europe. The differences are most particularly noted in terms of definitions, as explained in the previous section; the actors taking a leading role in SRI; the respective approaches that are implemented in terms of SRI screening, and; the approaches used to engage with other corporations (Louche and Lydenberg, 2006). These differences have resulted in alternative approaches to SRI practice on both sides of the Atlantic.

As noted by Louche and Lydenberg (2006), "The European emphasis on the three 'pillars' – social, environmental and financial– is related to the influence of the concept of sustainable development, which is much stronger in Europe than in the United States" (p. 12). The SRI approach in Europe is therefore often equated with the triple bottom line–***people, planet, and profit***—approach. The scope of what SRI encompasses by designations varies as well. In the United States the main designated categories of strategies are screening, shareholder activism, and community investing. In Europe these designated categories can be summarized as screening, engagement, and shareholder activism based on private dialogue or proxy voting (Louche and Lydenberg, 2006). The 2008 European SRI study distinguishes between core and broad SRI in an effort to harmonize methodologies across regions within Europe. These consist of the following strategies (Eurosif, 2008, p.7):

Core SRI:

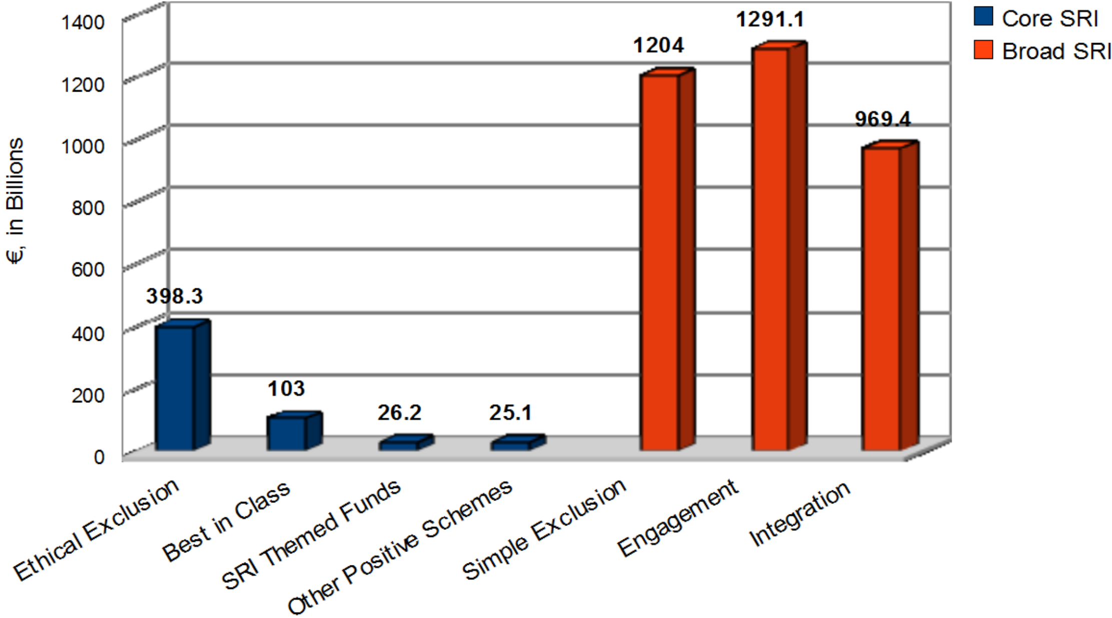
Ethical exclusions (more than two negative criteria applied);
Positive screening, including best-in-class and SRI-themed funds;
Combination of ethical exclusion and positive exclusion and positive screening

Broad SRI:

Simple screening, including norms-based screening
Engagement
Integration

In general broad SRI practice represents the area of greatest interest among European investors and has been the most mainstreamed of SRI approaches, encompassing a much larger volume of asset classes than core SRI (**See Figure 1**) (Eurosif, 2008). The Netherlands is distinguished as having experienced the fastest growth in terms of broad SRI adoption (Eurosif, 2008).

Figure 1: SRI strategies applied in Europe



Source: Eurosif European SRI Survey, 2008
Note: total of individual strategies added together may be superior to the total of Core and Broad SRI due to overlaps

As can be seen by means of the distinction between core and broad SRI practice, investment screens have evolved over time and can now be classified into two main groups. While negative screens were more commonly applied as some of the oldest and most basic SRI strategies, various negative and social screens can now be distinguished. A typical negative screen can be applied in the form of an exclusion list, which often includes products and services produced in "sin industries" (Renneboog et al, 2007). Other forms of negative screens may include issues related to human rights violations, labour conditions, animal testing, and environmental degradation, to name a few. Contemporarily, however, SRI portfolios are mostly based on positive screens that identify companies with progressive and proactive track records or companies that stand out as leaders in their sectors. The focus on positive screens is commonly based on the identification of good corporate governance, labour relations, the environment, sustainability of investments, and the stimulation of cultural diversity (Renneboog et al, 2007). A subsequent approach to screening initiatives is the above mentioned triple-bottom line, an integrated approach of selecting companies on the basis of specific ESG criteria that results in a combination of both negative and positive screens. Lastly, but also importantly, another approach to screening results from a combination of the above mentioned approaches coordinated with shareholder activism and commitment. This generally consists of an attempt on behalf of respective portfolio managers to influence the company's actions on ESG issues through direct dialogue with the management or by means of voting rights–this process is commonly referred to as ***engagement***.

Engagement practices have clearly distinguished European socially-responsible investors from their North American counterparts, and the UK is a leader in this area followed by the Netherlands and the Nordic countries (Eurosif, 2008). It is also worth noting that there has been a rapid increase, particularly triggered by a few large institutional investors, in terms of the practice of ***integration***, which implies the inclusion by asset managers of ESG-risk into their financial analysis (Eurosif, 2008). One caveat that has left various investors highly sceptical with regard to integration, however, is the current lack of a mechanism for the assessment and comparison of integration practices, which results in the absence of clarity in terms of the actual impact of this practice.

2.2. Trends and Dynamics

Over the past two decades, a series of regulations regarding social and environmental investments were passed by several governments of European states and have provided, most notably, tax advantages for investments in renewable energies and other specific 'green projects', which has resulted in a positive impact on the growth of SRI in Europe (Eurosif, 2008). Although European SRI may be within its early stages of development, its growth has been rapid and significant.

Eurosif (2008) reports a remarkable growth of 102 percent of SRI assets since 31 December, 2005, with the total SRI assets under management reaching an outstanding value of €2.665 trillion as of 31 December, 2007. The figures represent as much as 17.5 percent of the asset management industry in Europe. Among the countries with the highest percentage of socially-screened assets in Europe, the UK, the Netherlands, and Belgium can be distinguished as country leaders (Renneboog et al, 2007). The volume of SRI assets will continue to grow worldwide, and some of the largest pension funds in the world have already begun to show an increasing interest in participating in SRI by revisiting their investment strategies to promote integration of ESG criteria into the investment process.

The main SRI vehicles used at European level are discretionary mandates, investment funds, and other vehicles such as structured products (Eurosif, 2008). In terms of the geographical allocation of assets, a significant share was invested within Europe in 2008: estimated figures reveal that close to sixty percent of all SRI assets have been invested within Europe, 25 percent in North America, and only seven percent in emerging markets (Eurosif, 2008). It is important to note, however, that the main investors in emerging markets are the Nordic countries and the Netherlands.

Emerging markets can offer a higher than average expected return, which may result from the diversification opportunities for institutional investors while also providing greater access to economic growth in developing countries (Kargin, 2002; Mercer; 2008).The market inefficiencies in emerging market regions,

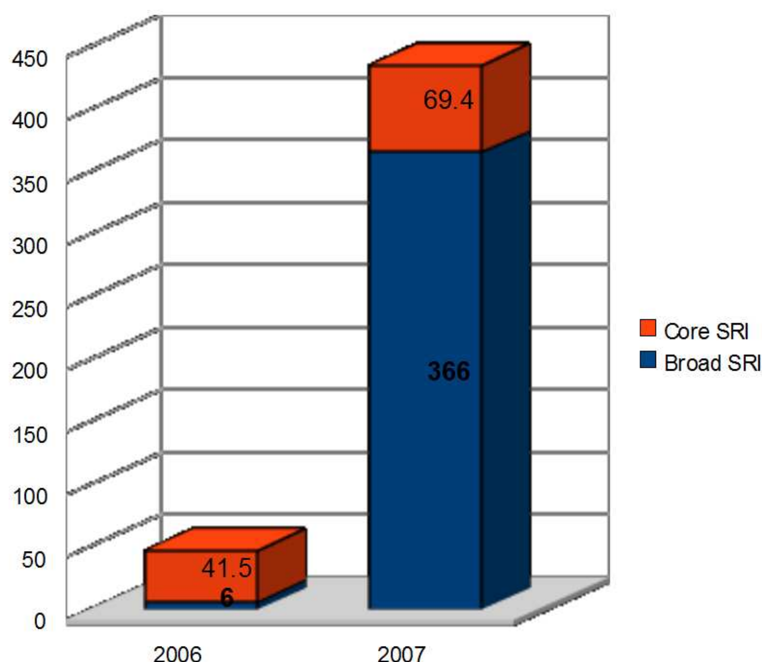
however, coupled with lack of transparency or data availability, poses significant risks to investments. The potential link between ESG issues and emerging market investment strategy can be vital from a risk management perspective, and this link is also integral as an alternative means to identify good investment opportunities. Microfinance, for example, has received greater attention on behalf of SRI investors seeking to increase their respective allocations to alternative asset classes and emerging markets. This is due to the relatively low credit risk and robust earnings records of microfinance (Eurosif, 2008). Moreover, supporting the private sector in developing countries contributes to structural and sustainable economic growth in these countries, which will in turn result in healthy returns for the respective international financial institutions.

While financial investment criteria are highly relevant within the European financial context, financial actors are increasingly aware of the importance of considering SRI as a means to ensure success and good performance (Martin, 2009). Despite the challenges of the current financial crisis that have left financial markets in a current state of turmoil and uncertainty, the trends and dynamics that have characterized the European market have demonstrated that SRI/ESG criteria will continue to play an important role. This growth in SRI and ESG criteria is expected to expand to new geographical areas such as emerging markets as information becomes more available and mainstreaming of SRI approaches occurs on a wide-spread level.

2.3. Dutch Market

In recent years total SRI assets under management in the Netherlands have increased significantly from €47 billion to €435 billion at the end of 2007, with approximately €69.4 billion of that amount regarded as core SRI and approximately €366 billion as broad SRI (See **Figure 2**) (Eurosif, 2008). In addition it is important to note that socially-responsible investments are more common among larger institutional investors and those investors expecting greater risk-adjusted returns from such investments (Cumming and Johan, 2004). Although the Dutch SRI market is dominated by fixed income and listed equities, it has increasingly begun to diversify into other asset classes such as hedge funds, private equity, sustainable property, and commodities such as forestry (Eurosif, 2008). The overall trends, however, have shown the Netherlands to be one of the fastest growth partners in terms of SRI in Europe with a total market share of forty percent

Figure 2: SRI Market in the Netherlands



Source: Eurosif European SRI Survey, 2008

It is difficult to establish the exact reasons that have led to major developments in the Dutch SRI community. Regulations may have had substantial effects on the growth of SRI asset management, and several of the largest institutional investors were already in the process of implementing SRI policies prior to 2007. The Dutch financial community was strongly influenced by the release of a documentary in 2007 (*The Cluster Bomb Feeling*)[3], however, which publicly exposed the investment strategies of various pension funds. The broadcast showed that some of the large pension funds of the Netherlands invested in companies that utilise child labour, companies that were major polluters, and companies that produced controversial weapons like landmines or cluster bombs. The documentary triggered greater public attention and scrutiny of the investment strategies and decision-making processes of pension funds and other financial actors like banks and insurance companies. Although it is certainly not the sole reason for the growth in SRI, it is arguably since the release of this broadcast that Dutch financial investors have increased efforts to develop and implement SRI policies to address ESG issues.

This broad assessment of (socially) responsible investment, its meanings and applications, and its growth across European and Dutch markets alike has provided the appropriate context in which the FMO-commissioned study of Dutch-incorporated investments in emerging markets can be understood. The

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[3] Access to documentary via website link: http://www.stopexplosiveinvestments.org/the-cluster-bomb-feeling

following section will thus examine the recent study and its implications for what it means to "be social, make profit."

3. Study Context and Methodology

Throughout the previous discussion of socially-responsible investment, financial versus social gains, and possible ways to reconcile risk with return, it was noted that the strength and productivity of an investment is not necessarily dampened but strengthened by the implementation of social selection criteria. While this statement comes with the caveat that the productivity of an investment depends on a number of contextual features such as the investor profile, investment environment, investment instrument, etc., it does help orient the FMO and its interest in the socially-responsible investment and return nexus.

As had been stated prior, this research was commissioned by the FMO for use in its 40th anniversary symposium entitled "Be Social, Make Profit!", and its aims were simple: to substantiate the link between "social" behaviour and financial return. To assess how this objective was met, it is first essential to explain how the data was collected. This section will explain the sample selection method, the composition of included actors, and the means of data collection. The methodology used for this study reflects a number of inherent constraints, which will be explained at the end of this section.

3.1. Sample Selection

To draw the most relevant and substantial insights from research participants, a specific cross-section of financial sector actors were identified for use in the research sample. To ensure consistent and comprehensive disagreggation of financial flows to emerging markets and to ensure that the profiled firms shared enough points of comparison that they could be reasonably assessed using a common survey tool, the participant pool was comprised entirely of financial sector actors.

Within the Dutch financial sector there are several groups that can be distinguished. To cover the widest range of business formats and capital capacities, this research approached asset and investment management firms; commercial, community, and investment banks; investment firms; microfinance institutions; venture capital firms, and; pension funds. The initial selection process was based upon net worth: the sample was first selected based upon the top-ranked institutions in each category based upon the market capitalisation. As the sample involved only Dutch-incorporated institutions, and lists are not regularly compiled for venture capital firms or are not relevant for institutions such as microfinance, alternate criteria for selection also had to be applied. For microfinance institutions the filter for inclusion was investment in emerging markets; this reduced the list of potential respondents to a handful. The situation for venture capital firms

was very similar, particularly given the emphasis of many venture capital firms in the Netherlands on start-up enterprises within the Benelux area. Asset and investment management firms were not initially included in the sample but were added following discussions with pension funds, many of which commission external asset managers to make strategic investment decisions on the behalf of the fund.

The firms approached for participation in this research were initially contacted via telephone calls and emails, and chief financial officers (CFO)/chief investment officers (CIO) were generally the first individuals at each firm approached. Following this initial contact, the research team was generally then forwarded to a contact within the sustainability, asset/investment management, or corporate social responsibility departments.

3.2. Data Collection Tools

The research was driven by two objectives: to identify the flows of capital moving from the Netherlands to emerging markets and to determine what being "social" actually means to the every-day business practises of investors. To meet this objective, three data collection tools were used.

The first tool designed to collect the more quantitative data was a survey comprised of 38 questions. These questions were broken into four categories: basic business information; investment background; financial data, and; social, environment, and governance data. The survey enabled a swift assessment of not only the scale of emerging-market investments but also of the scope by determining the countries, sectors, and instruments via which investments from Dutch firms were made in emerging markets. The survey also asked information about how investors internalise concerns about socially-responsible investment (SRI) and ESG issues into their business operations and how those concerns were mainstreamed into concrete norms and practises. These questions were more qualitative in nature and inspired further dialogue with the respondents. All survey information reflects the data for the fiscal year 2008, and builds further upon available annual reports and documentation publicly available online for each financial investor. The survey builds upon similar studies carried out by EMDP (2009)[4] and the Columbia Business School RISE Investor Survey (2003)[5], which have also evaluated socially-responsible investments and attitudes among investors about SRI. The survey can be seen in **Annex I**.

The survey was made available in electronic format (via an online form), by PDF/Word document, and by phone interview. Given the nature of the questions and the degree of preparation they required,

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4 EMDP (2009) "Emerging Markets Investor Survey Report: An analysis of responsible investment in emerging market".

5 Columbia Business School Rise Investor Survey (2003) available online: http://www.riseproject.org/mission.htm

respondents were encouraged to fill out the survey online or by PDF/Word. Most chose for this option, but several preferred telephone administration of the survey.

To draw out the more complex ideas revealed by the survey, the second data collection tool used was in-depth interviews. Each of the respondents was approached for an in-depth interview that would be used to further expand upon the ideas mentioned briefly in survey responses, to fill in gaps left in the survey, or to provide proper context for the survey answers. The interviews ranged in length from twenty minutes to one hour, depending on the time available. While the respondents were encouraged to first fill out the survey, several preferred to speak with a member of the research team before filling out the survey, and as a result, several in-depth interviews exist for investors who failed to complete the survey. Given the time constraints faced by respondents, several of the respondents were not interviewed.

The third data collection method was desk research. Where the survey and in-depth interview either failed to capture the appropriate level of detail, or when respondents were unable or unwilling to complete one or both, desk research was used to fill the information gap. Annual reports and other public materials were used to gather data.

Throughout the data collection process, potential respondents were assured of the confidential treatment of their data. While most investors wanted the firms they represented to be explicitly named as research participants, several would participate only under the condition that they remain completely anonymous. This desire for anonymity is also reflected in the reporting of results. While indicators of the general company format will be reflected in the data, no data will be reported in connection with a firm name. Similarly, because interview guides were tailored to each individual investor, they will not be made available in an annex for fear they could compromise investors' anonymity.

3.3. Included Actors

The sample summarised in the next section includes a diverse mix of financial sector actors representing a variety of business formats and sizes. From the approximately 70 actors that were approached for participation, approximately half tentatively agreed to complete the survey. By the end of the data collection period, twenty actors had completed the survey, 21 of those approached declined participation, and the remainder failed to reply or provide a definitive answer. The number of respondents initially appears to be low, but one important caveat applies to judging the sample size.

In assessing the number of survey respondents, it is essential to consider the nature of pension funds, which constituted a large portion of the initial sample pool. Pension funds do not always manage their own investments, and of the pension funds that had declined participation, most did so on the basis that they do

not determine their own investment strategy. They commonly referred the research team to the asset/investment management firm that acts on the pension fund's behalf. Seven of the survey respondents were asset management firms, and each of those respondents provided data for the business in total plus, when available, disaggregated data by their largest clients. Those seven asset managers collectively represent over **85** clients and are able to provide a more realistic approximation of true investment flows to emerging markets. The asset management firms represent a range of institutional clients, from pension funds and corporations to banks. The diversity represented by the inclusion of these asset managers provides a number of important insights, which will be discussed at more length in the following section.

3.4. Limitations

Throughout the research it was apparent that a number of inherent constraints would need to be addressed prior to data analysis. Those constraints related to the selection of respondents, the state of the financial system, and the study time frame.

Any research without a large sample pool risks introducing bias into the resulting data, and this research is no different in this regard. Even though the number of clients and the number of diverse investment streams represented by the inclusion of asset/investment management firms helps ease this concern, the small respondent pool still introduces bias. The primary form of bias in the respondent pool relates to positive self-selection of respondents. Many of the investors surveyed were explicitly interested in (S)RI policies and the topic of the research: several had begun their careers in the field of SRI and others represented firms that had either been created or reformed around a basis of SRI strategies. The worry then becomes that the investors included dilute the true picture of investment flows from the Netherlands to emerging markets because they are the actors that are already engaged in responsible investing practises. The financial sector institutions and actors that actively disregard ESG and SRI concerns may have not responded to the request for participation exclusively because they do not incorporate those concerns into their investment strategy. The data may thus reflect only those investors who are already active in the field of "socially"-oriented investment in emerging markets, and as such it may provide an inappropriately positive picture.

Further, the respondents who participated in the survey were often chosen to represent their respective firms or businesses because of their role in alternative or targeted investments and strategies. While the explicit (and stated) aim of the research in general and the survey specifically was to assess the strategies and perceptions of investors who invest in emerging markets, it was never stated that the investors must be "social" investors and must employ (S)RI strategies. Many of the respondents, however, represented designated branches or arms of a larger financial group that deal exclusively with responsible investments,

sustainable investments, or targeted "social" investments and vehicles. As a result of this process of delegating the task of completing the survey to an office or branch created with the explicit purpose of addressing ESG/RI interests and concerns, the survey results represent incomplete group-level data. Several respondents provided information only for their particular office or arm of the entire financial group, despite the fact that other parts of the institute or group invest in emerging markets. As a result the financial flows reported are somewhat abbreviated and may considerably underestimate the true volume of capital moving from the Netherlands to emerging and frontier markets. Further, the respondent selection may also skew the perceived dedication of investors to responsible investment strategies. If, for example, a respondent representing the designated SRI office of a large financial group reports that they employ a certain investment selection procedure that is exceptionally stringent, one may mistakenly make the assumption that this policy holds for all investments made by the entire financial group while it may, in reality, be applied only to the assets invested in by that SRI office in designated SRI/ESG-themed funds.

The state of the financial system is also a constraint that requires consideration. The survey used for this research asks for data from fiscal year 2008. This date was chosen because all investors have data for this year prepared and available in annual reports, whereas the data for fiscal year 2009 was not available for all investors upon commencement of this research. Further, both 2008 and 2009 were cataclysmic years for the world-wide financial sector, and the Netherlands was affected on a massive scale. Data for 2009 is often inconsistent and less transparent than it had been in previous years due to shifts in company orientation and activity to accommodate the financial crisis. The choice to request data on 2008 is thus fortuitous in that regard. The choice of using 2008 for the collection of baseline data is disadvantageous in other ways, however. In 2008 many of the major Dutch banks experienced plummeting market capitalisation and required emergency assistance. As a result many banks and financial service providers were forced to restructure their business operations to accommodate mergers, acquisitions, and new requirements presented as conditionalities on emergency aid. This restructuring movement meant that investment and asset management for the international portfolios of several Dutch firms were moved to other divisions of the bank or the bank's partners, several of which are not Dutch-incorporated. The information for 2008 has thus been difficult to find for several banks due to the scattering of personnel and movement of units within banks. Despite the complications it introduced, the financial crisis was of great interested throughout this research. While the data collected in this study reflects financial flows at the beginning of the financial crisis (and for several actors, before the financial crisis' affects had become fully manifest), the interviews reflect perspectives firmly linked to (post)crisis mentalities and strategies. Further, the data provided via both survey and interviews give an interesting view on how investment flows respond to times of economic uncertainty.

The last constraint was the time frame in which the research was conducted. The survey was made available at the beginning of January and was set to close on 12 February. This six-week window of opportunity was not wide enough to ensure maximum response, particularly when considering that it took an average of four weeks to be forwarded to the correct contact person within each approached firm. Further, the research would have proved a great deal more insightful if it would have been able to document investment and ESG trends over time. To take a "snap-shot" of investment flows in one year, particularly in a year characterised by financial upset, is an appropriate way to measure *potential* investment flows, but it would be more valuable to conduct a longitudinal study. The measurement of features such as gross internal rates of return (IRR), willingness to sacrifice financial returns for social returns, and the link between the application of ESG criteria and share-price performance are all better measured over a series of years. As many firms have only recently reformed their investment policies to reflect ESG/SRI criteria traditionally associated with triple-bottom-line ventures, many of the effects of such policies have not had time to appropriately manifest. This could not be avoided, but it does point to the need for future research that tracks the evolution of these features as ESG/SRI concerns become more embedded in business plans.

4. Summary of Results

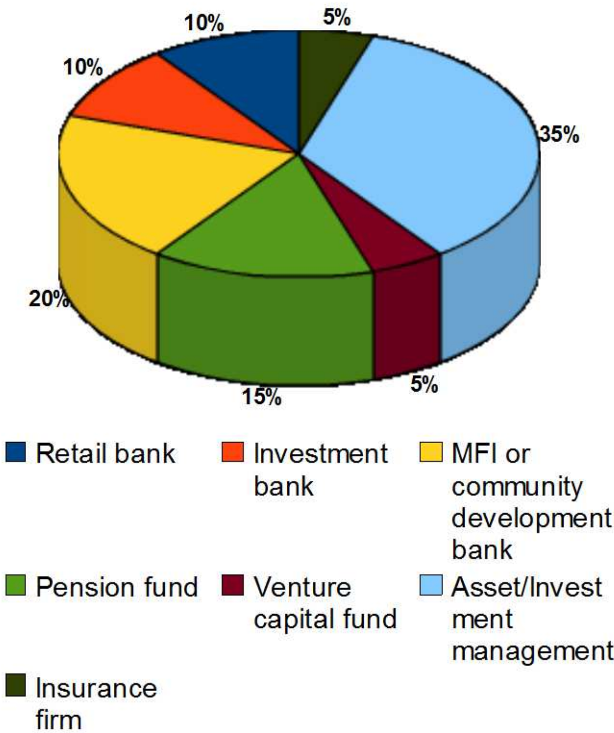
The data collected via surveys, in-depth interviews, and desk research have provided a rich body of information that helps answer "What does it *mean* to be social and make profit?". To explore this question, the data gathered from the survey will be discussed first, and the information collected in interviews will then be explored.

4.1. Overview of Survey Results

The survey results discussed in this section will encompass the quantitative questions from the survey; the qualitative questions requiring explanation of rationale and context were expanded upon in in-depth interviews and will thus be described in the next section.

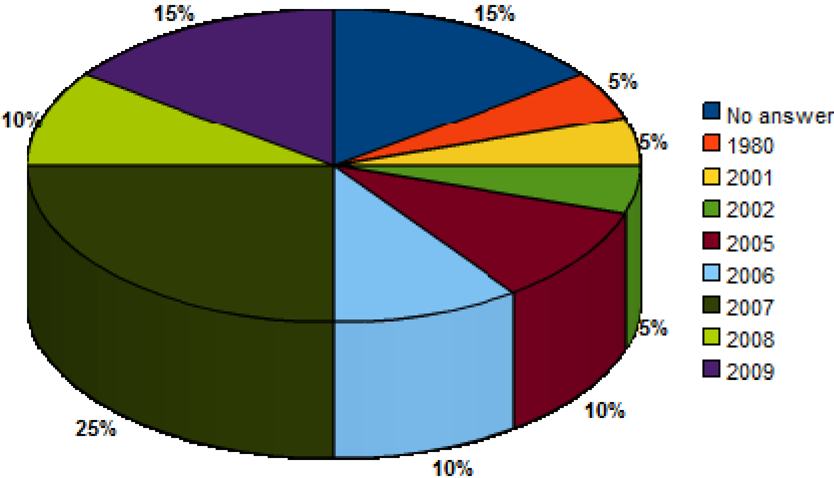
As mentioned earlier, the survey was comprised of four sections, the first of which focused on the business set-up of the surveyed investor. This section asked information about what type of financial service provider the investor is, what the investor's (social) mission statement is, and the year in which the mission statement was created or last updated (See **figure 3**; See **Figure 4**).

Figure 3: Respondent Composition



Source: Data compiled from survey

Figure 4: Year of Mission Statement Implementation/Update



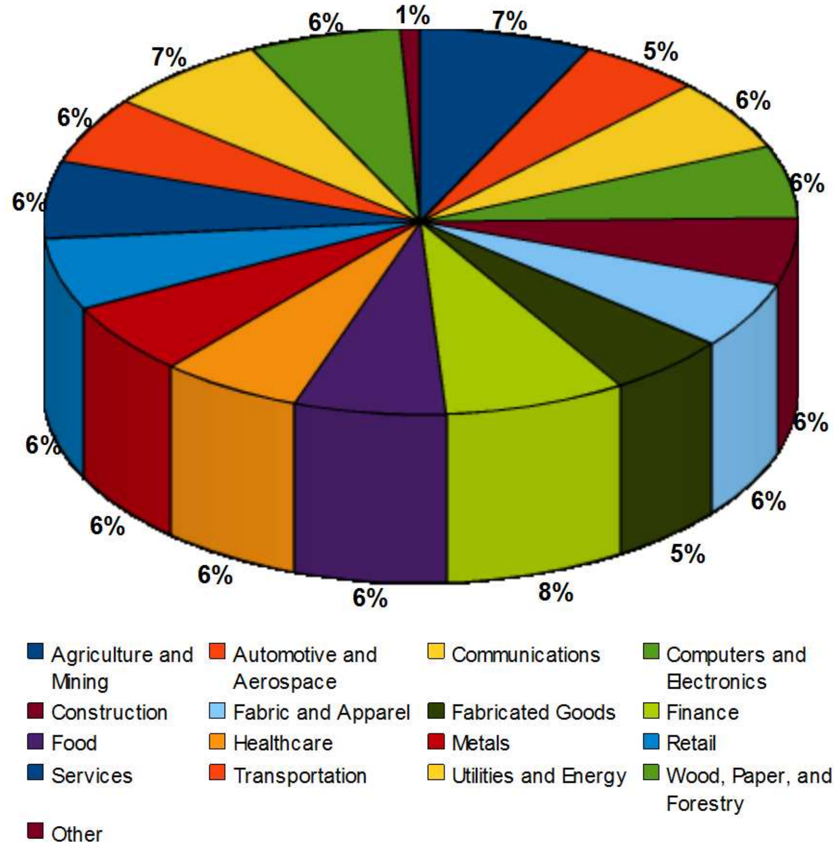
Source: Data compiled from survey

Nearly half of the respondents represented asset or investment management firms; nearly a quarter represented microfinance institutions or community development banks. The remainder represented venture capital firms or commercial and investment banks. Asset managers are over represented within the survey sample; this can be directly correlated to the number of pension funds approached for participation, as several pension funds referred external asset or investment managers for participation in the research. Further, several of the asset and investment management firms surveyed indicated that they did not manage investments exclusively for pension funds. Most represented a combination of institutional investors such as pension funds, corporate investors, and banks. More importantly, the distinction between different financial service providers is not discrete: there is a considerable amount of overlap among the financial actors. It should also be emphasised that respondents often represented a particular unit of a larger firm or financial service group as was noted in the description of the study's methodology. As such, the categorisation of respondents is not as useful because it simply reflects the section of a business from which respondents hailed. Few respondents reported a mission statement or social investment policy that was implemented or updated before 2002, and the majority noted that the statements were developed or updated between 2007 and 2009, a feature that helps explain the limited link between the policies and manifest effects of the policies that so many respondents noted. Several respondents also indicated that statements are reformulated and updated regularly, and many have been updated in the last years in response to the financial crisis.

Section Two of the survey then asked a series of questions used to assess investors' investment backgrounds; 17 questions were included in this section, and the questions focused primarily on the investor's actions in emerging markets (unless otherwise indicated). The first question in this section asked

about the industry areas in which the investor makes or seeks to make equity investments in emerging markets, the results of which are displayed in **Figure 5** below.

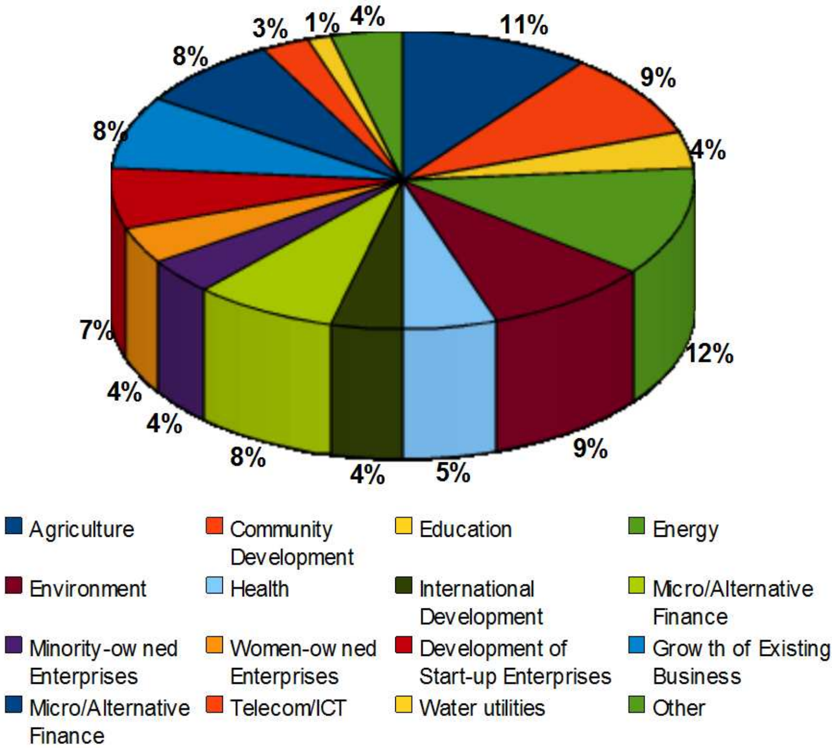
Figure 5: Industry areas of equity investments in Emerging Markets



Source: Data compiled from survey

As the figure indicates, equity investments made in emerging markets are distributed fairly equally among all sectors, and none of the sectors listed in the survey were not invested in. The next question in the survey asked about the areas in which the investor makes social or environmental investments in emerging markets. While several of the investors commented about the ambiguous meaning of "social or environmental investments" (this will be discussed in more detail below), most listed investments that were made with the intention of achieving dual social/financial return. The areas of such investments are seen in **Figure 6** below.

Figure 6: Area of Social/Environmental investments in Emerging Markets



Source: Data compiled from survey

Agriculture, energy, and "other" areas of investment were the most common destinations for social and environmental investments. The "other" category is of particular interest, as several of the investors indicated investment in microfinance and other forms of alternative financial service provision.

The next question in the survey covered countries in which the investor currently has investments, and this question merits additional discussion. While most of the respondents simply checked the appropriate boxes and wrote in the countries of investment not listed on the survey, four (all asset managers) stated that it would be too time consuming to list all of the countries due to the complexity of client portfolios and the number of countries included; the MSCI Emerging Market Index, however, was indicated as a guide in determining countries of investment. This index distinguishes among several type of markets, the most relevant of which are emerging market and frontier market countries. There are 44 countries within these categories, and in lieu of definitive answers from those four respondents, this list suggests most pertinent countries of investment. The investment flows to the regions identified in the survey can be seen in **Figure *7*,** and as can be seen, the total volume of reported investments in emerging markets amounted to €29.93 billion.

Figure 7: Investment flows by region

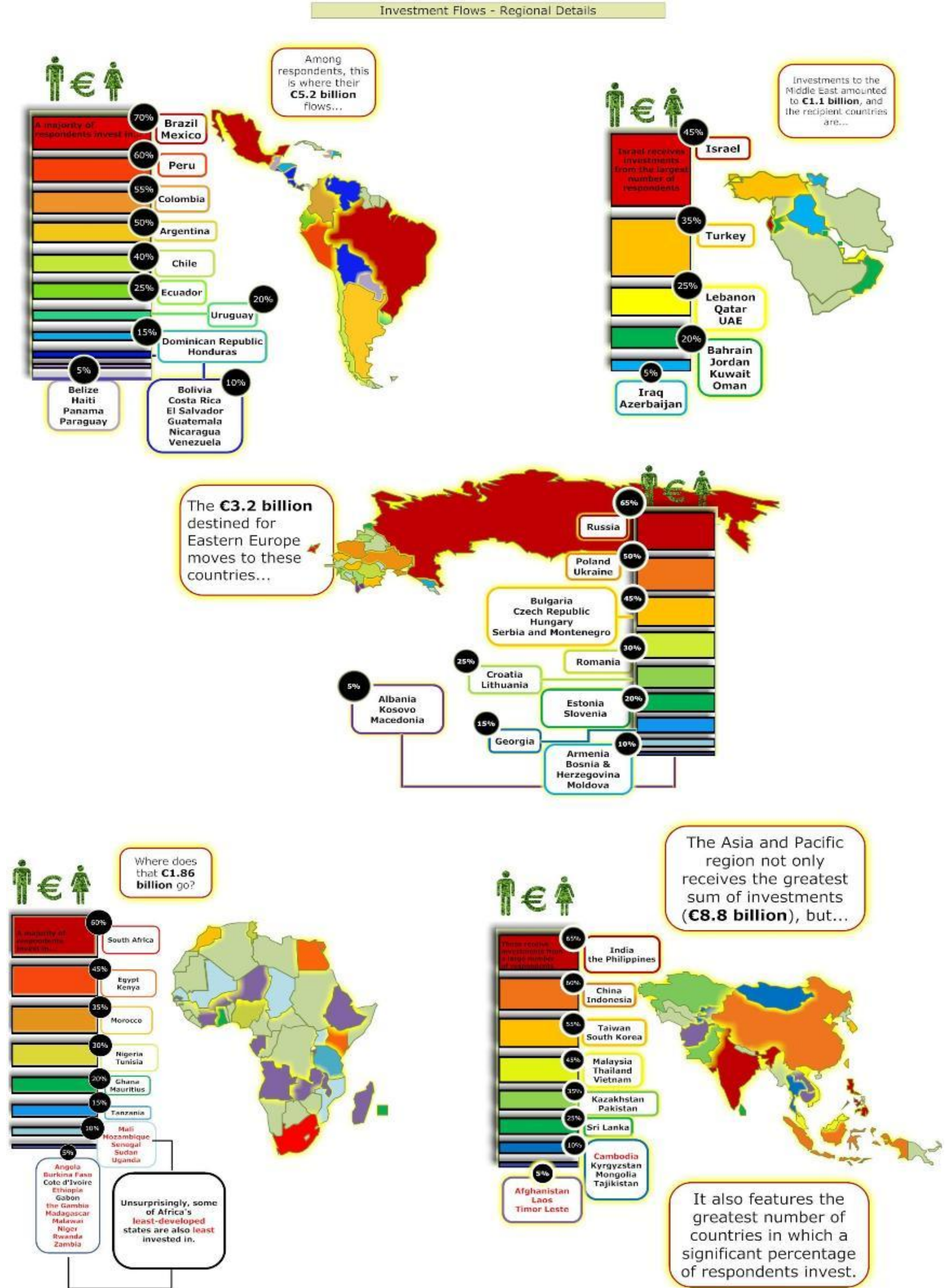
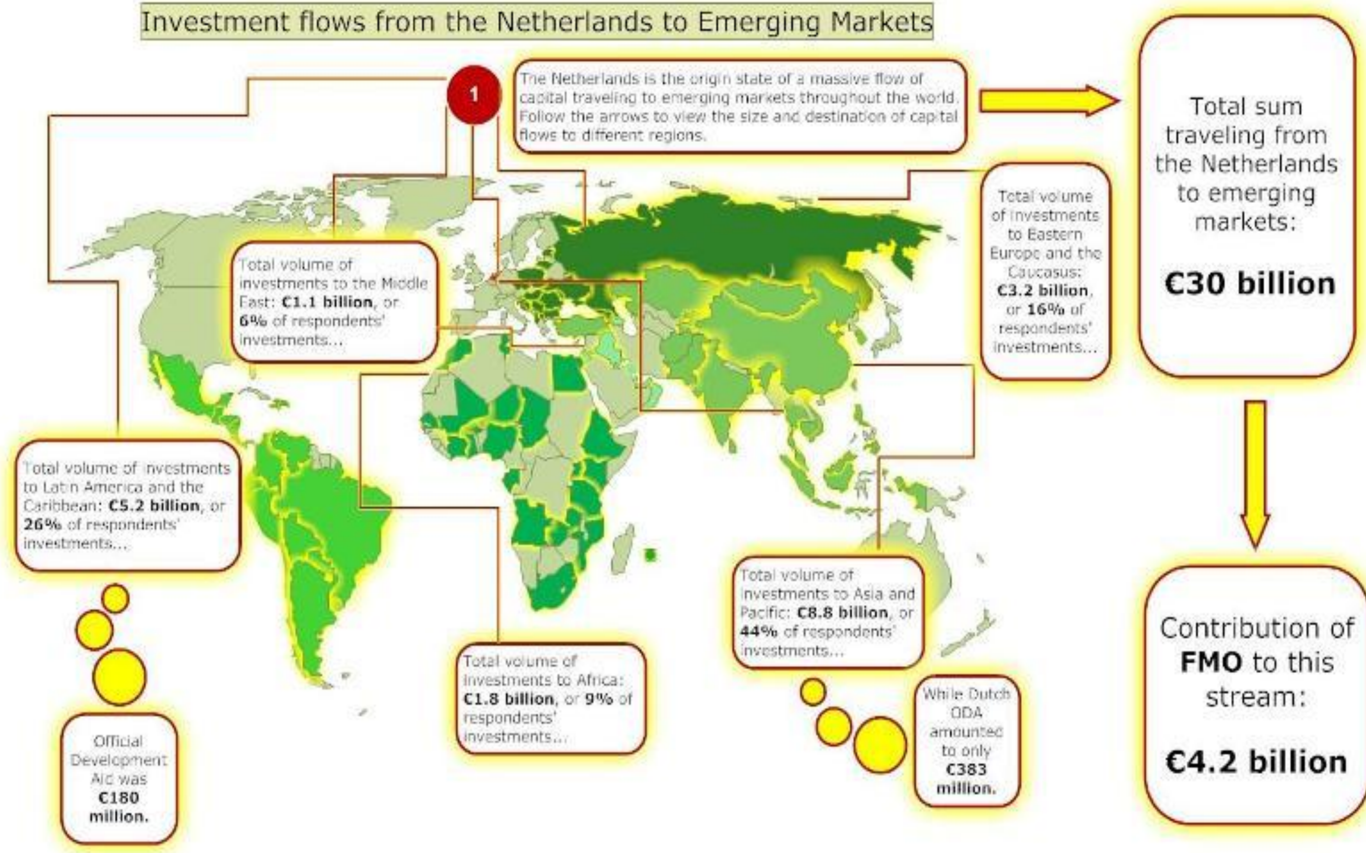


Figure 8: Countries invested in and volume of capital moving to each region



Source: Data compiled by survey

Figure 8 displays the countries invested in, the proportion of respondents who indicated investments in those countries, and the approximate volume of capital moving to each region[6]. As the illustration demonstrates, the investments span wide geographical distances and a range of market maturity. While many of the respondents indicated that they do not invest in least-developed countries (LDCs), it is worth noting that investments in such countries do occur, though perhaps not on a wide scale. The volume of investment flows, and the destination of investments, paints an interesting picture of the included respondents. As can be seen the Asia and Pacific region, which encompasses 23 countries (six of which—Afghanistan, Bangladesh, Cambodia, Laos, Nepal, and Timor Leste—are considered LDCs) receives the greatest volume of investments at €8.8 billion. Within this region the top destinations were India and the Philippines, in which 65 percent of respondents noted investments, and China and Indonesia, in which sixty percent of respondents invested in. The region that received the next-greatest volume of investments was Latin America with €5.1 billion worth of investments reported. Within this region there were twenty countries in which investments were made (including Haiti, the only LDC in the region). Brazil and Mexico

[6] Please note that **FIGURE** *7* does not provide a complete disaggregation of investment flows by region. Not all respondents were able to breakdown their investment amounts by region, either due to the complexity of the client portfolios and number of portfolio companies or because of disclosure concerns. The sums indicated are thus based upon the data provided and should be viewed merely as indicative of the potential value of investment streams.

were the most-commonly cited countries of investment (with 70 percent of respondents indicating investments), followed by Peru (with 60 percent). Eastern Europe was the third-largest region in terms of total investment volume. An estimated €3.1 billion was reported as invested in the region's twenty countries, only three of which—Russia, Poland, and the Ukraine—were invested in by fifty percent or more of all respondents (with 65 percent for Russia and fifty percent for both Poland and the Ukraine.) The Africa region, despite encompassing the greatest number of destination countries at 34, received the second-lowest volume of investments (€1.7 billion). Considering the number of least-developed countries within this region (21), this is not entirely surprising, and only one country (South Africa) was the destination for a majority of respondents (60 percent). The Middle East region—comprised of the fewest number of countries with eleven—received the smallest volume of investments with €1.1 billion. No country was invested in by a majority of participants (even Israel was invested in by only 45 percent of respondents).

The next questions in the survey asked about the amount of capital (in euros) that had been invested in emerging markets in 2008 and what percentage emerging-market investments constituted of all investments in the international portfolio. **Table 1** below shows the answers to these questions by displaying the type of financial service provider, the total capital under management by the firm, the capital invested in emerging markets, and the percent of the international portfolio such investments constituted. Please note that some respondents were not able to disclose precise amounts, thus several of the figures are approximate indications, and other respondents were not able to provide figures—such missing values are thus indicated by dashes.

Table 1:Total capital under management by firm, capital invested in emerging markets and percetnage of international portfolio

Type of Provider	Total € Amount Under Management	Total € Amount Invested in Emerging Markets	% of Emerging Market Investments of International Portfolio
Venture Capital Fund	€4.6 million	€1.4 million	100.00%
Asset/Investment Management Firm	€4.5 billion	€1.5 billion	30.00%
Investment Bank	€80 million	€80 million	100.00%
Asset/Investment Management Firm	€180 billion	€ --	--
Pension Fund	€11 billion	€450 million	4.00%
Asset/Investment Management Firm	€54 billion	€6.21 billion	11.60%
Asset/Investment Management Firm	€42 billion	€2.3 billion	15.00%
Pension Fund	€10.5 billion	€1 billion	10.00%
Asset/Investment Management Firm	€70 million	€2 million	75.00%
Asset/Investment Management Firm	€22.9 billion	€120 million	0.50%
Pension Fund	€13 billion	€250 million	6.00%
Asset/Investment Management Firm	€135 billion	€11.3 billion	9.00%
Microfinance Institution	€150 million	€38.5 million	90.00%
Microfinance Institution	€400 million	€350 million	98.00%
Retail Bank	€ --	€20 million	5.00%
Microfinance Institution	€149 million	€135 million	98.30%
Community Development Bank	€4.2 billion	€4.2 billion	100.00%
Retail Bank	€1.8 billion	€197 billion	66.00%
Investment Bank	€175 million	€1.2 billion	--
Insurance Firm	€31 billion	€ --	--

Source: Data compiled from survey

Following several qualitative questions relating to the choice of countries/markets for investments as well as expected social and financial gains from those investments, the survey asked about the length of time in which the respondents' firms had been investing in emerging markets. **Figure 9** shows that the majority of investors have been active in emerging markets for more than ten years, and the least number of

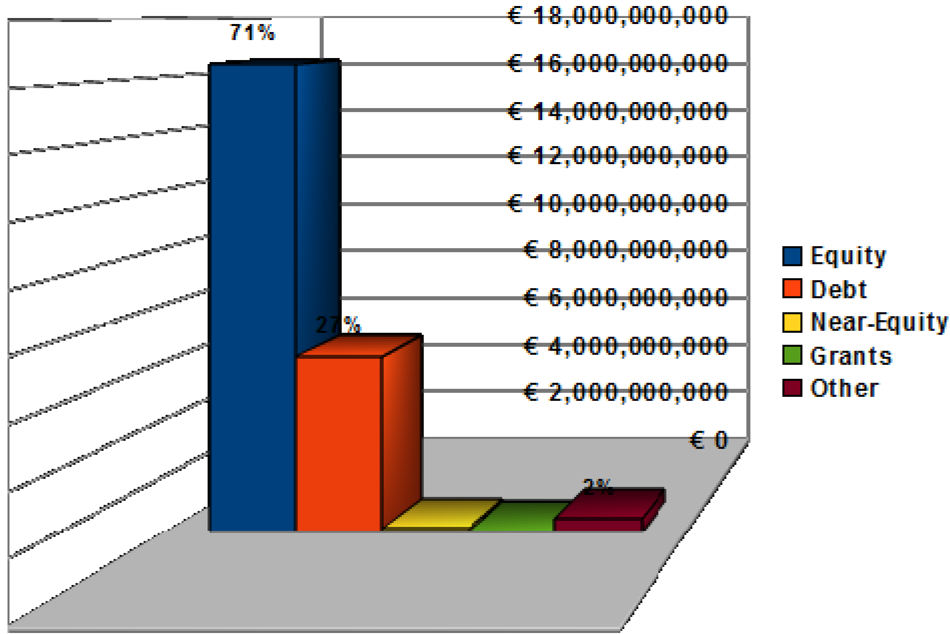
respondents have been active in emerging markets for between one and three years. This indicates that emerging market investments are relatively well-established among the included investors. The next question was about the size of enterprises invested in, the results of which are displayed in **Figure10**. Most respondents reported investments in large enterprises (enterprises with over 250 employees and/or more than €43 million of an annual balance sheet total). Micro-enterprises (those with fewer than ten employees and/or less than or equal to €2 million of an annual balance sheet total) were the least invested in, and small (less than fifty employees and/or less than €10 million of an annual balance sheet total) and medium (less than 250 employees and/or less than €43 million of an annual balance sheet total) were equally as often invested in.

Figure 9: Number of years active in EM; Figure 10: Size of investment enterprises

Source: Data compiled from survey

The survey then posed a series of questions about the means by which each respondents' firm invested, both in total and in emerging markets. While the investment instruments used to invest in general were fairly diverse (in addition to investment via listed equity and debt, several respondents also reported investments in commodities, real estate, infrastructure, hedge funds, and private equity), investments in emerging markets were made primarily via listed equity and debt, as **Figure 11** shows.

Figure 11: Capital invested by instruments



Source: Data compiled from survey

As can be seen, over seventy percent (equalling over €16 billion) of the emerging-market investments made by the surveyed investors were made in listed equities while 27 percent of investments (nearly €6 billion) were made through debt. Debt has two distinct meanings in this context. For the asset management firms who responded to the survey, debt is fixed-income investments such as corporate or state bonds. For the respondents representing microfinance firms, debt is credit. The remaining two percent of investments were made via grants, near-equity instruments, or other investments such as commodities and real estate.

In addition to the instruments used to make emerging-market investments, the survey also assessed the socially-oriented investment vehicles that are run in emerging markets. **Figure 12** shows the types of vehicles that are run.

Figure 12: Special investment vehicle run in EM

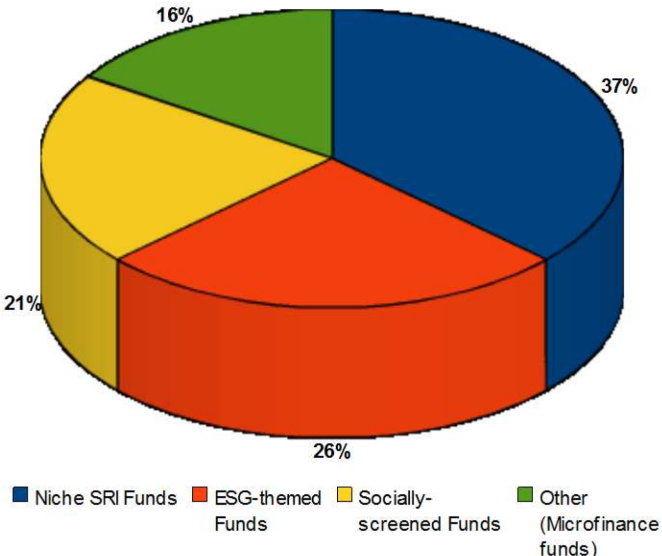


Figure 13: Target internal rate of return

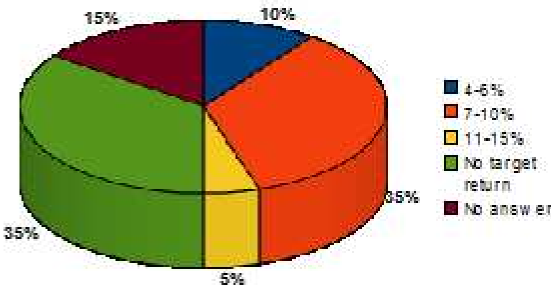
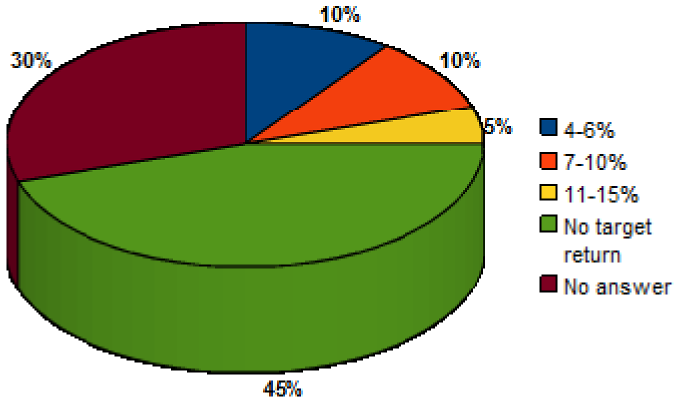


Figure 14: Average return hurdle



Source: Data compiled from survey

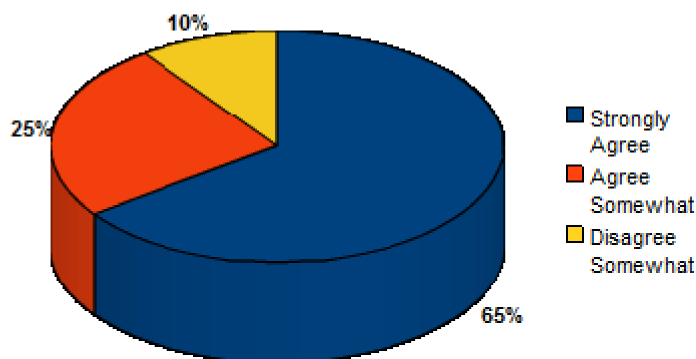
Among respondents niche socially-responsible investment funds were the most often used, and ESG-themed funds were the next most-run vehicles.

Section Three of the survey asked about financial data such as the investor's target rate of return, the estimated returns on portfolio companies, and the average return hurdle per portfolio company. The

answers respondents gave to the first and last question can be seen in **Figure 13 and 14**, but the answer to the question of estimated returns cannot be discussed with any level of surety. What can observed, however, is that it is relatively uncommon for the investor to set a strict target internal rate of return, but when they do, it is mostly like to fall within the seven-to-ten percent range.

Section four of the survey collected data about respondents' investment strategies and perceptions of ESG concerns. The first question in this section asked the question: "To what extent do you agree with the following statement?: 'Management of ESG issues is an important part of our business operations and our investor relations process.'" The answers to this question were mixed in an interesting way. As can be observed from **Figure 15**, 65 percent of respondents strongly agreed with this sentiment while 25 percent agreed with it "somewhat" (as one respondent stated, "The 'somewhat' depends on the formulation!"). Only ten percent indicated disagreement with this statement.

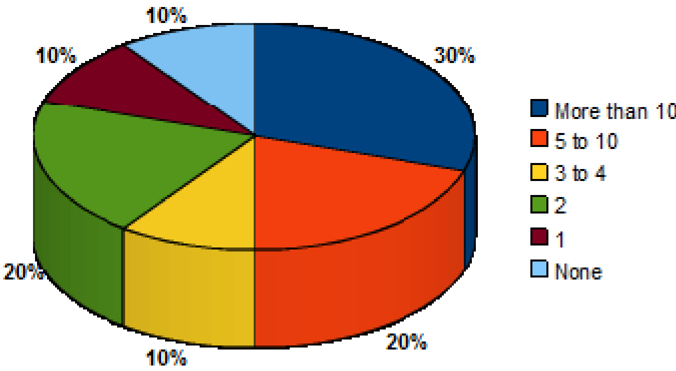
Figure 15: "Management of ESG issues is an important aspect of business…"



Source: Data compiled from survey

Respondents were then asked about how many professionals the investor employs who are capable of evaluating the impact of ESG issues on business operations or of explaining the company's ESG position to investors or relevant stakeholders. The answers to this question were interesting: as several respondents pointed out, the number of trained professionals is difficult to answer when the firm requires all investment managers to be well-versed in ESG issues yet there are no dedicated ESG professionals on staff. **Figure 16** must thus be evaluated in this light.

Figure 16: Number of on-staff professionals trained to evaluate ESG issues



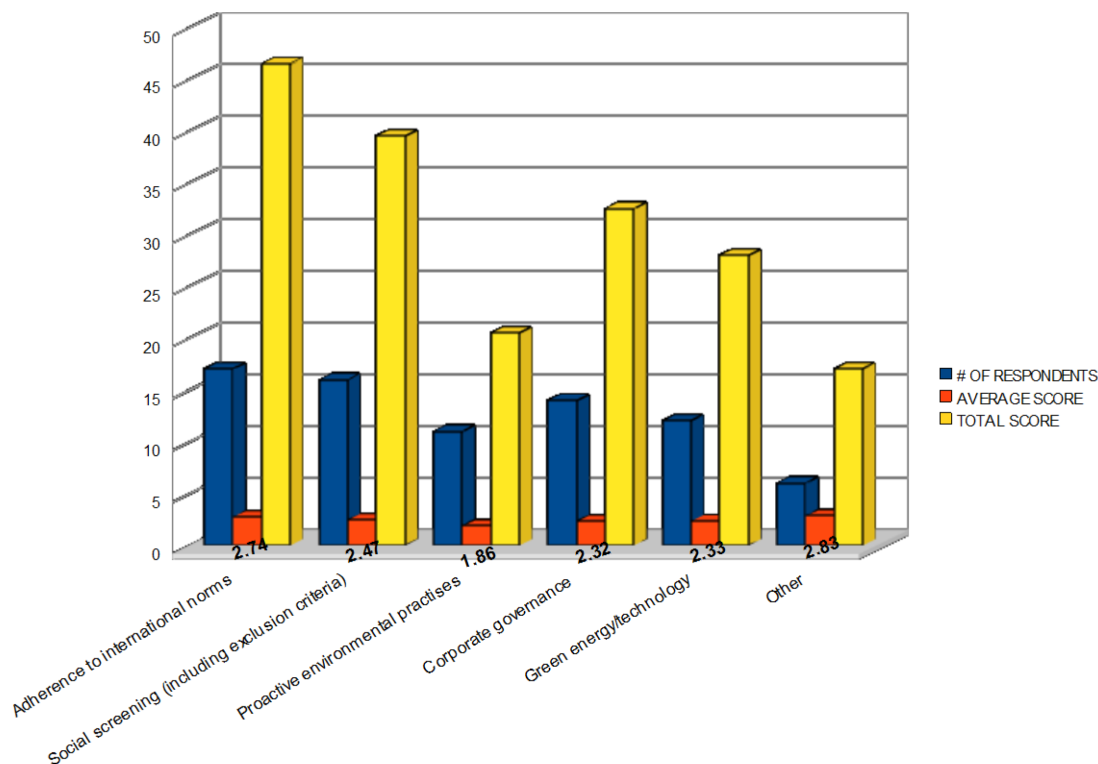
Source: Data compiled from survey

Following this question the survey then asked about the ESG/SRI criteria taken into consideration when an investment is being evaluated. The responses to this can be seen in **Figure 17**.

Most respondents indicated the prior to making investments in emerging markets, they first considered if the investment adhered to international norms relating to fields such as human rights and labour relations. Many others conducted some form of social screening to determine if the potential portfolio company was involved in the manufacture of undesirable products (such as cluster munitions and anti-personnel landmines, which were nearly universally condemned by all investors) or if the company supported regimes with poor human rights records. As can be seen from the figure, it is also not uncommon for investors to consider features such as the potential portfolio company's proactive environmental practises, corporate governance policies, or emphasis on green energy or technology products and services. Respondents were then asked to rank the criteria based upon the weight the criteria carry in influencing an investment decision, and the importance given to each criteria can be seen below, also in **Figure 17.** The figure makes clear that proactive environmental policies have the least amount of influence on an investment decision, and corporate governance policies and positions are likewise not as important in guiding an investment choice. Adherence to international norms was by far the most important criteria considered, and this makes sense when considering the relationship between adherence to norms and the application of an exclusion policy. Most of the respondents mentioned that when considering an investment, some form of exclusion criteria was used. As was mentioned earlier this criteria also includes refusal to invest in companies that produce certain classes of weaponry. Rather than being an expression of dislike of arms manufacture on a moral or ethical basis, several respondents mentioned in interviews that the exclusion criteria used reflect not only international norms but binding or near-binding international agreements and prohibitions (such as the United Nations' convention on the prohibition of the use, stockpiling, production and transfer of anti-personnel mines). It thus makes sense that adherence to international norms would be a major feature

guiding investment decisions. Several respondents answered that other criteria are important in guiding investment decisions, and these criteria often included specific client-driven features.

Figure 17: Importance of ESG/SRI criteria to investment decision

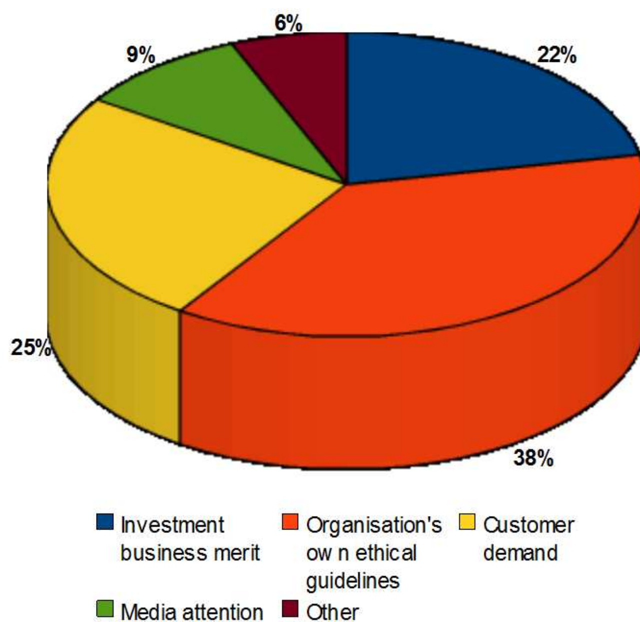


Source: Data compiled from survey

Respondents were then asked about the motivation that drives the investor to consider ESG or SRI criteria prior to making investments, and the answers given in both the survey and in-depth interviews were surprisingly candid. Well over one-third of the respondents said that the investor's own internal ethical guidelines were the primary motive for addressing ESG concerns, but it is worth noting that this motive was mentioned more among the respondents with explicit social investment components. Customer demand was the second most common motive for the incorporation of ESG concerns into investment strategies, and this reason was commonly associated with asset and investment management firms that reported employing investment strategies based upon the needs and wants of individual clients. Investment business merit was the third most common motive for addressing ESG concerns while media attention and “other” reasons ranked fourth and fifth respectively. While it is not necessarily reflected in **Figure 18**, many respondents noted that ESG issues are incorporated into the business's investment strategies as a means of controlling and mitigating risk, an idea that was explored much more thoroughly in the in-depth interviews.

Respondents were then asked to consider the strength and the consistency of the link between their companies' actions on ESG issues (including the incorporation of ESG concerns into investment policies and strategies) and the long term share-price performance of portfolio companies.

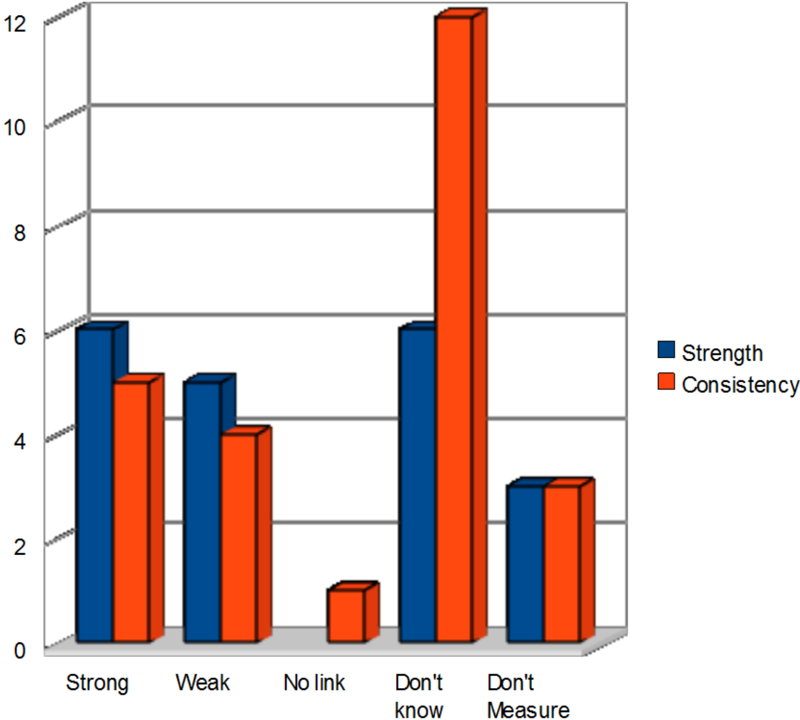
Figure 18:Motive for addreessing ESG concerns



Source: Data compiled from survey

Most of the respondents reported that they either did not know an answer to these questions or that the questions were not relevant to their particular company due to lack of interest in measuring such correlations. **Figure 19** shows the responses.

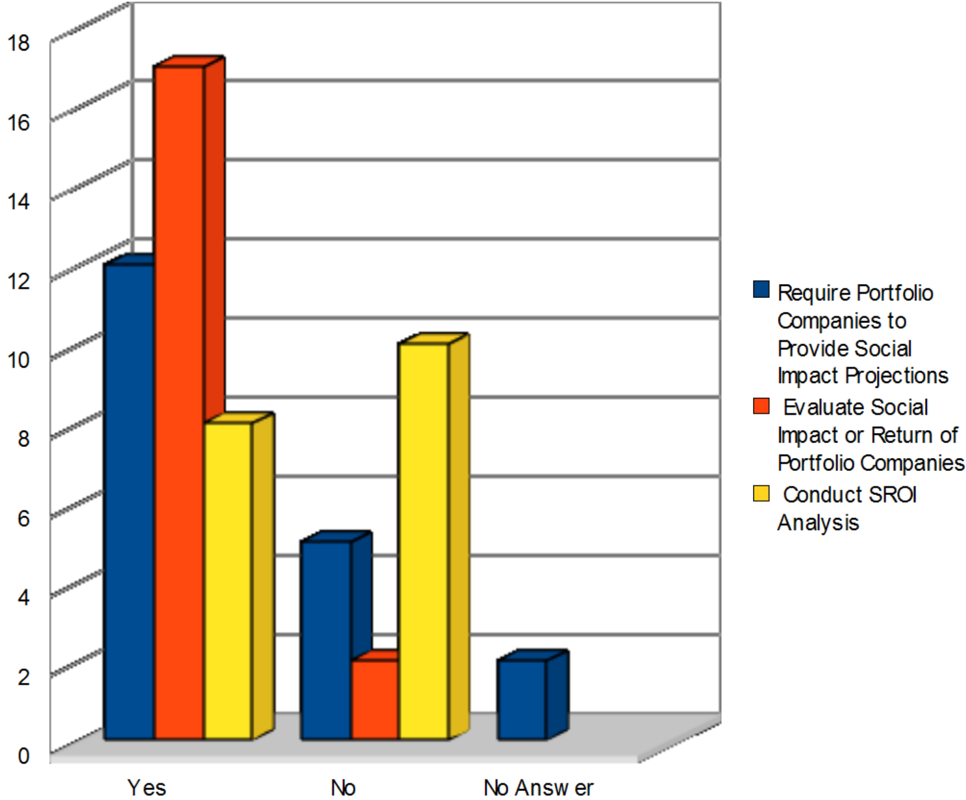
Figure 19: Strength & consistency of link between actions on ESG and share-price performance



Source: Data compiled from survey

To enable a better overview of how investors express aspects of "social" investment insight in every-day business practices, the survey then asked a series of questions about the types of evidence required before an investment will be made. Respondents were asked if entrepreneurs were required to make social impact projections, if the social impact or return of portfolio companies was evaluated by the investor, and if the investor conducted social return on investment (SROI) analysis (these features are described in more detail in the section on interview results). The answers are presented in **Figure 20**, which shows that a majority of respondents do evaluate the social impact or return of portfolio companies and do require social impact projections from entrepreneurs.

Figure 20: Respondents'social impact projections

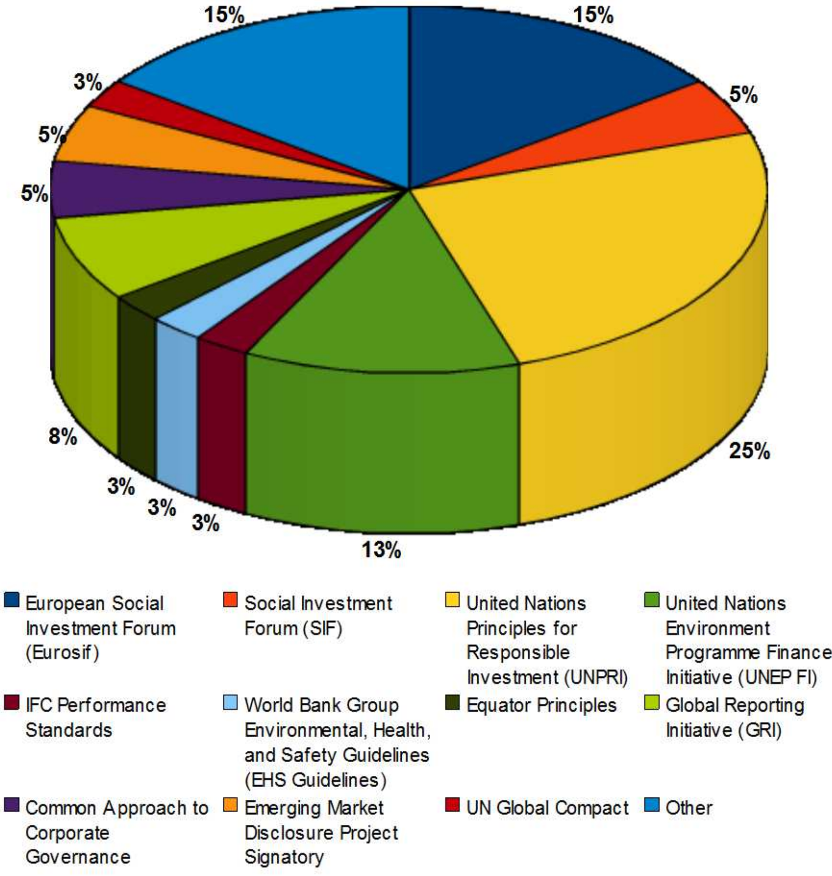


Source: Data compiled from survey

Respondents were then asked to list all organisations, projects, and agreements to which they are signatories or members of. A large number of the respondents are signatories to the United Nations Principles for Responsible Investment (UNPRI), and several participate in the European Social Investment Forum (Eurosif), the United Nations Environment Programme Finance Initiative (UNEP FI), and the Carbon Disclosure Project. The memberships and signatory projects can be seen in **Figure 21.**

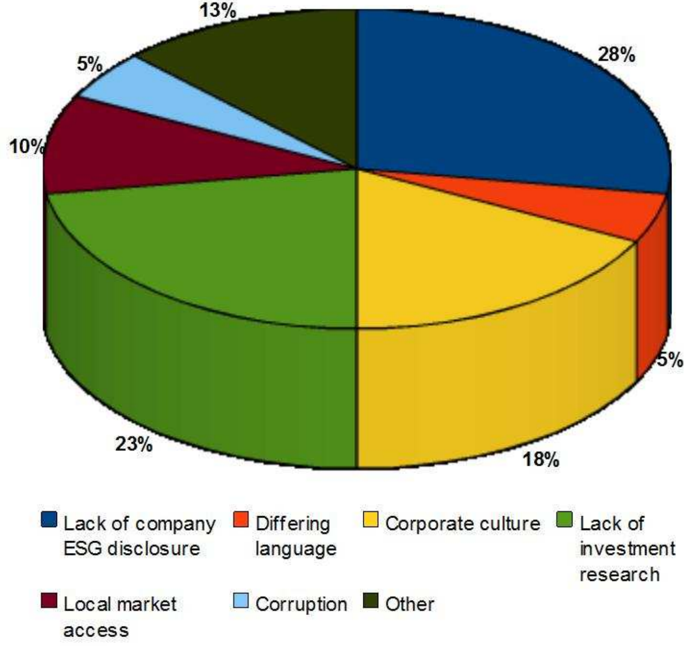
The last survey question that can be discussed in a quantitative manner is the question about key challenges that investors have faced when investing in emerging markets. As **Figure 22** below shows, lack of company ESG disclosure was a common-cited challenge to investing in emerging markets, a feature that can be connected to overall lack of transparency and lack of available quality research on emerging market companies (which 23 percent of respondents listed as being a considerable challenge). Other challenges include differing corporate culture and limited local market access.

Figure 21: Memberships, agreements and signatory projects



Source: Data compiled from survey

Figure 22: Key challenges of investing in EM



Source: Data compiled from survey

4.2. Overview of Interview Results

As was mentioned previously, in-depth interviews were conducted with respondents from across the spectrum of financial service providers represented in the survey pool. While most interviews were conducted following the completion of the survey and thus often followed up on points identified in the survey, the discussions more broadly focused on the incorporation and manifestation of responsible investment policies and criteria in everyday business operations. The interviews provided a wealth of information about the expectations and perceptions held by respondents on responsible investment; they also provided enormous clarity to the disconnect between principle and practise and the means by which each investor reconciled "social" behaviour with their fiduciary duties.

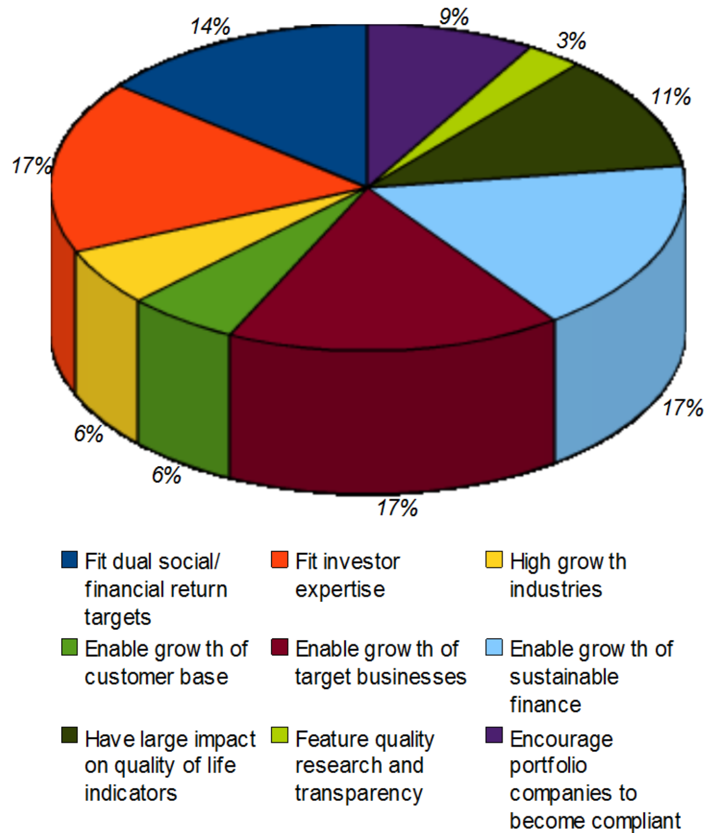
To create a clear structure for the analysis of the qualitative data collected, the open-ended questions presented in the survey will be discussed first, with reference to in-depth interviews where appropriate. Following the assessment of the qualitative survey questions, several clear categories of topics discussed during in-depth interviews will then be evaluated. The ultimate aim of the study—to define and map the "social-profit" nexus—will then be assessed through the lens of this collected wisdom.

4.2.1. Survey Questions

Seven qualitative questions were asked within the survey. The first, which sought a social purpose or mission statement of the investor, was used for own reference. The second question regarding the reasoning behind making social or environmental investments sought to engage respondents further in the quest for defining "social". Respondents were able to indicate fields in which social and environmental investments are made; the results can be seen in **Figure 6.** The answers given to this question were fairly consistent, and the answers provided to the question of rationale were surprisingly consistent among respondents as well. **Figure 23** below displays the answers given. The wording of these two questions was left intentionally ambiguous; the definition of social or environmental investments was not given, and respondents were left to decide for themselves what such investments would constitute. In most cases respondents answered by providing explanation for investments that were made with the explicit purpose of meeting predefined social or environmental (sustainability) goals or as investments made that produced positive externalities in these fields. The answers were categorised following the collection of survey results, and the reasoning given for making the social/environmental investments in the indicated areas fit into one of nine primary categories. While many of the respondents simply stated that they do not make social or environmental investments (unless those investments were the accidental by-product of a strictly financial return-based investment), most of the respondents explained their rationale as it related to the business design, selected target group, and mission statement.

The reasons given for making social/environmental investments seldom lacked a financial component as well: the two top answers given (that investments "enabled growth of sustainable finance" and "enabled growth of target businesses") certainly represented a synthesis of social and financial profit components. The next top reason, that the investment "fit investor expertise", relates to the investor's capacity to tap into pre-existing areas of social or environmental investment and make a significant knowledge contribution.

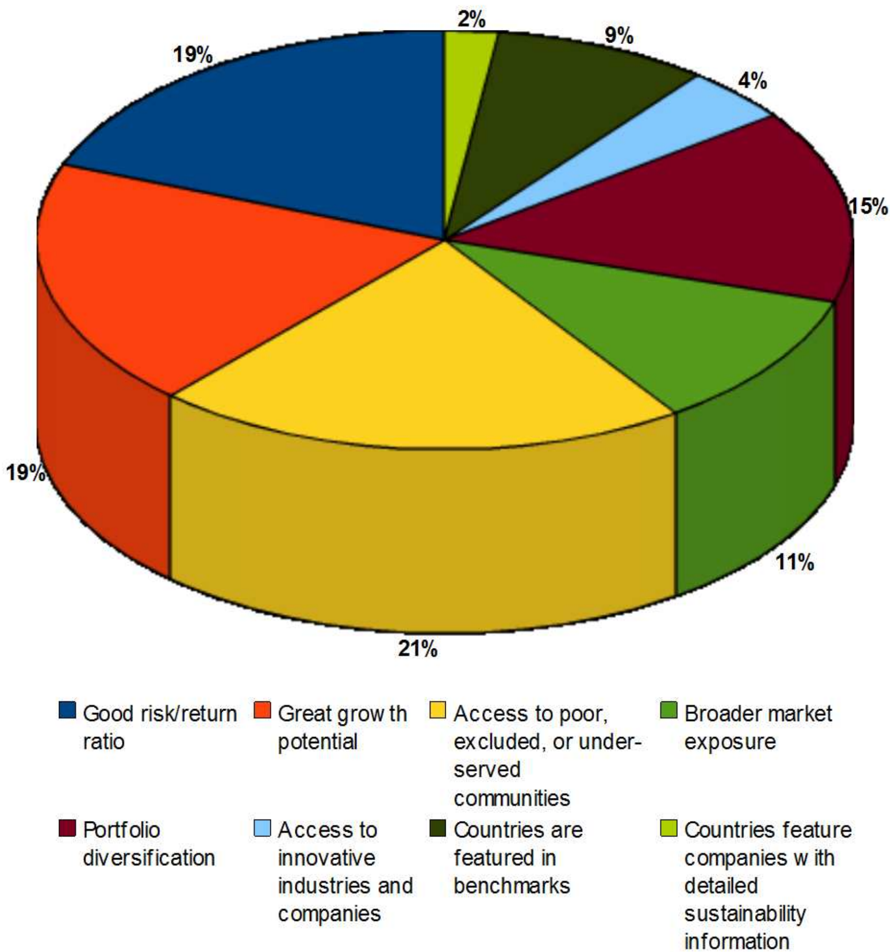
Figure 23: Reasons for for social and environmental investments



Source: Data compiled from survey

The third qualitative question posed in the survey asked the investor to explain why investments were made in emerging markets in general and the countries indicated specifically. This question was expanded upon in most interviews to include the business rationale used to justify what could potentially be higher-risk investments, and the responses provided an interesting window into investors' perceptions of emerging markets. The summary of survey answers can be seen bellow, in **Figure 24**.

Figure 24: Reasoning behind investment choice for EM and the countries indicated specifically



Source: Data compiled from survey

The survey responses provided good initial insight into the choice to invest in emerging markets, and the answers given in interviews largely corroborated the answers given in the survey. In interviews respondents consistently underscored the growth potential of emerging markets. As one investor stated:

> "In absolute terms [emerging markets] give better returns because there is much greater growth potential. As you can see, China has the biggest growth class in economic growth. India... is also a huge market. It is also about the availability of investments... in terms of companies that are listed and accessibility of these markets." (Asset manager)

Another investor added:

> "When investments are made in emerging markets, the investor guarantees that the portfolio is exposed to the entire investment universe. In the long term emerging markets are also expected to outperform established markets, so in this

> sense it... [can] guarantee optimal productivity of investments over the investments' lifetime." (Asset manager)

The rationale behind investing in emerging markets differed according to the type of investor, however. Asset managers and pension fund representatives were more likely to mention portfolio diversification, the higher risk-return potential of emerging market investments, and the growth potential of emerging market companies; community finance respondents, on the other hand, more often explained the investment choice as an integral part of their business operations. As one microfinance representative explained: "By social mandate we are dedicated to emerging and poor countries where the population suffers from exclusion in many aspects, including exclusion from access to financial services."

The next open-ended question continued with this line of reasoning and asked respondents about the particular social and financial returns expected of the emerging market investments made. Most respondents answered that they expected robust financial returns, but the answers to the expected social returns were much less consistent. Most of the respondents representing asset management firms responded that social returns were not expected and did not address this question at any length. Several did provide interesting insights, however. One noted that the incorporation of environmental, social, and governance criteria into the investment selection process can help ensure stability of the macroeconomic environment in the emerging-market countries invested in and thus ensure maximal productivity of the investment; the social return in this case (a more aware and responsive investment environment) is part of a risk-reduction strategy that inadvertently produces several different types of returns. Another respondent answered that the expectation was a more robust customer base created by the empowerment of underserved communities through the growth of industry; this represents the culmination of optimal social and financial returns.

The last questions of the survey ask "Is this investor willing to sacrifice financial returns for higher social returns" and "Why or why not?". These questions proved to be particularly rewarding when discussed in in-depth interviews, and the answers to these questions have yielded insightful and poignant quotations that point to what it actually means to be "social".

Defining "social"—and discovering what it means to "be social" while maintaining a profit focus—is a process that cannot culminate in a concrete, two-line statement that accurately encompasses the entire concept. That said, "social" is a charged word, one that inspired comment from most respondents. The survey featured several questions that used the word "social", and respondents were left to decide the meaning themselves; "social" was not qualified anywhere in the survey, and the intentional ambiguity resulted in several discussions in in-depth interviews.

To arrive at a meaning for “social” and to better understand how “social” attitudes were incorporated into daily business, several proxies were designed to draw out thoughts on what it means to be social and how such “social” attitudes translate into concrete action. One straight-forward approximation of “social” attitudes is determining the level of recognition investors have of the potential importance of investment ventures on social, economic, and political conditions in the countries of investment. To this end the survey asked about the investors' requirements regarding social impact projections on behalf of entrepreneurs, monitoring and assessment of social impacts, and social return on investment (SROI) analysis.

While there is certainly a component of financial foresight in these actions, recognition of social impacts and returns may represent more than extended financial risk assessment. Social impact assessments are part of a larger group of impact assessments that investigate the context in which an investment will occur beyond due diligence procedures and normal business operations to understand existing (and potential future) conditions that may effect the implementation of the business venture. Social impact assessments take this basic contextual evaluation a step further by measuring potential impacts the business venture may have on groups and individuals within the local community with an eye to identifying groups who will be disproportionately affected by potential business activities (IFC, UNGCO, & IBLF, 2007). The survey asked if investors required potential portfolio companies to conduct a social impact assessment as well as if the investor measures the social impact of portfolio companies itself. To take it a step further, the survey also asked if the investor conducted SROI analysis. While there are several methodologies that can be used to conduct SROI analysis, the objective of the analysis is generally to quantify the social externalities that a business venture creates. The social impacts created by a business venture are “monetised”, or converted into monetary value, that can then be measured relative to the monetary value of the investment. Further, SROI analysis seeks to uncover the additional value created not only for the investor but for other stakeholders involved in the investment process (Social E-Valuator, 2008).

The survey further investigated “social” attitudes with the question: “Is the investor willing to sacrifice financial return for social return?” The answer to this question was seldom straightforward, and the following selection of quotes taken from in-depth interviews reveals some of the candid responses given (See **Figure 25**).

Investors were also asked about the expected social and financial returns of investments made in the emerging markets. While respondents generally did not discuss this question in as much depth, several interesting thoughts were given about it (**See Figure 26**).

Figure 25: Willingness to sacrifice financial return for social return

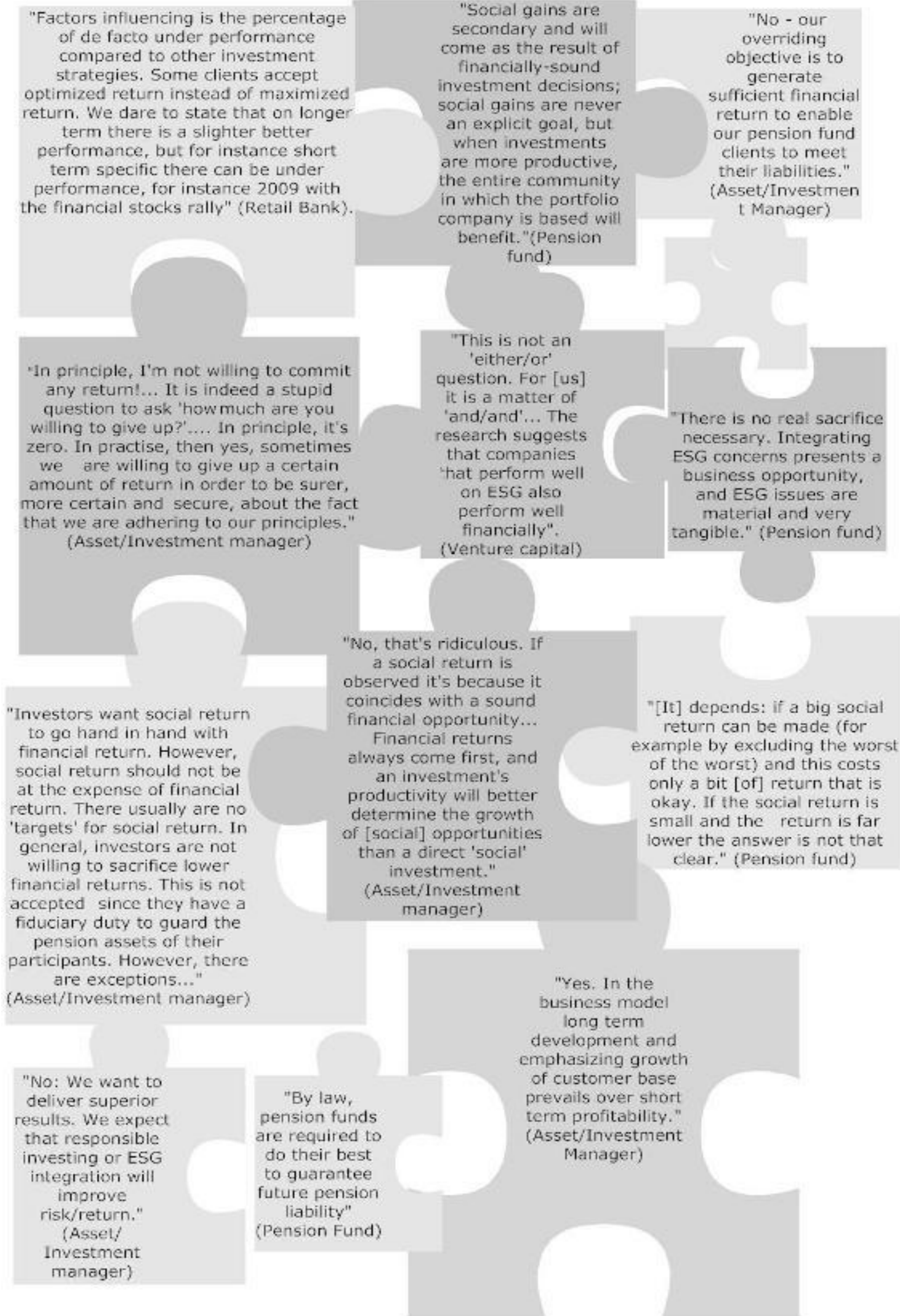
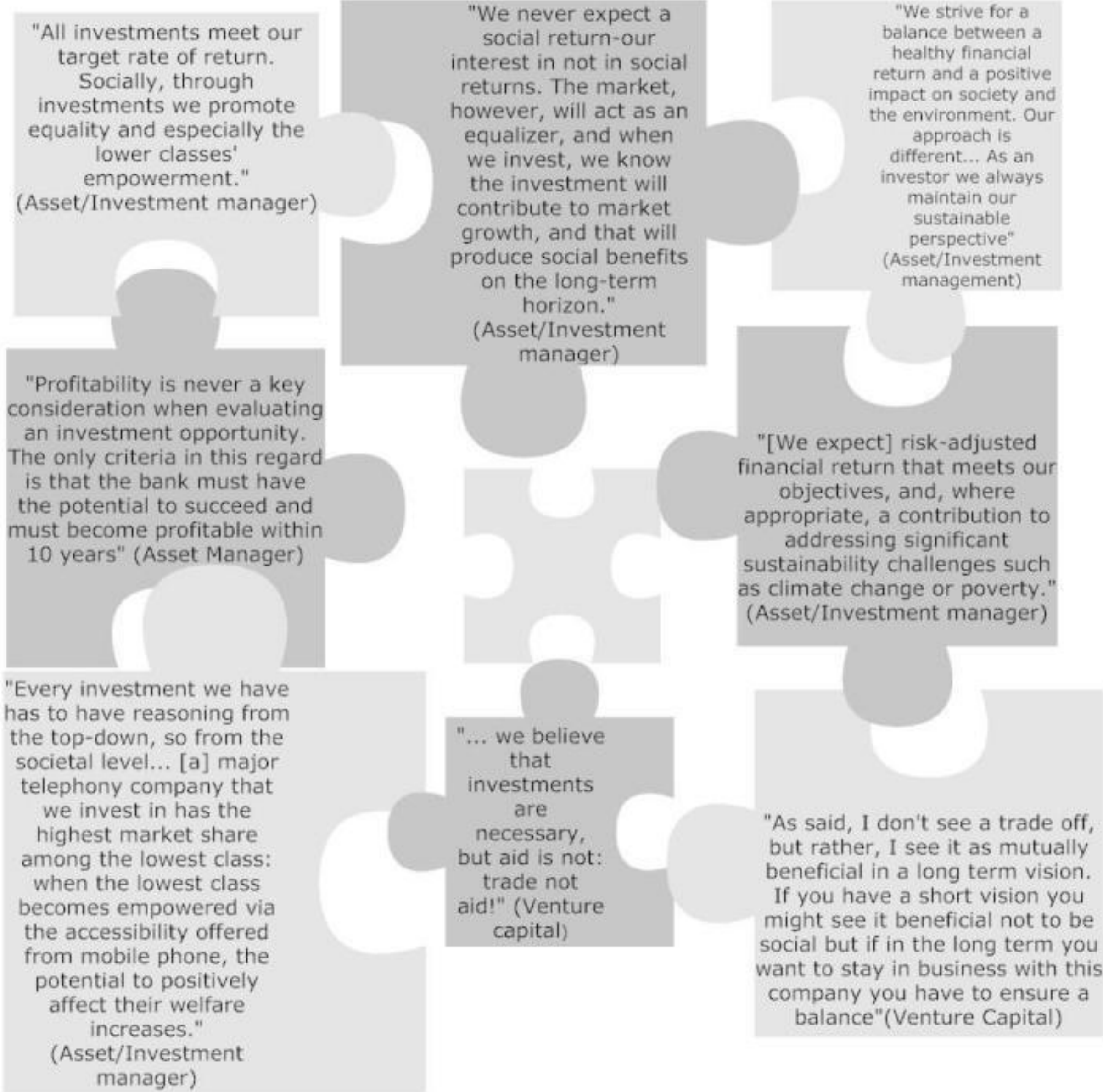
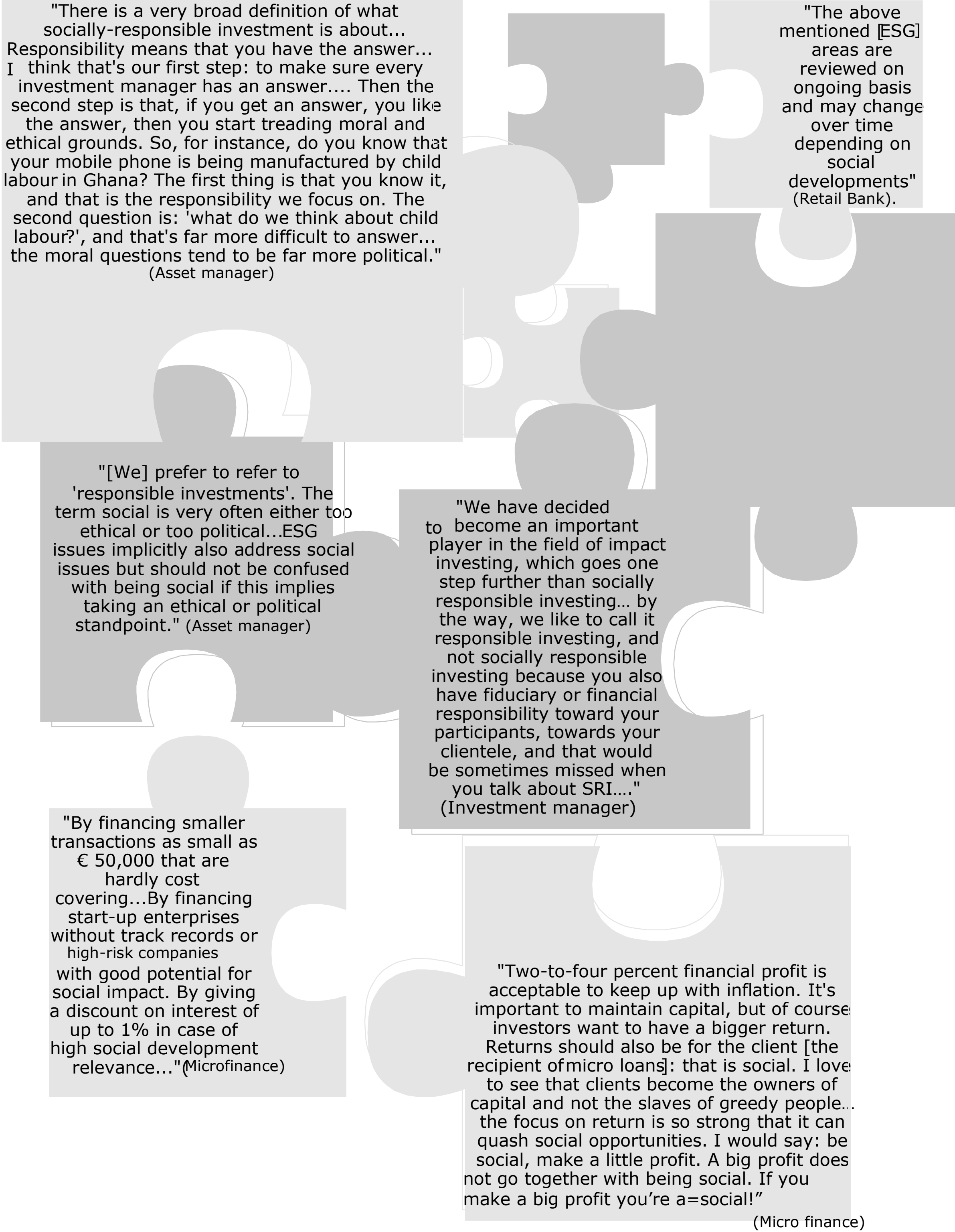


Figure 26: Expected social and financial returns of investments made in EM



What do these statements say about what it means to be “social”? The statements highlight several interesting themes that recurred throughout the interviews, the first of which is the difference between principle and practise. While in principle all respondents (excepting those with an explicit social component, such as microfinance institutions) answered that financial returns cannot be sacrificed to realise better social returns, most also indicated that in practise, the process of making investment decisions can result in a minor trade-off between financial and social returns. It is rarely that an investor is faced with the clear decision to sacrifice 'x' percent of financial returns to achieve an 'x' percent increase in social returns; rather, it is through smaller cumulative processes that an investor has to opportunity to realise social returns in practise. A second recurring theme seemed to be that the idea that “social” is extremely nuanced and is a tricky concept to manoeuvre in the context of responsible investment.

Figure 27: What do statements say about what it means to be 'social'?



4.2.2. Interview Results

It is difficult to separate the survey and interview responses into two discrete categories; most major points of discussion were covered in both media. This section will discuss the themes that recurred throughout in-depth interviews. While most topics also appeared in survey responses, the degree to which they became focal points in conversation during interviews merit separate examination here.

The first theme that made itself apparent throughout the discussions is the relationship among risk, return, and "social" attitudes and practises. This had been mentioned fleetingly in the previous section regarding the reported rationale for investing in emerging markets, but the scope of this discussion in interviews was great enough to incite more detailed examination. Most respondents stated that emerging-market investments are appealing because they can produce better returns on investment relative to risk; at the same time, many respondents also explained that risks encountered in emerging markets can be significantly greater because of lack of market transparency, limited detailed information on the ESG performance of potential portfolio companies, and general political/economic/social instability. Given the volume of capital that the respondents are willing to invest in emerging markets, it can be reasonably assumed that the risks presented by emerging markets are offset, at least partially, by potential market growth, promising rates of return, increased market access and coverage, etc. to a large enough degree that the investment remains lucrative. The risk any given investor is willing to face or absorb is related to a number of factors, and of principle interest in this context is the role that "social" drivers play in affecting risk appetite.

Among investors with explicitly socially-oriented missions (for example, to provide finance to excluded or underserved populations), the willingness to invest in emerging markets regardless of potentially higher risk is not entirely surprising. While explicitly "social" investors need a consistent and secure capital pool from which to draw as much as any other investor, the responsibilities and duties microfinance institutions and funds owe to the providers of capital significantly changes the relationship between investment strategy and risk capacity. As one representative of a microfinance institution explained, alternative finance providers should always occupy a middle position between target financial and social returns, and they can function from this position because their capital pool is not comprised of assets from clients but from donations. While the source of funding is not the same for all alternative finance providers, this particular respondent's institution works with (in his words) "free money" donated by individuals and companies. This donated capital, which is often provided with "no strings attached", enables investment in higher risk markets without the pressure of guaranteeing target financial returns, which other investors—particularly asset managers—may face when responsible for the strategic investment and allocation of institutional clients' assets. That said, microfinance and other alternative finance providers are not immune to the risks that

investment in emerging markets poses, and the maintenance of capital stock remains imperative to basic business capacity. The relationship between social and financial returns, however, may be easier for such institutions to reconcile. This is not to say that greater financial returns immediately imply asocial investment behaviours; rather, the constraints each type of financial service provider faces are intrinsically different. Microfinance institutions have embedded risk calculations into their investment strategies differently than other types of financial institutions; given the business structures and mission statements of the respondents included in this study, the different embodiment of risk in business practise is entirely reasonable as reflected in the quotes presented in **Figure 27**.These manifestations reflect a unique capacity to absorb risk, one which other types of financial institutions do not always share. This idea was the topic of major discussion with all respondents representing asset/investment management firms and pension funds. Respondents consistently emphasised the limitations they face in terms of meeting the fiduciary responsibility borne to stockholders, pension holders, and clients. The relationship among risk, emerging market investments, and fiduciary responsibility is certainly not an unobserved one, and treatment of this triangle in financial research is not novel. Less documented and discussed is the role the that responsible investment plays in controlling and mitigating risk, and it is this point that so many respondents were keen to discuss.

The relationship between risk and responsible investment, particularly in emerging markets, is a complex one. Throughout discussions with respondents it became clear that responsible investment criteria and policies are integral to filtering out investments that may have the potential to become too risky over time, and the prospect of ensuring adherence to social norms is widely regarded as a clear method to ensuring stable financial return.

Equity and debt are the primary instruments via which investments in emerging markets are made. Each instrument imposes different constraints and considerations for investors, and their relationship to risk is likewise different. Both instruments are sensitive to changes in the macroeconomic environments in the countries of investment, but the implications of wider societal stability are slightly different for each. One respondent from an asset management firm provided interesting insight into evaluating the risk posed by investment in debt (in this particular case, government bonds):

> "Debt must be approached via a more 'top-down' approach because general market conditions must be taken into consideration. How the country is 'institutionalised' is an important factor to consider… ESG issues play a greater role in this process because if there is the sense that in a country where a government bond may be taken out that there is disregard for ESG issues, the country itself may not be as stable and may involve a higher level of risk."

The inclusion of responsible investment criteria is thus used as an initial filter to assess the potential level of risk invited by investment via debt. The process of using responsible investment considerations as a baseline is similar when considering listed equity investments.

While investments in emerging markets can prove particularly risky due to the lack of detailed information about the practises of potential portfolio companies, many respondents reported that using a "best-of-class" investment approach for choosing emerging-market listed equity investments is a way of reducing risk. The companies functioning in emerging markets that are chosen for investment are generally those for which there is substantial and quality information documenting businesses practises; such companies tend to be more transparent and to incorporate ESG concerns and interests into their business operations to a much larger extent than their competitors. One respondent from an asset management firm explained that:

> "What you also see is that if you are best in class, asset pure player in your sector, than you're already a company who is applying those norms pretty well. I've never seen a really bad company being the leader in its category."

This statement provides interesting insight into the treatment of the risk-return-social triad by non-explicitly socially-oriented investors. The "best-in-class" approach is used to identify companies that are leaders in their class and sector, meaning they have the best capacity to meet investor norms, to match market demand, to ensure long-term stability, etc. There is an inherent financial stake in choosing best-of-class companies, but such companies also tend to perform to international standards and norms. The incentive to invest in a company because of financial return may thus carry with it better social return in the form of adherence to ESG norms, even if this is not a direct goal of an investment.

Financial and social returns are linked on a number of indirect levels but, as mentioned previously, it is difficult to demonstrate correlation of the incorporation of ESG criteria on return performance over time. Most respondents acknowledged that academic sources are mixed on the relationship between financial performance and responsible investment. As one respondent stated:

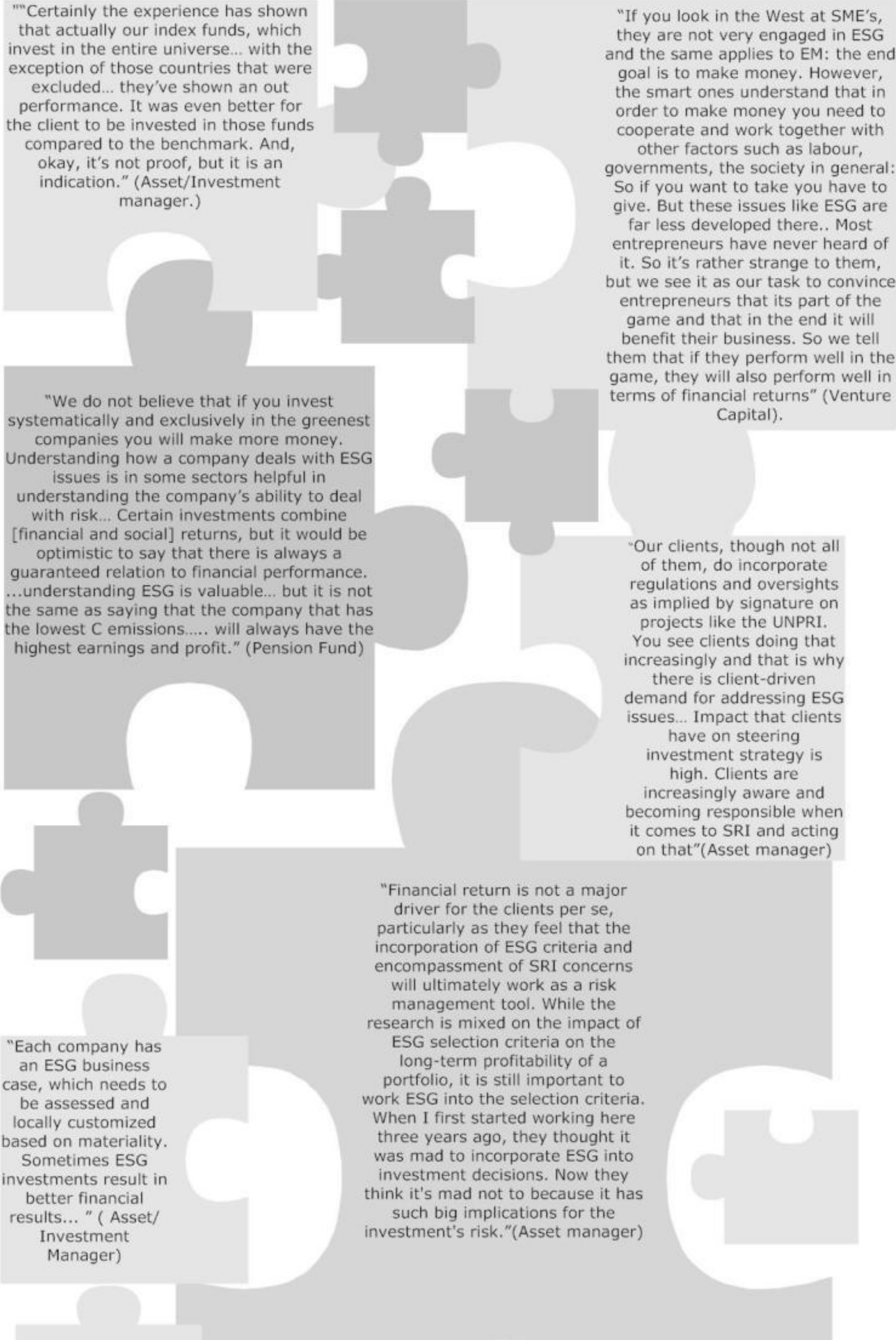
> "Many studies have been done to connect the ESG performance on the one side and the financial performance on the other side, but it remains tricky… In [one] particular survey… they found that there was out performance of approximately 8%. And what others found afterwards… [is] that much of the 8%—I believe it's 7%—had to be attributed to the IT sector because it was the general innovation in the market. So talking about correlation between, on the one hand, taking ESG

> issues into consideration and, on the other hand, trying to account for financial out performance is definitely a tricky one …"

Despite this widely acknowledged lack of concrete and demonstrated correlations, several respondents still gave credence to the idea that the incorporation of responsible investment criteria will produce healthier economic environments—and thus healthier investments—in the long term. Indeed, as **Figure 28** displays, some respondents provided examples of how this relationship has already been affirmed within their own portfolio. This is not to say that among respondents there was universal agreement on the role that responsible investment can play. One respondent who represented a pension fund made a particularly poignant assessment. This scepticism was echoed by several other respondents, but it is valuable to note that, while many regarded the relationship between *higher* financial returns and responsible investment strategies as dubious at best, most also noted that there is no risk of lowering returns by implementing specific responsible investment policies. While the types of RI/ESG policies differed widely among respondents, most noted that their policies have an element of exclusion. The exclusion of companies—most often those that produce or sell anti-personnel landmines and cluster munitions—was never observed in interviews to be detrimental to portfolio returns. Several respondents noted that these exclusions, done on a company-by-company basis rather than on a sector basis, had minimal affect on the composition of the portfolio because only a limited number of companies in the investment universe fit the exclusion criteria.

The neutral effect of ESG-criteria on returns provides a good segue into the other main theme that was uncovered during the course of interviews. In the in-depth interviews specific elements of (S)RI/ESG policies were discussed, and it became apparent that exclusion is increasingly being regarded as a first step in implementing/enacting policies rather than the entire policy in itself. Engagement rather than strict exclusion seems to be the preferred mode of policy implementation, and this has a very direct implication in what it means for an investor to be "social".

Figure 28: Putting the pieces together on ESG incorporation



The development and implementation of responsible investment policies has undergone considerable transformation over the years, and the increased awareness of responsible investment and its potential has been accompanied by the development of strategies that are deeper rather than wider in terms of degree of implied investor action. Four broad strategies of (socially) responsible investing can now be distinguished. The first involves simple screening—exclusion of companies or sectors on the basis of certain (undesirable) activities that the investor explicitly does not want to support (as in respondents' refusal to invest in companies involved in certain forms of arms manufacture). The second strategy, norms-based screening, takes this approach one step further by excluding on the basis of non-compliance or non-adherence to international standards and norms espoused by agencies such as the United Nations and its bodies. This strategy is also incorporated by many respondents, particularly among asset management firms, and is connected to the decision to exclude arms manufacturers. The next strategy is engagement. The process of engagement revolves around that idea that an investor has the capacity to incite change in the treatment of ESG concerns and practises by potential portfolio company by engaging the company in dialogue. The process would ideally culminate with the acquiescence of the company to change its behaviour over time to meet the standards of the investor. The idea that an investor can exert enough pressure on a company so as to inspire change has gained considerable traction over the last few years, particularly among large institutional investors (such as asset managers and pension funds). The last broad strategy of integrating responsible investment concerns into investment practises is through integration. The process of integration involves the incorporation of ESG-risk into financial analysis. (Eurosif, 2008)

Of these strategies, the process of engagement was most consistently discussed in detail. The process is long-term and can be quite intensive for the investor: it requires not only in-depth and detailed research on company activities and practises but also requires willingness on behalf of the investor to interface directly with a company that may never agree to change. The process is further complicated by the investment strategy employed by the investor. Most respondents representing asset managers and pension funds indicated that at least part of their investments (the majority if not all, among pension funds) are externally managed by specialised asset managers, most of whom are selected on the basis of track record and incorporation of ESG considerations into portfolio selection. This does not necessarily mean that the investor's ability to influence a potential portfolio company's action through engagement is diminished; rather, the potential scope of an investor's influence increases when additional asset managers can be drawn into responsible investment processes. As one pension fund representative so succinctly explained:

> "It's easy for us because we have one asset manager—the biggest in the world—and we're their biggest client… If everybody does it [requires the application of ESG criteria to asset manager and portfolio selection], you raise the expectation level."

The respondent also explained that when enough large institutional clients such as pension funds demand that asset managers integrate ESG concerns into their portfolio selection process, industry-wide standards will gradually change, and asset managers will begin to perceive the integration of ESG issues as having an intrinsic value. This "client-driven integration process" was reflected in many of the discussions with asset management representatives. While many indicated that their motive for addressing ESG issues was from their own internal guidelines, most also indicated that the creation of a policy was client driven to at least some extent. Many indicated that they have very flexible responsible investment policies to accommodate the degree of ESG integration desired by clients; in this sense, asset management firms may not be assigning the "intrinsic value" discussed above so much as adopting minimum standards or baselines from which individual clients can build. Several asset management representatives did note the development of their own policies and criteria to which clients would be required to adapt, however. One particular respondent representing an asset management firm that has a responsible investment policy to which clients must adapt told this:

> "… if you're clear about where you stand, what your policies are, you attract a certain clientele that other asset managers would not attract and vice versa. Some people think [we]… have become fundamentalist in applying ESG criteria to the entire portfolio…which is fine. Then you won't be our customer, we won't work for you… On the one side, yes, we have our principles, and you have to stick to your principles. On the other side… that will be to the detriment of your financial returns, but that's the way life is. We're not opportunistic—you can't be. When you have these principles you have to apply them."

This statement may indeed speak to a wider process of industry-wide perspective change, but it also taps into the third theme observed from in-depth interviews: the integration of ESG issues and the transition to more responsible investment represents a unique business opportunity, one that may off-set short-term financial losses.

The discussion of the link between risk and return suggested the idea that the integration of responsible investment criteria could help stimulate greater financial returns, but in that context the role of such integration was more-or-less limited to controlling risk and ensuring investment sustainability. Many

respondents suggested that the link between responsible investment and financial return could be much more direct, however. A pension fund representative explained that the adopted engagement policy could ultimately provide asset managers with an opportunity to fill a niche in the investment market by offering ESG-themed funds and products for (S)RI-focused clients. Indeed, of the respondents surveyed, nearly eighty percent offered some sort of specialised thematic fund or product for clients (institutional and retail alike) that encompass some aspect of responsible investment. Such products range from carbon offset credit cards to thematic sustainability equity funds, sustainable real estate funds, explicit SRI funds, and microfinance initiatives. As one investor stated: "You can make good money from making sustainable investments. You can generate reasonably attractive return from investing in microfinance in emerging markets." The offer of such thematic funds and vehicles is largely limited at the moment to developed markets, but some thematic funds are offered in emerging markets. The major constraint to offering more specialised emerging-market investment opportunities relates back to the lack of adequate information on emerging-market companies. The presence of these funds and vehicles on the market as a whole, however, points to the idea that investors are becoming more aware that they can indeed "be social" and make a profit.

The information and insights garnered from the survey and in-depth interviews alike not only suggest that investors are indeed aware of the link between "social" investment behaviours and financial investment but are willing to adapt investment strategies to accommodate long-term goals. By acknowledging and discussing the role that the incorporation of ESG/(S)RI criteria plays in influencing risk and financial return, by modifying their (responsible) investment strategies to include deeper engagement between the investor and the company invested in, and by recognising the business opportunity presented by the shift to responsible investment norms, respondents displayed a level of proactive of awareness that has provided some promise to the maxim "be social, make profit."

5. Conclusions and Recommendations

When combined with the wider empirical studies conducted on socially responsible investment and emerging market investments (such as those conducted by Eurosif and the Emerging Market Disclosure Project), the qualitative insights offered by this study may help better explain the constraints and considerations investors face when incorporating responsible investment concerns into their investment processes. Beyond that, the study has demonstrated the multiplicity of meanings that the word "social" can have and has provided insight into the social-financial return nexus. As the in-depth interviews demonstrated, the relationship between being "social" and reaping financial returns is not a linear one that can be disaggregated into its component parts with ease. While there is certainly no information from this study that would suggest that being social and making a profit are mutually exclusive, identifying and isolating the factors that influence the relationship is not easily done. The importance that financially-driven investors place on being social largely reflects their desire to make investments that not only involve a rational risk reward but promise more consistent and robust financial returns in the future.

To corroborate these general conclusions, a series of more specific points will be discussed below under the headings of financial flows, trends, and recommendations.

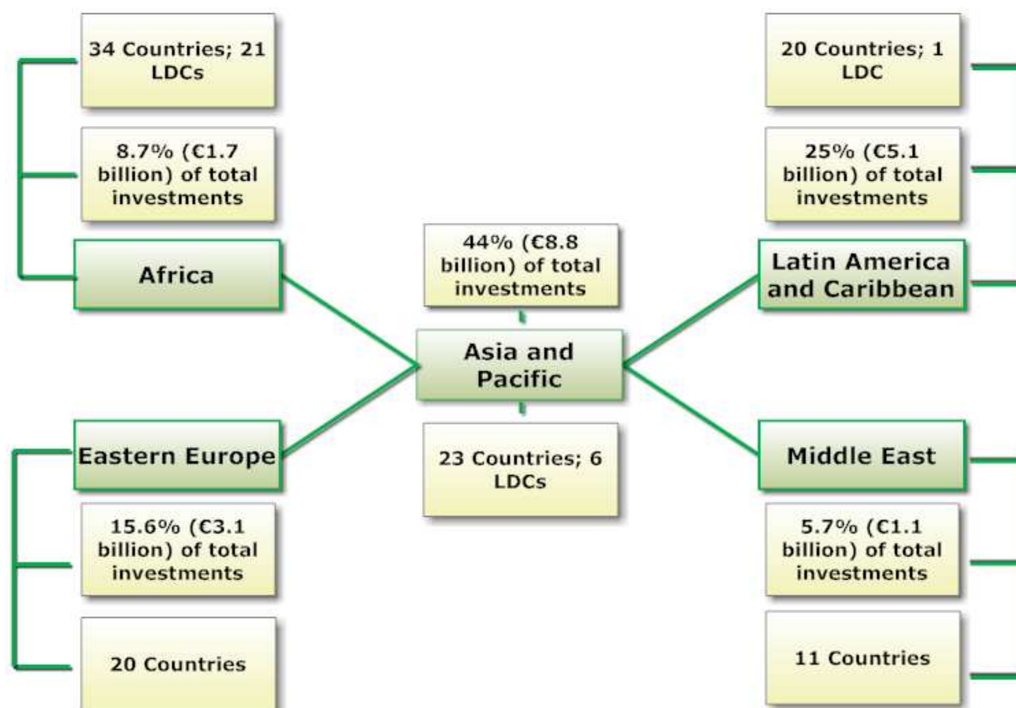
5.1. Financial Flows: Key Findings

The twenty respondents included in this study represent a range of Dutch-incorporated financial actors, from venture capital firms and community development banks to asset management firms with upwards of fifty institutional clients. The diversity of respondents provides a unique window into the topic of responsible investments in emerging markets and enables a micro-level assessment of the capital stream flowing between the Netherlands and emerging markets. While it must be cautioned that the information gathered via the survey and in-depth interviews is not entirely representative of the target group due to data omissions by respondents, the following major conclusions jumped out regarding the capital stream moving between participating institutions and emerging markets:

1. Approximately €30 billion is invested in emerging markets. This number does not include the data of two respondents, one of which reported the greatest value of assets under management. While the respondents could not disclose the capital value of emerging market investments, it can be projected that the volume of emerging market investments would be considerably larger with their contributions.
2. Among respondents who were able to disclose information about their emerging market investment portfolios as disaggregated by region, the Asia and Pacific region received the

greatest volume of investments at approximately 44 percent of the total emerging market capital pool. The Latin America and Caribbean region accounted for 26 percent of the total volume of emerging market investments; Eastern Europe received 16 percent of all funds. Africa received just nine percent of the total emerging market capital pool while the Middle East received the least at six percent.

3. Regional investments can be broken down in the following way:



4. The volume of capital moving to emerging markets via trade from the surveyed respondents alone amounted to more than five times Dutch official development aid in the same period[7]. While ODA has certainly targeted least developed countries more strategically and with greater capital, the capital moving through trade has a wider geographic distribution and greater capital volume capacity.
5. The FMO is a significant contributor to the stream of capital moving to emerging markets: at €4.2 billion in investments to emerging markets, the FMO contributes the third largest amount among all respondents and provides the largest amount among non-asset/investment management firms. The only other community development bank included in this study that has a mandate and business format similar to that of the FMO controls a much smaller capital pool; its investments in emerging markets amount to €175 million. The FMO can further be distinguished by the regional concentration of investments. While the other community development bank directs forty percent of its

[7] Organisations for Economic Cooperation and Development (OECD), Development Cooperation Directorate. 2009. "Aid at a Glance: Netherlands." <http://www.oecd.org/dataoecd/42/7/44285089.gif>

emerging market investments to the Latin American and Caribbean region and 26 percent to Eastern Europe (with investments to the Asia and Pacific region at 22 percent, and investments to Africa at 12), the FMO has allocated the greatest volume of capital to emerging markets in Africa (with 28 percent of all capital directed to 25 countries, 14 of which are least-developed countries). Investments in the Asia and Pacific region account for 24.8 percent of all capital (and includes 13 countries, two of which are LDCs), the Eastern Europe and Central Asia region with 19 countries accounts for 22.43 percent, and the Latin America and Caribbean region receives 22.54 percent of all investments among 17 countries. Unlike the other included community development bank, which invests in forty countries, the FMO invests in 74.

5.2. Key Trends

Throughout the research process it has become apparent that the financial world—in the Dutch as well as many other markets—is undergoing a series of fundamental transformations as the result of the global financial crisis. The paradigms that govern what it means to be responsible are consequently shifting and so, too, are investment strategies. The data collected via the literature review, survey, and in-depth interviews strongly signalled the following trends.

Box 1: Key trends

TERMINOLOGY SHIFT

As the discussion about the evolution of (socially) responsible investment in the European market in Section 1.2 has revealed, the term "responsible investment" has come to be the preferred term among Dutch investors. This insight was reinforced during interviews; several respondents explicitly noted that the term "socially responsible investment" may not properly encompass the duties investors have toward protecting financial interests and may place inappropriate emphasise on social and environmental concerns. This may in turn imply political, moral, or ethical standpoints on particular investments or sectors, which many respondents noted is not in their best interests, particularly among corporate pension funds. Further, the research has demonstrated that there is reluctance to acknowledge SRI as a broad rubric due to the charged and loaded interpretation of the term "social"; this reluctance may also be informed by perceived "fanaticism" among investors of "socially" responsible investments.

In line with this shift in terminology and conceptualisation of the relevant terms, it should also be noted that existing investments and instruments are also being relabelled in an attempt to update the portfolio without instituting material, structural change. Innovative investments and investment strategies are also increasingly being viewed as part of the movement toward realising better encompassment of environmental, social, or governance (ESG) norms and standards in business practise. This trend introduces both positive and negative repercussions. While the trend is

certainly toward greater recognition of the need to consider ESG concerns in business practise and structure—and the majority of respondents had instituted concrete change to their investment strategies or portfolios to act on these concerns—there is also the risk that the bar is lowered for becoming a "responsible" investor. Particularly if this greater recognition of ESG concerns is accompanied by re-labelling and repackaging of non-ESG investments as responsible investments (a clear example of this is of the labelling of investment in music rights as "social" investments), than the distinction between responsible investors and their less ESG-conscious counterparts becomes less clear. Such "green washing" of investments and strategies may dilute the level of commitment expected of responsible investors over time. This does signal, however, a more important and fundamentally positive shift in perception about (S)RI that has led to a mainstreaming process.

MAINSTREAMING IS A GRADUAL PROCESS

The process of becoming a responsible investor and incorporating ESG/(S)RI concerns into business strategies and day-to-day business operations is a gradual one, and this process evolves with other changes in the financial system on the macro-level. As was mentioned previously, the Dutch financial system was shaken by the release of a documentary that exposed the potentially disastrous investments made by pension funds. That documentary—in combination with larger structural and institutional factors arising at the same time—proved catalytic to the growth of responsible investment among Dutch financial firms. The mainstreaming of SRI norms into business operations is not a linear process that occurs within every financial institution at the same time and at the same pace. Responsible investment strategies and norms must, of course, meet the needs of customers and stakeholders. From within the respondent pool, however, it also became clear that the incorporation of ESG concerns and the mainstreaming of responsible investment practises into business operations sometimes hinged upon the advocacy efforts of one individual. It can also be observed that financial institutions are highly sensitive to the changes initiated by members of their cohort and are highly aware of the strategies and tactics employed by other investors. That said, the mainstreaming of (S)RI throughout the financial sector can occur both through minor steps and by leaps and bounds: the incorporation of ESG-concerns into strategies and business operations by one institution may encourage and incentivise other institutions to do the same, and to remain competitive, highly progressive and proactive mechanisms may be adopted to distinguish the (S)RI approach of one institution from similar institutions. In this sense the risk of "green washing" may in fact turn out to be a boon to the growth of responsible investment.

The trend of more institutions recognising the need to address ESG concerns has also brought with it the development of more (S)RI specific investment vehicles and tactics that enable a wide range of clients to become part of the responsible investment movement. This trend can be directly observed from the strategies employed by several of the respondents. Several of the asset managers have responsible investment strategies in place that prospective clients must agree to: while clients are still able to scale policies up to include more specific concerns or exclusions, such policies cannot be scaled down to be less discriminatory. Further, asset managers who choose external portfolio managers may only choose institutions or individuals who employ a responsible investment policy that is similarly targeted. In this sense asset managers are wielding their power to engage a wider network of institutions in responsible investment. Banks provide a similar function, but rather than engaging institutional clients (such as corporations and pension funds) they are able to directly interface with retail clients and customers by offering funds and vehicles specifically tailored to ESG concerns. While the retail client base is often undervalued because private individuals generally do not represent singularly large sums of money, taken together private clients due control a huge amount of capital. By offering retail clients specific investment vehicles, retail arms of banks are

able to gradually introduce responsible investment to a wider client base in such a way that it becomes part of the norm rather than a radical divergence of expected service.

INCORPORATION OF SRI/ESG

While the process of mainstreaming responsible investment concerns and strategies into business structures and practises is well under way, it should be noted that such mainstreaming does not imply broad so much as deep integration of SRI concerns into business operations. While many financial institutions are making progress toward developing and implementing responsible investment strategies, such strategies may not always be deployed across the entire financial group; rather, those strategies may be implemented in an isolated business segment where they can be fostered and monitored without risk to the greater financial group as a whole. As was mentioned in the methodology, many of the respondents represented offices or arms of larger institutions that were designed to deal exclusively with SRI, ESG, or emerging market investments. This may indicate that financial institutions are not fully prepared to overhaul all investments and strategies to reflect a broader acceptance of responsible investment norms. Given the relatively recent surge of interest in responsible investment, this can hardly be surprising. Responsible investment does not necessarily imply a radical and disruptive reconfiguration of investments and strategies, but it does imply a series of interconnected changes that can have serious implications for the management of large sums of capital.

SHIFT TO POST-CRISIS MENTALITY

While the origins of the SRI movement certainly predate the current financial crisis, the current crisis has had a massive influence on the trajectory of responsible investment trends. The current crisis has been extremely successful in revealing shortcomings of the financial system and in revealing (as one respondent called it) the "myopia" that has resulted in the improper integration of risk concerns into investment strategies. Such myopic attitudes have also translated into disregard for the creation of negative (social and environmental) externalities that have the capacity to hinder financial returns. The crisis has thus reinforced the need for financial institutions to strategise with long-term, sustainable goals in mind. Financial institutions have responded accordingly by designing strategies that not only recognise the multiplicity of potential effects created by investment decisions but that also encourage the monitoring of the effects of investment policies and procedures on returns over a considerably extended time horizon.

The financial crisis has also encouraged a shift in perception about the inherent financial value of designing policies that will come to fruition in the long term. While it must again be stated that there is no way to confirm without a doubt that incorporating ESG concerns into an investment strategy will lead to higher financial returns, there is the perception among most financial institutions that there is a link. Even if higher financial returns cannot be directly and undoubtedly correlated to ESG-sensitive policies, most investors suspect that there is a profitable or, at worst, neutral connection in the long term.

The financial shake-up has also encouraged financial institutions to increasingly view (socially) responsible investment as a new business opportunity, one that can be highly profitable if properly seized. Financial institutions are not only inclined to design innovative products and services that are tailored to ESG-conscious investors, but

many are also now willing to expand their geographic range of investments to include those in emerging markets. At this point the availability of specific ESG-themed investments in emerging markets is extremely limited, and this is directly related to the lack of quality information about emerging market companies. Financial institutions are increasingly more willing to invest in emerging markets in total, however, because of such markets' perceived potential. Many respondents see emerging markets as a valuable venue for portfolio diversification, particularly after the last two years of financial chaos have demonstrated the (often cataclysmic) weaknesses in some developed markets. Beyond that financial institutions also increasingly view emerging market investments as having greater returns to risk. Some emerging markets (notably Brazil, Russia, India, and China) have also experienced unprecedented growth, which is expected in some countries to outpace that of developed markets. This predicted growth has also propelled investors to place greater capital in emerging market investments.

The perception that responsible investment can be a valuable business opportunity has also, in many cases, translated into wider interest in the connection between social and financial ventures. While most respondents said they are not interested in making "social" investments, several also indicated that they make investments in the countries and sectors they do because of their desire to contribute to private sector development (the "trade not aid" attitude discussed in previous sections) and to empower entrepreneurs at various socio-economic levels. This is not a selfless decision: in expanding emerging-market investments and exposure, investors are also tapping into new sources of product demand and "growing" their own future customer base.

The synergy between socially and financially-valuable business opportunities may be best expressed by microfinance initiatives. Microfinance funds and initiatives are increasingly being viewed as palatable and valuable means of allowing financial firm to join the (socially) responsible investment movement without imposing unacceptable risk. Given the relatively robust earnings records of microfinance funds as well as increased familiarity with the fundamental principles of microfinance, many institutions have begun offering clients the ability to invest in microfinance funds. This attests once more to the how the process of mainstreaming (S)RI into business strategies has led to diversification of investment vehicles and allowed investors to tap into the marketplace for conscientious investors.

FIDUCIARY RESPONSIBILITY

The rethinking of (S)RI as a business opportunity and as a long-term commitment has also been accompanied by a shift in perception about the relationship between responsible investment and risk. Among respondents the incorporation of ESG and SRI criteria into portfolio management tactics has often occurred to stabilise returns over time and ensure that their susceptibility to risk is controlled as much as possible. Many investors regard responsible investment as a means of controlling and mitigating risk because it can contribute to a more durable and sustainable financial framework over time. This rationale reflects an interesting shift in the perception of responsible investment as it relates to fiduciary responsibility. Pension fund representatives and asset managers in particular must ensure maximal productivity of investments, and the incorporation of ESG concerns was often seen as a threat to return because of categorical exclusions or divestments. As the responsible investment movement has matured—and its manifestations in business practises has moved beyond simple exclusion, particularly of entire sectors—the relationship between responsible investing and honouring fiduciary responsibility has undergone a complete transformation. Instead of being regarded as a threat to the financial obligations asset managers have toward their clients and stakeholders, ESG considerations are increasingly being viewed as ways of protecting those very same

financial interests. As one respondent from an asset management firm explained: "When I started working here three years ago, they thought it was mad to incorporate ESG into investment decisions. Now they think it's mad not to because it has such big implications for the investment's risk."

5.2. Recommendations

While it would be incorrect to say that all institutions desire to "be social", most are inadvertently being just that by recognising and acting upon the link between financial returns and ESG criteria. Responsible investments will continue to grow and will constitute ever greater proportions of all assets under managements, but the process of mainstreaming (S)RI into every-day business practises has already met a number of prohibitive hiccups. As a result of discussions with academics and investors alike, the following recommendations can be made that will ease the process of becoming "social".

Box 2: Recommendations

IMPROVE INFORMATION ACCESS

When discussing the factors that influence choice of investments in emerging markets, very few respondents failed to mention the role that the lack of detailed company-level information plays in steering investment decisions. While the situation is not uniform across all emerging and frontier markets, very little data is available about specific market conditions and company-specific track records in many emerging-market countries. This limited information availability increases the perception that emerging market investments are riskier, and it also decreases the chances that a financial institution with a detailed (S)RI policy will be able to find emerging market investments that are fully compliant with their norms and standards. Larger firms may be able to overcome this uncertainty by commissioning research that seeks out more detailed and comprehensive company data; the "best of class" approach may also help institutions avoid this problem by pinpointing only companies with transparent and expansive public records. These techniques may not be accessible to small financial institutions or those wishing to invest in listed equity of companies that are not large enterprises or multinational enterprises. To improve the information available about companies operating in emerging markets, the recommendation is to increase the dissemination of information generated by cooperatives such as the Emerging Market Disclosure Project, EuroSif, and the United Nations Principles of Responsible Investment. While none of these initiatives is able to offer an instant panacea to the problem of limited information availability and transparency in emerging markets, their capacity to connect investors across wide geographical distances can certainly help increase information exchange and partnerships.

SUPPORT SMALLER INSTITUTIONS AND ACTORS

Smaller financial institutions are limited in their capacity to tap into resources and tactics employed by larger firms, a constraint that was hinted at above. Several respondents noted that adequate data collection about emerging-market

investments required not only a large sum of money and manpower but also an appropriate supporting framework. The UNPRI provides that framework in part, but many initiatives that help individual firms overcome the information barrier are better tailored for large investors who can afford to invest in large enterprises that have appropriate disclosure and reporting procedures in place. As one respondents said:

> "What's difficult is that a lot of policies… are for really big institutions like pension funds, but specifically in emerging markets we need more small investment funds, and there's no way for those companies to really fit into the big work streams like the UN. They need a more appropriate framework… more transparency so that smaller funds that can't afford to hire someone like Goldman can better know what issues are there." (Asset manager)

The last few years have seen an incredible surge in the number of initiatives and cooperative agreements that support financial institutions' transition to responsible investing. As those initiatives continue to grow and stabilise, they must also begin to encompass and address the needs of a wider range of participants. This should include helping medium and small financial firms access information-gathering resources that have been out of reach due to cost.

DEVELOP MORE SPECIFIC BENCHMARKS

While this particular study has explicitly focused on tracking responsible investment trends among financial firms investing in emerging markets, comments received during in-depth interviews pointed out several inadequacies in becoming part of the responsible investment movement in total, regardless of where investments occur. The mainstreaming of responsible investment has been accompanied by the growth of indices and benchmarking attempts, the formation of standards such as the UNPRI, and initiatives such as the Global Reporting Initiative (GRI) that encourage disclosure and subsequent ranking based upon that disclosure. These are all valuable tools toward realising a more informed and proactive body of investors, but they do not necessarily address the incorporation of ESG-concerns across all sectors and sizes of enterprise. One respondent noted that:

> "For example in our industry [ICT], I think privacy is the biggest issue there is, and privacy is not addressed by the UN... Privacy is a luxury problem. … In our industry… this is the biggest issue but people focus on environment or equality or corruption... and this makes it very hard to benchmark success because all the sustainability indexes are very much in with developing [market] problems while there are also a lot of first-world problems. For us this impacts ESG norms, but they're not taking it [privacy] into consideration."

The choice to address ESG concerns is necessarily informed by the customer base of the financial firm and the specific features of the institutions' area of expertise. Responsible investing, and the incorporation of ESG concerns into investment strategies and business operations, cannot be initiated by a "one-size-fits-all" approach that seeks standardisation of norms. While ideally investors would be able to address a core set of ESG standards in all investments, the process of becoming a responsible investor must start somewhere, and by tapping into a particular investor's area of expertise and encouraging action in that field, it may be easier for institutions to mainstream ESG into their daily business operations. The recommendation is thus to develop support networks that can help investors active in particular industries collect, share, and compare industry-specific information.

5.3. Concluding Remarks

The information gathered in the course of this study has revealed some of the most poignant and relevant trends in the responsible investment movement in the Netherlands, and its exposure of the gaps that remain for investors to cross to become "responsible" has provided important insight into needed future synergies among financial institutions. This study represents only a limited cross-section of all actors involved in the Dutch responsible investment movement, and as such its conclusions and suggestions must be evaluated within that context. It has provided a valuable basis for future study, however, by uncovering preliminary patterns among Dutch investors.

To provide a more responsive and comprehensive assessment of the relationship between being social and making profit, further studies would be well-advised to evaluate responsible investments and strategies through a longitudinal approach that gives investors the opportunity to establish their own baselines against which performance can be measured. This study was plagued by unfortunate timing: to conduct an assessment of (socially) responsible investing following a wide-scale disruption of the global financial system lead to the collection of data that will be unrepresentative of future market conditions. That said, future studies could provide additional insight by gauging the role of the current financial crisis on accelerating or immobilising responsible investment trends.

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ANNEX 1: SURVEY PREVIEW

Maastricht University

FMO
Finance for Development

"BE SOCIAL, MAKE PROFIT!"

INVESTOR SURVEY QUESTIONS
FINANCIAL INSTITUTIONS

Supporting Institution:
Maastricht University

As part of the celebrations surrounding its 40th year of operations, the FMO (the Netherlands Development Finance Company, or Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V) has commissioned a study of Dutch-incorporated investment actors whose portfolios include emerging-market ventures.

The aim of the research is to a gain a better understanding of ***how*** and ***where*** Dutch incorporated companies and financial institutions invest in emerging markets and to analyze the current level of investment in emerging markets by responsible investors. It also aims to assess whether such companies and financial institutions are willing to ***sacrifice financial returns for social returns***.

The research relies upon the following survey to collect the relevant information from select investment actors. Your participation in this survey is absolutely vital to the research's success, and we truly appreciate your time and cooperation. The survey is structured as follows:

Section 1 will ask for accurate **public information** about the investment firm.

Section 2 will ask for information about the firm's investment portfolio, **Section 3** about the firm's financial data, and **Section Four** will seek information relating to the environmental, social, and governance considerations taken by the firm.

The end result of this collected information will be a graphic and narrative report to be published by the University of Maastricht Graduate School of Governance. The data collected from survey respondents will be treated with the utmost confidentiality; no information provided will be released in connection with the company name. The results will only be reported in aggregate form.

Please note that unless otherwise stated, **all information should reflect the data of fiscal year 2008.** If you cannot answer all questions immediately, please keep in mind that it is possible to return to the survey at a later time—your progress will be saved and you will be able to edit responses. Please complete the survey as soon as possible; the survey will close by **12 FEBRUARY, 2010**.

Thank you again for your participation, and if you have any questions or concerns, please do not hesitate to contact research managers Graciela van der Poel at

g-.vanderpoel@student.maastrichtuniversity.nl or Michaella Vanore at: m.vanore@student.maastrichtuniversity.nl

Section One, Part A: Contact Information

1. Investor (name of firm):
*

2. Please enter the name and position of the individual completing this survey.

* Name of Respondent:

Position of Respondent:

3. Business address:
* Street and house number:

Postal Code and city:

4. Phone number of contact person:
*

5. Fax number of contact person:

6. Email address of contact person:
*

7. Address of investor's website:

Section One, Part B: Contact Information

1. What type of financial service provider is the investor?

- ☐ Retail Bank (excluding community development banking)
- ☐ Investment Bank
- ☐ Microfinance or community development banking)
- ☐ Pension Fund
- ☐ Insurance Firm
- ☐ Venture Capital Fund
- ☐ Other (please specify): ________________________________

2. What is the social mission or purpose statement of the financial investor?

3. In what year was this mission statement formulated (or updated)?

Section Two: Investment Background

1. Please check all industry areas in which the investor makes or seeks to make equity investments in emerging markets:

- ☐ Agriculture & Mining
- ☐ Automotive & Aerospace
- ☐ Communications
- ☐ Computers & Electronics
- ☐ Construction
- ☐ Fabric & Apparel
- ☐ Fabricated Goods
- ☐ Finance
- ☐ Food
- ☐ Healthcare
- ☐ Metals
- ☐ Retail
- ☐ Services
- ☐ Transportation
- ☐ Utilities & Energy
- ☐ Wood, Paper & Forestry
- ☐ Other (please specify):

2. Based on the industry areas in which the investor makes financial investments in emerging markets, check those categories in which *social/environmental investments* have been made:

- ☐ Agriculture
- ☐ Arts
- ☐ Community Development
- ☐ Education
- ☐ Energy
- ☐ Environment
- ☐ Health
- ☐ International Development
- ☐ Minority-owned enterprises
- ☐ Women-owned enterprises
- ☐ Development of start-up enterprises
- ☐ Growth of existing business
- ☐ Other (please specify):

3. Please state why the social and environmental investments were made in the indicated industries.

4. In which emerging market countries does the investor currently have holdings (check all that apply)?

- ☐ Argentina
- ☐ Bulgaria
- ☐ Brazil
- ☐ Chile
- ☐ China
- ☐ Columbia
- ☐ Czech Republic
- ☐ Dominican Republic
- ☐ Ecuador
- ☐ Egypt
- ☐ Hungary
- ☐ India
- ☐ Indonesia
- ☐ Israel
- ☐ Kenya
- ☐ Lebanon
- ☐ Malaysia
- ☐ Mexico
- ☐ Morocco
- ☐ Pakistan
- ☐ Peru
- ☐ Philippines
- ☐ Poland
- ☐ Romania
- ☐ Russia
- ☐ Ukraine
- ☐ Uruguay
- ☐ Senegal

☐ South Africa
☐ South Korea
☐ Taiwan
☐ Thailand

5. In the investor's international portfolio, what euro amount was invested in emerging markets as of December 31, 2008?

6. In the investor's international portfolio, what percentage of all investments have been made in emerging markets?

7. In which regions does the investor currently have holdings in emerging markets (check all that apply)?

☐ Africa
☐ Asia Pacific
☐ Eastern Europe
☐ Latin America and the Caribbean
☐ Middle East

8. What percentage of the investor's portfolio is invested in emerging markets in each region?

Africa:
Asia/Pacific:
Eastern Europe:
Latin America and the Caribbean:
Middle East:

9. Please state why the investor has chosen to invest in emerging markets in general and in the countries listed above in particular.

10. What does the investor expect to gain from those investments (both in terms of financial and social returns)?

11. For how long has the institution been investing in emerging markets?

☐ Less than one year
☐ 1-3 Years
☐ 4-6 Years
☐ 7-10
☐ More than 10 years

12. How much capital (in euros) was under management as of December 31, 2009?

13. How much capital has been invested in social and environmental areas as of December 31, 2008?

14. In general, what is the size of the enterprises invested in?

☐ Micro enterprises (<10 employees or ≤ €2 million annual balance sheet total)
☐ Small enterprises (<50 employees or ≤ €10 million annual balance sheet total)
☐ Medium enterprises (<250 employees or ≤ €43 million annual balance sheet total)
☐ Large enterprises (>250 employees or >€43 million annual balance sheet total)

15. Provide a rough estimate of the percentage of the *entire* portfolio that is invested through the following instruments (adding up to 100%). In case of a nonprofit foundation, estimate the percentage of your portfolio invested in the form of program-related investments (PRIs).

In the event that the percentage is unknown but the instrument is used, please indicate so next to the instrument. (Ex: Used, but % unknown.)

Equity: ____________ %
Near-equity (convertible-debt, equity kickers, etc):_________ %
Debt: _____________ %
Grants: ____________ %
Debt through PRIs or similar vehicles: ___________ %
Equity through PRIs or similar vehicles: __________ %
Other (list all on separate lines): ____________________ %

16. Provide a rough estimate of the percentage of the portfolio that is invested through the following instruments in *emerging markets* (adding up to 100%). In case of a nonprofit foundation, estimate the percentage of your portfolio invested in the form of program related investments (PRIs).

In the event that the percentage is unknown but the instrument is used, please indicate so next to the instrument. (Ex: Used, but % unknown.)

Equity: ____________ %
Near-equity (convertible-debt, equity kickers, etc):_________ %
Debt: _____________ %
Grants: ____________ %
Debt through PRIs or similar vehicles: ___________ %
Equity through PRIs or similar vehicles: __________ %
Other (list all on separate lines): ____________________ %

17. What types of investment vehicles are run in emerging markets (check all that apply)?

☐ Niche SRI funds
☐ ESG-themed funds
☐ Socially-screened funds
☐ Other (please specify):

Section Three: Financial Data

1. What is the investor's overall target internal rate of return (gross IRR)?

☐ 0-3%
☐ 4-6%
☐ 7-10%
☐ 11-15%
☐ 16-20%
☐ 21-25%
☐ 26-35%
☐ 36-50%
☐ 50%+
☐ No target return
☐ Undefined

2. What are the estimated returns (gross IRR) as of December 31, 2008?

3. What is the average return hurdle per portfolio company?

☐ 0-3%
☐ 4-6%
☐ 7-10%
☐ 11-15%
☐ 16-20%
☐ 21-25%
☐ 26-35%
☐ 36-50%
☐ 50%+
☐ No target return
☐ Undefined

Section Four: Social, Environment, and Governance Data

1. To what extent do you agree with the following statement? "Management of ESG issues is an important part of our business operations and our investor relations process."

☐ Strongly agree
☐ Agree somewhat
☐ Neutral
☐ Disagree somewhat
☐ Strongly disagree

2. How many professionals does your organization have on staff who evaluate ESG (environment, social, governance) issues as they relate to business operations or explaining the company's ESG position to investors?

☐ More than 10
☐ 5 to 10
☐ 3 to 4
☐ 2
☐ 1
☐ 0

3. When investing in emerging markets, what ESG/SRI criteria are taken into consideration?

☐ Adherence to international norms (ex. human rights, labour relations)
☐ Social screening for undesirable investments (sector-specific investments such as in weaponry or adult entertainment businesses, business support of regimes with poor human rights record, etc.)
☐ Proactive environmental practices
☐ Corporate governance
☐ Green energy/technology
☐ Do not apply ESG/SRI criteria
☐ Other (Please Specify)

4. Please rank the criteria below using a scale of 1 to 10; assign a value to each criteria based upon that criteria's importance in evaluating ESG issues, relative to the other criteria. Please note that the total value for *all* criteria should not exceed 10. (Ex.: Corporate governance=7, Proactive environmental policies=2, Green energy/technology=1)

CRITERIA	VALUE
Adherence to international norms (ex. human rights, labour relations)	
Social screening for undesirable investments (sector-specific investments such as in weaponry or adult entertainment businesses, business support of regimes with poor human rights record, etc.)	
Proactive environmental practices	
Corporate governance	
Green energy/technology	
Other (please add as many rows as needed)	

5. What is your organisation's motivation for addressing ESG (environment, social, governance) issues? Please choose the top two reasons.

☐ Regulatory and compliance issues
☐ Investment business merit
☐ Your organization's own ethical guidelines
☐ Customer demand
☐ Media attention
☐ Pressure from NGOs
☐ Other, please specify ___________________________________

6. How strong is the link between your company's actions on ESG matters and your long-term share price performance?
☐ Strong
☐ Weak

☐ None
☐ Don't know

7. How consistent is the link between your company's actions on ESG matters and your long-term share price performance?

☐ Strong
☐ Weak
☐ None
☐ Don't know

8. Are entrepreneurs asked for social impact projections at the time of the investment?

9. Does the investor evaluate social impact or return of portfolio companies?

10. Which of the following is the investor party to or a member of (check all that apply)?

☐ European Social Investment Forum (Eurosif)
☐ Social Investment Forum (SIF)
☐ Social Investment Organization (SIO)
☐ United Nations Principles for Responsible Investment (UNPRI
☐ UNEP FI
☐ IFC Performance Standards
☐ World Bank Group Environmental, Health and Safety Guidelines (EHS Guidelines)
☐ Equator Principles
☐ GRI Reporting Initiative
☐ Common approach to Corporate Governance
☐ Emerging Market Disclosure Project Signatory
☐ Other (Please Specify)

11. What are 3 imperative lessons the investor has learned about investing in social or environmental areas that would be valuable to other investors, and in which countries were those lessons learned?

12. What are the key challenges to investing in emerging markets that the investor has faced (check all that apply)?

☐ Lack of company ESG disclosure
☐ Differing language
☐ Corporate Culture
☐ Lack of investment research
☐ Local market access
☐ Corruption
☐ Other (Please Specify)

13. Does the investor conduct social return on investment analysis?

14. Is the investor willing to sacrifice lower financial returns for higher social returns? Please explain your answer. If the answer is "no", please skip the following question.

15. In practise, how is the company's willingness to sacrifice financial returns for social returns manifested?

SURVEY COMPLETE!

Finished!

Thank you sincerely for your participation. If you have any questions, comments, or would like more information about the research, please do not hesitate to contact the research team. We can be reached at the following postal address:

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