

Responsible investing in South Africa: past, present and future

*SUZETTE VIVIERS AND ⁺GIDEON ELS

*Department of Business Management, Stellenbosch University, Matieland, 7602, South Africa.

Email: sviviers@sun.ac.za

⁺Department of Finance and Investment Management, University of Johannesburg, PO Box 524, Auckland Park, 2006, South Africa.

Email: gideone@uj.ac.za

Abstract

Despite strong growth in responsible investing (RI) internationally, only a few institutional investors in South Africa have adopted this investment philosophy. This article contributes to the limited body of African RI literature by identifying significant events that shaped the nature of the South African RI market from 1992 to 2014, investigating the RI strategies and investment criteria used by local RI fund managers and evaluating the ethical underpinnings of these funds. The publication of the three King reports on corporate governance in 1994, 2002 and 2009 and the launch of the United Nations Principles for Responsible Investment in 2006 had the biggest positive impact on the RI market's development. Legislative changes and the formulation of institutional investor guidelines (such as the Code for Responsible Investing in South Africa) also provided some impetus, but not as much as initially anticipated. The vast majority of local RI funds have an impact investing strategy, employ socially-oriented investment criteria and have a utilitarian or Islamic ethic. The wider adoption of RI in South Africa is recommended given the benefits this investment discipline holds for investors, society and nature. Improved corporate reporting as well as investor and trustee education are, however, necessary to achieve this goal.

Keywords: Social and Corporate Governance; Impact investing; Institutional investors; Responsible investing; South Africa.

1. Introduction and research objectives

Following his appointment in 1971 as director at General Motors, the Reverend Dr Leon Sullivan became the driving force behind the anti-Apartheid divestment movement that swept across America, Canada, Europe, the United Kingdom (UK) and Japan. In 1977 he formulated the Sullivan Principles which became a code of conduct for banks and businesses with operations in South Africa. Non-compliance with the Sullivan Principles led to the immediate exclusion of a bank or company from institutional investors' portfolios (Grossman and Sharpe, 1986). This social movement served as a blueprint for ending Apartheid many years later (Lewis, 2001) and sparked global interest in the phenomenon of shareholder activism. It serves as a good example of how investors can harness their collective power to ensure social justice (Kaempfer, Lehman and Lowenberg, 2009).

Shareholder activism is only one of the strategies that responsible investors can use to influence corporate policies and practices, the others being screening and impact investing. Although there is no consensus on an exact definition (Capelle-Blancard and Monjon, 2012), responsible investing (RI) essentially refers to “an investment discipline that considers environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and [a] positive societal impact” (US SIF Foundation, 2014).

While anti-South African sentiments ignited significant growth in RI markets across the globe (Renneboog, Ter Horst and Zhang, 2008), not much happened on local soil, nor has the topic enjoyed much attention in academic circles. To explain the lacklustre uptake of RI in South Africa, three research objectives were formulated, namely to identify significant events that have shaped the nature of the local RI market over the period 1992 to 2014; to investigate the RI strategies and investment criteria used by local RI fund managers; and to evaluate the ethical underpinnings of local RI funds. The current state of affairs is lamentable as RI offers investors an opportunity to redress the socio-economic imbalances of the past and promote more sustainable and ethical business practices going forward, all whilst securing their own financial futures.

The significance of this article can be viewed from two perspectives. Firstly, a research methodological contribution and secondly a practical one. Most studies in the field of RI seem to analyse and interpret RI from a financial performance perspective, for example, by measuring value creation and returns. This study does exactly the opposite. It looks at historical timeline of RI, not by comparing

funds, but rather, in a qualitative sense, comparing, evaluating and describing the patterns of change that have taken place in the RI sphere over time. A good understanding of these patterns is critical if interest in this investment discipline is to be stimulated among local investors (particularly institutional investors) and other role players.

The South African RI market was chosen as the unit of analysis as it is the largest RI market on the African continent (Sinclair and Yao, 2011) and has one of the longest track records of RI among emerging markets. Although some academic research has been done on related topics such as corporate social responsibility and corporate governance in Africa (e.g. Ntim and Soobaroyen, 2013; Jarl and Vivien, 2012; Ntim, Opong and Danbolt, 2012; Amao and Amaeshi, 2008), the majority of RI research has been conducted in South Africa (see Viviers, 2014 for an overview in this regard). The historic narrative provided in this article thus makes a valuable contribution to the limited body of knowledge on African RI. The findings might also interest scholars of social movements, institutional change and financial market policy formulation. Practical suggestions are furthermore offered to RI practitioners and academicians.

2. Research design and methodology

Given the nature of the research objectives, the adoption of a phenomenological research paradigm was deemed most appropriate. The origins of phenomenology can be traced back to Kant, Hegel and Husserl. Husserl in particular did not believe that objects (or ‘events’ in this study) exist independently from the researcher and argued that information about objects is reliable for scientific enquiry (Groenewald, 2004). Vandenberg (1997:7) likewise fostered the idea that “the human world comprises various provinces of meaning”. Groenewald (2004:2-3) notes that phenomenological research aims to “return to the concrete”, a notion that can be captured in the slogan “Back to the things themselves!”. The operative word in phenomenological research is therefore ‘describe’: describe, as accurately as possible, the phenomenon, refraining from using any pre-given framework, but remaining true to the facts.

To describe (as ‘accurately as possible’ without any pre-given framework) the significant events that shaped the nature of the South African RI market over the period 1992 to 2014, a research method known as document analysis was used. Bowen (2009) notes that qualitative research techniques (as described above) requires “robust data collection techniques” and “detailed information about how the study was designed”. As such, information for this study was collected from

more than 100 articles published in local newspapers and financial magazines, 22 research reports compiled by local academics and RI practitioners, RI asset managers' websites, RI fund fact sheets and notes from personal interactions with investment analysts and fund managers.

A process of deductive qualitative content analysis, as proposed by Elo and Kyngäs (2007), was then used to summarise the information per research objective.

3. Significant events that shaped the RI market in South Africa over the research period

In this section, the key events that shaped the RI market in South Africa during five distinct phases are summarised.

3.1 Conceptualising competition in the banking sector

As indicated in Table 1, three events prompted interest in the nascent RI market in South Africa after the launch of the first two funds in 1992.

TABLE 1: KEY EVENTS THAT SHAPED THE LOCAL RI MARKET DURING THE ESTABLISHMENT PHASE

Event	Year	Impact on RI market development	Scope of the event
Publication of the first King report on corporate governance in South Africa (King I)	1994	Positive	Local
Introduction of the South African government's Reconstruction and Development Programme	1996	Positive	Local
Economic turmoil brought on by the financial crisis in Asian markets	1997/8	Negative	International
Publication of the first King report on corporate governance in South Africa (King I)	1994	Positive	Local

King I defined acceptable standards of conduct for directors of companies listed on the Johannesburg Stock Exchange (JSE), banks and certain state-owned enterprises (The King Report on Corporate Governance, 1994). The report strongly advocated an integrated approach to stakeholder management and set out principles dealing with the composition and mandate of boards. The report furthermore outlined the requirements for balanced corporate reporting, effective auditing and affirmative action programs.

The Reconstruction and Development Programme (1996) was an integrated socio-economic policy framework which sought to mobilise "all [of] our people and all [of] our country's resources toward the final eradication of Apartheid

and the building of a democratic, non-racial and non-sexist future". The RDP set out to meet basic needs, develop human resources, build the economy and democratise the state and society. These two events provided local investors with specific examples of non-financial investment criteria to consider in their investment analyses and ownership practices.

The Asian financial crisis began in July 1997 and had a profoundly negative impact on the fledgling RI market in South Africa. The crisis consisted of a series of currency devaluations that spread through a number of East Asian markets such as Thailand, South Korea, Japan, Indonesia, the Philippines and Malaysia. Financial markets across the globe reacted sharply to these devaluations (Joh, 2003). Although South Africa did not experience the same economic problems as these East Asian countries, the contagion effect eventually reached the country in May 1998. The large outflow of non-resident funds from May to December 1998 caused the yield on long-term South African government bonds to increase to over 20% (Stals, 1999).

Liquidity in the banking sector was drained to such an extent that banks had to borrow large amounts from the Reserve Bank on a daily basis. Banks consequently curtailed credit extension to the private sector and short-term interest rates increased to record levels (Stals, 1999). The credit crunch coupled with rising inflation and a depreciating Rand severely depressed economic activity in the country in 1999 and resulted in fewer investors expressing an interest in RI post-1998.

3.2. The decline phase (1999 – 2003)

According to a report by the International Monetary Fund, South Africa was the only sub-Saharan African country to be fully exposed to the Asian contagion (Faulkner and Loewald, 2008). Given the adverse economic consequences of the crisis and the subsequent poor performance of listed equities, many market participants became reluctant to invest in RI funds after 1998 (Harris, 1999). Investors were particularly weary of funds facilitating broad-based black economic empowerment (B-BBEE) transactions as the special purpose vehicles designed for this goal proved unsustainable in the aftermath of the Asian financial crisis (De Cleene and Sonnenberg, 2002). Media headlines at the time reflected the negative sentiment towards RI and consequent stunted growth in the market (Investors must navigate minefield of socially acceptable offerings, 2003; West, 2002). Three events occurred during this phase to offset the negative sentiment. These events are listed in Table 2.

TABLE 2: SIGNIFICANT EVENTS THAT SHAPED THE LOCAL RI MARKET DURING THE DECLINE PHASE

Event	Year	Impact on RI market development	Scope of the event
The World Summit on Sustainable Development held in Johannesburg	2002	Positive	International
Publication of the second King Report on Corporate Governance (King II)	2002	Positive	Local
Promulgation of the B-BBEE Act (No. 53 of 2003)	2003	Positive	Local

The 2002 World Summit on Sustainable Development, also called the ‘Earth Summit’, culminated in the Johannesburg Declaration and highlighted “worldwide conditions that posed severe threats to sustainable development” (Johannesburg Declaration on Sustainable Development, 2002). The Summit contributed to a greater awareness of the need for sustainable business and investment practices and provided guidance on specific areas of national priority, such as corruption, chronic hunger and chronic diseases (in particular HIV/AIDS, malaria and tuberculosis).

In line with international developments, the King II Report on Corporate Governance (2002) included dedicated chapters on sustainability, risk management and the role of the board. The report also proposed a number of mechanisms, including that of shareholder activism, to ensure managerial conformance to the principles of good governance. After the publication of King II, the JSE changed its listing requirements thereby obligating listed companies to disclose the extent to which they complied with King II’s recommendations. Many of the principles put forward in King II were also embodied in the ‘new’ Companies Act (No. 71 of 2008) (King II empowers shareholders, 2002).

The promulgation of the B-BBEE Act in 2003 provided investors and companies with some guidelines on promoting broad-based black economic empowerment through ownership, management control, skills development, enterprise and supplier development as well as socio-economic development. Even though Herringer, Firer and Viviers (2009) acknowledged the importance of this Act in promoting B-BBEE, they warned that the number of empowerment-related funds and transactions might remain subdued due to the lack of a clear link between RI and B-BBEE.

3.3. *The resurgence phase (2004 – 2008)*

Improvements in global financial markets led to a reawakening of RI in South Africa in 2004. A more positive disposition towards RI was reflected in newspaper headlines such as ‘Do well, do good – there is no reason to sacrifice returns’ (Thomas, 2004) and ‘Social investments give great returns’ (Healing, 2005). As illustrated in Table 3, six major events influenced the uptake of RI during this phase.

TABLE 3: SIGNIFICANT EVENTS THAT SHAPED THE LOCAL RI MARKET DURING THE RESURGENCE PHASE

Event	Year	Impact on RI market development	Scope of the event
Launch of the Financial Sector Charter	2004	Positive	Local
Launch of the JSE SRI index	2004	Inconclusive	Local
Inauguration of the SA Social Investment Exchange	2006	Positive	Local
Launch of the United Nations Principles for Responsible Investment (PRI)	2006	Inconclusive	International
Establishment of the South African Network for Impact Investing	2008	Positive	Local
Introduction of the FTSE/JSE Shari’ah All Share index	2007	Positive	Local
Introduction of the FTSE/JSE Shari’ah Top 40 index	2008	Positive	Local

The Financial Sector Charter (2002) came about as a result of intensive discussions between the South African government, business, labour and community constituencies. The Charter committed signatories to transform in areas such as human resource development, the procurement of goods and services, providing access to financial services, black ownership and control as well as corporate social investment. The Charter also promoted the provision of empowerment financing to targeted investments in transformational infrastructure, low-income housing, agricultural development and black small and medium enterprises. The terminology and targets used in the Charter, particularly as it pertained to empowerment financing, provided local investors and consultants with much needed practical guidance.

The main objective of the JSE SRI Index (launched in 2004) was to “identify those companies that integrate the principles of the triple bottom line and good governance into their business activities”. The Index was designed to serve as

a holistic assessment of companies' policies and practices against "globally aligned and locally relevant corporate responsibility standards" (JSE SRI Index: Background and Criteria, 2014). The Index was the first of its kind in an emerging market and the first ever to be launched by a stock exchange (Wadula, 2004). At the time, market observers claimed that the index would contribute to the development of (more) responsible business practice among JSE-listed companies. Fifty-one companies qualified as constituents after the first round of voluntary screening in 2004. By 2014, a record number of 156 companies were reviewed with 82 becoming constituents. Opinions are currently divided on the impact that this index has had on promoting RI in the country other than it being a performance benchmark (Crotty, 2013b).

In 2005, the former UN Secretary General, Kofi Annan, invited a group of the world's largest institutional investors to develop a set of RI principles. Intense discussions between stakeholders from the global investment industry, intergovernmental organisations, civil society and academia led to the formulation of six principles launched in 2006 (United Nations Principles for Responsible Investment, 2013). By becoming PRI signatories, institutional investors acknowledge that they have a duty to act in the best long-term interests of their beneficiaries and that ESG issues can affect the performance of their investment portfolios.

The largest pension fund in South Africa, the Government Employees Pension Fund (GEPF), was one of the founding signatories of the PRI and warned that they would use their financial might to "force corporate South Africa to shape up in areas of good governance, social responsibility and environmental protection" (Cameron, 2006). As the GEPF controls almost half of all retirement savings in the country, they have the potential to exert enormous pressure on investee companies to reform their policies and practices.

Although the PRI has provided investors the world over with a more standardised definition of RI, critics argue that the Principles promote ethical egoism – a theory which suggest that investors will only invest in responsible investments if they benefit financially (Richardson, 2010). Lewis (2004) aptly describes the danger of such a self-interested approach by saying that "when you are honest only because honesty pays, you risk forgetting the meaning of honesty. When you are responsible only because responsibility pays, you lose any real sense of what responsibility means".

In 2006, the SA Social Investment Exchange was launched with the aim of matching donor funding to high performance development projects. This online exchange was only the second of its kind in the world and went a long way in promoting impact investments in South Africa (SA Social Investment Exchange, 2007). Two years later the establishment of the South African Network for Impact Investing (2013) provided a much needed platform for dialogue on the concept, practice and growth of impact investing on the continent. The network's has since organised several high profiled conferences on the topic.

Given growing interest in Islamic financing, the JSE launched the FTSE/JSE All Share index in 2007 and the FTSE/JSE Shari'ah Top 40 index in 2008. These indices exclude companies involved in conventional finance (i.e. non-Islamic banking, finance and insurance), alcohol, pork, non-Halaal food production, packaging and processing, entertainment (casinos, gambling, cinema, music, pornography and hotels), tobacco and weapons (FTSE/JSE Africa Index Series, 2013). These indices had a positive impact on the local RI market as they serve as performance benchmarks used by a growing number of Islamic investors in the country.

It could be argued that improved financial performance of RI funds during this phase contributed to their growing popularity. Several RI funds, most notably those managed by Fraters Asset Management (now Element Investment Managers) received ACI/Personal Finance Raging Bull Awards based on outstanding three-year risk adjusted performance (Dynes, 2009).

3.4. The strong growth phase (2009 – 2011)

The global financial crisis, which started in 2008, drove share prices on the JSE to record lows in March 2009. However, within six months the FTSE/JSE All Share index bounced back by 50% (Dynes, 2009). According to some analysts, the JSE's resilience confirmed that foreign investors were returning to the market in large numbers. A sharp increase was also noted in the number of private equity investors who invested in South Africa post-2008 (Sinclair and Yao, 2011). The events that led to strong growth in the RI market over the period 2009 to 2011 are listed in Table 4.

TABLE 4: KEY EVENTS THAT SHAPED THE LOCAL RI MARKET DURING THE STRONG GROWTH PHASE

Event	Year	Impact on RI market development	Scope of the event
Publication of the third King Report on corporate governance in South Africa (King III)	2009	Positive	Local
Introduction of the South African government's New Growth Path	2009	Positive	Local
The British Petroleum (BP) oil spill in the Gulf of Mexico	2010	Positive	International
The UN Convention on Convention on Climate Change held in Durban	2011	Positive	International
Amendments to Regulation 28 of the Pension Funds Act (No. 24 of 1956)	2011	Neutral	Local
Launch of the Code for Responsible Investing in South Africa (CRISA)	2011	Neutral	Local

In line with international corporate governance developments, King III introduced new topics such as shareholder approval of non-executive directors' remuneration and the evaluation of the board and directors' performance. The report further recommended that all public, private and non-profit entities prepare integrated annual reports based on the Global Reporting Initiative's Sustainability Reporting Guidelines. As before, the JSE changed its listings requirements thereby obligating listed companies to adopt King III's recommendations. It could be argued that King III's greatest contribution to RI in South Africa lies in its recommendation that listed companies should provide stakeholders with more detailed ESG information in their integrated reports. The lack of measurable ESG information has long stifled the adoption of RI by mainstream investors in South Africa (Herringer *et al.*, 2009).

The New Growth Path announced by the South African government in 2009 emphasised infrastructure development, job creation, improvements to the agriculture value chain and the creation of a green economy. Many of the investment mandates of RI funds established during this phases reflect the government's objectives set out in the New Growth Path.

On the international front, the BP oil spill in the Gulf of Mexico in April 2010 led to a 'green awakening' among many investors. By November 2010, BP had agreed to pay more than \$12 billion in government and private party settlements and still faced billions of dollars of claims for the catastrophe (Cronin-Fisk and Mattingly, 2012). Following a US judgement that BP was grossly negligent in

the lead-up to the oil spill, management set \$43 billion aside to cover expected fines, legal settlements and clean-up costs (BP found ‘grossly negligent’ in 2010 Gulf oil spill, 2014). The BP oil spill made a financial case for RI in general and green investing in particular by showing that “it is not about feeling good, it is about surviving” (Fisher-French, 2012). The need for a more concerted effort among South African companies and investors to ‘go green’ was further highlighted at the United Nation’s Convention on Climate Change which took place in Durban in 2011 (COP17/CMP7 – The Durban conference delivers a historical breakthrough in climate change talks, 2011).

After many years of deliberation, Regulation 28 of the Pension Funds Act was finally amended in 2011 to ensure that savings invested in South African retirement funds were prudently invested from an ESG risk management perspective (Peacock, 2011). Two specific amendments have implications for the RI market. The first deals with the nature of local pension funds’ investment policy statements, whereas the second centres on prudential investment limits.

Trustees of local pension funds are now required to develop an investment policy statement which should describe their fund’s approach to trustee education, B-BBEE and ESG issues, outline how the fund will match its assets to its liabilities, its due diligence process on all investments, how it will monitor compliance by its service providers and how it will ensure understanding of the fund’s changing risk profile (Cameron, 2011). In addition to emphasising members’ interests and trustees’ obligations, the Act now compels fiduciaries to adopt a liability-based approach to investing and to take a long-term view (Swart, 2011). This amendment is exactly what was called for by De Cleene and Sonnenberg in their 2002 and 2004 reviews of the burgeoning RI market in South Africa.

The revised prudential limits of Regulation 28 eased prior restrictions on alternative investments including hedge funds and unlisted equities. The latter amendment was aimed at ensuring that “investment into this pro-development funding channel is not impeded”. No more than 15% of a retirement fund’s assets may now be invested in hedge funds and private equity funds (compared to 5% previously). It has long been argued that private equity investments provide trustees with another (profitable) avenue besides listed securities to explore B-BBEE and ESG investments. This development is very encouraging given that the number of listed companies on the JSE is relative small compared to other emerging markets. Private equity funds are also believed to have more comprehensive ESG strategies than traditional equity funds (Cranston, 2012).

However, despite being allowed to invest more in private equity opportunities, South African pension funds are still underweight in this asset class, with less than 1% of their funds committed to such investments (Pickworth, 2012).

As the regulatory changes described above called for specialised, industry-specific training, the Sustainable Returns for Pensions and Society Project was launched in 2013. This industry-led initiative was designed to build capacity and develop tools to support principal officers and pension fund trustees in implementing the new requirements of Regulation 28. The Institute of Directors in Southern Africa (IoDSA) also drafted a Code for Responsible Investing in South Africa (CRISA) to help institutional investors comply with these amendments as well as the PRI and King III recommendations. CRISA was launched in July 2011 and is based on the six principles promoting the integration of ESG factors into investment analysis and ownership practices. CRISA applies to asset owners and their service providers (asset managers and consultants) and encourages the adoption of its principles and practice recommendations on an ‘apply or explain’ basis. Although compliance with CRISA is voluntary, the Minister of Finance hinted that more active involvement by the government could be expected if “this voluntary code to promote more open and broadly beneficial investment proves ineffective” (Crotty, 2011).

3.5. The CRISA phase (2012 – present)

Scepticism regarding the effectiveness of CRISA post-2011 was voiced by many role players in the country (Greenblo, 2012). Journalists initially reported very negative views about the amended Regulation 28 (Pension money ‘can’t be wasted’, 2010 and Zerbst, 2010), but later shifted their focus to the practical implications thereof (Crotty, 2011; Wasserman, 2011).

The authors of the 2012 Sanlam Benchmark Survey (a survey of South Africa’s retirement fund industry) claimed that ESG considerations were not yet embedded in the investment processes in the industry (Fernandez, 2012). Only 19% of funds in the survey had an ESG investment policy at the time of the survey and just over a quarter (26%) invested in responsible investments. The slow uptake in terms of investment policy formulation and RI was mainly attributed to a lack of knowledge among fund managers as to what exactly RI entails.

They claimed that a lack of knowledge inevitably results in fund managers ‘ticking the right boxes’ rather than actively integrating ESG considerations into the investment process. The authors concluded that despite amendments to Regulation 28 and the launch of CRISA, the adoption of RI principles

among local retirement funds “remained muted” in 2012. Similar findings were reported by the CRISA Committee in 2013. The executive director of the IoDSA acknowledged that the outcomes of these report were concerning, but believed that the situation will improve once investors were under pressure to improve their levels of disclosure (Crotty, 2013a). Table 5 reflects two events that have shaped RI attitudes and practices during the CRISA phase.

TABLE 5: KEY EVENTS THAT SHAPED THE LOCAL RI MARKET DURING THE CRISA PHASE

Event	Year	Impact on RI market development	Scope of the event
The PRI in Person conference held in Cape Town	2013	Positive	International
Publication of the PRI’s ‘new’ reporting framework	2013	Positive	International

Some delegates at the 2013 PRI in Person conference claimed that South Africa was at the forefront of RI and ESG developments in the world and attributed this to the host of local RI guidelines available to investors. In addition to CRISA, the Principle Officers’ Association designed their own guide on RI for local pension funds. Their guide is aimed at new chairs, trustees and principal officers who require practical guidance on fund planning and implementation. The guide also assists trustees and principal officers to better assess and manage the ESG risks, impacts and business opportunities that can affect the long run financial performance of investment portfolios (IFC and South Africa’s POA release guide to responsible investing for pension funds, 2013).

The PRI’s ‘new’ reporting framework (launched in 2013) was designed to make reporting by PRI signatories “more objective and better aligned with the investment activities they undertake” (Nicholls, 2013). As from October 2013, all signatories now have to publically disclose information on their RI policies and practices. At the end of December 2015, six South African asset owners, 36 asset managers and 11 professional services providers were signatories of the PRI (United Nations Principles for Responsible Investment, 2016). Experts claim that PRI’s ‘new’ reporting framework will enhance public accountability among these signatories thereby promoting more RI.

In addition to these two events, the authors have also noticed an increase in the number of local RI forums that took place during this phase. For example, in August 2014, Trialogue and E&Y hosted a Sustainability Forum to discuss the drivers and barriers of RI in the country. Panellists noted that challenging

conversations about RI are beginning to take place among senior decision makers in the industry. They also argued that CRISA was an important driver of RI, albeit limited to listed securities. Prominent fund managers were of the opinion that unlisted securities hold “great potential” for responsible investors (Silverman and Duncan, 2014).

The following barriers to RI in South Africa were mentioned: asset owners failing to embrace a broader definition of wealth and returns, the misalignment of time frames and incentive structures for CEOs and pension fund trustees, and the lack of comparable and standardised ESG data. It should be noted that all three of these barriers have been present since the establishment phase (Herringer et al., 2009). A concerted effort is thus necessary to address these and other challenges in the local RI market.

Although the panellists agreed that RI regulation was important, they were concerned about the time required to comply. They were also quite sceptical about the potential for shareholder activists to influence the policies and practices of local companies. One speaker remarked that “the South African market has quite a lot of maturing to do before it’s ready to respond to shareholder pressure” (Silverman and Duncan, 2014).

Concerns about the lack of shareholder activism in the country were also voiced at a CRISA panel discussion in September 2014. One speaker claimed that shareholders fail to develop relationships with investee companies as the average time they own shares has become months instead of years. As such, shareholders are unlikely to engage managers, especially on long-term ESG considerations. Access to management to discuss ESG concerns was highlighted as another barrier experienced by many shareholders, including those who hold significant stakes in investee companies. The need for greater buy-in from pension fund trustees and the lack of accountability among asset consultants are were highlighted as further barriers to RI in South Africa. One speaker also remarked that excessive execut

The authors furthermore observed that the *modus operandi* of the largest institutional investor in the country, the Public Investment Corporation (PIC), came under increased scrutiny during this phase. Some critics claimed that the PIC based certain decisions on political rather than economic considerations, that they were hostile towards foreign investors and that they failed to enforce sound corporate governance principles (Fink and Lubber, 2015). Other critics asserted that the PIC has become “too tame” in their public shareholder activism

endeavours (Barron, 2014; Mantshantsha, 2014; 2013). ive remuneration is a “burning issue” that needs to be addressed urgently.

4. The RI strategies and investment criteria employed by local RI fund managers over the research period

The following section deals with the second research objective, namely the identification of the dominant RI strategies and investment criteria employed by local RI fund managers. The number of local RI funds established and discontinued during each phase is reflected in Table 6.

TABLE 6: NUMBER OF LOCAL RI FUNDS ESTABLISHED AND DISCONTINUED OVER THE RESEARCH PERIOD ^(a)

Phase	RI funds established	RI funds discontinued ^(c)
Establishment (1999-2003)	18	0
Decline (1999-2003)	12	10
Resurgence (2004-2008)	29	1
Strong growth (2009-2012)	24	3
CRISA (2013 – present) ^(b)	8	2
Total	91	16

(a) Details of the reviewed RI funds can be obtained from the authors on request.

(b) This total only reflects the number of RI funds established up to the end of December 2014.

(c) A discontinued fund refers to one which was either closed or merged with other fund at some point before 31 December 2014. It also refers to RI funds.

4.1. The establishment phase (1992-1998)

Spurred on by anti-Apartheid shareholder activists in the America, local trade unions began to mobilise in the late 1980s. Their actions led to the creation of one of the first RI funds in South Africa in 1992, namely the Community Growth Equity Fund (De Cleene and Sonnenberg, 2002). This fund was initiated by the Community Growth Management Company which was jointly owned by Unity Incorporation (representing the interests of seven trade unions) and the Old Mutual Investment Group South Africa. The fund’s mandate prohibited investments in JSE-listed companies that were supportive of the Apartheid regime and those with poor labour relations. This fund was one of 18 local RI funds launched during the establishment phase.

The vast majority of RI funds launched during this phase employed an impact investment strategy (either on its own or in combination with a positive screening

strategy).¹ Most of the newly established RI funds focused on infrastructure development, the promotion of B-BBEE, job creation, skills development and affirmative action. The emphasis on empowerment financing was so intense towards the end of this phase that one journalist remarked “empowerment deals have come of age” (Bridge, 1999). Despite the turmoil that prevailed in global financial markets in 1998, four new RI funds were established in this year alone.

Futuregrowth Asset Management (2013) firmly positioned itself as a RI pioneer by launching five RI funds during the establishment phase. Twenty years after the launch of the Futuregrowth Community Fund, it still remains one of the few local RI funds to invest in the development of shopping centres in townships and underdeveloped urban areas. It is estimated that these shopping centres service approximately seven million previously disadvantaged South Africans. Along with the emphasis on infrastructure development, a few of the RI funds launched during the establishment phase focused on small business development (as did RDP managers).

4.2. The decline phase (1999 – 2003)

Eight of the RI funds launched during the establishment phase were discontinued during this phase, as were two other funds launched after the turn of the millennium. The high occurrence of fund closures could be attributed to the disappointing performance of many RI funds (especially empowerment funds) in the late 1990s (De Cleene and Sonnenberg, 2004; 2002). Half of the new RI funds established during this phase (10 in total) consequently employed an impact investing strategy focussing exclusively on infrastructure development (rather than on B-BBEE financing).

The popularity of infrastructure funds in the wake of the Asian financial crisis, the Enron scandal and the bursting of the dot.com bubble in this phase could be ascribed to the low level of correlation that exists between the returns of listed securities and those of infrastructure investments (called targeted development initiatives). According to Petersen (2005), investors could thus address the country’s social challenges whilst benefitting from the diversification offered by these investments. Harris (2004) also highlighted the diversification benefits associated with infrastructure investments, but cautioned that they are not suitable to all investors as they tend to be illiquid and require a commitment over the medium to long term (5 to 10 years).

Shari’ah compliant funds represented another category of RI funds which offered investors diversification benefits during the decline phase. Abdulla,

Hassan and Mohamad (2007) found that Shari'ah compliant funds in Malaysia outperformed conventional funds during bearish economic trends (such as that following the Asian financial crisis), whilst conventional funds performed better during bullish economic conditions. Viviers and Firer (2013) attributed local Shari'ah funds' solid performance during and after the Asian financial crisis to their exclusion of financial and retail companies as these two sectors were particularly hard hit during the crisis.

Cameron (2003) noted significant growth in the number of Shar'iah compliant banking and investment products in South Africa during this phase (be it for diversification or moral reasons). Noteworthy examples include the Old Mutual Albaraka Equity Fund established in 1992 and the Oasis Crescent Equity Fund launched in 1998. In 2003 Sanlam became the first mainstream asset manager in the country to offer a Shari'ah compliant fund (Bolin, 2003). What makes their Nur Equity Fund worth mentioning is that Sanlam was traditionally an Afrikaner/Christian-oriented company.

4.3. The resurgence phase (2004 – 2008)

An analysis of the investment mandates of the 29 new RI funds launched during the resurgence phase (2004-2008) reveals that the range of RI strategies and investment criteria used by local RI asset managers expanded to include environmental and corporate governance considerations alongside existing social and financial criteria. This development was most likely in response to the launch of the JSE SRI index in 2004 and the PRI in 2006. As indicated earlier, the performance of RI funds during this phase could also have contributed to their growing popularity. Impact investing, either on its own or in combination with other RI strategies, remained the most prominent RI strategy employed by local RI asset managers during this phase.

4.4. The strong growth phase (2009 – 2011)

Almost half of the 24 new RI funds launched during the strong growth phase employed ethical exclusions based on Shari'ah principles. As Islam prohibits its followers from making certain investments, Islamic investors represent a captive investment audience. The growth in Islamic financing in recent years is not unique to South Africa (Islamic Wealth Management Report, 2012). Although only approximately 2% of the South African population state their religion as Muslim, support for Islam is rapidly growing, especially among black South Africans (International Religious Freedom Report 2005, 2005; Bell, 2004). The trend is attributed to Islam's emphasis on charity and the faith's focus on

lifestyle and social reform. Despite being a minority group, it is estimated that Muslim purchasing power is about a quarter of gross domestic product.

According to local asset managers, Shari'ah compliant investing is gaining substantial momentum among young professionals. "Not only are there more Shari'ah compliant investments available, but young professionals are also discovering the benefits of these diversified portfolio options...we're seeing a big generational change" (Rise in Shari'ah compliance, 2012). According to a Sanlam spokesperson, the retirement industry is becoming a big contributor to the growth of local Shari'ah investments. In a special report on Islamic financing in South Africa, Patel (2012) remarked that the scope for Islamic financing is significant as it could be used to "encourage small and medium-size enterprise development, provide affordable housing, finance infrastructure projects, facilitate empowerment deals, etc. while always ensuring fair, ethical business practices aligned with an increase in real assets and employment".

Another reason for the rise in Shari'ah compliant funds during the strong growth phase could relate to their solid financial performance in the aftermath of the 2008 global financial crisis. As indicated earlier, Shari'ah fund performance tends to be counter cyclical. Elfakhani and Hassan (2005) claim that the establishment of credible Shari'ah equity benchmarks, such as the Dow Jones Islamic Market Index and the FTSE Global Islamic Index Series, represented a turning point for the industry globally as it gave both Islamic and conventional investors a benchmark to compare their investments' performance against. The same could be said for the establishment of the FTSE/JSE Shari'ah indices in 2007 and 2008. The argument that non-Muslim investors are also drawn to Shari'ah compliant funds was also highlighted in the Islamic Wealth Management Report (2012).

Although only two of the RI funds established during the strong growth phase employ a shareholder activism strategy, more attention was given to this RI strategy in the media (probably as a result of King III's emphasis on its benefits) (Crotty, 2012a; 2012b; 2011; Planting, 2012). Particular mention was made of the activism endeavours of the GEPIF and its primary asset manager, the PIC (Moloto, 2010). Two interesting developments in terms of the investment criteria used by local RI fund managers also occurred during this phase. Firstly, a return to infrastructure development and B-BBEE financing is noted, most likely in response to the objectives of the New Growth Path (Ramataboe, 2010).

Secondly, environmental criteria began to feature more prominently in RI funds' investment mandates from 2010 onwards (Biyase, 2012; Cranston, 2012;

Fisher-French, 2012; Giamporcaro, 2010). On the one hand, the enhanced focus on environmental considerations could be as a result of investors becoming more aware of their responsibility (and power) to encourage greener behaviours among investee companies. On the other hand, it could be driven by the financial performance of green companies. Nedbank's Green Index for example outperformed the FTSE/JSE Shareholder Weighted All Share and Top 40 indices by 18% and 40% respectively over the period 1 July 2008 to 31 December 2011 (Schnehage, 2012). The Nedbank Green index consists of companies selected from the JSE's Top 100 and serves as a benchmark for environmentally conscious investors. Constituents are selected and weighted on the extent to which they measure and disclose carbon emissions as well as their attempts to reduce emissions.

Interest in environmental criteria could also be ascribed to improved corporate reporting on environmental matters. Since 2000, the Carbon Disclosure Project (CDP) has challenged the world's largest companies to disclose their greenhouse gas emissions, identify the perceived risks and opportunities that climate change present for their businesses and describe their strategic responses to these risks and opportunities. The CDP has engaged the JSE's Top 100 to do the same since 2007. According to the 2012 CDP South Africa 100 Climate Change Report, the Top 100 are increasingly anticipating and responding to climate change issues.

4.5. The CRISA phase (2012 – present)

Not only did the number of companies with greenhouse emissions reduction targets increase in 2012, but improvements were also observed in terms of disclosure, climate change governance, risk management and performance (South African business – Shifting the focus to performance, 2012). Access to detailed information on greenhouse gas emissions makes it easier for (conventional and responsible) investors to evaluate the long-term strategic risks. In contrast to the vaguely formulated environmental mandates of the past, new RI funds clearly articulated investment criteria dealing with emissions, water and renewable energy.

As shown in Table 6, only eight RI funds were established over the period 2012 to 2014. A strong focus on environmental considerations is observed in the investment mandates of these funds, the majority of which employ an impact investing strategy. The low number of new RI funds could be attributed to asset managers making the mindset shift from seeing RI as purely product-based to process-based (De Bruin, 2015).

The final research objective of this study involved evaluating the ethical underpinnings of local RI funds, the main findings of which are presented in the following section.

5. The ethical underpinnings of local RI funds

It is widely accepted that responsible investors consider both financial and non-financial returns associated with investments. Within the field of ethics, normative or prescriptive ethics provides guidance as to what behaviour is considered ‘good’ or socially acceptable. Rational arguments framed within theoretical approaches to normative ethics offer decision makers grounds for deciding whether something (such as an investment) is morally pleasing or culpable. Over time a number of normative theories such as a virtue theory, deontology and utilitarianism saw the light.

Viviers and Eccles (2012) found that utilitarianism was the most commonly observed ethical position reported in 190 academic articles on RI. Proponents of utilitarianism claim that the morality of an action should be judged by its consequences or outcomes. Mill (quoted in MacIntyre, 2004) was convinced that actions are ‘good’ when they contribute towards achieving the greatest good for the greatest number. Not all investors are, however, in favour of managers using their investments to make the world a better place (for example by investing in environmentally friendly technologies or supporting charitable causes). Statman (2008) aptly remarks that “[P]art of the objection to SRI is the mixing of the utilitarian nature of investing ([measured in terms of] returns, risk, liquidity, taxes, and so on) with the expressive nature of investing (e.g. patriotism, social cachet, socially responsibility, prestige)”. The above mentioned objection, however, seems tenuous as many studies have shown that utilitarian RI performs, on average, as well as conventional investing (see Renneboog, Ter Horst and Zhang, 2008 for a summary of prominent studies).

Interest in impact investments in general and B-BBEE funds in particular could be attributed (at least in part) to one of Statman’s (2008) expressive characteristics, namely that of patriotism. Pentz (2011) showed that South Africans (especially black South Africans) exhibit a strong sense of ethnocentrism (a construct which includes patriotism). Investing in home-grown projects which could improve the lives of local communities might thus be more attractive to local investors than investing in a passive fund which merely tracks some or other RI index.

Given South Africa’s unique history, it is not surprising that most local RI fund managers view social issues as very important, particularly those dealing

with the welfare of employees and local communities. Further evidence of a utilitarian ethic is found in the combination of social and environmental criteria. The evidence suggests that local investors seem to realise that these two issues are inextricably linked and that economic development should not come at the expense of the natural environment (Giamporcaro and Viviers, 2014).

In contrast to utilitarianism, deontology is concerned with the moral obligations, duties and responsibilities which are inherently necessary for morality to prevail, irrespective of the ends or consequences they produce. An action is therefore only deemed ethical if it conforms to certain moral or universal principles. Quakers and others who base their investment decisions on Christian or Jewish values typically employ a deontological lens (Schwartz, Tamari and Schwab, 2007; Beabout and Schmiesing, 2003).

Although it is tempting to apply the same logic to Shari'ah compliant funds, this cannot be further from the truth. Some vehemently opposed viewpoints have been put forward in research challenging the Western idea of ethics within a Shari'ah focus. Choudhury (2016) for example disagrees with the viewpoint that Shari'ah funds ought to be described within a deontological framework. He argues that "all the utilitarian ethical standards have entered Islamic banking and finance lock, stock, and barrels [sic]". Prominent Islamic scholars have, however, disagree with Choudhury. Al-Aidros, Shamsudin and Idris (2013), for example, note that "Islam does not accept utilitarian theory as a sufficient theory because this theory considers ethics as having the greatest consequences for the greatest number, when some actions may be inherently wrong". In the same vein, Al-Aidros *et al.* (2013) also claim that not even the deontological theory is acceptable in an Islamic context "because the only lawgiver for the overall system, including the ethical system, is Allah". These scholars state that the only ethical principles accepted within an Islamic viewpoint may be characterised as comprehensive, realistic and in moderation.

6. Summary, conclusions and recommendations

In light of the documentary evidence presented, it seems that the publication of the three King reports on corporate governance in 1994, 2002 and 2009 and the launch of the PRI in 2006 had the biggest positive impacts on the development of the local RI market over the research period. Legislative changes (such as amendments to Regulation 28) and the formulation of institutional investor guidelines (such as CRISA) also provided some impetus for the wider adoption of RI in South Africa, but not as much as initially anticipated.

It is also evident from the information reviewed that the vast majority of local RI funds have an impact investing strategy (either on its own or in combination with a positive screening strategy) and employ socially-oriented investment criteria. Most of the 107 RI funds that were launched over the research period are/were underpinned by a utilitarian or Islamic ethic. These findings not only highlight local investors' RI preferences, but also point to opportunities for asset managers to differentiate themselves by offering new and unique RI products.

RI offers South African investors diversification benefits and returns that are generally on par with conventional investments (Viviers, Bosch, Smit and Buijs, 2008). The appropriateness of RI as an investment strategy for local pension funds (who are after all the stewards of ordinary citizens' savings) was aptly summarised in the thought provoking questions posed by a prominent RI fund manager: "[W]hen I retire, will I have money to spend? Will I also have clean air to breathe, fresh water to drink? Is the world I am going to retire into being degraded to fuel the growth of my pension fund?" (Boshoff and Schulshenk, 2014). Local communities and the natural environment also stand to benefit when companies respond to shareholders' demands for more ethical and sustainable business practices.

In the following section a number of recommendations are set forth for directors of JSE-listed companies, the IoDSA, consulting companies, the PRI and educators to encourage the wider adoption of RI (be it in terms of launching dedicated RI funds, engaging more companies on ESG concerns or placing more emphasis on ESG criteria in the investment process).

First and foremost, JSE-listed companies should be encouraged to increase reporting on their ESG policies and practices. Although the advent of integrated reporting in King III has led to an improvement in the volume of ESG information available, much remains to be done to increase comparability. In line with Marx and van Dyk (2011), the authors also call on public companies to have their non-financial reports verified by external, independent auditors. The availability of credible ESG information will enable investors (both responsible and conventional) to make better informed decisions.

The authors further recommend that the IoDSA consider designing a practical framework to enhance listed companies' relationships with investors. The framework of the Australian Institute of Company Directors, for example, sets out the legal underpinnings governing the relationship between boards, shareholders and executives and provides guidance to institutional investors

on creating effective communication strategies. This move would, however, require that local institutional investors be exempt from collusion charges when collectively engaging investee companies.

Although a few consulting companies (such as ISS Proxy Voting Services and Glass Lewis) already provide proxy voting advice to local institutional investors, more of these specialist services are necessary. Industry-specific research is furthermore required into gap observed between the nature of ESG data required by investors and the data published by JSE-listed companies. As mentioned above, the availability of material ESG data is crucial for sound investment decision making.

All PRI asset owner and asset manager signatories are required to publish their proxy voting policies and results online. Unfortunately, very few local signatories are currently doing so (Viviers and Smit, 2015). The PRI should investigate the reasons for non-compliance and institute mechanisms to address this lack of transparency among local signatories.

Tertiary sector educators have an important role to play in shaping the views of commerce graduates. Not only should educators create a greater awareness of RI among their students, but they should also imbue the next generation of investment professionals with moral courage and the skills necessary for effective ESG analysis and engagement. The same argument applies to private sector training providers.

Although the South African RI experience could serve as a valuable case study for other emerging markets (Heese, 2005), a significant mind set shift is required among mainstream institutional investors and other role players (including policy makers). Investors in particular need to realise that effective RI calls for a collective and focussed approach which cannot be separated from the desire to 'do good'. Finally, RI champions are called upon to share their success stories and prompt others to take concrete action. Unless definitive interventions are undertaken, the mediocre growth rate in RI will continue, thereby robbing investors of the opportunity to address the many and diverse social and environmental challenges faced in the country.

7. Limitations of the study and suggestions for future research

Implementing a qualitative framework in any study will always lead to some criticism. It is therefore understandable that this phenomenological study may be viewed with scepticism. The authors acknowledge that document analysis

as a qualitative research method has some disadvantages. As in any other study using this method, researcher and data subjectivity might have led to difficulties in establishing reliability and validity. The researchers are also cognisant of the fact that collected documents were not written for research purposes and that there might have been different motives behind their initial creation (e.g. newspaper articles being written with a profit motive in mind). Despite these limitations, the authors still believe that chosen method was appropriate to achieve the study's research objectives.

RI in general and impact investing in particular presents numerous opportunities for future research. Future studies could extend beyond the borders of South Africa to other RI markets on the African continent, most notably Nigeria and Kenya. More research (albeit non-academic) is also required on the role and impact of shareholder activism in South Africa. The current approach to shareholder engagement in the country is very fragmented (as in most common law countries) (Viviers and Smit, 2015). It would be interesting to see if there is a need for a forum such as the Association of British Insurers in South Africa. Members of this forum collectively address investee companies on issues that concern them. Future research could furthermore investigate the role that trade unions could play as potential change agents. Prominent shareholder activists are of the opinion that local trade unions are missing "a great opportunity" to exercise their power as shareholders by questioning management on remuneration-related matters (Mathews and Hasenfuss, 2013).

End Notes

1. Impact investing is an RI strategy that refers to investments in social and/or environmental purpose-driven enterprises that address social and/or environmental causes by applying market-based strategies in sustainable business models that can deploy and provide both financial returns and social and/or environmental impact. This strategy entails investment in the real economy. Investors who employ a positive screening strategy focuses on the selection of securities that meet a defined set of ethical and/or ESG criteria. This is in contrast to an ethical exclusions strategy where investors use negative (exclusionary) screens to avoid investments in morally undesirable countries, industries and companies.

Biographical Notes

Suzette Viviers is a professor in the Department of Business Management at Stellenbosch University. Her PhD centred on the financial performance of socially responsible investment funds in South Africa. In subsequent studies she has focussed on different aspects of responsible investing such as the definition, strategies, drivers, barriers and enablers. Of late, she has investigated various public and private mechanisms employed by institutional investors to influence the policies and practices of local companies.

Gideon Els was until December 2016 associate professor in the Department of Finance and Investment Management at the University of Johannesburg (UJ). In January 2017 he was seconded as associate professor to the School of Accountancy at UJ. He holds doctoral qualifications in Quantitative Economics from the Rand Afrikaans University and Auditing from the UJ. His research interests include Business History and Research Methodological aspects. He is also a part-time organist, conductor and arranger.

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