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Book Review: Responsible Investment

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Defined broadly, “socially responsible investment” (SRI) is a financing process that considers the social, environmental and ethical consequences of investments and loans. SRI is also sometimes known as “ethical investment” or “sustainable finance”. In recent years, investors such as pension trusts and mutual funds have begun to pay more attention to the environmental and social behaviour of companies they finance. The SRI sector has emerged from its obscure origins as church-based activism with single-issue preoccupations into a broad coalition for socially, ethically and environmentally responsible financing.¹ The SRI sector challenges the traditional modes of financial decision-making that do not necessarily account for these concerns.

In Responsible Investment, editors Rory Sullivan and Craig Mackenzie bring together an array of practitioners, consultants and commentators in the field of SRI to assess the state of this market, its governance and regulation, and challenges to making SRI a mainstream investment approach. Though the anthology comprises mostly discrete case studies, rather than a sustained and in-depth theoretical analysis, Responsible Investment nonetheless provides a reasonably coherent scholarly account of many of the pressing issues in SRI and its governance.

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Rory Sullivan and Craig Mackenzie both work for Insight Investment, and have each accumulated extensive experience in the SRI industry as advisers and consultants. Over thirty other contributing writers feature in Responsible Investment, including such luminaries as Matthew Kierman of Innovest, The Rise of Fiduciary Capitalism authors Jim Hawley and Andrew Williams, Bob Monks of Lens, and the prolific SRI commentator and fund manager, Russell Sparkes.

Responsible Investment is a fairly balanced assessment of SRI, elucidating the strengths of socially responsible investing while also highlighting its weaknesses as a means of changing corporate behaviour. Sullivan and Mackenzie frame the book with a set of core questions, including whether SRI actually improves corporate governance and corporate social, ethical and environmental behaviour, and whether SRI enhances financial returns for investors. They also enquire to what extent it is in investors’ interest to encourage higher standards of corporate social responsibility. While the second of these questions has received much attention in the extant literature, the first and third questions, also very relevant, have been mostly shunned.

The book’s thirty-three chapters are organized into four parts. The first part introduces the key questions, traces the historical development of SRI and assesses the current prospects for investor action on corporate social and environmental performance. In perhaps the book’s most crucial chapter (2), Mackenzie argues that harmful corporate impacts on society and the environment have three main sources: market failure where social and environmental costs are “externalized” by businesses, agency problems within corporate governance, and thirdly, the bounded rationality of companies. The role and impact of SRI is then examined for how it can address these sources of corporate harm. Much of the rest of the book is devoted to how enhanced investment analysis and shareholder activism can overcome these crucible sources of harm.

The second part (chapters 4-12) canvasses the contribution of enhanced investment analysis in financial decision-making. This phrase describes the integration of social and environmental factors into financial analysis. Many contributors contend that enhanced analysis can identify opportunities to boost financial performance. However, Sullivan and Mackenzie assuage the implicit assumption advanced by many of the contributors correlating enhanced analysis with enhanced financial
performance by noting that corporate irresponsibility can also boost financial performance in the short term. For example, in the absence of government regulation or social sanctions (e.g., consumer pressure and media) to correct market failures concerning the environment, businesses have competitive incentives to exploit them. Sullivan and MacKenzie also caution that enhanced analysis is not costless, and so whatever financial benefit it offers may be outweighed by its expense. Further, and more fundamentally, the editors query whether this will have a material effect on the ultimate behaviour of corporate management.

Shareholder activism is the major theme of the final two parts (chapters 13-32). The contributors show the many ways in which corporate engagement – as shareholder activism is also known – can promote more responsible corporate behaviour. Evidence correlating active ownership with superior financial performance is also presented. For instance, Peter Frankental of Amnesty International (chapter 21) praises corporate engagement as a necessary conduit between business and activists, but he also identifies some limitations of engagement, such as its instrumental reliance on framing issues in financial terms. In the next chapter, Ralph Edmondson and Adrian Payne of British American Tobacco express frustration that SRI practitioners who rely on screens or best-in-class methods of asset selection fail to engage the company more actively. Raj Thamotheram’s “Critical perspective on activism” explains the structural and self-imposed constraints institutional investors such as pension funds experience, such as the limited capacity for activism and lack of coordination among shareowner activists.

In conclusion, Responsible Investment finds that “mainstreaming of responsible investment still has a long way to go” (p. 348). On whether SRI strategies can contribute to improved social and environmental performance by companies, the editors conclude “the case studies in this book offer encouraging evidence that shareholder activism strategies can make important contributions to addressing agency problems, bounded rationality and market failure issues” (p. 345). But they see only “limited evidence” that enhanced analysis can contribute to these goals. Shareholder activism is seen as a more promising vehicle for addressing corporate harm: it encourages “companies to deliver stronger
self-regulation, more effective governance, improved incentive structures and more rational business practices” (p. 347).

On the question of whether SRI can enhance financial performance for investors, Sullivan and Mackenzie find “some limited evidence to support a positive conclusion in this regard” (p. 346). To the extent which it is in investors’ interest to encourage superior corporate social and environmental performance, they find that “long-term, broadly-based investors do have an interest in encouraging higher standards of [corporate responsibility], but the way pension funds invest in practice may not be fully consistent with this interest” (p. 346).

*Responsible Investment* is somewhat disappointing in its insufficient analysis of how the law shapes the behaviour of investors and the SRI market. For example, the treatment of institutional investors’ fiduciary duties is sparse, and does not properly distinguish between the different formulation of those duties in the context of pension trusts, mutual funds and insurance companies (see pp. 217-19). Similarly, the construction of shareholders’ rights in corporate governance is glossed over. The issue of the democratization of the governance of financial institutions themselves is virtually ignored altogether. There is some useful discussion of Britain’s pioneering amendments to its pensions legislation to oblige trustees to report on their SRI policies, but no broader critique of the value of informational policy instruments as a means of reflexive regulation of financial markets. The Dutch Green Investment Scheme – the leading precedent for an incentive-based approach to SRI – is disregarded.

While *Responsible Investment* largely ignores the law, lawyers interested in SRI should not ignore it. Governments around the world are increasingly legislating to promote SRI, and non-state, “soft law” initiatives are emerging, such as the United Nations Principles on Responsible Investment (2006) and the Equator Principles (2003). One cannot expect to comprehend the efficacy of such reforms without concomitantly understanding the dynamics of financial markets and their impact on corporate behaviour.

*Responsible Investment* is valuable reading for all those involved in the field of socially and environmentally responsible investment, corporate governance and corporate social responsibility whether they are academics and students, or financial advisors and investors. Legal
scholars interested in SRI and corporate responsibility should welcome the interdisciplinary perspective this book adds to their doctrinal analysis. While much of the book’s content is based upon United Kingdom experience, it is generally relevant to other European jurisdictions and North America.