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# Responsible investing in South Africa

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## ABSTRACT

Given growing interest in the phenomenon of Responsible Investing (RI), both locally and internationally, the purpose of this paper is to provide an overview of the RI sector in South Africa. It focuses on the definition and characteristics of RI within the South African context; the size and nature of the local RI sector and the obstacles which impede on the growth of the local RI sector. Recommendations are made on overcoming these barriers. It is suggested that local institutional investors drive the re-branding of RI in South Africa and that more RI products be developed to cater for the diverse needs of RI investors, both locally and internationally.

## 1. INTRODUCTION

*“There are three steps in the revelation of any truth: in the first it is ridiculed; in the second, resisted; in the third it is considered self-evident.”*

This statement by German philosopher Arthur Schopenhauer (1788-1860) is particularly apt in the light of increasing calls from a new generation of investors, so-called responsible investors, to integrate ethical as well as environmental, social and corporate governance (ESG) considerations into investment analysis and decision making processes.

This phenomenon has been described under various names such as ‘ethical investing’, ‘green investing’, ‘sustainability investing’, ‘directed investing’ and ‘socially responsible investing’ (White, 1995:323; Cowton, 1998:181). In the South African context reference is also frequently made to ‘targeted investing’ (Cranston, 2004; Petersen, 2005).

Although many investors still question the rationale and effectiveness of responsible investing (RI) strategies, empirical evidence suggests that RI in developed economies is gradually moving from a fringe investment strategy to a mainstream consideration (Knoll, 2002:681; Schueth, 2003:189). A report by the US Social Investment Forum for example shows that \$2,29 trillion or nearly one out of every ten dollars under professional management in the USA in 2005 was invested on the basis of ethical and ESG criteria (Mitchell and Larson, 2006:2). This statistic represents a 260 percent absolute increase in RI over the past decade.

Strong growth has also been observed in the United Kingdom, the Netherlands, Sweden, Australia and Japan (Socially responsible investment taking root in Europe, 2002:17; Holland, 2002:49; Guay, Doh and Sinclair, 2004:126).

Although the first RI funds in South Africa were launched in 1992, the local RI sector has not been able to attract the same level of funding as compared with its international counterparts. Interest in the field is however steadily growing in South Africa due to initiatives such as the Financial Sector Charter and the FTSE/JSE Socially Responsible Investment (SRI) Index (Du Preez, 2005:35; Leeman, 2005:9).

As the purpose of research is to unlock new knowledge, the focus of this paper is to provide an overview of several facets of the South African RI sector, such as:

- the definition of RI within the South African context;
- the main RI strategies available to asset managers;
- the number of RI funds established in South Africa over the period 1 June 1992 to 31 March 2006;
- the size of the local RI sector on 31 March 2006;
- the RI strategies actually employed by local RI asset managers; and
- the obstacles which hinder the growth of the local RI sector.

Due to the nature of this study, a phenomenological research paradigm was adopted. Consequently, qualitative data was sourced by means of an extensive literature review as well as semi-structured, face-to-face interviews conducted with local RI asset managers and industry experts. The qualitative data was analysed through a process of analytical induction as proposed by Morse (1994:15) and Lindlof (1995:5).

## 2. DEFINING RI WITHIN THE SOUTH AFRICAN CONTEXT

‘Ethical investing’ suggests that investments are based on an individual’s ethical disposition which is often based on the investor’s religious convictions. Devout members

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of religious groups, such as Quakers and Methodists, were the first investors who screened their investments for moral acceptability (Schueth, 2003:189; Sparkes and Cowton, 2004:45). The concept 'ethical investing' has however increasingly been replaced by a more contemporary concept namely that of 'socially responsible investing'.

Mansley (2000:5) argues that many investors feel uncomfortable about using the word 'ethical' to describe investment matters as it carries religious or moralising overtones. Sparkes and Cowton (2004:45) further argue that some investors object to the use of the word 'ethical' as it seems to imply that mainstream approaches to investment are 'unethical'. By using the concept 'socially responsible investing', it is anticipated that some of these preconceptions will be avoided and that a broader, more positive approach to non-financial considerations will be adopted by investors.

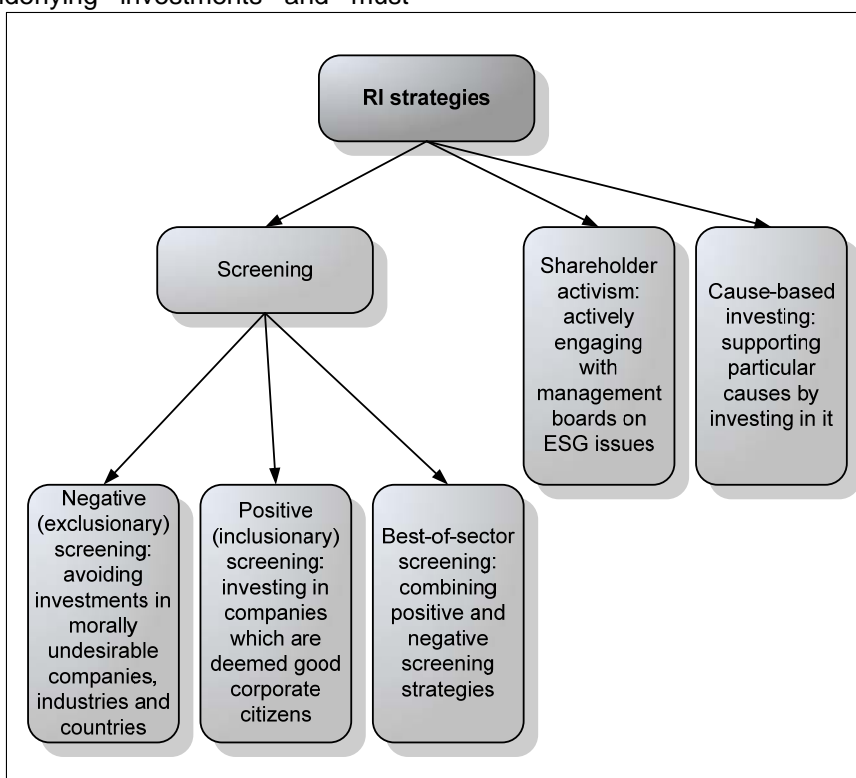
Besides ethical investing and socially responsible investing, a third concept, namely responsible investing (RI) is gaining international popularity (Ambachtsheer, Myllynen and Nuzum, 2006:1; United Nations Principles for Responsible Investment, 2006:1). In contrast to 'ethical investing', this approach is not premised on religious or moral principles but rather on the belief that ESG risks can affect the performance of underlying investments and must

therefore be managed systematically. This notion emphasises the importance of sustainable business practices such as the sustainable use of resources and the dynamic management of reputational risks (Tranchimand, 2006:4). The concept RI will thus be used in this paper given the prominence thereof in the international arena.

RI experts in South Africa point out that confusion exists on the role that Broad-Based Black Economic Empowerment (BBBEE) ought to play in defining and operationalizing RI activities in South Africa (Leeman, 2005:9; Heese, 2005:730; Petersen, 2006:9). The authors are of the opinion that BBBEE forms an integral component of RI as it represents a "social" consideration along with other social, environmental and corporate governance (ESG) concerns. As will be pointed out in the following section, social factors often serve as the basis for the formulation positive investment screens, shareholder engagement agendas and cause-based investment mandates.

### 3. OVERVIEW OF RI STRATEGIES

Responsible investors can employ one or more of the strategies illustrated in Figure 1.



**FIGURE 1: Prominent RI strategies**  
Source: Researchers' own construct

Each of these strategies will now be discussed in more detail.

### 3.1 Negative (exclusionary) screening

As indicated earlier, members of religious groups were the first investors who avoided investments in so-called 'sin shares', that is securities of companies associated with, amongst others, the production and/or sale of alcohol, tobacco, firearms and weapons as well as those involved with gambling (Sparkes and Cowton, 2004:46; Guay *et al.*, 2004:126). Many still do so today.

Detailed investment guidelines and criteria regarding 'acceptable investments' are outlined on websites tailored to the needs of members of several denominations within the Christian faith (Ethical considerations for Quaker investors, 2001; Crosswalk.com, 2007; Christian Investment Services, 2007). Similar websites exist for Jewish and Islamic investors who wish to invest according to the tenets of their faith (Religious Action Centre for Reform Judaism, 2007; iHilal Financial Services, 2007)

Some Islamic investors screen companies based on Shari'ah principles which are in accordance with Islamic law and generally exclude companies associated with alcohol, gambling, pornography, non-Halaal foodstuffs (such as pork), tobacco, firearms, weapons and entertainment. Shari'ah compliant funds also exclude financial institutions as the Qur'an expressly prohibits any association with the charging of interest or usury (The Institute of Islamic Banking and Insurance, 2007). In similar fashion, Shari'ah compliant funds also excluded companies with high levels of financial leverage (gearing), debtors and interest income. As will be indicated later, several local RI funds employ a negative screening strategy based on Shari'ah principles.

Other (non-faith based) responsible investors screen potential investments for highly specialised issues (e.g. uranium) or cater for the concerns of specific groups such as animal rights activists (Whitten, 2004:20). In the 1970s and 80s screens with a political motivations, like an anti-South Africa screen, were developed. This screen was the most prominent exclusionary screen used in developed economies such as the USA, UK, the Netherlands and Japan in the 1970s and 80s (Rudd, 1979:5; Posnikoff, 1997:76; Teoh, Welch and Wazzan, 1999:35).

An ethical case for an avoidance strategy follows from the *prima facie* argument that holding a share in a company suggests approval of their activities, and that approving an immoral action is immoral (Larmer, 1997:397). By owning a security and earning a return from it, a shareholder thus indicates some acquiescence or support for the activities of the company in question. Mills (1996:3) follows the same

line of thought when stating that "...the righteousness of any monetary return is conditional upon the absence of the exploitation of customers, workers, creditors and suppliers".

A major drawback of an exclusionary screening strategy is that it reduces efficient portfolio diversification (Knoll, 2002:686; Sparkes and Cowton, 2004:55). This drawback is of particular concern for South African investors given the relatively small size of the Johannesburg Securities Exchange (JSE) compared with global securities exchanges (Leeman, 2003:6). Baue (2002) explains that the exclusion of certain JSE-listed companies or entire sectors will significantly reduce investors' ability to diversify their portfolios.

In dealing with this problem, investors typically use a maximum percentage, say ten percent, of a company's sales turnover in a problem area as an exclusionary threshold. According to Sparkes and Cowton (2004:45), the use of such an acceptability threshold, which essentially entails a value compromise, poses a problem in principle. They argue that the use of an arbitrary cut-off point, rather than absolute avoidance, in effect condones the presence of certain apparently undesirable attributes in an investment portfolio.

Responsible investors might also use 'case specific' exclusionary screens to limit the adverse effect of screening on diversification, animal testing being a case in point. They might, for example, shun cosmetic companies that conduct animal testing but could include pharmaceutical companies that undertake animal testing in the development of potentially life-saving drugs. In cases where animal testing is unavoidable, responsible investors typically require that it be done in a humane manner (Selcraig, 2006:102).

A second major criticism of exclusionary screening is that ostracising 'bad companies' does not necessarily reform them. From a theoretical perspective it could be argued that exclusionary screening would raise a company's cost of capital (as fewer investors are willing to provide capital to the company) thus lowering its value (Reilly and Brown, 2000:797). Heinkel, Krauz and Zechner (2001:431) however found that excluding polluting companies from portfolios did not persuade them to reform as the cost of environmental reform out-weighed the capital cost of being eschewed.

A further disadvantage of using an exclusionary approach to RI lies in its subjective nature i.e. 'sin lies in the eye of the beholder'. To illustrate the arbitrary nature of negative screening, Belsie (2001:20) shows that some RI funds exclude tobacco manufactures but not the producers of cigarette-rolling paper. A critic of exclusionary screening contends that the boundary lines of negative screening can be drawn so sharply that "... all one would ultimately invest in would be

environmentally friendly factories where nuns make choir robes" (Belsie, 2001:22).

Despite the shortcomings of negative screening, it remains the basic approach used by most RI asset managers in the USA and UK (Schueth, 2003:189).

### 3.2 Positive (inclusionary) screening

In contrast to exclusionary screening, investors who use a positive screening approach to RI strive to include the securities of companies in their portfolios which are perceived to be reputable as good corporate citizens. Exactly how 'good corporate citizenship' is defined and measured has long been the focus of debate. Empirical research by Aupperle, Carroll and Hatfield (1985), Wartick and Cochran (1985) and Graves and Waddock (1994) led to the development of several multi-attribute research instruments to evaluate companies' products, policies and procedures with regard to a range of ethical and ESG considerations.

A number of stock market indices, such as the FTSE4GOOD series, the Dow Jones Sustainability Indexes and the KLD indices, have also been developed to screen companies on as many as 300 different ESG criteria (FTSE4GOOD Indices, 2007; Dow Jones Sustainability Indexes, 2007; KLD Indexes, 2007). In similar vein the FTSE/JSE SRI index was launched in South Africa in 2003 (FTSE/JSE SRI Index, 2007).

Ambachtsheer *et al.* (2006:9) point out that no definitive list of ESG issues exists globally, but argue that positive screens typically display features such as:

- a public-concern focus;
- a medium or long-term time horizon;
- qualitative objectives that are not readily quantifiable in monetary terms; and
- externalities (i.e. costs borne by other firms or by society at large) which are not well captured by market mechanisms.

A global survey revealed that investment professionals perceived globalisation, corporate governance and terrorism as the most important ESG screening criteria in 2005 whereas environmental concerns were anticipated to feature more prominently as positive screening criteria by 2010 (2006 Fearless Forecast: What do investment managers think about responsible investment?, 2006:5).

The King II report on corporate governance in South Africa (2002:31) provides valuable insights into what constitutes good corporate citizenship in this country. The report identifies socially responsible businesses

as "...those well managed companies which are aware of, and respond to social issues, and place a high priority on ethical standards". The report suggests that businesses' ESG responsibilities should incorporate issues such as corporate values, human rights, animal rights, HIV/AIDS, environmental protection, supply chain integrity, product life cycle impacts, occupational health and safety, BBBEE, diversity, community rights, employee satisfaction, corporate social investment and the development of intellectual capital.

Investors who apply positive screens often argue that companies which are good corporate citizens tend to be more profitable than companies that fail to take cognisance of or act upon the needs of their stakeholders. They claim that responsible companies avoid expensive fines and litigation and benefit from higher levels of customer loyalty, better relations with suppliers as well as more dedicated and productive employees (McWilliams and Siegel, 2000:603; Hillman and Keim, 2001:125; Orlitzky, Schmidt and Rynes, 2003:409).

Despite the growing appeal of positive screening, a number of weaknesses of this approach also need to be highlighted. Positive screening is more difficult to administer than exclusionary screening as investors cannot simply look at the products or services of a business to determine its suitability, but need to examine its corporate policies and practices on a variety of ESG issues. To do so investors need access to information which is often not available to the public or is in a format that is difficult or expensive to analyse (Kinder and Domini, 1997:12).

Yet another drawback of positive screening is that once investors have evaluated non-financial corporate performance, they are often left balancing performance across diverse areas. For example, a company might perform very well in some areas (such as environmental management) but may perform very poorly in other areas (say labour relations) (Knoll, 2002:683). Finally, RI experts point to the time factor involved in screening and monitoring non-financial corporate performance (Personal communications Adsetts and Davids, 2006). As "someone has to foot the bill" RI funds generally exhibit higher expense ratios as compared with conventional funds (Sauer, 1997:137; Cowton, 1998:190; Bauer, Koedijk and Otten, 2005:1755; Ambachtsheer and Steward, 2006:19).

### 3.3 Best-of-sector screening

According to Bauer, Otten and Rad (2006:11) a best-of-sector (also called best-in-class) approach combines positive and negative screening on a sector basis. Using such an approach implies that a full universe of companies is evaluated against some key criteria allowing investors to select the top ranked company or companies across sectors, even though some might be deemed 'undesirable' from a negative screening point of view (De Cleene, 2002:17). As

such, investors can include the securities of companies in their portfolios which are taking decisive actions to improve their non-financial (ESG) performance across the board (Solomon, Solomon and Norton, 2002:3). In evaluating ESG performance, investor could use techniques associated with positive screening, such as multi-attribute checklists and establishing whether a specific company features in RI indices, such as the FTSE/JSE SRI index.

Bauer *et al.* (2006:11) argue that the best-of-sector approach has mainly been developed to overcome the difficulty which most asset managers face when trying to limit deviations from a general benchmark (i.e. tracking error). By including securities from companies across economic sectors, a best-of-class approach leads to smaller sector biases and thus more efficient portfolio diversification. This approach is particularly suitable for the South African RI sector given the relatively small size of the JSE compared with global stock exchanges and the dominance of a few large companies.

Cowton (1998:183) shows that responsible investors in the UK tend to favour a best-of-sector approach as do responsible investors in Western Europe (Tranchimand, 2006:4). The main criticism against the application of a best-in-sector approach is that resultant portfolios are morally 'tainted' in that they contain securities of 'undesirable' companies next to morally acceptable ones (Sparkes and Cowton, 2004:46).

Along with the growth of positive and best-of-sector screening approaches, many contemporary RI practitioners are also increasingly becoming 'engaged shareholders'. This concept, which attempts to promote social change by influencing corporate decision making, will now be presented.

### 3.4 Shareholder activism

Shareholder activism, also called 'active engagement', refers to shareholders communicating with management boards on specific ESG issues. Investors can do so through dialogue, by filing resolutions, using their voting rights at annual general meetings and divesting from companies that fail to transform (De Cleene and Sonnenberg, 2004:6).

A report by the UK Social Investment Forum indicates that active engagement strategies are becoming more commonplace among institutional investors across the globe (Walker, Desgagniers and Walmsley 2007:i). According to a 2006 European RI survey, the use of an engagement strategy was also the most prevalent among responsible investors in Europe (Tranchimand, 2006:10). More support for this approach to RI is foreseen in the global arena as active ownership forms a cornerstone of the United Nations Principles for Responsible Investment (2006:4).

As a signatory of the United Nations' Principles, the South African Government Employees Pension Fund (GEPF) has indicated that it will start using its financial power to "...force corporate South Africa to shape up in areas of good governance, social responsibility and environmental protection" (Cameron, 2006). The GEPF has the potential to exert enormous influence on corporate decision making in South Africa as it controls almost half of the total retirement savings of the country.

The main shortcoming of a shareholder activism approach is that, in order for it to be effective, shareholders need to have a significant stake in a company. As such, this approach calls for the support of large institutional investors such as pension funds, insurance companies and commercial banks. With the GEPF taking the lead in South Africa, it is foreseen that many more institutional investors will become active shareholders in the near future. A second problem associated with shareholder activism relates to the time and resources required to analyse companies' products, policies and practices with regard to ESG considerations, to obtain support for resolutions, to attend meetings and to formulate policies on issues of materiality (Personal communication Canter, 2003; Personal communication Davids, 2006).

Another mainstream RI strategy, and one that is of particular importance within the South African context, is that of cause-based (targeted) investing.

### 3.5 Cause-based (targeted) investing

Whereas screening and shareholder activism strategies deal with secondary investments in existing financial securities, cause-based investing involves direct investments in the 'real economy'. This approach refers to supporting a particular ESG (including BBBEE) causes by financing it (Schueth, 2003:191).

Leeman (2005:9) classifies cause-based investments as **primary investments** since they have a powerful and visible impact on the economy in terms of infrastructural development and job creation. Although **secondary investments** do not directly benefit local communities, they still give investors the power to influence corporate decision making in favour of improved ESG policies and practices.

Cause-based investors generally seek a financial return equal to market rates, although some investors may accept marginally lower returns in order to support a particular cause. In South Africa, the National Treasury stipulates that cause-based (targeted) investments are only acceptable investment vehicles for pension funds if they offer inflation-linked returns (Petersen, 2005).

Several authors show that cause-based (targeted) investing is a RI strategy that is increasingly being supported by institutional investors in developed countries (O'Reilly, 2001:19; Beckwith, 2004). According to Mitchell and Larson (2006:2) cause-based investing in the USA has nearly quintupled since 1995.

Despite the dire need for greater cause-based investing in South Africa, many local institutional investors are still reluctant to make such investments. They cite a number of reasons ranging from the lack of viable opportunities to the illiquid and long-term nature of such investments (Wierzycka, 2004; Personal communication Canter and Dinan, 2003; Davids, Sonnenberg and Adsetts, 2006). These problems mainly originate from the fact that cause-based (targeted) investments are often private equity based (Bacher, 2004:4; Segal, 2004:6; Social responsibility must be put on agenda, 2005). Private equity investments also carry a much higher risk of default. In this regard Barrow, Brown and Clarke (2001:198) estimate that approximately one third of all private equity investments are failures, another third merely produce enough profits to survive, a further 25 percent only offer modest returns and a meagre 10 percent of all private equity investments generate superior returns.

#### 4. THE DEVELOPMENT OF RI FUNDS IN SOUTH AFRICA

Prior to the commencement of this research the population of RI funds in South Africa was unknown and thus had to be constructed. For the purpose of the study a RI fund was defined as "...any local collective investment scheme that employs a screening, shareholder activism and/or cause-based (targeted) investment strategy". The population was compiled based on an extensive literature review and interviews conducted with local RI asset managers and industry experts.

As indicated in Figure 2, the first two RI funds in South Africa were launched in June 1992. Up to 31 March 2006 (the cut-off date for this research) a further 41 local RI funds were established. During this period eight local RI funds were discontinued i.e. they were either closed or merged with other funds at some point before the 31<sup>st</sup> of March 2006. In some cases the investment mandates of funds also changed substantially, so much so that they could no longer be classified as RI funds.

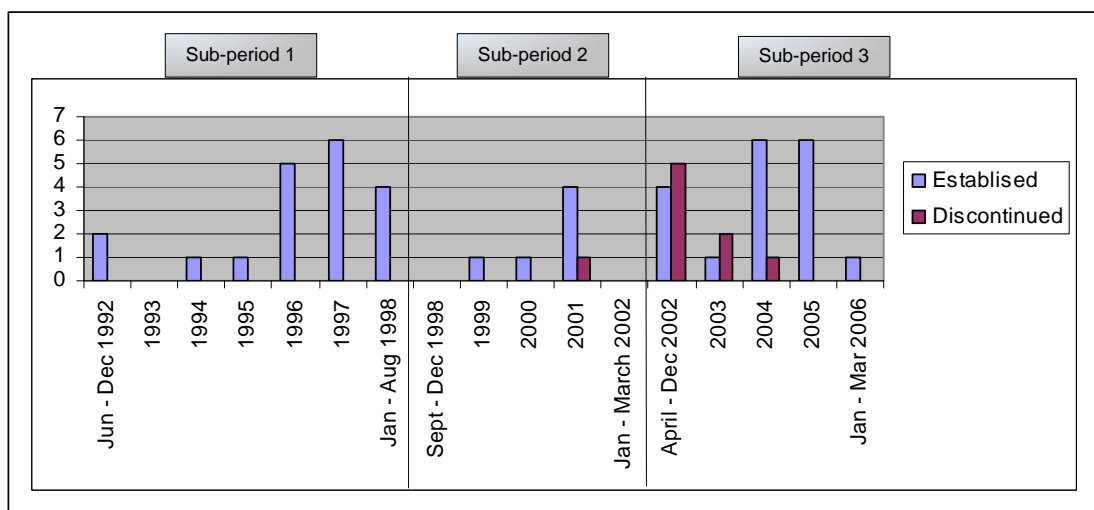


Figure 2: RI funds established and discontinued over the period 1 June 1992 to 31 March 2006  
Source: Researchers' own construct

As shown in Figure 2, three distinct sub-periods can be identified in the history of the local RI sector, namely:

- Sub-period 1: the **establishment period** (1 June 1992 – 31 August 1998);
- Sub-period 2: the **decline period** (1 September 1998 – 31 March 2002); and
- Sub-period 3: the **resurgence period** (1 April 2002 – 31 March 2006).

During the establishment period, 19 RI funds were launched, followed by only six RI funds in sub-period two. This decline can be attributed to the collapse of several special purpose empowerment vehicles after the market crash of August 1998 (Bridge, 1999). Improved economic conditions, rising commodity prices and property values led to renewed confidence in the economy as well as the establishment of 18 new RI funds in sub-period three.

Tables 1 and 2 provide a breakdown of the total population of RI funds established in South Africa as on 31 March 2006.

It can be seen from Tables 1 and 2 that almost one third (30,2%) of local RI funds are (or were in the case of discontinued funds) classified as **unit trusts**, 48,8 percent as **pooled funds other than unit trusts** and 4,65 percent as **segregated funds**. In seven cases (16,3%) it could not be established whether the RI funds were pooled or segregated in nature. Most of these funds were discontinued at some point before

the 31<sup>st</sup> of March 2006 which complicated the verification of fund particulars.

In terms of first-tier classification, only one fund, the Oasis Crescent International Fund of Funds, is classified as a **foreign** fund, whereas the rest of the funds are (were) classified as **domestic** funds. Domestic funds invest at least 85 percent of their assets in South African financial markets at all times, whereas foreign funds invest 85 percent of their assets outside South Africa at all times (Oldert, 2006:85).

**Table 1: Salient features of RI unit trusts**

Fund name	Status <sup>(a)</sup>	Classification <sup>(b)</sup>	Date of inception	Date of discontinuance
Community Growth Equity Fund	A	D-E-G	1 Jun 1992	-
Community Growth Gilt Fund	A	D-F-B	14 Jul 1998	-
Fraters Earth Equity Fund	A	D-E-G	4 Oct 2001	-
Fraters Flexible Fund	A	D-AA-F	15 Oct 2001	-
Fraters Islamic Equity Fund	A	D-E-G	1 Feb 2006	-
Fraters Real Income Fund	A	D-AA-TARR	9 Oct 2002	-
Futuregrowth Albaraka Equity Fund	A	D-E-G	1 Jun 1992	-
Nedbank Sustainability Investing Index Fund	D	D-E-G	6 Aug 2002	31 Oct 2003
Oasis Crescent Equity Fund	A	D-E-G	31 Jul 1998	-
Oasis Crescent International Fund of Funds <sup>(c)</sup>	A	F-E-G	28 Sep 2001	-
Sanlam Empowerment Equity Fund	D	D-E-V	15 Sep 1997	30 Apr 2003
Sasfin Socially Responsible Fund	A	D-E-V	14 Oct 2005	-
Sasfin TwentyTen Fund	A	D-E-G	1 Nov 2005	-

(a) A = Active; D = Discontinued

(b) D = Domestic; F = Foreign; E-G = Equity-General; E-V = Equity Varied Specialist; AA-F = Asset Allocation-Flexible; AA-TARR = Asset Allocation-Target Absolute and Real Return; F-B = Fixed Interest-Bond

(c) This fund also called the Oasis Crescent International Feeder Fund

Source: Viviers (2007)

More than a third of the local RI funds (40%) can be classified as asset **allocation (balanced)** funds, 30 percent as **equity** funds and 21 percent as **alternative (private equity)** funds. Three local RI funds can be classified as **fixed interest** funds and only one fund invests primarily in **real estate**.

## 5. THE SIZE OF THE LOCAL RI SECTOR

Establishing the exact size of the RI sector in South Africa is complicated given the diverse definitions of RI used by research agencies and practitioners. The best estimate therefore is that RI funds represent approximately R18 billion or 0,7 percent of the total investment capacity in South Africa (Alexander Forbes Asset Consultants Targeted Development Investment Vehicles Manager Watch Survey September 2006, 2006). It should however be noted that this figure excludes multi-managers and private equity funds.

Despite the lack of more accurate data, it is still clear that the local RI sector is significantly smaller than its counterparts in developed economies.

## 6. RI STRATEGIES EMPLOYED BY LOCAL RI ASSET MANAGERS

The RI strategies employed by local RI funds were determined by carefully analysing the each funds' investment objectives. As indicated in Table 3 more than half of the local RI funds employ (or employed in the case of discontinued funds) a cause-based (targeted) investing strategy, either on its own or in combination with other RI strategies.

Closer analysis reveals that local RI funds which have a cause-based (targeted) investment mandate mainly invest in companies and projects which promote BBBEE and social infrastructure development, such as the provision of housing, roads, electrification etc.

Nine local RI funds screen companies' products, policies and practices on a variety of ESG factors before investing in their financial securities. The following ESG screens featured prominently:

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- management's commitment to combating unethical behaviour such as discrimination, bribery, corruption and extortion;
- the company's commitment to ethical marketing practices;
- managerial support of small business development projects;
- the percentage of equity candidates at board level;
- the firm's progress in the recruitment, training and promotion of equity candidates at different managerial levels;
- the extent to which the company procures goods and services from its local community;
- sound environmental practices;
- respect for human rights; and
- equal opportunities in society, especially in areas that require an acceleration process with regards to skills development.

**Table 2: Salient features of other pooled (non-unit trust) and segregated RI funds**

Fund name	Status <sup>(a)</sup>	Classification <sup>(b)</sup>	Date of inception	Date of discontinuance
African Harvest Infrastructure Bond Fund	A	S-D-F	1 Jan 2001	-
AIIF African Infrastructure Investment Fund	A	P-D-ALT	2003	-
AIIF South African Infrastructure Fund	A	P-D-ALT	1996	-
AMB Empowerment Equity Fund	D	D-E <sup>(c)</sup>	1 Apr 1997	31 Dec 2002 <sup>(d)</sup>
Community Growth Equity Fund of Funds	A	P-D-AA	1 Apr 2005	-
Futuregrowth Anchor Fund	D	P-D-E	1 Jul 1997	31 May 2004
Futuregrowth Community Property Fund	A	P-D-Prop	1 Jul 1996	-
Futuregrowth Diversified Development Fund	D	P-D-AA	1997	31 Jul 2001
Futuregrowth Infrastructure Bond Fund	A	P-D-F	1 Jan 1994	-
Futuregrowth RI Balanced Fund	A	P-D-AA	30 Sep 2004	-
Futuregrowth RI Equity Fund	A	P-D-E	1 Jul 2004	-
Futuregrowth Structured Empowerment Fund	A	P-D-ALT	1 Oct 1995	-
Investec Mafisa Fund	D	D-ALT <sup>(c)</sup>	1 Oct 1997	31 Aug 2002 <sup>(d)</sup>
Investec Sechaba Fund	D	D-ALT <sup>(c)</sup>	1 Aug 2000	31 Aug 2002 <sup>(d)</sup>
Investec RI Life Fund	A	S-D-ALT	17 Oct 2005	-
Investment Solutions Sakhisizwe Fund	A	P-D-ALT	1 Nov 2004	-
Investment Solutions Shari'ah Fund	A	P-D-ALT	1 Apr 2005	-
Metropolitan Futurebuilder	A	P-D-AA	1 Oct 1996	-
Metropolitan RI Fund	A	P-D-AA	1 Dec 2005	-
Momentum Supernation Fund	A	P-D-AA	1 Oct 2002	-
OMAM IDEAS Fund	A	P-D-ALT	1 Jan 1999	-
Prodigy Transformation Fund	A	D-ALT <sup>(c)</sup>	1998	-
Rocklands Growth and Development Fund	A	D-ALT <sup>(c)</sup>	2004	-
Rocklands Social Responsible Balanced Fund	A	D-AA <sup>(c)</sup>	2004	-
Rocklands Social Responsible Private Equity Fund	A	D-ALT <sup>(c)</sup>	2004	-
Sanlam Community Builder Fund	A	P-D-AA	1 Jan 1996	-
Sanlam Development Fund	A	P-D-ALT	1 Nov 1996	-
Sanlam Development Fund of Funds	A	P-D-ALT	1 Jul 2002	-
STANLIB Corporate Wealth Development Fund	A	P-D-AA	1 Jan 1997	-
TopGEAR Fund	D	P-D-AA	1 Feb 1998	30 Sep 2002 <sup>(d)</sup>

(a) A = Active; D = Discontinued

(b) P = Pooled; S = Segregated; E = Equity; AA = Asset Allocation; F = Fixed interest; ALT = Alternative; Prop = Property

(c) It could not be established whether these funds were pooled or segregated funds

(d) As the exact date of discontinuance could not be established, the date on which the fund was excluded from the AFAC TDI Manager Watch Survey serves as proxy

Source: Viviers (2007)

Table 3: RI strategies employed by South African RI asset managers

Type of RI strategy employed	%	RI fund names
Cause-based (targeted) investing	27,91	1. AIIF South African Infrastructure Fund 2. AIIF African Infrastructure Investment Fund 3. AMB Empowerment Equity Fund 4. Futuregrowth Community Property Fund 5. Futuregrowth Diversified Development Fund 6. Futuregrowth Infrastructure Bond Fund 7. Futuregrowth Structured Empowerment Fund 8. Investec Mafisa Fund 9. Investec Sechaba Fund 10. Investec SRI Life Fund 11. OMAM IDEAS Fund 12. Prodigy Transformation Fund
Positive (inclusionary) screening	20,93	1. African Harvest Infrastructure Bond Fund 2. Community Growth Fund of Funds 3. Community Growth Gilt Fund 4. Futuregrowth Anchor Fund 5. Futuregrowth SRI Equity Fund 6. Nedbank Sustainable Investment Index Fund 7. Sanlam Empowerment Equity Fund 8. Sasfin Socially Responsible Fund 9. Sasfin TwentyTen Fund
A strategy combining cause-based (targeted) investing and positive screening	18,60	10. Futuregrowth SRI Balanced Fund 11. Metropolitan Futurebuilder Fund 12. Metropolitan Socially Responsible Investment Fund 13. Sanlam Community Builder 14. Sanlam Development Fund 15. Sanlam Development Fund of Funds 16. STANLIB Corporate Wealth Development Fund 17. TopGEAR Fund
A strategy combining cause-based (targeted) investing with two other SRI strategies	9,30	18. Investment Solutions' Sakhisizwe Fund 19. Rocklands Growth and Development Fund 20. Rocklands Social Responsible Balanced Fund 21. Rocklands Social Responsible Private Equity Fund
Negative (exclusionary) screening	9,30	1. Futuregrowth Albaraka Equity Fund 2. Investment Solutions Shari'ah Fund 3. Oasis Crescent Equity Fund 4. Oasis Crescent International Fund of Funds
Shareholder activism	6,98	5. Fraters Earth Equity Fund 6. Fraters Real Income Fund
A strategy combining shareholder activism and positive screening	4,65	7. Momentum Supernation Fund 8. Community Growth Equity Fund
A strategy combining shareholder activism and negative screening	2,33	1. Fraters Islamic Equity Fund
<b>Total</b>	<b>100</b>	<b>43</b>

Source: Viviers (2007)

Given the time and cost associated with positive screening, three "positive screening" RI funds opted to track the FTSE/JSE SRI Index. This index addresses issues relating to the three pillars of the triple bottom line (economic, social and environmental sustainability) as well as companies' adherence to the principles of fairness, accountability, responsibility and transparency (FTSE/JSE SRI Index, 2007).

The combination of a cause-based (targeted) investment strategy with a positive screening approach makes intuitive sense given the overlapping nature of the ESG issues supported and evaluated within the South African RI sector, most of which centre on the

promotion of BBBEE and social infrastructural development.

De Cleene (2002:52) warns that greater diversification of positive screening criteria is required in South Africa to enable RI to sustain itself and suggests the inclusion of more environmental screens such as alternative technologies, waste minimisation, water management and land biodiversity. This suggestion by De Cleene (2002:52) is of critical importance and strongly supported by the authors.

A number of local RI funds also employ a negative (exclusionary) screening strategy which is based on

Shari'ah (Islamic law) principles. One asset manager cautioned that the performance of local Shari'ah funds should not be compared directly with one another as different Shari'ah advisory boards formulate different criteria for 'acceptability' (Personal communication Craig, 2006). An analysis of Table 4 reveals that this is indeed the case.

All of the funds launched and managed by Frater Asset Management employ a shareholder activism strategy (either on its own or in combination with another RI strategy). This asset management company, which is pioneering shareholder activism in South Africa, promotes an awareness of corporate social responsibility, including environmental management, economic empowerment and corporate governance, through constructive engagement with the management boards of the companies in which they invest (FundsData, 2006; Frater Asset Management corporate website, 2006; Personal communication Craig, 2006).

### 7. OBSTACLES TO GROWING THE LOCAL RI SECTOR

The relatively small size of the local RI sector and the lack of interest among institutional investors, can be attributed to, amongst others (Viviers, 2007):

- negative perceptions regarding the historic performance of local RI funds (De Cleene and Sonnenberg, 2004; Hirsh, 2005, Thomas, 2004; Personal communication Forster and Mafolo,

- 2003);
- the lack of a proper definition of RI in the South African context, particularly in terms of its relationship to the promotion of BBBEE (Du Preez, 2005:39; Leeman, 2005:9; Wierzycka, 2004; Heese, 2005:730; Petersen, 2006:9);
- the lack of clarity regarding proposed amendments to pension fund legislation (Rose, 2004:15; De Cleene and Sonnenberg, 2004:x; Strong investment case for SRI, 2005:58; Wierzycka, 2004, 2005: Personal communication Jackson, 2003);
- the lack of new RI opportunities, asset classes and RI funds (Social responsibility must be put on agenda, 2005; De Cleene and Sonnenberg, 2004:x; Personal communication Plaistowe, Canter and Dinan, 2003; Personal communication Davids and Adsetts, 2006);
- the lack of RI expertise among local asset managers and investment analysts, particularly with regard to cause-based (targeted) investing (Horsley, 2004:35; Healing, 2005:18; Personal communication Adsetts, Davids and Johnston, 2006; De Cleene and Sonnenberg, 2004:x); and
- the lack of appropriate benchmarks (Leeman, 2003; Du Preez, 2005:38; De Cleene and Sonnenberg, 2004:x).

**Table 4: Negative screens employed by local Shari'ah compliant RI funds**

RI fund name	Alcohol	Gambling	Non-Halal foodstuffs	Financial institutions	Pornography	Tobacco	Weapons	Entertainment	High levels of gearing, debtors and interest earnings
Fraters Islamic Equity Fund <sup>(a)</sup>	✓	✓	✓	✓		✓	✓	✓	
Futuregrowth Albaraka Equity Fund	✓	✓	✓	✓					
Investment Solutions Shari'ah Fund	✓	✓	✓	✓		✓	✓		✓
Oasis Crescent Equity Fund	✓	✓	✓	✓	✓	✓	✓		✓
Oasis Crescent International Fund of Funds	✓	✓	✓	✓	✓	✓	✓		✓

(a) This fund also employs a shareholder activism strategy  
Source: Viviers (2007)

Some of these impediments to RI are not entirely unique to South Africa as a lack of expertise and concerns regarding fiduciary obligations among institutional investors have also been identified by the World Economic Forum as barriers to the wider adoption of RI principles globally (Mainstreaming Responsible Investment, 2005:10).

As a full description of these impediments to the growth of the local RI sector is beyond the scope of this article, only the most important one, namely negative perceptions regarding the risk-adjusted performance of local RI funds, will be highlighted. A study by Viviers (2007) indicates that the negative perceptions regarding the risk-adjusted performance of local RI funds are unjustified. Viviers' analysis of 24

local RI funds over the period 1 June 1992 to 31 March 2006 indicate that the risk-adjusted performance of local RI funds is not significantly different from the RI funds' respective benchmark indices, a sample of conventional (non-RI funds) and the general equity market in South Africa. These findings are similar to international research which shows that responsible investors can "do good by doing good" (Guerard, 1997a:11, Guerard, 1997b:31; Goldreyer and Diltz, 1999:23; Statman, 2000:30; Bauer *et al.*, 2005:1755; Bauer *et al.*, 2006:33). An analysis of local RI fund performance is explored in greater detail in a second paper.

### 8. CONCLUSIONS AND RECOMMENDATIONS

There is no longer any doubt that RI is a growing and increasingly important phenomenon in the international investment arena. South African investors need to take greater cognisance of this development, particularly in the light of the contribution that RI can make to the socio-economic development of South Africa. This point was also highlighted at the first South African RI roundtable in May 2007 in Cape Town and decisions were taken to address the most pressing barriers as listed in the preceding section (Responsible investing in South Africa – The way forward, 2007:2).

Steps need to be taken to define RI clearly within the South African context, particularly in terms of how it relates to the promotion of BBBEE. A re-branding of the concept is suggested to ensure that investors, particularly foreign investors, view RI in South Africa as, firstly, being aligned to established, global RI practices, but also being a means through which investors can address the socio-economic needs of South Africa. It is critical to have the buy-in of major public and private pension funds as well as stakeholders, such as the National Treasury, trade unions and professional associations in this re-branding process.

Although a cause-based (targeted) strategy is the most prevalent RI strategy employed by South African asset managers, it is recommended that more local RI funds with more assets under management should be developed given their direct impact on local communities. It is further suggested that a more diverse range of positive screening criteria be adopted in South Africa given greater emphasis to environmental management concerns.

More research and industry collaboration is also required to grow the local RI sector.

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