A Herringer, C Firer* and S Viviers

Key challenges facing the socially responsible investment (SRI) sector in South Africa

ABSTRACT

This study explores the factors that impact the growth and development of the Socially Responsible Investment (SRI) sector in South Africa. In addition it investigates the role that SRI has to play in ensuring sustainable economic growth and development for South Africa going forward. Consistent with earlier research, the study's findings suggest that there are a number of factors which directly impact the growth and development of the local SRI sector. The success of the local SRI sector is dependent on a solid understanding of the concept as well as the ability of the various stakeholders to overcome the identified challenges.

1. INTRODUCTION

> *"The defining challenge of the 21st century will be to transform the system governing markets so that they work for, rather than against, sustainability."*
>
> One Planet Business: Creating Value within Planetary Limits (2007)

One of the mechanisms which could facilitate the transformation in market governance is that of Socially Responsible Investing (SRI). Although a clear definition eludes academicians and practitioners, SRI can be broadly defined as an investment strategy that balances financial and social objectives (De Cleene & Sonnenberg, 2004:2). Socially responsible investors typically integrate ethical as well as environmental, social and corporate governance (ESG) considerations into investment analysis and ownership practices. A fundamental belief that socially responsible investors share is that the manner in which they invest matters. They argue that there is a basic conflict between making the highest possible profit for the few that have investments and building the most liveable world for the many that inhabit it (Domini, 2001:4).

Viviers (2007:365) suggests that, if properly implemented, SRI in South Africa could serve as a valuable example for other developing countries. However, much still remains to be done for this to become reality. According to Finlay (2004), SRI in South Africa is "…a big boat we're still trying to row with little oars…and we've got a long way to go before we reach the harbour gates and high seas".

The purpose of this study is to identify the key challenges facing the local SRI sector and, by engaging a variety of key stakeholders within the sector, develop a roadmap in order to overcome the identified challenges.

* Respectively Graduate School of Business, University of Cape Town, Private Bag X3, Rondebosch and Department of Business Management, Nelson Mandela Metropolitan University, PO Box 77000, Port Elizabeth 6031, Republic of South Africa.
The authors acknowledge the financial support provided by the National Research Foundation.
Email: cfirer@gsb.uct.ac.za

2. LITERATURE REVIEW

2.1 Defining SRI

Despite significant growth in the quantum of SRI research being conducted globally, the field remains characterised by a lack of consensus regarding definitions and concepts. For the purpose of this research, a comprehensive definition of SRI, similar to that of Mansley (2000:3), was adopted, namely that SRI constitutes of a set of approaches which include moral and ESG considerations along with conventional financial criteria in decisions regarding the selection, retention and realisation of particular investments.

SRI is referred to by a number of other names including 'ethical investing', 'green investing', 'targeted investing', 'values-based investing', 'sustainable investing' and more recently just 'responsible investing' (White, 1995:323; Cowton, 1998:181; Cranston 2004; Petersen, 2005).

The historic roots of SRI date back to the Quakers in the 18th century who shunned investments in alcohol, weapons and slaves. The first socially responsible mutual fund, called the Pioneer Fund, was founded in 1928 by evangelical Protestants who opposed the use of alcohol and tobacco (Becker & McVeigh, 1999:15). SRI experienced a rise in popularity during the 1960s and 1970s over issues such as environmental protection and promotion of equality rights. Thereafter movement gained substantial momentum in the late 1970s and 1980s as investors in North America, Europe and Japan divested South African stocks. Into the 1990s SRI evolved to cover a range of issues including anti-tobacco, the treatment of workers, and environmental management (Schueth, 2003:189; Heese, 2005:729).

In 2006, a global survey gauged the views of 157 investment professionals on the most important ESG criteria used at the time. At that stage they considered globalisation, corporate governance and terrorism as having the most important impact on corporate and investment performance. Environmental issues (such as water supply and quality) were seen as becoming the most important ESG criteria by 2010 (2006

Fearless Forecast: What do investment managers think about responsible investment? 2006:5). In South Africa Eccles, Nicholls and De Jongh (2008:15) found that local pension funds, asset managers and advisory service providers viewed corporate governance, infrastructure development, sustainability, black economic empowerment, gender empowerment issues and employee relations as the most important ESG issues in South Africa at present.

According to a 2008 European SRI Study (2008:52), significant growth in SRI has been noted in developed markets such as the USA, Europe, the UK and Australia. As indicated in Table 1, the European market (including the UK) is currently the largest SRI market in the international arena.

The 2007 Report on Socially Responsible Investing Trends in the United States (2007:ii) indicates that SRI is thriving in the USA and growing at a faster pace than the broader universe of all investment assets under professional management. SRI assets rose more than 324 percent from $639 billion in 1995 to $2,71 trillion in 2007. During the same period, the broader universe of assets under professional management increased less than 260 percent from $7 trillion to $25,1 trillion. From 2005-2007 alone, SRI assets in the USA increased more than 18 percent while the broader universe of professionally managed assets increased less than 3 percent.

In terms of size, SRI in emerging markets is totally insignificant. According to the International Finance Corporation only 0,1 percent or $2,7 billion of global SRI funds was invested in emerging markets in 2003, mainly Brazil and upcoming Asian markets (Baue, 2003; Balch, 2005; Responsible Investment in Focus: How leading public pension funds are meeting the challenge, 2007:4).

The origins of SRI in South Africa can be traced back to the investing practices of trade unions in the early 1990s. They refused to invest their members' contributions into companies that were supportive of the apartheid regime or that practised poor industrial relations (De Cleene & Sonnenberg, 2004:15). These early SRI vehicles focused almost exclusively on matters relating to empowerment and infrastructure provision. The overriding motivation of these funds was that previously disadvantaged individuals should receive benefits from their investments in the form of enhanced standards of living and all that this encompasses. Unfortunately the local SRI sector has not been able to attract the same level of funding as its international counterparts. The best estimates are that SRI in South Africa constitutes less than one percent of all assets under management (Viviers, 2007:53).

Table 1: Global SRI data

Region	SRI strategy	2007	Total SRI	Total SRI in Euros	% of world total
United States (2007)	Social screening Shareholder advocacy Screening and shareholder* Community investing	US$2098 US$739 (US$151) US$26	US$2 710	€1 917,30	38,63
Canada (2006)	Core SRI Broad SRI	Cnd$57,4 Cnd$446	Cnd$503.6	€333,60	6,72
Australia/NZ (2007)	Core SRI Broad SRI	Au$19,4 Au$52,8	Au$72,2	€41,4	0,83
Japan (2007)		Y840	Y840	€5,50	0,11
Europe (including the UK) (2007)	Core SRI Broad SRI	€511,7 €2 153,7	€2 665,4	€2 665,4	53,70
Total world				€4 963,2	100,00

Source: European SRI Study 2008 (2008:52)
*negative number to avoid double counting
Exchange rate as of 10/09/2008
Note: while methodologies of SRI market studies from the regional social investment fora are starting to converge, SRI practices can be quite specific from one region to another. As an example, shareholder advocacy, i.e. proposing to sponsor or co-sponsor shareholder resolution(s) based on ESG issues, is something quite specific to the US market, for both cultural and regulatory reasons. In addition, the year of the available data might differ as social investment fora such as the Responsible Investment Association of Australasia and the Social Investment Organisation of Canada only release updated data in the autumn of each year.

2.2 SRI strategies

In an effort to standardise the measurement of SRI activities in developed economies, eight common SRI strategies have been defined by European Social Investment Forum (EuroSIF). As indicated in Table 2 these strategies can be classified as either Core or Broad. According to EuroSIF, Core SRI could be perceived as the original form of SRI consisting of elaborate screening strategies based on religious and/or personal values. Many Core socially responsible investors such as individuals, churches and NGOs have been historical advocates of SRI. In contrast, Broad SRI consists of strategies such as simple screening, norms-based screening, engagement and integration. Broad SRI practitioners are mostly large institutional investors (which explains why the volume of Broad SRI is often much larger than that of Core SRI).

An increasing number of SRI fund managers in South Africa employ ethical exclusions based on Shari'ah or Islamic law, thus excluding 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 and companies with high levels of gearing, debtors and interest income (Hussein & Omran, 2005:105). Growing numbers of SRI funds and stock market indices based on Islamic, Buddhist and Hindu principles have seen the light emerging markets such as India, Malaysia, Pakistan and Bahrain (Shari'ah-compliant mutual funds growing in India, 2008; Moore Odell, 2008).

Research by Viviers, Bosch, Smit & Buijs (2008:5) indicates that the most pertinent positive screens used by local SRI fund managers centre on the promotion of black economic empowerment and social infrastructure development. The vast majority local SRI theme funds also focus on these two issues and have consequently been called 'targeted investments' by some practitioners. Although local investors have been slow to engage with boards on material ESG issues, strong growth is foreseen in this area (Cameron, 2006; Shevel, 2009). Petersen (2005) rightfully remarked that shareholder activism in South Africa has been limited to a number of highly publicised cases.

2.3 Factors influencing the demand for SRI funds

A number of factors have been identified as influencing the demand for SRI funds in South Africa, the most important being investors' concerns regarding SRI fund performance (Schröder, 2007:331; Eccles *et al*., 2008:5). International and local evidence however indicates that the risk adjusted performance of SRI funds compares favourably with conventional funds, especially over the long-term (Bauer, Koedijk & Otten, 2005:1751; Viviers *et al*., 2008:2).

Growing concern about climate change and its risk for portfolios is intensifying the interest in SRI among money managers. Investor demand is growing for portfolio opportunities in clean and green technology, alternative and renewable energy, green building and responsible property development, and other environmentally driven businesses (Report on Socially Responsible Investment Trends in the United States, 2007:5).

McLachlan and Gardner (2004:11) as well as Hutton, D'Antonio and Johnsen (1998:281) point out that socially responsible investors typically tend to be younger, better educated and higher income earners as compared with conventional investors. For these investors, their focus is not only about reducing risk and increasing returns, and it is also about meeting the expectations of society and the expression of personal values.

The balance of power among corporate stakeholders has also shifted. SRI, as an investment philosophy that intends to promote a "stakeholder" based corporate governance for the development of more social and environmental responsible companies, is becoming a strong market driver to advance good corporate governance (Christensen & Guyoton, 2004).

Mansley (2000:23) and Wilcox (2001) directly attribute the increase in the number of socially responsible investors, both institutional and individual, to the spate of corporate scandals that have occurred since the late 1990s. They observe that private investors in particular have become more interested in how their savings are invested, and have begun to question existing investment policies and practices.

Kawamura (2002) argues that corporate excellence has in the past been defined in terms of product quality, price, delivery time, and profitability. However, in the 21st century excellent companies must not only pursue economic rationality, but also social and environmental rationality. Stated differently, market valuation will reflect the relationship of companies to society, as well as their underlying integrity and ethical values. In this sense, SRI promises to be a powerful tool for redefining excellent companies in the context of their social existence.

Table 2: Core vs Broad SRI Strategies

CORE SRI STRATEGIES
Ethical exclusions: This refers to exclusions where more than two negative criteria/filters are applied (as opposed to just tobacco or weapons for example).
Positive screening: The selection within a given investment universe, of stocks of companies that perform best against a defined set of ESG criteria. This many include Best-in-Class or SRI theme funds for instance.
Best-in-Class: Approach where the leading companies with regard to ESG criteria from each individual sector or sector group are identified and included in the portfolio. (Subset of positive screening)
SRI theme funds: Thematic funds may focus on sectors such as water or energy, or issues such as the transition to sustainable development and a low carbon economy. To be considered SRI, a theme fund must show an explicit SRI motivation. Taking into account ESG considerations in the fund construction process. This requires the existence of specific mechanisms, such as the involvement of SRI expertise in stock analysis selection, the application of an ESG screen, or the management of the product by the SRI team. (Subset of positive screening).
BROAD SRI STRATEGIES
Simple screening: An approach that excludes given sectors or companies from a fund if involved in certain activities based on specific criteria, such as arms manufacture, publication of pornography, animal testing etc. If the exclusion approach is based on more than two criteria, it is considered to be an “ethical exclusion”.
Norms-based screening: negative screening of companies according to their compliance with international standards and norms such as issued by the OECD, ILO, UN, UNICEF etc. If norms-based screening is clearly based on more than two negative criteria (for instance, compliance with the 10 principles of the Global Compact), it is considered to be an “ethical exclusion”.
Engagement: A long-term process of dialogue with companies which seeks to influence company behaviour in relation to their social, ethical and environmental practices.
Integration: The explicit inclusion by asset managers of ESG risk into traditional financial analysis. Corporate Governance risk should be limited here to the interface between governance and social and environmental issues.

Source: European SRI Study 2008 (2008:54)

Indices are an important element of financial markets as they define a particular universe of securities in which an investor can trade and serve as benchmarks of performance. Notable indices in the SRI arena are the Dow Jones Sustainability Group Indices and the FTSE4Good Index Series. The FTSE/JSE Socially Responsible Investment (SRI) Index was launched in May 2004 in response to the debate around sustainability in South Africa. It was a pioneering initiative, the first of its kind in an emerging market, and the first to be launched by an exchange. As such it has led to increased attention to SRI in emerging markets like South Africa (FTSE/JSE SRI Index, 2008). The index is made up of companies that are included in the FTSE/JSE All Share Index. Participation in the screening process is voluntary, implying that companies which do not feature in the index haven’t necessarily failed to comply with the criteria.

Finally, De Cleene and Sonnenberg (2004:8) suggest that one of the most influential forces driving SRI globally has been the promulgation of legislation in Europe and Australia which requires of pension fund trustees to formally disclose the extent to which SRI and voting rights form part of their investment decisions. Because of the sheer size of pension funds, this will have a major knock-on effect for the SRI sector as a whole.

In summary, fund performance, new investor profiles, the growth of consumerism, the spate of corporate scandals, the role of business in society in the 21st century, sustainability indices and pension fund legislation have all been identified as factors that influence the demand for SRI funds.

2.4 Factors influencing the supply of SRI funds

Asset management companies offer SRI products either because of their investment philosophy or as a result of wanting to remain competitive and take advantage of investible funds with regard to a specific investment mandate. As indicated earlier, significant growth has been noted in developed economies such as Europe, the UK and the USA. According to the Finance Institute for Global Sustainability, growth is particularly evident in the number of “green” funds, with the majority being housed in Europe (IFC, 2003).

Scheuth (2003:191) claims “that the impressive growth in the US SRI sector is a direct result of increased consumerism among investors. He shows that the vast majority of the nearly 800 US investment companies that offered SRI portfolios in 2002 weren’t offering them in early 1990s, with very few expressing an interest in doing so at the same time. His research strongly suggests that most of these investment companies started developing SRI products purely as a strategy to grow their market share”.

According to Leeman (2005:9) the promulgation of the broad-based black economic empowerment (BEE) Act (Act No 53 of 2003), as well as the creation of a number of BEE sector charters and scorecards promoted SRI in South Africa. Eccles *et al.* (2008:9) however found that few local asset managers anticipated a growing requirement from institutional clients for BEE ownership as a necessary condition for investment. This could suggest a sense of optimism that there would no longer be a need for BEE ownership deals. Alternatively, it could indicate that asset managers anticipate a growing cynicism amongst investors surrounding BEE deals, particularly concerning BEE funding models and the likely impact of these on investment value.

2.5 Factors impeding the supply of SRI funds

De Cleene and Sonnenberg (2004:28) predicted that changing public sentiment, new laws, and the launch of SRI benchmark indices will encourage product innovation and further growth in the European and North American SRI sectors. Challenges impeding growth of SRI in international and South African markets are identified below. Firstly, there is no standard definition of SRI internationally (Business and Sustainable Development: A Global Guide, 2007). Several South African authors such as Wierzycka (2004), Heese (2005:729) and Du Preez (2005:32) have called for a clarification of the definition of SRI in South Africa, particularly in terms of how it relates to the promotion of broad-based BEE.

A challenge facing both the international and local SRI market is the use of short-term performance benchmarks. Since participants in pension plans, mutual funds, and insurance companies are investing to provide for their retirement or other long-term financial needs, the widespread benchmarking within the fund management sector against short-term performance benchmarks that fail to take account of social, ethical, and environmental aspects of corporate performance is increasingly out of step with underlying client interests (Mainstream Responsible Investing, 2004:19).

At present the only legislation that governs retirement fund asset allocation is regulation 28 of the Pension Fund Act (No 24 of 1956 as amended), a set of prudential investment guidelines, which stipulate that no more than 25 percent of retirement funds may be invested in private equity and no more than 75 percent into listed equities. Bonorchis (2006) and Healing (2005:18) indicate that there is broad support for the suggestion that the rules governing pension funds should be changed to encourage SRI. These authors are however quick to add that the local SRI sector is “far from ready” to take advantage of forced SRI asset allocations. To date no decision has however been taken by the National Treasury on the most appropriate action to take.

Besides the lack of regulatory clarity and support, a shortage of new SRI opportunities, asset classes and funds has also been noted as a considerable challenge to SRI growth. “A ‘lack of opportunities’ should be viewed in terms of the different social agendas which have evolved in the local SRI market over the years – some goals are too broad to appeal to the specific interest of any one group, whereas others are too narrow to attract enough support to be financially viable” (Investors must navigate minefield of socially acceptable offerings, 2003).

Financial performance is not the only challenge for the SRI sector. A whole range of funds are included in the Alexander Forbes' quarterly survey of so-called “targeted development initiatives”, which suggests that no meaningful financial benchmark exists, an issue compounded by the absence of independent verification of social returns. Not only is there a shortage of benchmarks, but a tendency in the sector to over-emphasise short-term performance.

Trustees have reportedly become increasingly impatient that empowerment funds have only benefited a small black elite group, and not their constituencies. The absence of both financial and social benchmarks and the inability to demonstrate social returns are clearly inhibiting the sector's growth (Socially Oriented Fund Review 2000: a mixed year sets an uncertain stage, 2001).

According to sector experts, one of the major obstacles in promoting SRI in South Africa, and caused-based investing in particular, relates to the lack of skills among local investment analysts and asset managers (Viviers, 2007:197). In addition she indicates that this is not limited to South Africa and argues that this variable is also one of the main inhibitors, or barrier to growth, of SRI internationally. A global report claims that the current generation of mainstream analysts is not able to factor ESG issues into their analyses as they neither understand these factors nor their relationship to the longer-term economic forces that drive individual companies and entire sectors (Mainstream Responsible Investing, 2004:18).

This report also shows that new regulations regarding trustees’ fiduciary duties, specifically the need for demonstrable compliance with clients' performance objectives, have heightened trustees sensitivity toward risk taking and have encouraged inertial around 'tried and tested' approaches. A second problem internationally is the practice of pension funds to rigidly split the functions of ownership and portfolio trading. The responsibilities to vote and monitor ESG risks often fall within the jurisdiction of the compliance or legal divisions, while professionals doing the buying and selling of securities are rarely encouraged to gain knowledge and experience on how ESG risks affect the performance of particular companies.

Healing (2005) attributes the low level of SRI in South Africa to the lack of legislative clarity and argues that the situation is unlikely to change unless regulators provide more guidance to the pension fund sector. The lack of rigorous, defensible research to refute the belief that SRIs yield lower financial returns as compared with conventional investments and the need to identify key areas of ESG materiality also remain obstacles in growing the local SRI sector.

In summary, a review of the literature suggests that factors impeding the growth of SRI funds in South Africa include the lack of a standard definition, the performance of SRI funds, the use of short-term benchmarks and a lack of skills among local investment analysts and asset managers.

3. RESEARCH QUESTIONS

The focus of this study is to understand the challenges facing socially responsible investors in the current South African investment landscape. The study is structured around a series of conversations with key stakeholders in the sector. During semi-structured personal interviews, the following four research questions were addressed:

- What are the key challenges currently facing the SRI sector in South Africa?
- Do certain challenges have a greater or lesser effect on the sector?
- Are there any preliminary steps that can be taken to overcome these identified challenges?
- What role does SRI play in ensuring sustainable economic growth and development for South Africa?

4. METHODOLOGY

Primary data was generated through qualitative semi-structured interviews that were conducted with personal interviewees on both the demand and supply side of the SRI sector. In looking at the supply side of SRI funds in South Africa, both asset managers offering SRI products and those not offering SRI products were consulted. From the demand side, various investors were consulted, ranging from the private investment community, the public sector and institutional investors. The academic literature was considered and used to ground and benchmark the findings gathered from the interviews.

The interviews were recorded by note-taking and by tape-recording, and were then transcribed. As suggested by Lewis, Saunders and Thornhill (2003:93), a summary was compiled including all the key points that emerged from the interviews. Transcriptions were analysed for common themes. Seven interviews were conducted covering a representative from each stakeholder group resulting in opinions from both the demand and supply perspectives. Some biographical information on the interviewees is given in Table 3.

Table 3: List of Interviewees

Name of respondent	Representing	Designation	Research Position
Mr Haroon Lachporia	Old Mutual Investment Group South Africa	Head of Entrepreneurial Ventures	Supply Side – Offers SRI Products
Dr Daniel Matjila	Public Investment Corporation	Chief Investment Officer	Demand Side
Mr Douglas Davids	Sanlam Investment Managers	Head of Socially Responsible Investment	Supply Side – Offers SRI Products
Mr Ian Liddle	Allan Gray	Chief Investment Office	Supply Side – Does not offer SRI products
Mr Godwin Sepeng	Old Mutual Investment Group South Africa	Head of Comanco Boutique	Supply Side – Offers SRI Products
Dr Neil Eccles	The Noah Chair for Responsible Investment, UNISA	Programme Manager	Neutral - Academic Overview
Mr Mike Richardson	City of Cape Town	Executive Director (Chief Financial Officer)	Demand Side

Qualitative data analysis was used to analyse the data contained in the interview transcripts. The technique involved 'codifying' or grouping excerpts of information together in order to aid analysis by looking for differences, commonality and trends (Coffey, Holbrook & Atkinson, 1996:44). The transcribed interviews revealed following themes:

- Defining SRI in the South African context.
- An overview of the SRI sector in South Africa.
- Challenges and impediments facing the local SRI sector.
- A roadmap to overcome the identified challenges.
- Using SRI to ensure sustainable economic growth for South Africa.

More details on the identified themes are given in the sections that follow.

5. RESULTS

5.1 Defining SRI in the South African context

Investment sector experts felt that prompt action was needed to secure an international, recognised and consistent definition of SRI. The extent of the concern was highlighted by virtue of the fact that coming to a common understanding of what was meant by SRI repeatedly slowed progress at the start of the interviews. Whilst there are some widely accepted definitions available, the interviewees felt that the lack of a recognised consistent definition had a number of knock-on effects for the SRI sector.

In the first instance, the asset management and investment industries require constant comparative measurement (returns, risk etc.). Without a consistent definition it proves challenging to measure relative performance across products, listed versus unlisted and from both a financial and social return perspective. The fact that different stakeholders define social return in different ways further exacerbates the problem.

Part of the challenge in defining SRI is around setting boundaries around what can be classified as SRI. There was a large degree of variance amongst interviewees as to what constituted a reasonable boundary, as different investment products offered different filters or degrees of inclusion. A case in point is that of Old Mutual Investment Group South Africa which recently broke its asset management offering into a number of boutiques, two of which fall under the ambit of SRI. One focuses on listed equities and the other on long-term infrastructure development. As such the two boutiques now have different degrees of financial and social return expectations.

The lack of clarity around definitions causes confusion amongst investment professionals and clients alike. Another example highlighted by one of the respondents is that of investing in SABMiller plc. "Here one is challenged by trying to judge if the company does more social good than the average alcohol company despite selling a product which is classed as addictive. One could argue that the 'Dry Roads' campaign put forward by SAB Miller qualifies them for doing social good and one that is having a positive return on society at large".

Not only South African, but also international asset management companies have been challenged in attempting to align their SRI principles to consistent global standards. In 2006, the UN Principles for Responsible Investment were developed by an international group of institutional investors, reflecting the increasing relevance of ESG issues to investment practices. These Principles provide consistency and a framework that goes along way to clarify SRI definitions and boundaries across borders. The Principles are voluntary and aspirational. They are not prescriptive, but instead provide a 'menu' of possible actions for incorporating ESG issues into mainstream investment decision-making and ownership practices (United Nations Principles for Responsible Investment, 2006).

5.2 An overview of the SRI sector in South Africa

Interviewees acknowledged that the South African economy was fundamentally different from that of developed economies in that there is a legacy of considerable social backlog hindering the country's socio-economic development. This view emphasises the need for more SRI in South Africa. When asked whether local and international investors should consider investing in the South African SRI sector, two major concerns repeatedly surfaced, namely long-term risk reduction and capital protection. Both concerns were based on the assumption that SRI is more risky than investing in a conventional manner, especially over the long-term.

Respondents suggested that by addressing ESG issues up front and establishing SRI vehicle options, the South African business community is being encouraged to do business in a responsible manner. If South Africa as a country is a perceived to be responsible place to invest, it would attract additional capital. One of the respondents made the point that long-term SRI investments have a capital protective element which reduces their relative riskiness.. It was also noted that on the other end of the spectrum there is reluctance by international investors to place funds in South Africa due to the limited infrastructure. With a growing number of SRI investments focussing on infrastructure development this reluctance could be lessened.

Although not explicitly stated by the interviewees, it was apparent that there were two clear motives as to why asset management companies offered SRI investment products. For some it was for business sustainability purposes, whilst others were just trying to generate further sales and comply. One of the interviewees explained that initially the focus was about meeting investor requirements and assets under management maximisation, but as asset management companies begin to see the social value of these funds being realised, the tide would turn away from compliance towards authentic business sustainability.

Although some asset management companies did not mention specific SRI products, their analysis approach inferred that they were reviewing companies from both financial and ESG perspectives and thus focussed on both business sustainability and profit maximisation. One of the respondents raised the point that despite the fact that his asset management do that does not offer distinct SRI products they still use SRI analysis techniques (particularly integrating ESG considerations) to get a more 'rounded' view of a company.

There were two predominant schools of thought with regard to what the future held for the local SRI sector. The first was the opportunity brought on by the current credit crisis (Steward, 2008). The naysayers expressed the view that current growth in the sector was extremely slow and in some instances the sector was viewed as 'gimmicky'.

One of the interviewees suggested that real opportunities for SRI may be presented as the weaknesses of the existing financial sector are exposed. He explained that the SRI agenda is gradually growing, driven by international initiatives such as the UN Principles for Responsible Investment, the Institutional Investors Group on Climate Change and the Carbon Disclosure Project.

The consensus amongst the interviewees' with regard to future growth prospects was that they perceived the SRI market to currently be tracking sideways. One of the respondents felt that the market had seen growth with the Government Employee Pension Funds (GEPF) acting as a signatory to the UN Principles thus forcing other asset managers to signup. However, he believes that further growth will be driven by the international community who are focussed on finding more sustainable ways of doing business.

5.3 Key challenges facing the SRI sector in South Africa

Interviewees highlighted a number of stumbling blocks currently restricting the growth of the local SRI sector.

5.3.1 Risk adjusted performance

As rightfully pointed out by one of the respondents, SRI investments require broader investment return objectives. Investors are looking for social return as well as financial return; however the addition of social return should not compromise that of financial return. There was some confusion amongst interviewees as to exact performance figures of SRI investments relative to other asset classes. This was surprising taking into account that the risk adjusted performance of SRI funds was regarded as one of their key selling points.

The description of 'social return' was vague and incongruent across interviewees. There was however consensus that for the most part, the benefits were immeasurable. With social returns included in the overall risk adjusted performance offering, further challenges confront the sector as benefits are offered to investors that are largely unquantifiable.

One of the respondents maintained that it is a perception that SRI funds are underperforming other asset classes due to the social component. Having said this, he believes that "there is double the amount of effort required for SRI professionals as not only do they need to meet financial performance criteria but must ensure their funds comply with the mandated SRI criteria".

Another explained that the risk adjusted performance argument surrounding SRI funds is fundamentally flawed. "The asset management sector is fixated with wanting returns in the short-term. The true positive value and return benefits of SRI investments can only be realised over the long-term. He believes that asset managers are greedy for fees and short-term return incentives drive the greed. Thus, until this stigma is broken, the SRI sector will struggle to benefit from the same growth levels as other short-term incentivised asset classes."

5.3.2 Human capital

Interviewees unanimously indicated that there was a shortage of skilled resources available in South Africa. A common concern was that the people required needed to a have vision and commitment towards SRI and have the desire and know how to seamlessly balance both financial and social return in all investment decisions. One of the interviewees extended the available skills shortage argument further. He believes that there are adequate actuarial and accounting skills, but that the sector lacks skills in the ESG analysis arena. "The combination of both deep ESG knowledge and financial skills are hard to come by". He goes on to explain that constant education around ESG is required as the field is currently developing rapidly.

Non-listed SRI projects (especially those investing in infrastructure development) have a long-term benefit realisation structure. One of the respondents felt that the management of human capital is challenged on two fronts. First is the ability to retain qualified resources to see projects throughout their lives, and second the transfer of "the knowledge, the passion, the know-how and the vision to someone else". This was confirmed by another respondent who observed that "the biggest thing is managing the (SRI) investment themselves, it's a huge challenge and you need special kind of people".

5.3.3 The SRI investment universe

The size and extent of the South African SRI investment universe is difficult to define, as different companies and organisations use different filters and techniques when compiling their investable universe. The size of the investment universe or number of opportunities available to South African SRI organisations was probed during the interviews. The comparability of the investment universes was also considered, questioning whether standardised criteria would have a positive or negative effect on the sector and if the selection and review criteria further challenge SRI portfolio managers.

The consensus amongst interviewees was that there were in fact sufficient investment opportunities and the available investment universe was in no way limiting the growth of SRI in South Africa. In the words of one respondent: "the available (SRI) investment universe in South Africa is substantial enough". This finding clearly contradicts the literature as discussed previously.

One of the respondents felt that even if more investment opportunities became available, the pension fund organisations, the Public Investment Corporation (PIC), which manages the government employees pension fund, would not allocate more capital towards SRI funds. He believed that the current five percent PIC SRI allocation was sufficient. In addition the PIC currently experienced difficulties in deploying the five percent of capital towards SRI type investments or initiatives.

Based on the responses gathered as well as the information obtained from the literature review, it was clear that different investors use different techniques for assessing which companies should be included in their investment universe. Some interviewees suggested that a standardised approach would taint the sector as the investment selection approach as well as the filter applied in selecting investments usually turned out to be a selling point for SRI funds.

Interviewees who conducted SRI analyses felt they were challenged relative to their 'general equities' counterparts. Every decision that the SRI analyst made needed an additional SRI lens with which to view the company. Thus a greater cost was incurred in analysis, for which they were expected to provide an equal or greater risk adjusted return. In addition, the investment universe had to be reviewed every year in order to ensure that companies still complied with the initial criteria making them eligible for a respective SRI fund.

Taking into account these arguments, the South African SRI investment universe is seen as a challenge to the sector, but a minor one at that, which does not currently hinder growth.

5.3.4 Availability of SRI information and research

For most interviewees, the availability of SRI information was a challenge but one that they felt was becoming easier as a result of more pressure being placed on companies to disclose ESG risk management. The advent of sustainability reports accompanying annual financial statements made the job of sourcing information considerably less time consuming, a fact which is confirmed in the literature (Visser, 2005:29). Some interviewees did however noted that the sustainability reports are for the most part unaudited and largely unquantifiable and may therefore be seen as a sugar coated compliance documents. "The accuracy of the numbers contained in these reports could not always be relied upon."

The FTSE/JSE SRI Index has also proven to be a catalyst in encouraging companies to comply with ESG reporting requirements. Certain interviewees believed that this has made their job easier as the information is more readily available and packaged in such a way that most analysts can understand.

5.3.5 Trustee fiduciary duties

De Cleene and Sonnenberg (2004:14) suggested that South African trustees adopted a more cautious approach to SRI or avoided SRI funds completely, since some funds suffered significant losses in the late 1990s. Interviewees for the most part agreed with this and gave various explanations as to why fiduciary duty was seen as a key challenge in growing the South African SRI sector. They noted that "unfortunately the reality is a lot of the trustees are caught up in the belief that SRI is an under-performing asset class". This finding underscores research conducted by Eccles *et al*. (2008:4) which shows that fiduciary duty was seen as the most critical barrier to SRI in South Africa among a sample of local pension funds, asset managers and advisory service providers.

The negative perceptions among trustees is no longer warranted as a growing body of research indicates that SRI funds tend to perform on par with conventional (non-SRI) funds and even outperform these funds over the long-term (Bauer *et al*., 2005:1752; Viviers *et al*., 2008:2; Renneboog, Ter Horst & Zhang, 2008:1723).

In addition, performance is a major consideration for trustees as they are normally in the trustee position for a shorter period of time than that of the investment horizon of the funds over which they preside.

5.3.6 The influence of South African pension funds

The major argument emanating from questions posed to interviewees regarding the influence of pension funds on the South African SRI market was based on the extent to which legislation should be used to drive growth. There was no clear consensus: some interviewees were clearly in favour of legislation while others believed that “by legislating you encourage investors to comply, and so they may not be investing for the right reasons.”

One respondent felt that there is misunderstanding of what exactly SRI constitutes amongst pension funds in South Africa and that Regulation 28 of the Pension Funds Act (No 24 of 1956 as amended) only goes as far as to describe asset classes that generate real returns, thus in a sense does not make a provision for SRI investments. Currently the regulation speaks to ‘alternative’ investments which could comprise SRI investments but does currently not specifically call SRI out as such.

A secondary argument stemming from the pension funds discussion was that of effective utilisation of what can be termed as South African savings. Pension funds are largely stores of wealth that government can use as a catalyst for change in the country. Some interviewees believed that capital tied up in these pension funds could be used more effectively to drive growth and development in the country. However, fiduciary responsibilities negate the opportunity for what was seen to be effective utilisation of SRI funds. An example given was that of SRI funds focussing on infrastructure development, which have lower market rates of return and a long vesting period, but use government’s money effectively by developing infrastructure in turn increasing GDP of the long-term.

Looking in aggregate across both the literature review and the research findings, it is clear that SRI in South Africa is challenged in more ways than one. In order to address these challenges and concerns, they are prioritised in the next section along with corresponding recommendations made by interviewees.

5.4 A way forward for the South African SRI Sector

Four suggestions were put forward by interviewees to increase the demand in for SRI investments in South Africa. The first relates to the need to motivate for a balance between risk adjusted return and social return. The benefits of the social return and the expected consequent lower short-term financial return could be explained to investors, both institutional and private. By placing more focus on the social upliftment component of the investment and justifying the positive spin-off as a result investors may start to see the pure financial return as less of an inhibitor to ‘performance’.

The second suggestion is to provide more education on the role of business in society. Businesses have an important role to play in society, and more businesses are becoming ESG conscious in their day-to-day operations in order to ensure long-term sustainability. Using these ‘converted’ businesses as successful case studies to encourage other businesses to follow suite will not only result in a more ESG conscious South Africa, but also encourage more SRI investment and have a positive effect on the overall economic sustainability of South Africa.

Thirdly, SRI-structured focussed private-public partnerships should be encouraged. With a large proportion of South Africa’s wealth tied up in its savings through pension funds, unit trusts and other savings vehicles, an opportunity exists to use the capital more efficiently. This can be achieved by not only deriving a return for investors, but also increasing economic growth and development in South Africa. Currently there seems to be a disconnect between those who hold the capital and those with the ability to spend it in a responsible manner. By encouraging the formation of public-private partnerships more structured co-delivery could be ensured.

Finally, SRI in South Africa should be made a strategic imperative. With anticipated growth in the local SRI sector, it implies that SRI should become a strategic objective for local asset managers who have not yet given it much thought. According to contemporary strategic management literature (for example Needle, 2004:300; Hitt, Ireland & Hoskisson, 2005:114), the formulation and implementation of strategic objectives lead to a bigger market share, a broader product line and an enhanced reputation.

In order to leverage the supply in the local SRI sector, the following suggestions are made. Current legislation does not assist SRI as it caps ‘alternative investments’ under which SRI falls. However, the implementation of such legislation could have unanticipated consequences if the reason for adoption is one of compliance as opposed to sustainable business practices. Instead of necessarily trying to implement revised legislation, the sector as a whole could consider the options available to better enhance the profile of SRI funds in South Africa through proposed legislative changes.

The widespread adoption of transparent ESG reporting will help the sector to acknowledging the positive contributions that selected companies are making. By encouraging, incentivising or obliging ESG reporting compliance, companies will start to look at themselves in a new sustainable light.

Although there is currently a conversation around SRI, stakeholders seem to be speaking very different languages. An identified challenge is the ability for the entire sector to work from a defined common platform. As pointed out by a number of interviewees, there is a need for proper debate in an sector which, despite having been around for some time, still lacks clear definitions that work for all. According to some interviewees, the UN Principles have to some extent replaced the need for debate. They do however admit that it still needs to be seen to what extent the Principles will be accepted internationally and locally.

Based on the suggestions provided, the relative difficultly in implementing the suggestions along with the suggested timing and cost has been graphed in Figure 1.

The x-axis indicates the relative degree of difficulty, with the y-axis showing the suggested timing of the suggestion. The size of the bubble shows the estimated cost of the implementing the suggestion. The green bubbles, 1(a) through 1(d), highlight demand leveraging suggestions while the orange bubbles, 2(a) and 2(b), highlight supply leveraging suggestions. The relativity of factors on the graph should be manipulated in order to find a 'best fit' for implementing the suggestions.

Controlled debate (2b) and educating business on their role in society (1b) are short-term objectives that form the basis from which the other suggestions can be built on. Focus on private-public partnerships (1c), review of legislation and ESG reporting (2a) and making SRI a strategic imperative (1d) for economic growth and social upliftment, all point to being able to motivate and possibly deliver more competitive risk adjusted performance, something the market uses as a major consideration when deciding as to where funds should be allocated.

The next section takes into account the challenges explored to date, and makes use of a model (in part suggested by the interviewees) on which to group the suggestions put forward. The objective of the model is to provide a macro level roadmap in order to ensure economic growth and development for South Africa.

5.5 Using SRI to ensure sustainable economic growth for South Africa

Socially responsible investment is a relevant issue that requires discussion, debate and a view of what is appropriate in South Africa. It is especially significant in the light of black economic empowerment, corporate governance development and international trends towards sustainable development (Manuel, 2001).

Based on the premise that economic growth is a spin off from social upliftment, few investment methods can compete with SRI, which if implemented correctly, can generate both social upliftment and subsequent economic growth and development. A macro strategy for ensuring sustainable economic growth for South Africa is depicted in Figure 2.

The model was generated from the responses gathered from the interviewees based on the question; "How can SRI be used to ensure sustainable economic growth and development for South Africa?" Each point is discussed in detail below.

5.5.1 Reviewing and adopting a working model

A number of interviewees linked their thinking to examples from developed economies such as the UK and Australia, where they felt successful models for ensuring economic growth and development existed. They believe that these were underpinned by SRI practices. Speaking specifically about UK, one of the respondents observed that particular regions that were noted to have sub-economic growth were stimulated by bringing taxpayers' money to the particular area and injecting it into infrastructure to realise economic growth. He felt that something similar could be achieved in South Africa through SRI investment, while at the same time generating a return for investors.

Legislation also provided a number of successful case studies. A wave of legislative amendments appeared in the UK in 2000 followed by changes in France, the Netherlands and Sweden in 2001, Austria and Germany in 2002, Spain in 2003 and Belgium and Italy in 2004. Tranchimand (2006:7) states that this kind of legislation has encouraged pension fund trustees in Europe to develop SRI policies. In Australia pension fund legislation has been taken a step further to include all pension fund trustees and has been extended to include labour-related considerations along with other ESG concerns (De Cleene & Sonnenberg, 2004:38).

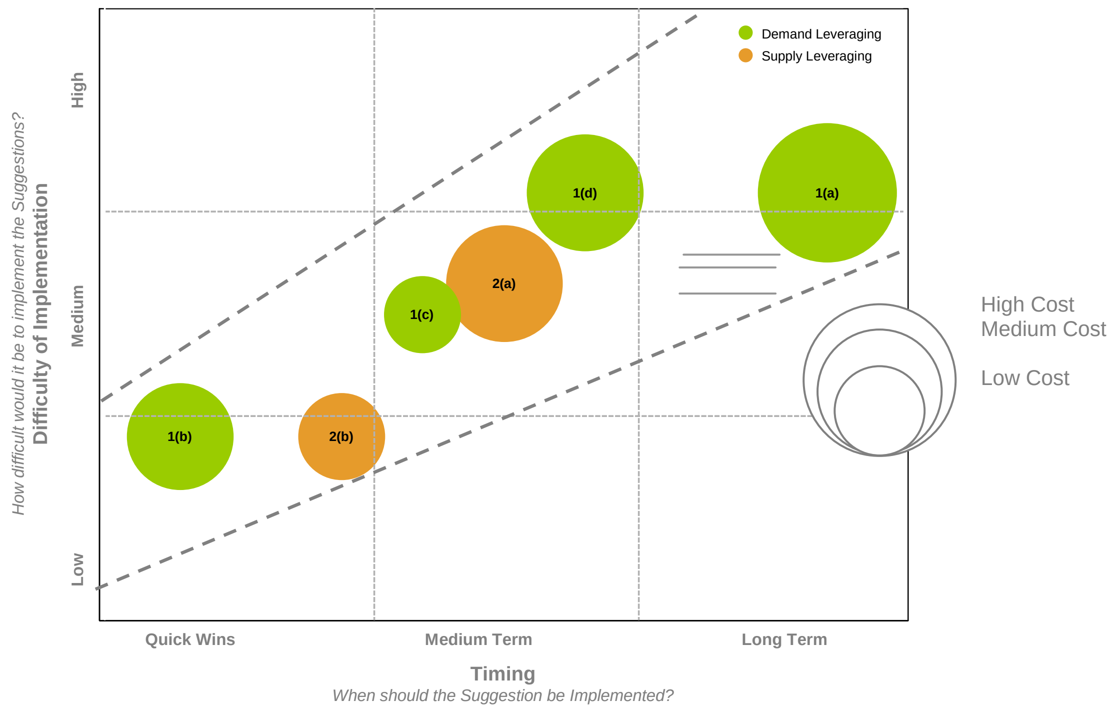

Figure 1: Suggested implementation and timing of SRI in South Africa

#	Suggestion	Demand or Supply Leveraged
1(a)	Motivate the balance between risk adjusted return and social return	Demand
1(b)	Educate on the role of business in society	Demand
1(c)	Encourage structured SRI focussed private-public partnerships	Demand
1(d)	Make SRI a strategic imperative in South Africa	Demand
2(a)	Targeted legislation and transparent ESG reporting	Supply
2(b)	Controlled debate around definitions and boundaries Source:	Supply

Source: Researchers' own construction

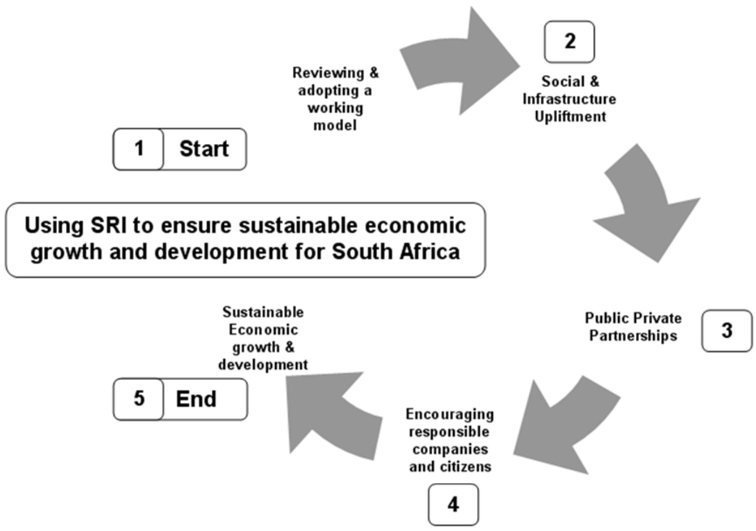

Figure 2: Macro Strategy for Sustainable Economic Development
Source: Researchers' own construction

An interviewee elaborated further, suggesting that an option for South Africa could be to use the UK approach, where pension funds are not forced to participate in any form of SRI-related investment practices, but are forced to disclose where exactly they are investing. This makes the investment mandate more transparent and applies pressure on the pension fund to conform should they find that other pension funds are investing in a socially responsible manner.

South Africa has the advantage in that being a laggard, it can pick and choose successful macro SRI practices as well as legislation, by considering the advantages and problems that other countries experienced in implementing SRI practices and legislation. Interviewees were of the opinion that best practices should be used, but also felt that it was a challenge to pick an appropriate option as most were based on developed countries economies.

5.5.2 Social and infrastructure upliftment

The local authority respondent explained that the municipality's primary focus is on investments in local communities and economies which in turn generates growth and translates into the improvement of people's lives. Through this grass roots approach he believed that sustainable economic growth and development could be achieved, provided that the way in which the City went about its investments was seen to be responsible and sustainable.

Another respondent believed that "one has to look more holistically at the problems currently facing South Africa and facilitate upliftment from the bottom up. By enabling people you enable the country." He pointed out that infrastructure is not only important for the growth and development of the people of South Africa, but also for international investors. "No one's going to come and invest on the continent of Africa unless it has infrastructure such as road, rail, telecommunications, airport and harbour infrastructure and couples natural resources with its people".

A number of SRI funds offered in South Africa look to provide either social or infrastructural upliftment along with a risk-adjusted return (for a complete list of local SRI funds see Viviers *et al*., 2008:13). However, it is the uptake and support of these products that pose the challenge. An interviewee remarked that SRI needs to be seen as making an impact on the under-serviced sectors of the economy. But, the truth is that investors are reluctant to support this belief as it compromises the risk adjusted return.

Government is seen to be solely responsible for infrastructure development in South Africa, which is not necessarily the case. With increased levels of infrastructural spend and gross capital formation government is stretched in trying to deliver, especially given the imminent 2010 Soccer World Cup. An opportunity thus presents itself for public-private partnership which can take capital with the objective of social and infrastructural upliftment and apply in a controlled, monitored and structured manner to projects which could assist government in meeting their development targets.

5.5.3 Public-private partnerships

There is interplay between corporate governance, corporate citizenship, corporate social investment, sustainable development, risk management and multi-sector partnerships. SRI offers the investor an opportunity to examine all of these in relation to a particular investment and reflect on the value-added dimension of a company within any given portfolio.

However, based on the responses from the interviewees, the ambiguity around the reporting on both the financial and social return left the investors feeling uneasy. Thus the suggestion of a 'structured partnership' was mentioned a number of times. The objective of such a partnership would allow for more effective and transparent allocation of capital.

An interviewee remarked that large amounts of capital is currently earmarked for South Africa from overseas donors, but they are reluctant to actually hand over the capital, as the companies currently tasked with delivery are awash with unqualified audit reports. He thus called for a greater degree of public-private partnerships which would, to some extent help, to overcome the challenges around delivery.

5.5.4 Encouraging responsible companies and citizens

The last lever in ensuring sustainable economic growth and development through SRI in South Africa is that of the companies and the consumers without whose support SRI would not be possible. From the interviews conducted, it is clear that there is a greater realisation about the factors constraining global and local growth. In the long run better management of finite resources will be beneficial for all involved.

One of the respondents believes that companies are starting to think differently about what type of entities they actually are. Consumers are also voicing an opinion as to where there money goes and aligning it with their personal principles. He elaborates, noting the job that Al Gore has done in convincing the world that there is an environmental problem. However, the real problem is that he has convinced the world that the only environmental problem is climate change.

Eccles *et al*. (2008:29) conclude their report on the state of SRI in South Africa by saying that perhaps the biggest need in the South African investment context is for certain myths to be dispelled. If SRI is embraced as an investment approach in South Africa it could assist in projecting the economy into the 21st century. More importantly, this will be achieved in a sustainable manner which will benefit all South African citizens. Thus, where possible, SRI should be used to ensure sustainable economic growth and development for South Africa going forward.

6. CONCLUSIONS

The objective of this paper was to identify the key challenges and issues facing the SRI sector in South Africa, offer suggestions to overcome these challenges and provide insights into using SRI to ensure the sustainable economic growth and development in South Africa. The key challenges facing the SRI sector in South Africa, based on the literature review and interviews include:

- The definition of SRI (or lack thereof). This factor was seen to be an obstruction to both asset management companies and investors who need to fully understand the sector and in turn take it forward;

- Risk adjusted performance of SRI funds. This is the most important consideration for investors when making SRI decisions. With a growing body of evidence suggesting that the risk adjusted performance of SRI funds is on par with conventional funds, especially over the long-term, negative perceptions among investors need to be challenged..

- Insufficient and inadequate human capital or skills challenges the sector. Firstly, South Africa has a skills shortage, particularly in matching financial and ESG skills. Secondly, with SRI investments being long-term in nature, retention and/or transfer of skills over the duration of the investments proved a challenge.

Interviewees' opinions as to how the identified challenges could be overcome were gathered. Specific suggestions were categorised in order to gauge the difficulty in implementing the suggestions and outlining the ideal sequential timeframe for implementation. The suggestions were summarised into a model on how best to ensure sustainable economic growth and development for South Africa through investing in a responsible manner.

In summary, the SRI sector in South Africa is plagued by many challenges, all of which could be resolved in time. However, SRI – specifically in a South African context – requires more debate around the meaning of concepts such as empowerment and sustainability and what they mean for South Africa going forward. A broader mandate for SRI will help secure its place in the financial mainstream.

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