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Rethinking Finance:
Responsible Investment in the European Asset Management Industry

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Abstract

Rethinking Finance:
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This dissertation explores the notion of **Rethinking Finance**, in the form of questioning previously established beliefs and models. In particular, it examines the current evolution of the European Asset Management industry as increasing institutional pressures push organizations to change their business models and integrate sustainability into their traditional investment practices. This is manifested in the phenomenon of Responsible Investment (RI) – any type of consideration of Environmental, Social, Governance and Controversial Business Involvement issues within the investment process.

The objective of this dissertation is two-fold: first, to examine the mechanisms underlying institutional change within the context of field-level institutional complexity and within a situation of *transition*, wherein organizations are embedded in a dominant logic while subject to pressures from a new, conflicting logic that does not bring with it theorized definitions or models of success and second, to provide an illustration of whether and how this rethinking is manifested within financial markets.

This dissertation is composed of three standalone papers that address the aforementioned research objectives. **Chapter 2. Institutional Complexity in a Transition Field: Responsible Investment in the European Asset Management Industry** asks the question, *how do organizations experience and respond to institutional complexity in a transition field?* Through a qualitative, abductive, exploratory study, we find that in a situation of transition, organizations make sense of institutional complexity through *logic assimilation*, which has two core mechanisms, *logic theorization* and *logic-archetype elaboration*. This chapter also highlights the existence of an *enabling organization*, which facilitates logic assimilation. In **Chapter 3. Responsible Investments: the Assimilation of Sustainability-related Sources of Risk,** I investigate a dataset of European Socially Responsible Investment (SRI) mutual funds, providing evidence that (1) sustainability information and (2) moral preferences of clients have a significant relationship with financial risk and fund flow volatility, respectively, in substantive forms of RI. In **Chapter 4. Rethinking Finance: Sustainability Governance in Responsible Investment**, we investigate a similar dataset, focusing on sustainability governance practices (sustainability disclosure, sustainability activism, and sustainability research). We show in a first attempt that governance practices related to sustainability issues – often overlooked in the literatures – are value-relevant. These latter two chapters illustrate primary workings of how logic assimilation is manifested within financial markets.

This dissertation incorporates the notions of conflicting logics, institutional embeddedness, and logic assimilation within previous work in the Social Studies of Finance, harmonizing complementary views from Institutional theory. It further goes beyond previous ethnographic and descriptive work and illustrates how such a reconceptualization of previously well-established beliefs *perform* markets and become manifested in financial models, thus providing an important empirical linkage between the experience of institutional complexity and actual practice change in financial markets.

Estratto

Ripensare Finanza:
Investimento responsabile nel settore della gestione patrimoniale europea

Questa tesi esplora il concetto di 'Ripensamento della Finanza', interrogandosi sulle idee e sui modelli precedentemente affermati. In particolare, il documento esamina l'attuale evoluzione del settore europeo del risparmio gestito, dal momento che crescenti pressioni istituzionali spingono le organizzazioni a cambiare i loro modelli di business e a integrare la sostenibilità nelle loro pratiche di investimento tradizionali. Questo si manifesta nel fenomeno di Investimento Responsabile (RI) – che include ogni tipo di considerazione sui problemi legati all'ambiente, al sociale, alla governance e al coinvolgimento in business controversi da parte delle imprese nel processo di investimento.

L'obiettivo di questa tesi è duplice: in primo luogo, esaminare i meccanismi alla base dei cambiamenti istituzionali nel contesto della complessità istituzionale (*institutional complexity*) e nell'ambito di una situazione di *transition*, in cui le organizzazioni sono integrate in una logica dominante e allo stesso tempo sono soggette a pressioni da una nuova logica conflittuale che non porta con sé definizioni teorizzate o modelli di successo; in secondo luogo, fornire un esempio di come e quando questo ripensamento si manifesta all'interno dei mercati finanziari.

Questa tesi si compone di tre documenti indipendenti che affrontano gli obiettivi di ricerca sopracitati. **Capitolo 2. Institutional Complexity in a Transition Field: Responsible Investment in the European Asset Management** si domanda: *in che modo le organizzazioni sperimentano e rispondono alle complessità istituzionale in un transition field?* Attraverso un studio *abductive*, qualitativo, ed esplorativo, troviamo che in una situazione di *transition*, le organizzazioni danno un senso alla complessità istituzionale attraverso *logic assimilation*, che ha due meccanismi fondamentali, *logic theorization* e *logic-archetype elaboration*. Questo capitolo evidenzia anche l'esistenza di un *enabling organization*, che facilita il *logic assimilation*. Nel **Capitolo 3. Responsible Investments: the Assimilation of Sustainability-related Sources of Risk**, analizzo un set di dati di fondi europei di investimenti socialmente responsabili (SRI), fornendo la prova che (1) le informazioni sulla sostenibilità e (2) le preferenze morali dei clienti hanno rispettivamente una relazione significativa con il rischio finanziario e con la volatilità del fondo, nei casi di forme sostanziali di Investimenti Responsabili. Nel **Capitolo 4. Rethinking Finance: Sustainability Governance in Responsible Investment**, analizziamo una serie di dati simili, concentrandosi sulle pratiche di governance della sostenibilità (divulgazione dei dati, attivismo e ricerca sulla sostenibilità). In un primo risultato mostriamo che le pratiche di governance relative alla sostenibilità - spesso trascurate nella letteratura – hanno un valore rilevante. Questi ultimi due capitoli illustrano le prime manifestazioni di come il *logic assimilation* si manifesta all'interno dei mercati finanziari.

Questa tesi incorpora i concetti di logiche conflittuali, *institutional embeddedness*, e *logic assimilation* all'interno di precedenti studi negli Studi Sociali della Finanza, armonizzando punti di vista complementari dalla Institutional Theory. Il documento supera i precedenti studi etnografici e descrittivi e illustra come tale riconcettualizzazione di idee precedentemente consolidate diventa *performative* nei mercati e si manifesta in modelli finanziari, fornendo così un importante collegamento tra l'esperienza empirica di complessità istituzionale e il cambiamento reale delle pratiche nei mercati finanziari.

Acknowledgments

I embarked upon this Ph.D during a tumultuous yet meaningful four years of my life. Dividing my time between Milan and Paris, this period bore witness not only to growth in my career as a scholar but also to many personal milestones including my marriage as I began the program and my first pregnancy as I closed the program – these in addition to settling into new countries, adapting to the Italian and French systems of education, and having to learn two new languages. I have come to realize that the challenges involved in doing a Ph.D go far beyond the content of a dissertation; for above the intellectual requirements and constant pressures of publication, becoming a researcher entails a substantial amount of unusual sacrifice, mainly – dealing with the fundamental instability of an academic career path, the loneliness of writing periods, the isolation from the professional working world, and the perpetuating existential crises of whether what one is doing is appreciated by anyone or is relevant in the grander scheme of things. Whereas specific people are acknowledged at the end of every chapter for their intellectual contributions, I owe this broader Ph.D work and the sanity required to complete it to the following amazing people that surrounded me.

First and foremost, thank you to my supervisor in HEC, Diane-Laure Arjaliès, for taking a chance on an inexperienced stranger and for consistently guiding me from day one and over the last two years, both professionally and personally. I am truly afraid to imagine what quality of work I would have produced without your having shared your time and insights with me. Thank you to my supervisor in Politecnico, Marco Giorgino, for your friendship and care over the last four years. I thank my institution, Politecnico di Milano, for financially supporting me during the first three years of the Ph.D and for providing me with the opportunity to teach, an experience that I will always treasure. I thank the professors and staff of my department, the Dipartimento di Ingegneria Gestionale (DIG), who were helpful and kind to me.

I consider my period in Paris and particularly the 18 months I spent at HEC Paris as a critical and fundamental period of this dissertation. I thank HEC for providing such an inspiring and stimulating environment for visiting students; to the administrative staff, the professors at the Department of Accounting and Control, and to the members of the Society and Organizations Research center, in particular, Rodolphe Durand: thank you for welcoming me as one of your own. I thank the members of my jury, particularly Fabrizio Ferraro and Michela Arnaboldi – two researchers whom I greatly admire – for their willingness to participate and guide me through the culmination of this work. I am also grateful to the academic network of the U.N. Principles for Responsible Investment that took a keen interest in my work and has been a constant source of support, in particular, Natalie Beinisch.

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Ultimately, my greatest thanks go to my darling Stefano. Thank you for this wonderful life that you work hard to provide for me and for the endless adventures that we share; for bearing with me through every difficult period, for reading my papers and trying to make sense of them, for brainstorming ideas with me and making an effort to make me feel that my work matters to you, but most of all, for telling me at the beginning and end of each day that I am *bellissima* and *bravissima*. You are the person I aspire to be like the most, the source of my happiness and strength, and the reason that I can indulge in endless hopes and dreams.

I have come to accept that a Ph.D is, in fact, an end in itself; and that the key outcome is not a dissertation or publications but rather, personal growth. In learning what it truly means to *think* and be reflexive and what constitutes a significant contribution, I hope against all hopes that beyond whatever this dissertation may produce, my take-aways from these four long years may find fruition and may one day contribute, in whatever shape or form, to a better understanding of and a better future for our world.

D.L.L.F.

Dedication

To the men in my life:

My father, Atty. Jose Jesus de Guzman Laurel
My husband, Stefano Fois
My son, Francesco Galileo Laurel Fois

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CHAPTER 1

Rethinking Finance: An Introduction

1.1 Introduction

In the wake of the financial crisis of 2008 – considered to be the worst economic crisis since the Great Depression of the 1930's – and today's ongoing European debt crisis, we are faced with downturns in financial markets across the world and the collapse of the largest financial institutions. The crises have effects felt throughout real-life: the failure of businesses, declines in consumer wealth, and massive unemployment, are just a few examples. During such a situation of a colossal system breakdown, we are prompted to examine the causes of such disintegration. Because of the failure of extant economic models to predict the crises, the current global calamity has allowed for the 'flowering of alternative perspectives' (Lounsbury & Hirsch, 2010). Indeed, it is usually during situations of uncertainty that previously well-established beliefs and models are first questioned, ideologies and policies are scrutinized, and received wisdom is reevaluated (Lounsbury & Hirsch, 2010).

Because differing types of market stability produce different kinds of politics, markets in crisis are susceptible to transformation (Fligstein, 1996). A crisis is similar to 'external shocks' which have been found to potentially introduce new paradigms and ultimately trigger change (Clemens & Cook, 1999). By disturbing a settled arrangement, shocks enable actors to reflect upon 'institutional logics' (Friedland & Alford, 1991): the

identities and valuation orders that structure their decision making and practices (Thornton & Ocasio, 1999b:805), and to consider previously unthinkable possibilities (Smets, Morris, & Greenwood, 2012). Actors begin to reflect upon taken-for-granted structures and act as 'institutional entrepreneurs' (DiMaggio, 1988), purposefully using institutional logics in order to realize an interest that they value highly (Leca & Naccache, 2006), resulting in field-level institutional change.

Literatures in the Social Studies of Finance (SSF) have examined how such 'rethinking' and change constantly occur in the financial industry. SSF scholars have shown that while established financial models largely guide and frame action, reflexive agents actively take and transform the usage of existing models to fit their own purposes (Beunza & Stark, 2004; MacKenzie & Millo, 2003; MacKenzie, 2006). These studies illustrate how decisions in financial markets are based not only on financial models but also on calculated reflections of uncertainty (Beunza & Ferraro, 2010). When such calculated reflections become diffused as shared beliefs, they become strong enough to trigger the creation, elaboration, or change of models. As such, financial markets are a reflection of how collective action by agents can trigger change from within the system itself.

In attempting to understand the broader role of financial markets and in particular, its role in addressing pressing societal problems, this dissertation takes the epistemological view of economic sociology that highlights how rationality is socially constructed and culturally contingent (Fligstein, 1996; Lounsbury & Hirsch, 2010). Economic worlds in which organizations are embedded are social worlds wherein actors engage in political actions vis-à-vis one another and construct local cultures that guide that interaction (Fligstein, 1996). In such a way, social concerns become fundamentally intertwined with economic and financial practices (Lounsbury & Hirsch, 2010). Financial markets are thus *performative* (Callon, 1998) in that theories, beliefs, ideologies, and

material artefacts affect their creation and operation (Beunza & Stark, 2004; MacKenzie & Millo, 2003; MacKenzie, 2006). This performative process is essentially a process of institutionalization wherein ways of being come to take on a rule-like status in social thought and action (Meyer & Rowan, 1977), become accepted classifications built into society (Berger & Luckmann, 1966), and eventually achieve stability (Fligstein, 1996). It is in this manner that both economic sociology and institutional theory literatures share a focus on socially constructed and culturally contingent dynamics of institutional stability and change.

We observe today that institutional change appears underway in the financial markets as manifested in the phenomenon of Responsible Investment (RI) within the highly significant Asset Management industry in Europe. RI in this dissertation refers to any type of consideration of Environmental, Social, Governance (ESG) and Controversial Business Involvement (CBI) issues within the investment process.

The phenomenon of RI, however, brings to light several neglects in the SSF and institutional theory literatures. The European Asset Management Industry presents a unique situation not only of 'Institutional Complexity' (Greenwood, Diaz, Li, & Lorente, 2010) wherein the existence of conflicting logics (in this case, between finance and sustainability) impose incompatible prescriptions upon the organizations within the industry, and not only a high level of uncertainty due to the financial crisis it finds itself embroiled in, but beyond these, a situation of even more salient complexity arising from the embeddedness of organizations in the dominant logic of finance and its widely accepted forms and structures - 'archetypes' (cf. Cooper, Hinings, Greenwood, & Brown, 1996; Greenwood & Hinings, 1993; Ranson, Hinings, & Greenwood, 1980) – while facing the increasing pressures of a logic of sustainability that is not yet theorized. Theorization consists of 'the development and specification of abstract categories and the elaboration of a chain of causes and effects' (Greenwood, Suddaby, & Hinings,

2002:60), which is necessary in order for new practices that may deviate from conventions to become available in simplified form for wider adoption. As such, we are brought to question how institutional change can occur in a mature field wherein organizations are subject to pressures from a new, conflicting logic that does not bring with it theorized definitions or models of success whilst needing to maintain adherence to a dominant logic: what is referred to in this dissertation as a ***transition field***.

Further, since most work on institutional change within financial markets has thus far been ethnographic and descriptive, we do not know whether and how such change is manifested in market pricing. That is, is there evidence to illustrate that 'rethinking' is in fact reflected in market prices? Can we illustrate how performativity and institutionalization occur through the language of finance itself, that is, through its own market models? This is an important empirical linkage between the experience of institutional complexity and actual practice change in financial markets. In sum, while SSF and institutional theory research has flourished in the last years, we still do not know enough about the mechanisms underlying institutional change in a situation of institutional complexity within a transition field.

From an overarching level, this dissertation explores the notion of **Rethinking Finance**, in the form of questioning previously established beliefs and models. In particular, it examines the current evolution of the European Asset Management industry as increasing institutional pressures push organizations to change their business models and integrate sustainability into their traditional investment practices. Related to the above-mentioned research neglects, the objective of this dissertation is thus two-fold: first, to examine the mechanisms underlying institutional change within the context of field-level institutional complexity and within a situation of transition and second, to provide an illustration of whether and how this rethinking is manifested within financial markets. It focuses on a paradoxical question, of why this mainstreaming of a new

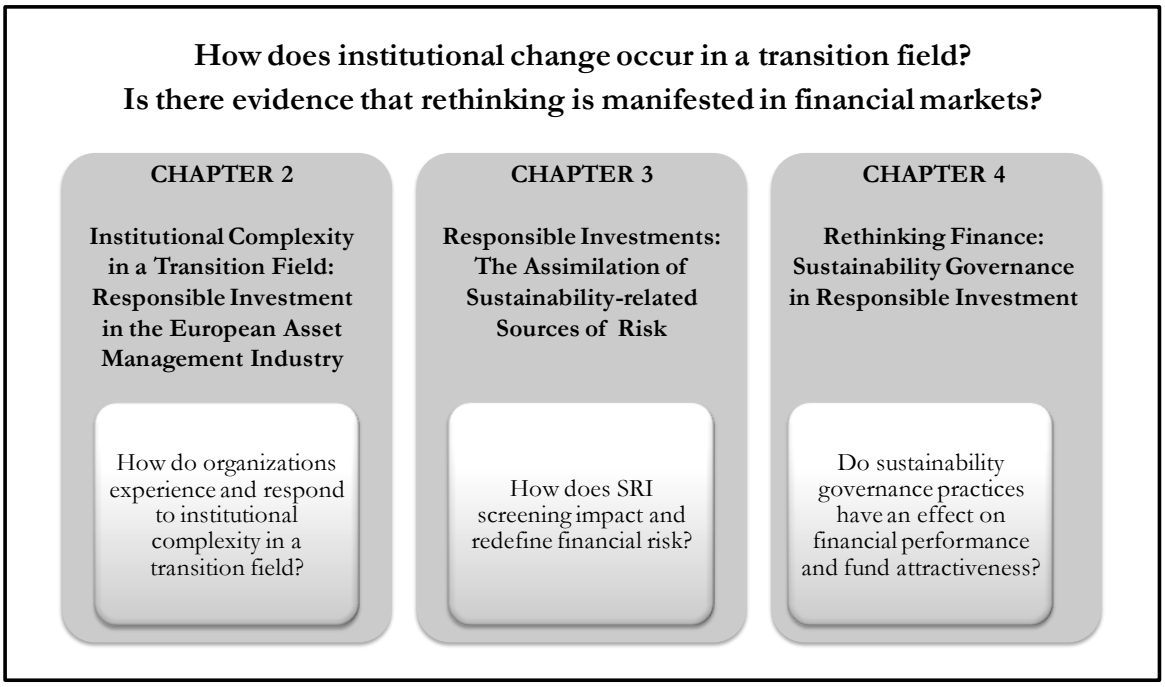
paradigm is occurring in spite of such a complex situation, evidencing that relying on an economic perspective is insufficient, and highlighting the necessity to examine within SSF studies, how structural attributes – in this case, the existence of conflicting institutional logics and a situation of transition – affect the dynamics underlying institutional complexity.

This dissertation is composed of three standalone papers that address the aforementioned research objectives. **Chapter 2. Institutional Complexity in a Transition Field: Responsible Investment in the European Asset Management Industry** asks the question, ***how do organizations experience and respond to institutional complexity in a transition field?*** Through a qualitative, abductive (Dewey, 1925; Lorino et al., 2011), exploratory study, we find that due to the structure of the Asset Management field as characterized by the co-existence of the conflicting logics of finance and sustainability and a situation of transition, organizations made sense of institutional complexity through ***logic assimilation***, which has two core mechanisms, *logic theorization* and *logic-archetype elaboration*. *Logic theorization* is the usage of an incumbent logic to frame and translate the untheorized logic in order to make it compatible with the incumbent logic. This process involves the creation and usage of models and tools in theorizing. Unlike previous accounts that highlight that theorization must be successful prior to diffusion (Greenwood et al., 2002), we posit that theorization and diffusion occur simultaneously. *Logic-archetype elaboration,* on the other hand, is the redefinition of the incumbent logic and consequently, its archetypes, based on the characteristics of the incoming *un*theorized logic. We find that these two mechanisms are recursive and underlie institutionalization. This chapter also highlights the existence of an ***enabling organization***, in this case, the Principles for Responsible Investment (PRI), as a facilitator of logic assimilation, which provided definitions, coordinated action, and legitimacy in this process. In **Chapter 3. Responsible Investments: the Assimilation**

of Sustainability-related Sources of Risk, I investigate a dataset of European Socially Responsible Investment (SRI) mutual funds that employ screening practices or the usage of environmental, social, governance, and controversial business involvement information to include and/or eliminate investee firms from an investment portfolio. I illustrate how logic assimilation is manifested within financial markets by theorizing and providing evidence that (1) sustainability information and (2) moral preferences of clients have a significant relationship with financial risk and fund flow volatility, respectively, in substantive (highly committed) forms of RI. This chapter highlights how logic assimilation occurs gradually. Indeed, whereas some sustainability issues are being priced in by financial markets, the financial logic remains dominant, illustrating how assimilation is a complex and contested process. Finally, in **Chapter 4**. **Rethinking Finance: Sustainability Governance in Responsible Investment**, we investigate a similar dataset as in Chapter 3, this time focusing on sustainability governance practices (sustainability disclosure, sustainability activism, and sustainability research). We illustrate how logic assimilation is manifested within financial markets by asking the question, *do sustainability governance practices have an effect on financial performance and fund attractiveness?* Our results have the following implications: at the beginning stages of the development of Responsible Investment, investors reward a fund for its legitimacy, particularly its depth of commitment to sustainability, rather than for its SRI strategy. We also find that not all sustainability practices provide legitimacy for an SRI fund. We show in a first attempt that governance practices related to sustainability issues – often overlooked in the literatures – are value-relevant, but that assimilation is by no means straightforward. Instead, investors are discerning regarding which *type* of sustainability governance practices should be rewarded (penalized), highlighting the need to include such issues as part of the overall strategy of a fund. While our results are primary, they illustrate how a rethinking has indeed began.

These latter two chapters provide initial evidence of how logic assimilation is reflected in financial models through market pricing, signaling the advent of practice change. Figure 1.1 summarizes the overarching objectives of this dissertation.

Figure 1.1 Objectives of the Dissertation



This introduction chapter provides a comprehensive synopsis and sets the foundation for the underlying ideas fundamental to understanding the following three chapters which comprise this dissertation. While the chapters are written to be able to stand alone, a thorough understanding of each is not possible without referring to this introduction. This is especially important to note since the essays were written simultaneously yet using widely differing approaches and drawing across different literature domains. This introduction therefore attempts to deconstruct the findings in order to comprehend them from a broader theoretical perspective.

The rest of this chapter is divided into seven parts. It begins with an explanation of the research context and phenomenon, discusses key theoretical contributions, and ends by providing future research directions and implications for practice and policy.

1.2 Research Context and Phenomenon

In looking at the transformation of financial markets at the wake of the financial crisis, this dissertation began with a general surface-level observation of a major movement occurring in one very key industry, that of the Responsible Investment[1] phenomenon occurring within the context of the European Asset Management industry[2].

1.2.1 Research context: the European Asset Management Industry

The practice of asset management wherein money is pooled into a fund from different sources and managed by a professional financial firm is a widely acceptable means of investing current wealth in anticipation of higher expected future returns. Investing money in the markets entails a substantial amount of time, research, and sophisticated tools in order to understand which sectors and companies are likely to perform best and have lower risks in the future: capabilities and resources which an individual or organization may not have. The idea behind asset management is that it is more effective and less risky to pool money – 'assets' – from several individuals or organizations and to outsource the collective management of these assets to a specialized firm. This allows risks to be spread across a diversified portfolio of assets which would otherwise be more expensive to do due to high transaction costs. Asset managers also monitor developments in the markets and are able to select interesting opportunities.

At the end of 2010, assets under management (AUM) in Europe was estimated to be worth EUR 14.0 trillion, comprising 33% of the global AUM – the second largest region after the U.S. The U.K. accounts for almost a third of this amount (33%) followed

[1] The term Responsible Investment is the term used by the United Nations' Principles for Responsible Investment (PRI) and focuses on (but is not limited to) the institutional investor movement. However, other organizations continue to use other terms. For example, local Social Investment Forums (SIFs) tend to use 'Sustainable and Responsible Investment' whereas other scholars use 'Socially Responsible Investment mainstreaming' (cf. Arjaliès, 2010) when referring to the same phenomenon. A lot of issues still surround the terminologies of the phenomenon and a discussion of this is beyond the scope of this dissertation.

[2] Asset management is also referred to as investment management or wealth management in other geographies.

by France (21%) and Germany (11%). To put the significance of this figure into perspective, the ratio of AUM to total GDP in Europe was 104% at the end of 2010. In the U.K., this ratio was at 270%. More than 3,100 asset management companies are registered in Europe employing about 85,000 people directly (EFAMA, 2012). The industry is clearly one of extreme importance in today's financially-driven economy. Figure 1.2 illustrates the evolution in assets under management in Europe while Figure 1.3 illustrates the geographical breakdown of the market.

Figure 1.2. European Assets Under Management (Adapted from EFAMA 2012)

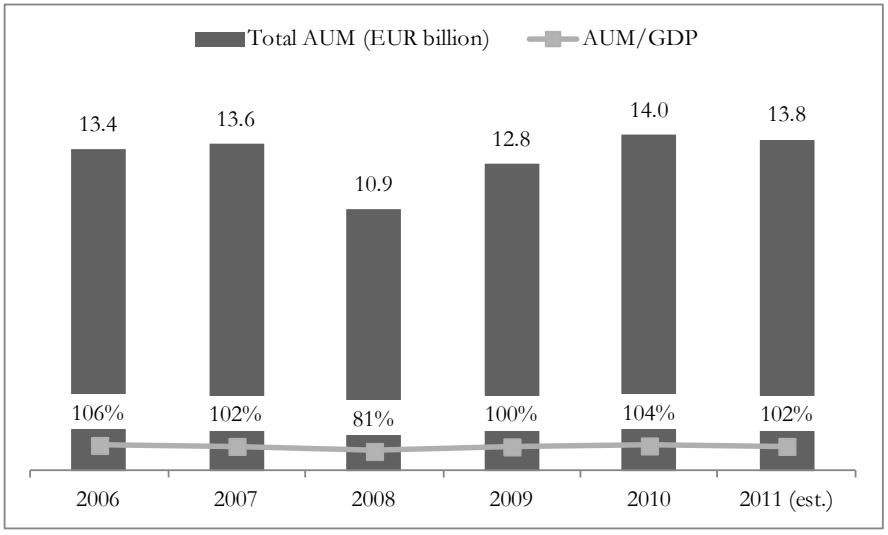
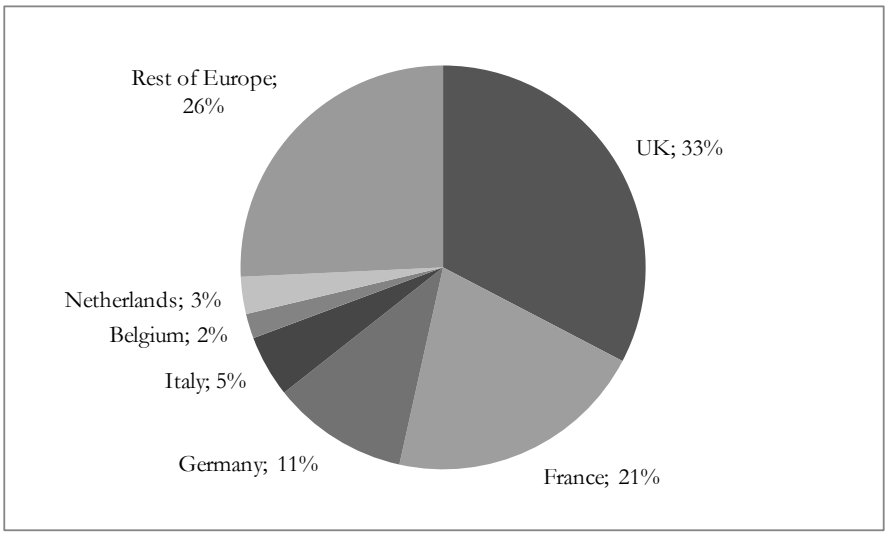
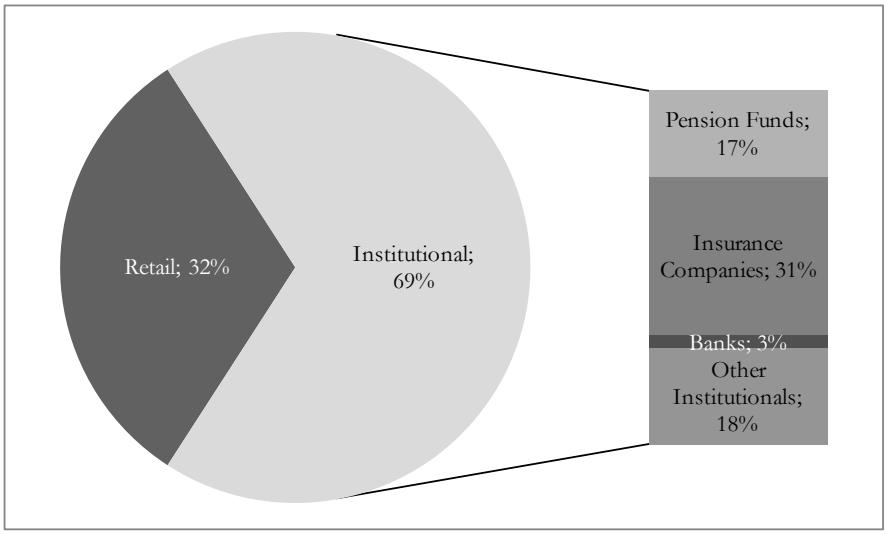


Figure 1.3. Market Share in Total AUM (2010) (Adapted from EFAMA 2012)



Asset management firms serve a diverse range of clients which include two broad types: 1) *retail clients* which are individual savers, including very wealthy clients, the so-called 'high net worth individuals' and 2) *institutional clients* which include government 'sovereign' wealth, insurance, pension, and corporate funds as well as charities, educational establishments, and the like. The former clientele accounts for around 32% of AUM while the latter represents the larger client category at 69%. Of the institutional cleints, insurance and pension funds are the most important categories, accounting for 42% and 27% of total AUM respectively (EFAMA, 2012). Figure 1.4 illustrates the breakdown in Client Type.

Figure 1.4. Client Type in AUM (end-2010) (Adapted from EFAMA 2012)

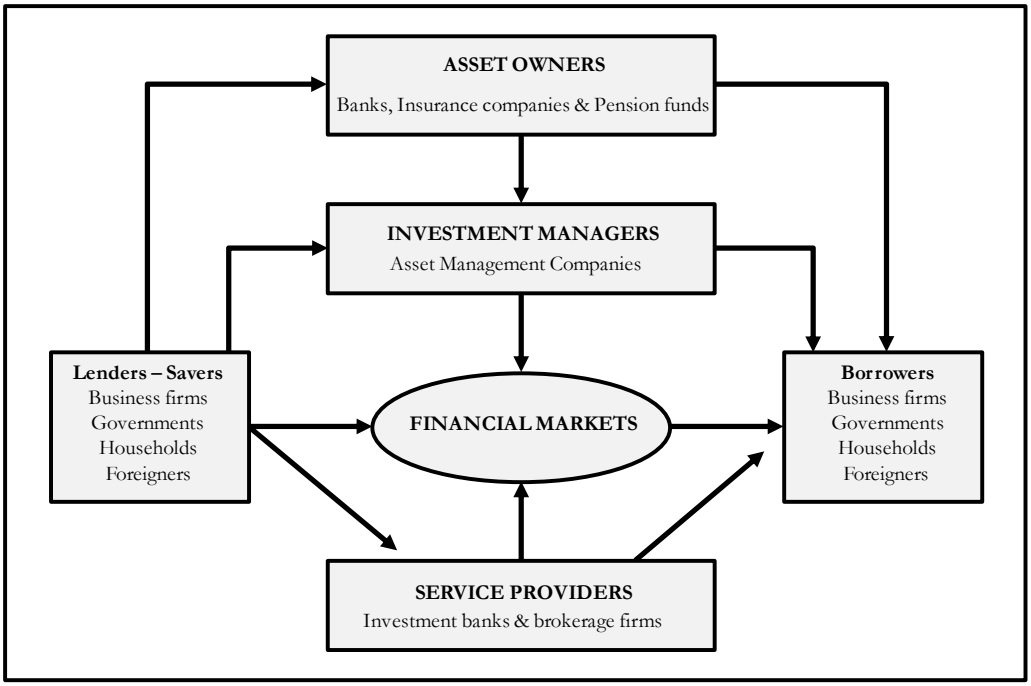


Clients are referred to as *asset owners* and play a key role in the selection of the asset management firm and the type of strategies which they want the latter to use in investing their assets (for example, whether to invest in large, medium-sized, or small firms). *Financial intermediaries* such as brokers, ratings, and research agencies act as a third player, providing information and tools to asset management firms and asset owners.

Most of these funds are invested in equity of companies listed on the stock market, in debt, and in money market instruments – collectively termed, 'securities' –

which are liquid and tradable and whose composition tends to change regularly. However, some funds – known as private equity funds – may also hold stakes of non-listed companies for an extended period of time. Two main types of investment vehicles are often used: investment funds and discretionary mandates. Investment funds raise capital from investors by issuing shares and investing the proceeds in assets. This is the vehicle mostly used for retail clients. By contrast, discretionary mandates are situations wherein decisions to buy and sell are made by the asset manager on behalf of a client in compliance with a pre-defined set of rules and principles: the vehicle mostly used by institutional clients (EFAMA, 2012). Figure 1.5 provides an illustration of the Asset Management Industry.

Figure 1.5 Asset Management Industry (adapted from EFAMA 2012)



1.2.2 Research Phenomenon: the development of Responsible Investment

Considering sustainability issues through the usage of ESG and CBI criteria in the investment process was not considered acceptable practice for mainstream asset managers in Europe prior to the mid-2000's. Before then, only a niche market existed

(continuing to date) wherein a moral approach to investing is used mostly by religious congregations in America and the U.K. to address their ethical concerns in society by excluding controversial businesses from their portfolios. This type of ethical investing has ancient Greek, Jewish, Christian and Islamic roots. The Torah, for instance, provides some rules on how money must be used ethically whereas the Catholic Church prohibits usury. As early as the 1700's, the Religious Society of Friends (Quakers) prohibited its members from participating in investing in the slave and weapon trade and during the same period, the founder of Methodism John Wesley preached a famous sermon calling on its faithful to avoid investing in companies engaged in alcohol, tobacco, gambling, and weapons. Following the rules enacted by the Koran, Muslim investors have historically avoided investing in companies involved in pork production, alcohol, gambling and in interest-based financial institutions. The Pioneer Fund in 1928 was the first mutual fund which used "sin screens" (Renneboog, Ter Horst, & Zhang, 2008a). Since these funds have existed for decades and continue to survive and even perform well, the financial sector was aware of the existence of combining non-financial and financial issues in a traditional investment process, albeit in a largely religious and moral sense. It was by no means dominant in the asset management industry.

From the 1960's, the consideration of integrating non-financial issues in asset management started shifting away from religious motivations and a spotlight was shed on pressing societal events. During the Vietnam war, students led a protest against the war and called for the boycott of companies providing weapons used in the war. This brought about the birth of the Pax World fund in 1971, which avoided investing in companies significantly involved in the manufacture of weapons, or weapon-related-products. The rise of the civil rights and racial equality movements in Europe and the U.S. through the Civil Rights Act in 1964 and the Voting Rights Act in 1965 increased the pressure on companies operating in South Africa during the reign of apartheid.

Investors were eventually forced to withdraw investments in these firms. Massive environmental disasters including the 1979 accident at the Three Mile Island nuclear power plant in the U.S., the 1986 Chernobyl catastrophe in Ukraine, the 1984 gas tragedy at Union Carbide pesticide plant in Bhopal, India, and the oil spill of Exxon Valdez near Alaska made companies more aware of the consequences of environmental risks on their revenues, and made investors question their investments from non-financial risk perspectives. These occurrences brought about a global discussion in the late '90s towards sustainable development, defined as "the kind of development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (Brundtland, 1987), which began with a largely environmental agenda. These critical events brought society's attention towards how money is invested and how it could be used for both negative and positive social ends, and cast a spotlight on the financial sector as instrumental for bringing about solutions to such massive societal problems.

In the first half of the 2000's, the Parmalat fraud and money laundering scandal of its CEO and top managers in 2003 and the audit scandal which led to the collapse of Enron in 2001 severely affected pension and mutual funds in Europe invested in these companies and highlighted the need for better governance controls, which was exacerbated even more during the 2008 financial crisis. The crisis thus provided legitimacy to ethical funds due to the fact that these funds had done more in-depth research and to some extent were divested from risky companies, making the practice of looking at ESG issues particularly attractive to the mainstream. Finally, it was also during this period wherein the Principles for Responsible Investment (PRI), a U.N.-backed initiative formed in 2005 with only a handful of pension funds as signatories, experienced a surge in signatories. This initial boost occurred primarily as a response to the increasing pressures of clients, especially large public pension funds, demanding for a new type of

finance and corporate asset managers trying to gain reputational benefits, which they somehow lost during the crisis.

In response to the societal crises described above, the European Union has began to advocate for the importance of standardized reporting of whether and how sustainability issues are integrated in the investment process through calls for more transparency and the creation of the European Transparency code in 2004.[3] Some countries have been able to implement RI through supportive legislation at a local level. For instance, the Belgian Parliament has prohibited the investment in companies producing anti-personnel mines, sub munitions and depleted uranium weapons since 2007. This was imitated recently in France in 2010 wherein the French Parliament enacted a law prohibiting any direct or indirect financial assistance to the production or trading of cluster munitions. In March 2011, the Italian Senate approved a motion similar to that of France. More popularly, Norway's 'Petroleum fund' – its government pension fund worth NOK 2.1 billion (c. EUR 460 billion) as of March 2012[4] – has had ethical guidelines since 2004 which has prohibited investments in tobacco and arms production, among others. Legislation has passed more easily in some countries than in others: Sweden has been integrating ESG issues in its National Pension fund system since 2000 whereas a 2007 law proposed in Spain to oblige its pension reserve fund (worth around EUR 64 billion as of December 2010[5]) to invest 10% of its assets in a sustainable manner is still pending Parliament approval. On July 3, 2012 the European Commission proposed a regulation on the Key Information Document for investment products (KID), which is linked to a wider EU initiative for a better regulatory environment of package retail investment products (PRIPs).

[3] For instance, after the U.K. led the enforcement of the Pensions Act in 2000, requiring reporting from its pension funds, other member states such as Sweden (2000), France (2001), Germany (2002), Austria (2004), Belgium (2004), Norway (2004), Italy (2005), the Netherlands (2007), and Denmark (2008) followed suit. These legislations, however, have been mostly limited to government pension funds.
[4] Taken from http://www.nbim.no/
[5] Taken from http://www.seg-social.es/prdi00/groups/public/documents/binario/146674.pdf/

The number of signatories to the PRI is currently approaching 1,000 Asset Management firms, representing the management of over USD 30 trillion globally (PRI, 2011), a significant amount of the industry. Europe is the leading geography in RI with Assets Under Management (AUM) of EUR 5 trillion, representing more than 46% of the overall investment universe in Europe (Eurosif, 2010). In many ways, the diffusion of RI has begun to change investment logics to such an extent that recent scholars have pointed towards its 'mainstreaming' in particular geographies such as France (cf. Arjaliès, 2010). Figure 1.6 illustrates the evolution of RI assets under management and Figure 1.7 illustrates the breakdown of investor types in Europe.

Figure 1.6 RI AUM in Europe 2002-2009 (EUR billions)
(Adapted from: Eurosif European SRI Survey 2010)
Note: Market data coverage is evolving

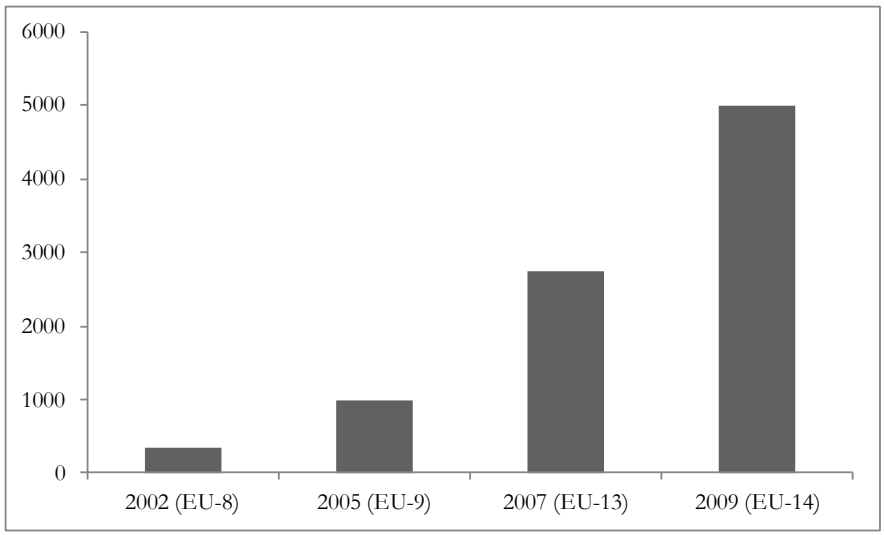
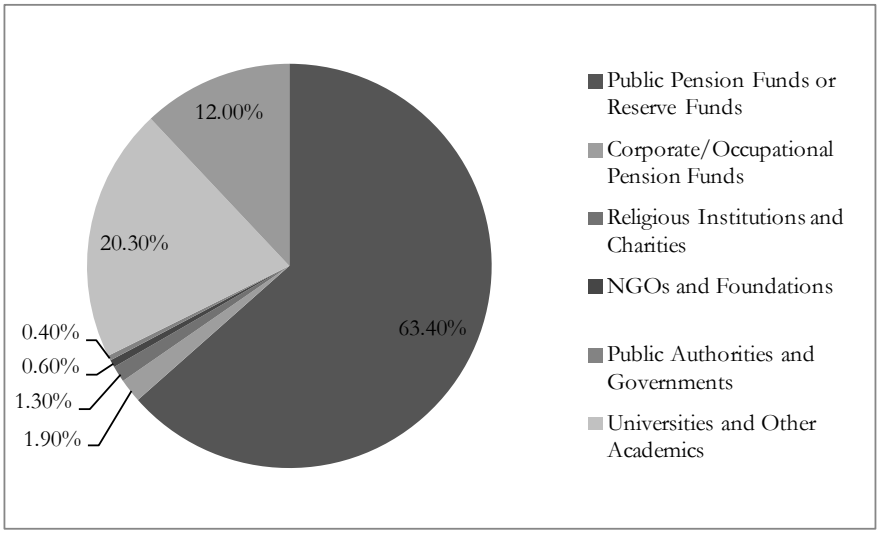


Figure 1.7 Type of Institutional Investors in Europe 2009 by Volume of SRI Assets (Adapted from: Eurosif European SRI Survey 2010)



1.3 Research Methodology

1.3.1 An abductive, exploratory, mixed-methods approach

RI within the European asset management industry, currently lacking a dominant, mainstream archetype, made it a very interesting time to examine the industry. Complexity is *especially* salient as meanings and practices are being constructed by heterogeneous actors in the field: insurance funds, pension funds, commercial banks, mutual funds, and the like. While RI has been examined using other perspectives, a deeper analysis was needed on how this phenomenon relates to institutions and organizational change. As such, this dissertation was largely a learning journey. Whereas it began by the perusal of performance studies which populate most studies within RI, it ultimately evolved into an exploratory, abductive (Dewey, 1925; Lorino, Tricard, & Clot, 2011) mixed-methods study which was appropriate for the complexity of the case and an approach that is largely lacking in the literatures. This work can be thought of mainly as a case study which mixes both qualitative and quantitative methods given the broadness of the research topic and the necessity to include the context as a major part of the study (Yin, 2009).

1.3.1.1 Qualitative approach

Chapter 2, which forms the theoretical basis for this dissertation, employs a qualitative approach which was well-suited given the non-apparent causality and ill-structured and complex links (Garud, Jain, & Kumaraswamy, 2002; Maguire, Hardy, & Lawrence, 2004). My co-authors and I perused interviews with significant decision makers in the asset management industry as our main source of data. We then triangulated this with archival data and participant observation in order to provide a contextual analysis of change (Creswell, 2009). The fact that the phenomenon is currently happening made it difficult to peruse historical data; further, currently available and reliable information from third parties remains scarce. This lack of information combined with the complex and exploratory nature of our research question made it imperative for us to contact key persons and retrieve information through direct dialogue.

We used the list of PRI signatories – which includes three types: asset owners, investment managers, and service providers – as our preliminary guideline to identifying the major organizations in the asset management industry involved in Responsible Investment.[6] We then defined the scope of our study as focused on Europe, the most important geography for RI.

I conducted a total of 25 semi-structured interviews with 28 persons[7] from May 2011 to July 2012 with a variety of respondents: all of which were at a Senior Managerial level with several years of experience in the industry that had insight into the strategic plans of the organization and more importantly, a strong understanding of the trends occurring within the industry. The interviewees represented organizations domiciled in 10 different countries with turnover ranging from EUR 0.45 billion to EUR 562 billion. While it would have been ideal to mitigate subject biases by using multiple informants,

[6] This list is available at http://www.unpri.org/.
[7] Three of these interviews were conducted by the third author in Italian. I was present during the conversation.

due to the fact that RI teams are relatively new and small (with some not formally existing at all), there was usually only one 'point person' in the organization who had the capability to answer our questions and we tried as much as possible to gain access to this person. Hence, our sample consists of one interviewee per organization, with the exception of two organizations which had two interviewees each. We are nevertheless confident that our interviews represent a sufficiently rich sample for two key reasons: first, because our informants were at the heart of organizational decision making and were key players in the field and second, because in our computations, our sample comprises organizations which cover assets under management of around EUR 2.8 trillion, which is roughly 56% of the total assets under management in Europe engaged in RI, able to capture a significant percentage of the industry and providing us with a rich narrative of the structure of the organizational field.

The interviews were semi-structured, following the structuration technique of Myers and Newman (2007). This means that given our research question, we had several preliminary ideas which we wanted to discuss. However, the discussion was ultimately guided by the responses of the interviewees and the interview questions evolved over time as our analysis evolved. Table 1.1 provides the structure of the interview questions and Table 1.2 provides the list of interviewees.

We perused archival data for three main reasons: first, to ensure more in-depth probing during the interviews; second, to cross-check the accuracy of facts and figures provided during the interviews and mitigate potential subject bias; and third, to substantiate our interview findings. We used the most recently available industry reports, sustainability reports, annual reports, and some additional reports directly provided to us by the interviewees in addition to online press releases and industry news. These reports are official records and represent trustworthy data which is of particular importance in an early stage of practice. Finally, our analysis is informed by knowledge gained from

continuous attendance to several RI-related practitioner events (provided in Table 1.3) as a form of participant observation over the four-year span of my Ph.D studies to make sure that I was very involved in the RI practitioner space.

Table 1.1 Semi-Structured Interview Questions

Section	Contents
Introductions	Explanation of research project Anonymity and recording
Relevant information	Description of the organization Description of the interviewee's previous experience and role within the firm
Personal views on RI	Main drivers of RI Difficulties in integrating RI
Investment Decision-making	Process of RI investment Challenges in the process Interaction of roles and management of divergent interests
Risk-return criteria	Links of practices to financial performance Decision process of ESG criteria
Engagement	Description of engagement process
Future of RI	Views on the evolution of RI Main hindrances

1.3.1.2 Quantitative approach

To address the second research objective of examining how rethinking is occurring within financial capital markets, I self-constructed and statistically examined a dataset of European SRI[8] mutual funds, an important sub-group of RI. Apart from their usual investment strategy, these funds use screening mechanisms, or the selection of investee firms based on pre-defined ESG and CBI criteria. The dataset uses a primary list of 529 Socially Responsible Mutual Funds domiciled in Europe as identified by the European Social Investment Forum (Eurosif). After adjustments from data availability and outliers, I reach a final unbalanced panel of 187 equity mutual funds for Chapter 3 and 88 equity mutual funds for Chapter 4. Historical financial data is provided by Morningstar and from public data sources, taking the time period April 2003 to March

[8] I use the term Socially Responsible Investment (SRI) mutual funds to distinguish from the broader field of Responsible Investment (RI)

2012. Figure 1.8 provides the evolution of mutual funds in the dataset and Table 3.1 provides the sources and uses of data.

Given that the boom in SRI mutual funds happened in the late '90's, as illustrated in Figure 1.8, the final panel captures a more recent time period of high but rather stable growth. The dataset is unique compared to previous studies in that it is focused on Europe, the most relevant geography for Responsible Investment. Further, our timeframe captures the period of the current financial crisis, which, to the best of my knowledge, has not been previously examined in the literature. The dataset is the most complete European dataset to the best of my knowledge.

Figure 1.8 Number of European SRI Funds Per Year Based on Inception Date (Total Initial Sample) adapted from Morningstar data

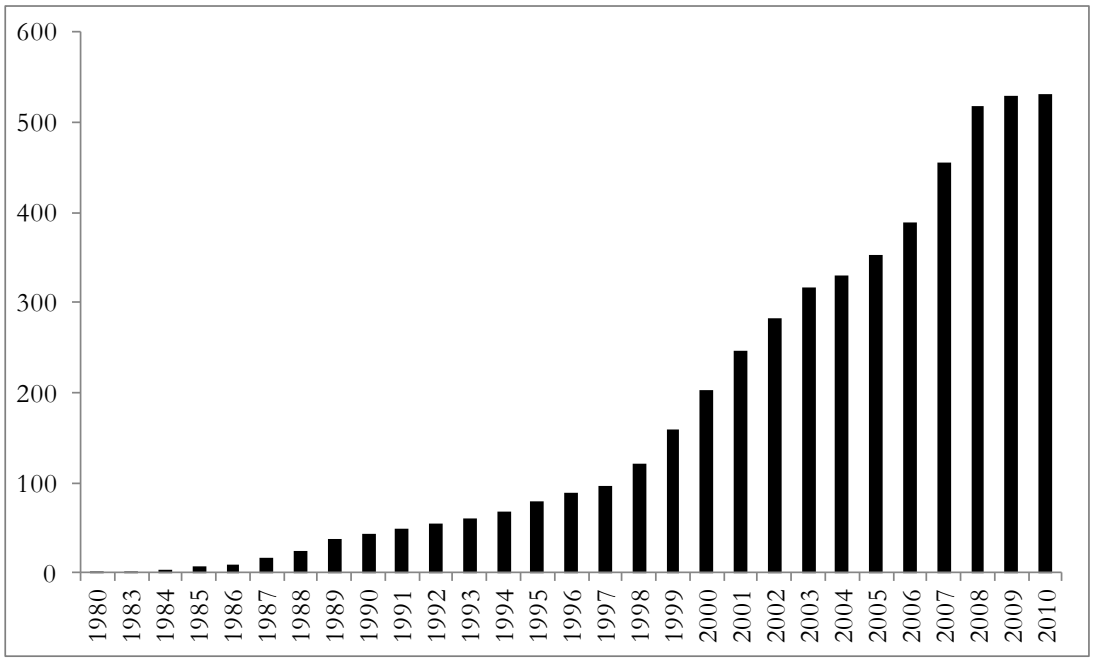


Table 1.2 List of Interviewees

Organization	AUM (EURbn)**	Type of Organization	PRI Classification	Domicile	Interviewee Function	Date of Interview	Record Length
APG	278.00	Pension Fund	Investment Manager	Netherlands	Head of ESG Integration	27/05/11	0h55
Triodos Bank	5.60	Retail Bank	Investment Manager	Netherlands	Sustainability Analyst	05/07/11	0h53
Etica SGR	0.45	Retail Bank	Investment Manager	Italy	Director General	26/07/11	1h03
Generali Investments*	324.30	Insurance Fund	Investment Manager	Italy	Head of SRI	27/07/11	1h34
AMF*	39.93	Pension Fund	Asset Owner	Sweden	Head of Business Development	19/09/11	0h41
Oddo Securities*	13.20	Investment Fund	Service Partner	France	Head of SRI Research	20/09/11	0h51
La Caixa Workers Fund*	3.95	Pension Fund	Asset Owner	Spain	President	21/09/11	0h58
Pioneer Investments	265.00	Investment Fund	Investment Manager	Italy	Head of Communications	28/09/11	0h34
BT Pensions*	55.00	Pension Fund	Asset Owner	U.K.	Trustee Director	13/10/11	1h06
SAM Asset Management*	11.30	Investment Fund	Investment Manager	Switzerland	Senior Analyst	18/10/11	0h36
UNPRI*	None	RI Initiative	None	Global	Executive Director	02/11/11	0h33
MSCI	None	Ratings Agency	Service Provider	U.K.	V.P. Commercial Relationships & Marketing	07/03/12	0h52
Alcyone	0.05	Investment Fund	Investment Manager	France	Head of SRI	07/03/12	1h03
Responsible Investor	None	RI Publication	Service Provider	U.K.	Publisher	08/03/12	0h42
Nordea	187.80	Retail Bank	Investment Manager	Finland	Director of Responsible Investments & Governance	08/03/12	1h05
Schroders	224.20	Investment Fund	Investment Manager	U.K.	Equity Analyst	08/03/12	0h34
Ionis*	8.70	Investment Fund	Asset Owner	France	Head of SRI	12/03/12	0h45
RCM	97.43	Investment Fund	Investment Manager	U.K.	Sustainability Analyst	12/03/12	0h52
Alliance Trust	3.56	Investment Fund	Investment Manager	U.K.	Senior Investment Analyst	19/03/12	0h56
Norwegian Pension Fund	460.00	Pension Fund	Asset Owner	Norway	Ethics Council Members (2)	18/04/12	0h57
West LLB	67.00	Retail Bank	Asser Manager	Germany	Head of SRI	30/05/12	1h13
Novethic*	None	Research Agency	Service Provider	France	Head of SRI Research	04/06/12	0h55
Natixis*	562.00	Investment Fund	Investment Manager	France	Head of SRI	05/06/12	1h12
Rabobank*	263.60	Retail Bank	Investment Manager	Netherlands	Program Manager – Responsible Investing	07/06/12	1h06
Generation Investment Management	7.00	Investment Fund	Investment Manager	U.K.	Director Head of Foundation	12/06/12	1h00
Total AUM	2.818						

*Interviewees for which face-to-face contact was also made

**Details based on interviews and company reports. Latest reported figures as of Dec. 2011

Table 1.3 Participative Observation

Date / Place	Event
June 2010 Brussels, Belgium	Annual conference: International Association of Investors in the Social Economy (INAISE)
June 2010 Florence, Italy	Meeting: Institute for Social Banking/Global Alliance for Banking on Values (ISB/GABV)
June 2011 Paris, France	Meeting with institutional investors: Chaire Finance Durable et Investissement Responsable (FDIR)
September 2011 Paris, France	Meeting: French Social Investment Forum (FIR)-PRI
March 2012 Paris, France	Academic-practitioner workshop (PRI-Mistra)
March 2012 Paris, France	PRI meeting of French signatories
April 2012 Paris, France	Meeting with institutional investors (FDIR)
May 2012 Webinar	ESG integration debate (MSCI)
May 2012 Paris, France	Academic-practitioner workshop (FIR-PRI)
June 2012 Paris, France	Academic-practitioner workshop (FIR-PRI)
June 2012 Paris, France	Meeting with institutional investors (FDIR)
July 2012 Paris, France	Meeting with institutional investors (FDIR)
October 2012 Paris, France	Europlace annual congress
March 2012 London, UK	Visit to the PRI Headquarters

Table 1.4 Sources and Uses of Data

Data	Uses	Source
Initial list from Eurosif	529 funds	Taken from http://www.eurosif.org/
Historical data coverage from Morningstar	April 2003 to March 2012 (108 months)	Data provided to the researcher by Morningstar
Funds for which screening criteria from Avanzi available	263 funds	Data provided to the researcher by Avanzi
Funds for which governance criteria from Avanzi available	263 funds	Data provided to the researcher by Avanzi
Final number after adjustments for outliers (Chapter 3)	187 funds	
Final number after adjustments for outliers (Chapter 4)	88 funds	
Historical data for Fama French and Carhart models	April 2003 to March 2012 (108 months)	Taken from Kenneth French website: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html/
Historical data for Market return (MSCI Europe Index)	April 2003 to March 2012 (108 months)	Taken from MSCI Europe website: http://www.mscibarra.com/products/indices/international_equity_indices/gimi/stdindex/performance.html/
Historical data for Risk Free rate	April 2003 to March 2012 (108 months)	Taken from Bundesbank website: http://www.bundesbank.de/Navigation/EN/Statistics/Time_series_databases/Macro_economic_time_series/its_details_value_node.html?tsId=BBK01.WZ9807&listId=www_s140_it03a/

1.3.2 Data Analysis and Research process: journey and epistemology

I went back and forth across the qualitative and quantitative analyses such that all three chapters were written simultaneously and were informed by and evolved alongside each other.

In analyzing the qualitative data, we used open-coding techniques to analyze the emergent themes, groupings, and hierarchies in the data until we reached 'theoretical saturation' (Glaser & Strauss, 1967) and stopped collecting data when we felt that we could confidently predict the responses (Miles & Huberman, 1994). We did this in four steps. The first step was to review all the printed transcripts in order to understand general ideas. The second step was to mark the transcripts, identifying emergent themes using codes. In this step, we employed theoretical sampling and pursued data relevant to the themes while at the same time used extant theory which allowed us to discover new themes, through an abductive manner. The third step was to transfer the relevant codes and supporting quotes to an organized NVivo software database which allowed us to structure the groupings and hierarchies. The fourth and final step was to cross check the accuracy of the data and substantiate our findings with archival sources and to link our findings to theoretical concepts and construct a narrative (Auerbach & Silverstein, 2003). In analyzing the dataset, we relied on statistical methods using Stata software to test the relationships between the independent variables screening intensity and sustainability governance practices on dependent variable measures of risk, return, fund flow, and fund flow volatility.

1.4 Findings and Contributions of the Dissertation

The objective of this dissertation is two-fold: first, to examine the mechanisms underlying institutional change within the context of field-level institutional complexity and within a situation of transition and second, to provide an illustration of whether and

how this rethinking is manifested within financial market models. This section narrates my findings, explains how they address the research questions, and attempts to comprehensively deconstruct the overarching theoretical contributions.

1.4.1 Institutional complexity within the European Asset Management Industry

This dissertation first and foremost attempts to move from theory to observation to empirics and finally, back to theory in describing and defining the context of study. Whereas we observed the emergence of sustainability issues within the asset management industry as manifested in RI, we were largely unaware as to what was causing this and how organizations within the industry were experiencing this. Previous studies have shown that formal pressures such as legislative initiatives or the existence of a common legal environment can affect an organization's behavior and structure. These rationalized systems and other legal and technical requirements of the state shape organizations (DiMaggio & Powell, 1983). Yet it is important to stress that whereas legislation on RI did increase towards the latter part of the study, it has been largely limited to disclosure (rather than actual integration) and mostly addresses public funds, leaving the adoption of the rest of the industry as largely voluntary. That is, legislation was not a strong enough force to explain the propensity of RI adoption in mainstream asset management.[9]

Given that legislation did not appear to be the main motivation for the adoption of this new practice, a second explanation could be the existence of a strong economic rationale to engage in RI. One of the main research streams in the strategy literatures holds that organizations engage in a practice based on their analysis of the industry and competitors and the economic outcomes of their decisions (e.g. Porter, 1980). From this perspective, there comes the idea that doing RI should provide a competitive advantage and be good for financial return. Admittedly, it is rather difficult to imagine that

[9] This finding is also formed from reflections of the interviewees.

mainstream asset managers decided to embrace a new role of solving societal problems without having an economic motive.

However, perusing studies comparing the financial benefits of sustainability integration show that decades of work in accounting and finance reached the same conclusion regarding responsible investments: that their benefits (detriments) to performance were inconclusive as compared to non-responsible investments (Juravle & Lewis, 2008; Renneboog et al., 2008a; Sjöström, 2009). Similarly, work in the field of corporate sustainability show conflicting results on the relationship between sustainability and financial performance. Indeed, the really pressing question is, why is this mainstreaming of a new paradigm occurring *in spite* of weak legislation and inconclusive evidence of financial performance?

The inconclusive results make clear the fact that analyzing the phenomenon from a purely economic perspective is insufficient. It also brings to light the apparent conflict between *institutional logics* (Friedland & Alford, 1991; Thornton & Ocasio, 1999a). Upon examination, several incompatibilities emerge between the traditional asset management practices based on a financial logic and the integration of sustainability issues based on a sustainability logic. For example, there is conflict in terms of the temporal dimension of the two logics. Listed companies are required to provide financial information to the public on a quarterly basis. Sustainability reports or sustainability information, on the other hand, are often updated annually at best. These imposed incompatible prescriptions: asset managers, while usually required to report on performance every 90 days, were now expected to take a long-term view at the same time. Conversely, taking a long-term horizon meant that asset managers could miss out on the profits provided by short-term trading, especially if he or she is good enough to anticipate the market ups and downs, making it all the more difficult to reconcile the profit motive with the long-term sustainability logic.

The institutional complexity (Greenwood et al., 2010) approach asserts that while firms are subject to institutional pressures (in this case, those of sustainability), they are concurrently embedded in rational action (in this case, having to make a profit on their investments) and have to make decisions by making sense of their institutional environments and technical considerations (cf. Battilana, Leca, & Boxenbaum, 2009; Cooper et al., 1996; D'Aunno, Succi, & Alexander, 2000; Kraatz & Block, 2008). This perspective addresses the fact that while logics are typically multiple – thereby providing alternative meanings which are subject to diverse interpretations, manipulation, and contestation (Friedland & Alford, 1991) – and in conflict – thereby fostering incompatible prescriptions upon the organizations in the industry (Lounsbury, 2007) – there are certain situations in which they are able to co-exist (cf. Dunn & Jones, 2010; Goodrick & Reay, 2011). The asset management industry was thus in a situation of tension between competing logics; with incompatible prescriptions being imposed. And it is within this situation of tension wherein rethinking is first triggered.

1.4.2 Conceptualizing the Asset Management Industry as a transition field

Having established the situation of conflicting logics within the field, we arrive at a notion central to this study: that of the *transition field*, and one of the key contributions of this dissertation. The conceptualization of the transition field addresses the need to examine how structural attributes affect organizations' experience of complexity. To understand this, one needs to go back to the definitions of *institutions, organizational fields*, and *institutional logics* in order to arrive at a characterization of the asset management industry as representing a new type of field, the transition field.

Institutions refer to shared rules – which can be as formal as laws or as informal as collective understandings – held in place by custom, explicit agreement, or tacit agreement (Fligstein, 1996). Institutionalization involves the processes by which social

processes, obligations, or actualities become institutions, that is, come to take on a rule-like status in social thought and action (Meyer & Rowan, 1977) or become accepted classifications built into society (Berger & Luckmann, 1966). *Organizational fields* are "sets of organizations that, in the aggregate, constitute an area of institutional life; key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products" (DiMaggio & Powell, 1983:148-149). Fligstein (1996) elaborates on this definition by considering how organizational fields (what he refers to as 'markets') are constructed and the roles that conceptions of control and politics play in this process. That is, he conceptualizes an organizational field as *embedded* within institutions. Recent institutional theorists have extended this idea to a firm level by conceptualizing organizations as embedded within *institutional logics* – or the underlying field-level identities that guide organizational action (Friedland & Alford, 1991; Thornton, Ocasio, & Lounsbury, 2012).

Fligstein (1996) and other institutional theorists have advanced rather clear conceptions of two types of organizational fields: stable fields and emergent fields. A stable field is defined as one in which the identities and status hierarchy of firms are well known and a conception of control that guides actors are shared. These fields have 'institutional scripts' (DiMaggio & Powell, 1983) that guide action and these stable institutional arrangements are manifested in widely accepted 'archetypes' (Cooper et al., 1996; Greenwood & Hinings, 1996). In mature fields, the dynamics of institutional logics are stable as long as the relationships between them are well-understood and predictable (Greenwood, Raynard, Kodeih, Micelotta, & Lounsbury, 2011).

An emerging field or a new market, on the other hand, is one wherein the institutional arrangements or the conceptions of control have yet to be defined and there is no accepted set of social relations (Fligstein, 1996). In the case of an emergent field, such as Microfinance, organizations have to build their practices without having

archetypes to follow (Battilana & Dorado, 2010). As compared to mature fields, organizations in emergent fields have more discretion in creatively responding to institutional demands given 'the ambiguity and the lack of specification of institutional prescriptions' (Greenwood et al., 2011).

The Asset Management industry in Europe, in its situation of institutional complexity, displays characteristics unique to previous studies examining mature and emergent fields. The asset management industry is an organizational field embedded in a dominant institutional logic of finance. This *financial logic* subscribes to a 'traditional view' of economic theory going back to expected utility theory which argues that investors are rational and wealth maximizing (Von Neumann, Morgenstern, Rubinstein, & Kuhn, 2007). Further, most asset managers have a *fiduciary duty* to act in the interest of their clients and are incentivized in the form of *management fees*, which adhere to financial theoretical concepts of agency theory and contract theory (Bolton & Dewatripont, 2005; Jensen & Meckling, 1976; Tirole, 2006). Thus, not only is the *financial logic* dominant in the industry, it is legally enforced and manifested in the existence of devices and practices that reinforce the strength of the logic. Finally, the asset management industry is largely 'quantitative', having formulas, data to plug into them, computers to calculate them, and electronic networks to connect them all (Beunza & Stark, 2004). To wit, the asset management industry is a stable field embedded in a dominant financial logic.

With the advent of global discussions surrounding sustainable development, a *sustainability logic* has recently penetrated the asset management industry. Yet, there was no agreed-upon definition of sustainability that would enable its immediate legitimate acceptance within the industry. Unlike other instances of conflicting logics wherein an emerging logic had a high level of theorization due to a social movement (Rao, Monin, & Durand, 2003) or a logic was 'borrowed' from another stable field (Reay & Hinings, 2005; Thornton, 2002; Thornton & Ocasio, 1999a), the sustainability logic emerged as

undefined. That is, most accounts of sustainability can be interpreted not as a true conceptualization of sustainability but rather, as how organizations would *like* to understand sustainability (Gray, 2010). As such, potential adopters of the sustainability logic across the asset management industry are heterogeneous with regards to their rationales and practices. Further, the diversity of organizations contributed to this transition situation. Greenwood et al. (2011) argued that organizational attributes act as 'filters' which moderate the degree to which complexity is experienced, and will consequently influence their responses. Indeed, the variety of organizations contributed to the difficulty in integrating the undefined logic. Finally, there was a lack of tools and models to facilitate institutional change.

Hence, in the asset management industry, we find an entirely new type of field, what we refer to as a *transition field*. It is a mature field used to 'regularized inter-organizational relationships' and having 'articulated institutional infrastructure' (Greenwood et al., 2011) that faces undefined institutional prescriptions with the emergence of a new, *un*theorized logic that appears incompatible with the field's existing logic. This is a relevant contribution to the literature because institutional complexity is *especially* salient for organizations during this period of transition wherein the dynamics of competing logics are at a tension between institutional maintenance and creation. Indeed, it has been pointed out that institutional complexity will be relatively low for mature fields because 'given a relatively predictable and consistent set of competing institutional demands, organizations should be better able to respond to institutional complexity by developing appropriate internal structures and practices' (Greenwood et al., 2011:336). Whereas in emergent fields, organizations may experience either a low degree of institutional complexity because of the flexibility they have due to a high degree of complexity when there is a complicated balance of interests stemming from practices rooted in logics from other fields. In a transition field, organizations need to remain

embedded in their institutional environment whilst engaging in the creation of new practices within a high level of uncertainty.

Understanding and establishing the characteristics of the field is an important starting point which contextualizes the phenomenon to be analyzed. The conceptualization of a transition field further answers recent calls to provide attention to field-level structures and their relationship to the underlying processes of institutional complexity (e.g. Glynn & Lounsbury, 2005; Marquis & Lounsbury, 2007) and brings to light a significant neglect in previous work.

1.4.3 Logic assimilation in a transition field

Experiences of institutional complexity can differ and the structural dimension of fields is one determinant of how organizations 'construct the repertoire of responses available to them' (Greenwood et al., 2011). Because of the characteristics of field that they were in, organizations in a transition field were pre-disposed to make sense of competing logics in a different way than organizations in a mature field or an emergent field. That is, they did so in a form of *logic assimilation*. Logic assimilation was first defined by Thornton et al. (2012) as consisting of combining elements of an emergent logic into a prevalent logic while maintaining the original logic. We substantially enhance this broad definition by empirically illustrating and specifying that in logic assimilation, a recursive process occurs through two core mechanisms: it involves (1) the usage of established (incumbent) logics to frame and translate the undefined logic to align it with the dominant logic in a process of *logic theorization* and simultaneously, (2) the redefinition of the incumbent logic and its archetypes based on the characteristics of the incoming new logic through a process of *logic-archetype elaboration*. Thus, logic assimilation is the sense-making process imposed upon organizations by an *un*theorized logic and 'feeding

back' into the dominant logic, the consequence of which is the elaboration of the incumbent logic and its archetypes that possess new characteristics.

Through logic theorization, asset managers were able to form new theoretical conceptions of the untheorized logic of sustainability that was acceptable to themselves as players embedded in the financial logic. They first did this by 'translating' the sustainability language into a financial language more understandable to asset managers. They simultaneously used models and tools to assist them in theorizing and attempted to quantitatively measure different ESG parameters, leading to the birth of rating agencies as well as a diffused amount of work on new 'triple bottom line' type measurement systems. Through our findings, we elaborate on previous definitions of theorization by illustrating that through the creation of models and tools, logic theorization – that is, the creation of an interpretative scheme and ideological coherence underlying a logic – and the diffusion of new ideas happen *simultaneously* in a transition field.

Recursively, asset managers began to rethink the financial logic itself in which they were embedded by examining the drivers of performance and risk given the characteristics of the sustainability logic and in doing so began to elaborate the financial logic and its embedded archetypes by introducing characteristics of the new logic. Asset managers began to create and subscribe to the belief that examining non-financial issues would provide informational benefits that would enable them to make better predictions for the future. They also began to believe that that it was imperative to engage in the practice of Responsible Investment because of the strong demand from and the 'stickiness' of RI clients. That is, they began to believe in the material benefits of having a clear RI strategy. By doing so, they were able to legitimize the practice by assimilating new sources of performance and risk brought about by the logic of sustainability.

In logic assimilation, radical change does not occur in which organizations abandon an institutionalized template for arranging their core activities. They also could

not make divergent changes because they did not have non-local models of change available in other sectors or organizations. Instead, asset managers began to subscribe to a new theoretical conception which enabled the sustainability logic and the financial logic to co-exist, downplaying their conflicting demands.

In sum, in a situation of institutional complexity in a transition field, paradigms change slowly through the recursive mechanism of logic assimilation which entails both the theorization of the undefined logic and the elaboration of the dominant logic and its archetypes. Our specification of these mechanisms substantially enhances previous accounts of theorization (Greenwood et al., 2002; Strang & Meyer, 1993; Tolbert & Zucker, 1999) by emphasizing not only the significant role of models and tools in theorization but further positing that theorization and the diffusion of ideas occur simultaneously. We emphasize how this may link to studies of performativity in Social Studies of Finance that focus upon the role that tools and models play in the institutionalization of practices (e.g. Arjaliès, 2013; Callon & Muniesa, 2005) and highlight how financial markets are *performative* (Callon, 1998) in that theories, beliefs, ideologies, and material artefacts affect their creation and operation (Beunza & Stark, 2004; MacKenzie & Millo, 2003; MacKenzie, 2006). We also enhance previous accounts of logic elaboration by emphasizing the fact that upon elaborating a logic, its organizational structures and systems – archetypes – also change. As such, we uncover a more nuanced description of logic assimilation in a transition field.

1.4.4 Enabling organization as facilitating logic assimilation

Finally, we find evidence that the PRI was instrumental in that it acted as a facilitator in the process of logic assimilation. Previous studies have highlighted the role of regulatory agencies and professional associations in institutional change (Greenwood et al., 2002). These external bodies play an important role in this process of theorization

by endorsing local innovations and shaping their diffusion; yet, more research on such and other external facilitators is needed. The PRI is unique in that while having some characteristics similar to a regulatory agency or professional associations, it also played an advocacy-type role that called for collective action and provided infrastructure for such action (Gond & Piani, 2012). The PRI is thus an enabling organization which allowed logic theorization and logic-archetype elaboration to take place. Such an enabling organization was particularly important in a situation wherein models and tools were lacking. Because of the initial absence of models and tools related to sustainability, the PRI created ways for asset managers to take financial models and concepts and use these to frame sustainability, providing the latter with the possibility to be defined by the same language.

1.4.5 How rethinking is performative: the assimilation of new sources of risk

Informed by Chapter 2, we take a step further in Chapters 3 and 4 and illustrate whether and how logic assimilation is occurring and manifested within financial market pricing models. Chapter 3 begins by highlighting the changes in investor beliefs regarding the drivers of financial risk and addresses the need for more comprehensive research on the theoretical motivations underlying the growing phenomenon of RI. In particular, it moves away from the performance debate and focuses instead on a reconceptualization of idiosyncratic risk and fund flow volatility.

Asset managers are assimilating new conceptions of risk. Through logic assimilation, two things occur: first, sustainability informational benefits lead to a decrease in idiosyncratic risk at a substantive level of SRI and second, the client 'stickiness' from moral considerations and legitimacy provided by SRI screening lead to lower levels of fund volatility, also at substantive levels of SRI. What I observe is the following: if we take the financial logic as a lens, idiosyncratic risk should increase with

an increasing number of SRI screens. When a fund increases its screens, it becomes more and more selective, decreasing its investable universe. Yet, what instead happens is that from a certain level of screening, idiosyncratic risk actually reduces, which goes against the expectation of modern portfolio theory. This opposite effect supports the claims of RI proponents that examining sustainability issues can provide increased informational benefits which allows the fund to make better (more selective) investment decisions. The same trend occurs when we take fund flow volatility as the dependent variable. The volatility increases as the number of screens increases yet starts to decrease from a high level of screening. This latter result supports the claim for the legitimacy benefits gained by firms having high sustainability performance. This is in line with some behavioral studies which argue that individuals make decisions based on cognitive limitations of their minds (cf. Simon, 1955) and through framing (Kahneman & Tversky, 1979, 1984; Statman & Caldwell, 1987) and posit that individuals may willingly choose immaterial utility such as happiness or satisfaction gained from moral considerations (Beal, Goyen, & Philips, 2005; Gao & Schmidt, 2005) and incorporate other decision variables (such as extra-financial variables) into their investment decisions (Keller & Siegrist, 2006; Lewis & Juravle, 2009; Nilsson, 2007). The strength of client considerations in RI was also illustrated by Beunza and Ferraro (2010) in that the Wall Street clients were the crucial arbiters of what ESG offerings to include. The authors touched upon the notion of legitimacy in their study when they illustrated that being part of the 'big tent' (the PRI) was advantageous especially in the absence of concrete results in performance. However, they strongly point out how *decoupling* occurred wherein there was little diffusion of novel investing practices, despite the strong allegiance to the principle behind them.

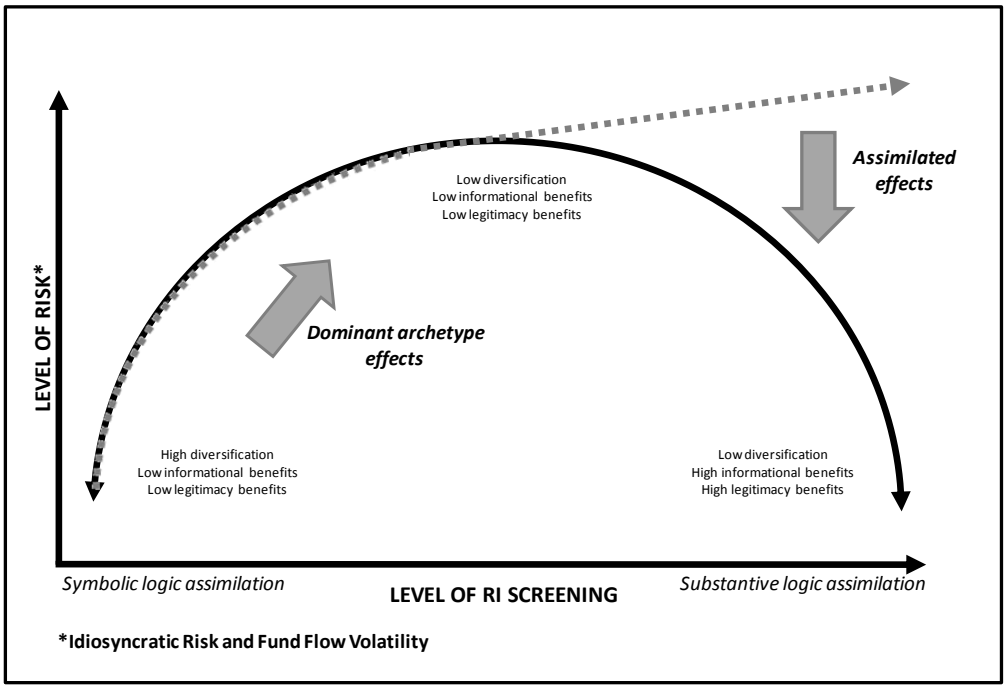
How can we link these results to logic assimilation and performativity? We can think of the level of SRI screening as a continuum of a given fund's assimilation of the sustainability logic. A low level of commitment represents almost no integration of

sustainability issues and likewise no real change in the financial logic. Even as the fund increases its SRI screening and thus increases the assimilation of the sustainability logic, the financial logic remained largely dominant. Thus, it is only from a certain level of assimilation that the effects of sustainability begin to offset those of the dominant logic. Figure 1.9 illustrates this effect.

This downward effect supports previous work which has shown that value added comes in the exchange of information between teams, especially when the situations are unique and non-routine (Beunza & Stark, 2004) and that moral attributes potentially provide high levels of stability. I concur with Derwall et al. (2005) and Lee and Faff (2009) in proposing that financial markets factor in the economic consequences of sustainability into current share prices and that current asset pricing models are inadequate in that they are unable to fully capture the influence of such sustainability-related issues. However, my results provide a substantial addition in that they go beyond anecdotal evidence and illustrate that the assimilation of sustainability issues within financial models is by no means a 'yes' or 'no' question and is instead a complex process.

The findings stress how traditional models of finance *remain* dominant yet how new ideas related to sustainability are *gradually* penetrating and manifesting their presence. This is a clear example of the performativity of logic assimilation wherein the logic of sustainability is theorized and the logics of finance and its archetypes are being elaborated and manifested in market models.

Figure 1.9. The assimilation of new sources of risk



1.4.6 How rethinking is performative: Sustainability Governance in RI

A second illustration of logic assimilation is through the examination of sustainability governance practices within SRI mutual funds (Chapter 4 of this dissertation). Governance involves internal or external systems of laws, rules, and factors that control operations at a company (Gillan & Starks, 1998) and mainly stems from agency theory which posits that control is required to prevent important conflicts of interests between the principal (the shareholder) and the agent (the manager). Without this control, the latter may diverge from his duties to the former and pursue practices which benefit his own interests at the expense of those of the former's (Eisenhardt, 1989; Jensen & Meckling, 1976). The mechanisms deemed to be relevant for performance are governance issues which are linked to the dominant financial logic such as board structures and managerial incentives, whereas in a fund management context they include share redemption, board structures and fund management fees (Del Guercio, Dann, & Partch, 2003; Tufano & Sevick, 1997). Issues relating to sustainability are far less examined. However, we are beginning to find evidence in the accounting literatures that

these are beginning to be significant (cf. Blacconiere & Northcut, 1997; Blacconiere & Patten, 1994; Dhaliwal, Li, Tsang, & Yang, 2011). Thus we address the question, *do sustainability governance practices affect financial performance and fund attractiveness?* investigating in particular, sustainability disclosure, sustainability activism, and sustainability research.

As presented in Table 1.5, we find that providing information related to a fund's SRI criteria – or the ESG and CBI criteria it uses to include or eliminate investee firms in its portfolio – is positively related to financial performance. This finding is in line with previous literature which posits that sustainability disclosure signals positive sustainability performance and such sustainability performance is rewarded by capital markets. As such, we add to previous findings that argue that sustainability disclosure should be taken into consideration as part of a firm's overall disclosure strategy (Richardson & Welker, 2001) since it plays a role in investors' evaluations of investment desirability (Patten, 1990). However, we do not find evidence that 'too much' disclosure through the provision of information related to SRI strategy – details on the investment process of how a fund selects and analyzes its investee firms – is negatively related to financial performance. This finding perhaps illustrates that the SRI investment strategy in itself is not yet a clear competitive advantage for these firms.

We find that engaging in a deep level of sustainability activism, such as the practice of regularly providing investee firms with profiles detailing their Social, Ethical, and Environmental situation, detracts from the bottom line and is negatively related to performance. This contributes to previous accounts of shareholder activism that have provided similar negative results, highlighting that such activities may impose substantial costs and distract managers from their main tasks which could be detrimental for performance.

Finally – and much to our surprise – we do not find evidence that having an internal sustainability research team is significantly positively related to financial

performance. This may again be a reflection of the fact that the field and its practices are still in construction and the costs of investing in such a team outweigh its benefits, particularly given the low level of quality of sustainability reporting from firms.

Our results on fund attractiveness, or the ability of a fund to attract more assets from clients, are more interesting. We posited that due to the fact that SRI investors have a moral concern, they are more likely to support a fund that displays a strong amount of commitment to sustainability, above and beyond the financial performance of the fund. While we do not find evidence that the disclosure of SRI criteria is positively related to fund attractiveness, we do find, however, that disclosing the SRI strategy has a negative relationship with fund attractiveness, showing that such type of disclosure has a negative effect on the legitimacy of the fund. While we expected that a deep level of sustainability activism would increase fund attractiveness, we find evidence to the contrary. Instead, we find that funds engaging in a deep level of activism are those with a very high level of screening and tend to ask for higher client fees. As such, this activism appears to drive down the attractiveness of the fund to a broader set of investors. Finally, we find evidence that having an internal sustainability research team is positively related to fund attractiveness. This finding supports the notion that having an internal team provides an important signal of legitimacy for an SRI fund.

When we examine governance mechanisms as a whole, we find that the relationship between governance intensity (the total amount of sustainability governance practices a fund engages in) and financial performance has an overall negative trend whereas the relationship between governance intensity and fund attractiveness is positive. These findings point towards a rather interesting illustration of assimilation; it appears that despite a negative underlying impact, investors are willing to support a well-governed fund. The performance impact, however, remains largely dominant.

Again, the above results on sustainability governance illustrate how performativity is occurring within the asset management industry and how traditional models of finance *remain* dominant yet how new ideas related to sustainability are *gradually* penetrating and manifesting their presence. We show in a first attempt that governance practices related to sustainability issues – often overlooked in the literatures – are value-relevant, but that such results are by no means straightforward. Instead, investors are discerning regarding which type of sustainability governance practices should be rewarded (penalized), highlighting how such assimilation is a performative and contested process and its manifestation in market models is constantly being constructed and adapted.

These two quantitative studies illustrate the workings of logic assimilation within a dataset of SRI mutual funds by showing how non-financial issues begin to have manifested effects on risk and return and how institutional complexity in a transition field is managed not through a straightforward process of direct translation, but rather, through a recursive, performative process. That is, it illustrates how agents are reflexive and make sense of what is to be assimilated. In doing so, this chapter challenges conventional financial theory and brings to light how traditional investment models are inadequate in capturing the increasing importance of sustainability issues as the asset management industry evolves and illustrates how such issues are gradually being assimilated within the industry's established logics and archetypes.

1.5. Concluding Remarks

Rethinking Finance is the logic assimilation occurring within the transition field of the European Asset Management industry due to the presence of an untheorized sustainability logic. To *rethink* means to involve oneself in reconsideration, and to think about something again, with a view to modifying one's opinions.

When we examine financial markets, it is impossible to ignore economic motives as the overarching and dominant template with which all things become measured. However, we also see the many situations in which this dominant template has failed – in situations such as market bubbles and crashes. Indeed, decades of work in behavioral finance have questioned pure economic motivations and put forward the notion of frames and non-financial considerations of individuals such as ethics and happiness as limitations to the pure economic framework of investing. In the case of Responsible Investment, I observe and illustrate how the dominant template does not completely change but can become gradually assimilated, addressing the paradoxical question of why this mainstreaming of a new paradigm is occurring in spite of such a complex situation. This work effectively challenges conventional financial theory and brings to light how traditional investment models are inadequate in capturing the increasing importance of sustainability issues as the asset management industry evolves.

The results of this dissertation are an initial and exploratory indication of how rethinking occurs in a situation of institutional complexity and within a transition field – particularly during a colossal system breakdown. In doing so, it incorporates the notions of conflicting logics, institutional embeddedness, and logic assimilation within previous work in the Social Studies of Finance, harmonizing complementary views from Institutional theory. It further goes beyond previous ethnographic and descriptive work and illustrates how such a reconceptualization of previously well-established beliefs *perform* markets and become manifested in financial models, leading to gradual practice transformation, thus providing an important empirical linkage between the experience of institutional complexity and actual practice change in financial markets. Overall, this dissertation allows us to better understand the mechanisms underlying institutional change in a transition field and thus answers previous calls for more in-depth studies of

the underlying processes of institutional complexity (Greenwood et al., 2011; Pache & Santos, 2010).

The introduction of new paradigms – Rethinking – echoes the social construction of markets; Actors reflect upon taken-for-granted structures and the institutional logics that guide their world and act collectively to theorize and elaborate logics to fit their purposes, enabling practice diffusion. Such a process of field-level change, as it is reflexive and contested, is a performative process. New practices can become assimilated within embedded logics yet assimilation is not a straightforward process; instead, organizations apply discretion on the issues that matter to them. Thus, organizations in a transition field are in a constant search for solutions.

Further research can enrich this study by examining other empirical examples of transition fields, by further specifying the characteristics of such fields, and by particularly focusing on the role of tools and models in the process of logic assimilation. I encourage further researchers to tease out the characteristics of an enabling organization and deepen our understanding of their role in the processes of institutional change. Finally, I encourage additional work on the extension of quantitative studies to include longer timeframes and richer data.

This dissertation comes at a time of major reflection in the industry and one of the main strengths of this work is the fact that it focuses on a highly relevant field and phenomenon, which I felt from the very beginning to be imperative. I chose the context significantly because examining the role of finance in society is a highly relevant focus of contemporary debate amongst policy makers, practitioners, and scholars across a broad range of fields.

Several questions that this dissertation might pose are, what is the future of Responsible Investment? Is the mechanism of logic assimilation strong enough to truly create a new paradigm for Finance? Or will sustainability issues be "eaten up" – so to

speak – by the dominant template and ultimately cease to exist? These questions force us to consider the temporality of this particular transition field: that is, the fact that this situation will not last and that in order for RI practice to take hold, institutionalization will need to occur. Such institutionalization follows from successful theorization; and only in such a case will the ideological coherence of ideas, beliefs, and values trickle down towards organizational structures and systems, which will transform practices into routines (e.g. Lawrence & Suddaby, 2006; Pentland & Feldman, 2005) to be institutionalized. Importantly, the effect of the financial crisis on this process of structuration remains to be seen.

Yet the mechanisms we see in place are a necessary first step. My findings do present an interesting case for asset managers. Engaging in RI remains attractive because of its unique risk profile, which however, mainly supports a case for a deep level of commitment, entailing a deeper engagement with firms and a better understanding of sustainability issues. Implications of this in practice point towards increased standardization of performance measures, the creation of models and tools, and increased specialization of sustainability roles through training and other knowledge-building practices. There are also implications, perhaps, on the role of better marketing, communication, and transparency of RI funds in order to attract and retain 'sticky' clients.

This work also brings us to question whether sustainability issues will really have a substantial impact on pricing in the long term, thus questioning the strength of the role of asset managers in constructing the field, their ability to influence prices, and whether this effect is consistent and permanent. We highlight the fact this study sheds light on the reality and plausibility of the integration of sustainability in the financial sector – arguably the most important sector today – a sector which, not only due to its complexity but also

due to its damaged reputation in the recent crisis can potentially provide real solutions to pressing social concerns despite its seeming to be a most unlikely candidate.

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Table 1.5 Logic assimilation in terms of RI governance and performance

	Performance Measures					Attractiveness Measures: Flow Rf			Attractiveness Measures: Flow RAP		
	RAP	**FF Alpha**	**Carhart Alpha**	**Sharpe**	**Info Ratio**	**Model 1**	**Model 2**	**Model 3**	**Model 1**	**Model 2**	**Model 3**
Disclosure of SRI Strategy						+ +	+ + +	+ +			
Disclosure of SRI Criteria		+ +	+ +								
Deep Activism	- - -					- - -	- - -	- - -			
Fully Internal Research						+ +	+				
Governance Intensity	- - -			- - -	- - -	+ +	+	+ +	+		+
+	Assimilation of Sustainability-related governance issues (number of + relates to higher degree of statistical significance)										
-	Maintenance of Dominant financial logic (number of - relates to higher degree of statistical significance)										

Table 1.6 Summary of Research Outcomes

Chapter	Research questions	Data & Analysis	Theoretical lenses	Key Findings and Contributions
Chapter 1. Institutional Complexity in a Transition Field: Responsible Investment in the European Asset Management Industry	How do organizations experience and respond to institutional complexity in a transition field?	25 semi-structured interviews; Archival documents; Participant observation Open-coding using NVivo	Institutional theory Social studies of Finance	1. Conceptualization of a *transition field* as one having a low level of theorization – a mature field facing penetration of an *un*theorized logic. 2. Logic assimilation as occurring when there is institutional complexity in a transition field and consisting of logic theorization and logic-archetype elaboration 3. Enabling organization as assisting in the assimilation of logics
Chapter 2. Responsible Investments: the Assimilation of New Sources of Risk	How does RI screening impact and redefine financial risk?	Database of 529 European SRI Mutual funds (187 final dataset) Statistical analysis using Stata Interviews from Chapter 1 used illustratively	Portfolio theory Agency theory Behavioral Finance RI studies	1. New beliefs in risk are occurring which includes informational benefits from sustainability and legitimacy from RI 2. The relationship between RI screening and idiosyncratic risk is positive and concave 3. The relationship between RI screening and fund flow volatility is positive and concave
Chapter 3. Rethinking Finance: Sustainability Governance in Responsible Investment	Do sustainability governance practices have an effect on financial performance and fund attractiveness?	Database of 529 European SRI Mutual funds (88 final dataset) Statistical analysis using Stata	Governance studies Accounting studies	1. Providing information related to SRI criteria is positively related to financial performance 2. Providing information related to SRI strategy is negatively related to fund attractiveness 3. Deep sustainability activism is negatively related to financial performance and fund attractiveness 4. Internal research is positively related to fund attractiveness 5. Governance intensity is negatively related to financial performance and positively related to fund attractiveness

CHAPTER 2

Institutional Complexity in a Transition Field: Responsible Investment in the European Asset Management Industry

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Abstract

This chapter answers recent calls for more comprehensive research on the processes underlying institutional complexity. In particular, we highlight that a key neglect in previous research is that it has tended to study how institutional change can occur in mature and emergent fields wherein logics are highly theorized. However, no attention has been paid to situations wherein institutional complexity is especially salient; that is, when it is triggered by a logic that is not yet theorized. This paper aims to address this neglect by exploring the field-level dynamics arising from institutional complexity in mature fields with stable institutional arrangements that face substantial transformation with the emergence of an *un*theorized logic that appears incompatible with the field's existing logic: what we refer to as 'transition fields'. It does so by means of an abductive exploratory case study of the development of Responsible Investment within the Asset Management industry in Europe. We analyze the ways in which institutional complexity is experienced in the asset management industry as organizations begin to incorporate sustainability issues within their traditional investment practices. We find that due to the transitional nature of the field, organizations made sense of complexity by undergoing a process of *logic assimilation*, which has two core mechanisms: *logic theorization*, or the usage of established (incumbent) archetypes to frame and translate the undefined logic in order to make it compatible with the prevailing logic and *logic-archetype elaboration*: the redefinition of the incumbent logic and its archetypes based upon the characteristics of the new logic. We further find that the logic assimilation process was facilitated by an enabling organization, leading to gradual practice transformation. Our study contributes to a better understanding of how Responsible Investment practices can become mainstream within the financial sector, driving profound institutional change.

Keywords

Institutional complexity – Institutional logics – Responsible Investment – Enabling organization

Estratto

Questo capitolo risponde ai recenti bisogni di una ricerca più completa sui processi alla base della "institutional complexity". In particolare, evidenziamo che una trascuratezza importante nella letteratura precedente consiste nella tendenza a studiare come il cambiamento istituzionale si verifichi in settori maturi ed emergenti, dove le logiche sono altamente teorizzate. Tuttavia, nessuna attenzione è stata ancora rivolta alle situazioni in cui la "institutional complexity" è particolarmente forte, cioè quando viene attivata da una logica che non è ancora teorizzata. Questo lavoro si propone quindi di colmare tale negligenza, esplorando le dinamiche a livello di settore in settori maturi con istituzioni stabili. Queste istituzioni affrontano una trasformazione sostanziale, con la progressiva comparsa di una logica non teorizzata, che appare incompatibile con la logica esistente nello stesso settore: questi tipi di settori maturi vengono chiamati "transition fields". Questa analisi viene condotta per mezzo di un "abductive exploratory case study" focalizzato sullo sviluppo degli investimenti responsabili nel settore dell'Asset Management in Europa. In questo capitolo analizziamo le modalità con cui la "institutional complexity" viene sperimentata nel settore del risparmio gestito, dal momento che le organizzazioni iniziano a integrare le questioni di sostenibilità all'interno delle loro pratiche di investimento tradizionali. Riscontriamo che a causa della natura transitoria di questo settore, le organizzazioni rispondono alla "institutional complexity" con un processo di *logic assimilation* che ha due meccanismi fondamentali: 1*) logic theorization*, ovvero l'utilizzo della logica esistente per strutturare e tradurre la logica non-teorizzata al fine di renderla compatibile con la logica prevalente e 2) *logic-archetype elaboration*: la ridefinizione della logica esistente ed i suoi archetipi basati sulle caratteristiche della nuova logica. Abbiamo inoltre scoperto che il processo di logic assimilation è stato facilitato da un *enabling organization*, che supporta una trasformazione graduale delle pratiche di investimento responsabile. Il nostro studio contribuisce anche ad una migliore comprensione di come gli investimenti responsabili possano diventare largamente diffusi all'interno del settore finanziario, guidando un profondo cambiamento istituzionale.

2.1 Introduction

Over the past years, several scholars have tried to understand the processes and mechanisms underlying field-level institutional change. Doing so entails an investigation of how 'institutional logics' are disturbed and amended and how organizations cope with these logics (Thornton & Ocasio, 2008). At an industry level, logics consist of the 'identities and valuation orders that structure the decision making and practices of players in a product market' (Thornton & Ocasio, 1999:805). However, this undertaking is by no means a straightforward task. We know from recent work that institutional environments are often fragmented (Lounsbury, 2007) and governed by multiple and competing logics that can co-exist (cf. Dunn & Jones, 2010). Since logics are typically multiple, they provide alternative meanings which are subject to diverse interpretations, manipulation, and contestation (Friedland & Alford, 1991). Since they are typically in conflict, they foster incompatible prescriptions upon the organizations in the industry (Lounsbury, 2007) in a situation known as 'institutional complexity'(Greenwood, Diaz, Li, & Lorente, 2010). Institutional complexity further asserts that while organizations are subject to institutional pressures, they are concurrently embedded in rational action and have to make decisions by making sense of their institutional environments and technical considerations (cf. Battilana, Leca, & Boxenbaum, 2009; D'Aunno, Succi, & Alexander, 2000; Greenwood & Hinings, 1996; Kraatz & Block, 2008).

Examining the logics in themselves, the dynamics between logics, and the experiences of the organizations that cope with these logics in the context of institutional complexity has merited scholarly attention. However, the difficulty underlying this task has brought scholars such as Greenwood et al. (2011) to caution in a recent literature review that empirical work on these processes is "scattered and largely suggestive". Similarly, while previous work has shown how logics may be transformed "through various mechanisms", calls abound for a better understanding of how strategic responses

to such complexity are conceptualized and implemented (Thornton, Ocasio, & Lounsbury, 2012) and for systematic predictions about the ways in which organizations respond to such conflict (Pache & Santos, 2010).

In response to these calls, we highlight that a key neglect is found within studies examining the relationship between field-level structure and the experience of institutional complexity (Greenwood et al., 2011), particularly in relation to a field's level of stability. That is: previous research has tended to study how institutional change can occur in mature and emergent fields wherein logics are highly 'theorized'. Theorization consists of "the development and specification of abstract categories and the elaboration of a chain of causes and effects" (Greenwood, Suddaby, & Hinings, 2002:60). Theorization leads to a common orientation and an underlying 'interpretive scheme' that offers ideological coherence manifested in a configuration of widely accepted forms and structures that represent recognizable and typical patterns of behavior with certain probable outcomes, commonly referred to as 'archetypes' (cf. Cooper, Hinings, Greenwood, & Brown, 1996; Greenwood & Hinings, 1993; Ranson, Hinings, & Greenwood, 1980). This interpretive scheme is a similar concept to logics in that it is composed of a set of ideas, beliefs, and values that underpin an organization's structures and systems (Greenwood & Hinings, 1993). It has been pointed out that the importance of theorization is likely to be especially acute in mature fields (Greenwood et al., 2002) and that archetypal coherence will exist when there is consistency between the underlying interpretive scheme and an organization's structures and systems (Greenwood & Hinings, 1993). In sum, mature fields tend to have logics that are theorized and manifested in widely accepted archetypes.

While not made explicit previously, this precipitating situation wherein logics are theorized results in certain field-level dynamics that we see across a majority of studies such as the move from one dominant logic to another, the merger of logics, or the

coexistence of several logics. Mature and emergent fields nevertheless differ in the ways in which they adapt to institutional complexity. Organizations in mature fields have little discretion in adapting their responses to institutional complexity due to their *embededdness* in existing archetypes related to the dominant logic (e.g. Cooper et al., 1996; D'Aunno et al., 2000; Djelic & Ainamo, 1999; Goodrick & Reay, 2011; Reay & Hinings, 2005). In contrast, organizations in emergent fields have more flexibility in the formation of their responses given the lack of specification of institutional prescriptions (e.g. Battilana & Dorado, 2010). Despite these differences, both mature and emergent fields tend to draw upon theorized logics in the formation of their responses.

It is noteworthy, however, that no attention has been paid to situations wherein institutional complexity is *especially* salient; that is, when institutional complexity is triggered by a logic that is not yet theorized. This is all the more surprising given that previous research has shown that the theorization process is key to the diffusion of new logics. That is, previous authors claim that diffusion occurs when new ideas are compellingly justified to be more appropriate than existing practices (Greenwood et al., 2002). That is, theorization, provides new ideas with the legitimacy necessary for their diffusion.

This paper aims to address the aforementioned neglect by exploring the field-level dynamics arising from institutional complexity (i.e. the existence of conflicting logics) in mature fields with stable institutional arrangements that face substantial transformation with the emergence of an *un*theorized logic: what we refer to as 'transition fields'. It does so by means of an exploratory case study of the development of Responsible Investment (RI) within the Asset Management (AM) industry in Europe. The asset management industry – worth EUR 14.0 trillion of assets under management (AUM) in Europe or equivalent to 104% of the region's GDP (EFAMA, 2012) – is one of the most important industries in today's financially-driven economy. It is a stable and

mature industry adhering to a financial logic which is experiencing gradual yet substantial institutional changes with the increasing penetration of an *un*theorized logic – the sustainability logic – due to a myriad of events ranging from environmental crises and corporate governance scandals to civil society movements. Whereas sustainability is one of the most pressing discussions at present, shared meanings across and within organizational fields are lacking. RI – defined in this paper as a generic term covering any type of investment process that combines investors' financial objectives with their concerns about Environmental, Social, and Governance (ESG) issues – emerged as a new practice in the midst of this complexity. RI now represents more than 46% of the overall AUM in Europe (Eurosif, 2010) and poses the possibility of mainstream adoption and institutionalization.

Due to the complex and exploratory nature of our research question, we use an abductive methodology (Dewey, 1925; Lorino, Tricard, & Clot, 2011) primarily based on semi-structured interviews with key RI decision makers across the most important institutional investors in Europe and substantiated with documentary evidence and participative observation in RI events from 2010 to 2013. We analyze the ways in which institutional complexity is experienced in the asset management industry as organizations begin to incorporate sustainability issues within their traditional investment practices and we attempt to determine the processes and mechanisms underlying this experience.

As the organizations began adopting RI, several findings emerged. We find that the field's level of stability affects the experience of institutional complexity. Due to the transitional nature of the field, organizations made sense of complexity by undergoing a process of *logic assimilation*, which has two core mechanisms, *logic theorization* and *logic-archetype elaboration*. *Logic theorization* is the usage of an incumbent logic to frame and translate the untheorized logic in order to make it compatible with the incumbent logic. This process involves the creation and usage of models and tools in theorizing. Unlike

previous accounts that highlight that theorization must be successful prior to diffusion (Greenwood et al., 2002), we posit that theorization and diffusion occur simultaneously. *Logic-archetype elaboration* is the redefinition of the incumbent logic and consequently, its archetypes, based on the characteristics of the incoming *un*theorized logic. We find that these two mechanisms are recursive and underlie institutionalization. Further, due to the saliency of the complexity, we find that the logic assimilation process was facilitated by the existence of the Principles for Responsible Investment (PRI), which acted as an enabling organization.

We highlight several contributions of the paper. First, the paper answers recent calls for more studies exploring the underlying processes of institutional change by focusing on a largely 'fuzzy' aspect, namely the role of field-level stability in the experience of institutional complexity. In doing so, we show how certain logic dynamics are likely to occur given precipitating situations related to field structure and the theorization of a logic. Specifically, we conceptualize and empirically examine a transition field, a situation in which institutional complexity is especially salient, and substantially enhance previous accounts of logic assimilation, logic theorization, and logic-archetype elaboration. We also shed light on the role of enabling organizations, which facilitate the process of logic assimilation by providing definitions, coordinated action, and legitimacy in this process. Finally, our study contributes to a better understanding of how Responsible Investment practices can become mainstream within the financial sector, driving profound institutional change, providing insights on the future of sustainability within finance.

2.2 Theoretical Framework

2.2.1 Institutional complexity in mature and emergent fields

It is at the organizational field level where we can consider both the normative contextual pressures that maintain stability, as well as dynamics that precipitate change (Greenwood & Hinings, 1996 cited in Reay & Hinings, 2005). This is because it is at the level of the field wherein overarching sets of meaning and normative criteria become encoded in 'local' logics that are manifested in rituals, practices, and day-to-day behavior (Dacin et al., 2010 cited in Greenwood et al., 2011). We know from an abundance of previous studies that the structure of a field is largely related to how organizations make sense of the conflicting logics prevailing within that field and how they eventually form their responses. Essentially, the structure of the field fundamentally shapes the nature and extent of institutional complexity facing organizations (Greenwood et al., 2011).

Despite advances in the literature, we continue to lack a fully developed framework to characterize and compare the structure of fields. However, an essential structural attribute of fields has been teased out in previous research; namely, a field's level of stability. In particular, Fligstein (1996) and other institutional theorists have advanced rather clear conceptions of two types of organizational fields: mature and emergent fields. The main difference between both is the 'presence in mature fields of *regularized inter-organizational relationships'* – i.e. identifiable patterns of interaction among organizations in the field – combined with an '*articulated institutional infrastructure'*. The identities and status hierarchies of firms in mature fields are therefore well known and a conception of control that guides actors is shared. These fields have 'institutional scripts' (DiMaggio & Powell, 1983) or 'rational myths' (Meyer & Rowan, 1977) that guide action and these stable institutional arrangements are manifested in widely accepted 'archetypes' or forms and structures that are recognizable and typical patterns of behavior with certain probable outcomes (Cooper et al., 1996; Greenwood & Hinings, 1996). An

emerging field, on the other hand, is one wherein the institutional arrangements or the conceptions of control have yet to be defined and there is no accepted set of social relations (Fligstein, 1996).

Previous research has identified several field-level dynamics that tend to occur in mature fields, mainly, a shift and replacement of an old logic by a new one, the layering of a dominant logic, and the co-existence of several logics.

The first dynamic, which is dominant in the literature, relates to how a logic can shift from the dominant logic present in the industry and be replaced by a logic dominant in another industry. In this situation, the process of institutional transformation simultaneously involves the deconstruction of an old order and the building up of a new one (Lounsbury, 2002). Thornton and Ocasio (1999) showed how the shift in institutional logics affected executive succession practices in the higher education publishing industry, and in later work, how this led to the change in structure of the organizations in the industry into a multi-divisional form (Thornton, 2002). The editorial logic, dominant in the 1960's which had a clear mission to build prestige and sales of the house shifted to a market logic whose main mission was to build its competitive position through acquisition growth. This incoming market logic penetrated the industry in the 1970's because of the conglomerate 'investment banking phenomenon' that was occurring in the U.S. at the time, showing how the logic was 'imported' from another field.

A similar mechanism was shown by Lounsbury (2002) who documents the increasing professionalization of the field of finance in the U.S. He illustrated the change in logics from a regulatory logic that was segmented by organizational form into a market logic that emphasized retail-oriented financial services, competition, and the blending of organizational forms. He showed that this shift was brought about by a high theorization of the market logic, which occurred as a result of regulatory policies complemented by

the creation of financial knowledge that fueled the development of new market-based capital formation tools and techniques. Again, in this example, the new logic arose from outside the center of the finance industry. The author (2007) later showed how the same mechanism can occur without a total shift or replacement of logics in his examination of the logics guiding the practices of Boston-based and New York-based mutual funds. He demonstrated how the rise of a performance logic was fueled by the rise of portfolio management theory and financial economics. Yet, whereas the dominant trustee logic was replaced by this new logic, the practices associated with the old logic did not totally disappear.

This response can also occur when a new logic is theorized by internal referents that challenge the incumbent logic. This occurs in cases wherein institutional change appears as the outcome of tensions and paradoxes, which intensifies as a field matures and has been shown for instance as a mobilization of a social movement that initiates change from the inside. In their study of the French gastronomic industry, Rao, Monin & Durand (2003) illustrated how the nouvelle cuisine logic in French gastronomy came about. They showed how identity movements prompted chefs to abandon classic cuisine and embrace nouvelle cuisine. Importantly, they highlighted the sociopolitical legitimacy of activism and most importantly, the level of theorization of new roles to be adopted with the nouvelle cuisine logic as mechanisms necessary for this to take place. Such theorization ultimately occurred because of the new logics that were being established in cognate fields such as literature, drama, and film in the late 1960's during an anti-authoritarian wave in France. Several anti-schools were established during this time that shared similar conceptual principles. The legitimate players in the French gastronomy industry used this as a springboard to create their own theorization of nouvelle cuisine, reinforcing this with written codes and communicating this through journalists and the media.

Whereas the above mechanisms have shown that the apparent unity of contradictions in logics cannot be sustained and eventually becomes overt or 'settled' over time (Suddaby & Greenwood, 2005), with the developing scholarship, extensions have been made towards portraying instances in which logics have persistently co-existed over time. The second dynamic refers to the 'layering' of a logic upon an incumbent dominant logic and its archetypes. Cooper et al. (1996) illustrated how law firms were previously dominated by an archetype, the P2 form. Over time, they were able to identify a second configuration of this archetype, the Managerial Professional business which is based on law firms becoming more business-oriented thus redefining the processes of strategic control. In what they call 'sedimentation', they showed how the organizations were able to make changes by layering a second archetype on the first, rather than the former totally sweeping away the residues of the other. These mechanisms are closely related to the intra-logic evolution phenomenon described by Kodeih and Raynard (2013) in their study of the French Grandes Ecoles field. The authors examine the endogenous processes of maintenance and change that enable a logic to preserve its 'essence', evolve and survive for a long period of time, and stave off displacement by alternative logics.

The third dynamic relates to how organizations can maintain several logics at the same time or how logics can continue to co-exist over time in spite of the fact that the dynamics between them are changing. Dunn and Jones (2010) analyzed the scientific logic and the healthcare logic in the medical industry under different dynamics. They found that the logics were supplementary rather than antagonistic to each other. Again, in this work, the logics of care and the logics of science were clearly defined due to the existence of a government report that provided the foundations of medicine over the next 70 years. Furthermore, numerous medical associations supported these accepted definitions. Similarly, Goodrick and Reay (2011) encompass the idea that logics can be both competitive and cooperative at different periods in time within the same industry

through their focus on the professional work of pharmacists who faced increasing market pressures. Again, in their example, they referred to ideal types that are clearly characterized.

Finally, a combination of the three responses can occur within the same organization operating in a mature field. Binder (2007) examined institutional complexity in the context of a non-profit organization wherein funding became largely reliant on the federal government. This shift in resource dependence introduced the expectation that a professional logic would penetrate and be conflicting to the social work logic and that the organization would shift away from moral work and become bureaucratic. Instead, she found that sub-units had subjective experiences of institutional complexity and managed to form different responses. Specifically, one sub-unit was able to hybridize the two logics, another remained adhered to the professional logic, and the third remained autonomous with the social work logic still its dominant guiding principle. This study shows that an organization can 'hybridize' as an attempt to combine and layer practices taken from different logics into a single organization (e.g. Binder, 2007; Pache & Santos, Working Paper), and/or it can 'compartmentalize' wherein separate sub-units deal with particular logics (e.g. Binder, 2007; Kraatz & Block, 2008). In this example again, the professional logic was one previously existing outside the field.

Although examples in an emergent field are more scarce, we find evidence of a similar mechanism of the 'borrowing' and maintenance of pre-existing logics in the example of Battilana and Dorado (2010)'s Microfinance case study. In their study, the organizations had to build new practices, but such practices were guided by logics brought in by 'institutional entrepreneurs' (Battilana et al., 2009), organized and purposeful actors who skillfully use institutional logics in order to realize an interest that they value highly (Leca & Naccache, 2006). In spite of the fact that the field was emergent, the same logic dynamics tended to occur in emergent as in mature fields,

regardless of the nature of the trigger of change whether it was an exogenous shock 'smacking into stable institutional arrangements' (Clemens & Cook, 1999:447) or a change triggered from within. These same dynamics also occur regardless of who brings in the logic, whether it be a strong regulatory framework (e.g. Lounsbury, 2002, 2007) or by institutional entrepreneurs that come from within the field of question or from outside of the field and who reflect upon the institutional logics ordering their world in order to consider previously unthinkable possibilities (Smets, Morris, & Greenwood, Forthcoming 2012).

2.2.2 Theorization as necessary for institutionalization

While the body of research previously discussed has been fruitful in furthering our understanding of how a new logic can replace an old one, or how two logics can merge or coexist, it has tended to assume logics as a 'given', pre-existing, easy to define using ideal types, and manifested in 'archetypes'. Indeed, we notice an important commonality across these studies. The pre-existence of the logics suggests that there is a high level of agreement amongst the players in the field regarding their understanding of extant logics – whether the logic is dominant or not – and this is usually supported and ratified by external constituents such as regulatory bodies, professional associations, the press, media, or academic research. It appears that in order for institutional change to occur, institutional forces supporting the incoming logic must be strong enough (D'Aunno et al., 2000) or supported by legitimate actors (Rao et al., 2003) to challenge the dominant logic. As such, what tends to occur is either the new logic is borrowed from existing fields and/or practices (e.g. the importation of the market logic) or the new logic is framed on cognate logics (e.g. Nouvelle Cuisine). Complexity then does not appear to be very salient in these cases.

To wit, logics in mature and emergent fields are 'theorized'. Theorization consists of "the development and specification of abstract categories and the elaboration of a chain of causes and effects" (Greenwood et al., 2002:60). In the process of theorization, actors develop shared understandings and explore the consequences of innovation through each others' experiences; they begin to make sense of the new ideas as to whether these appear more effective than the alternatives (Strang & Meyer, 1993). Theorization leads to a common orientation and an underlying 'interpretive scheme' that offers ideological coherence. This interpretive scheme is a similar concept to logics in that it is composed of a set of ideas, beliefs, and values that underpin an organization's structures and systems (Greenwood & Hinings, 1993).

The process of theorization is necessary in the specification of a new logic that may deviate from conventions, allowing it to become available in simplified form for wider adoption. This is usually achieved by aligning the new logic with prevailing normative prescriptions (i.e. incumbent logics), providing the former with cognitive and normative legitimacy *prior* to diffusion. Theorization includes two major tasks; namely, the specification of an 'organizational failing' for which a local innovation is a solution or treatment and a justification of the innovation "by appealing in a compelling way, to the particular values embedded in the setting" (Tolbert & Zucker, 1999:183). Diffusion is thus able to occur even within organizations that are heterogeneous. As theorization develops and becomes more explicit, variance in the form that the structures take in different organizations should decline (Strang & Meyer, 1993). Theorization turns diffusion into a rational choice and a social process (Strang & Meyer, 1993) and forms an important part of the overall process of institutionalization. Tolbert & Zucker (1996) suggest that a high level of theorization occurs during the stage of semi-institutionalization before such practices become fully institutionalized or taken for

granted and codified in organizational routines, structures, and systems as in a mature field.

To the best of our knowledge, no research has explicitly studied how organizations cope with institutional complexity when logics are not yet theorized. This is highly problematic, as it wrongly assumes that institutional complexity always encompasses institutional logics with ideological coherence accepted by legitimate actors. To address this neglect, the objective in this paper is to explore the field-level dynamics associated with a *mature field* in which the new logic triggering institutional complexity is not yet theorized: what we refer to as a 'transition field'. Specifically, we aim to explain how and why the dynamics within a transition field differ from the above-described dynamics associated with mature and emergent fields in which logics are already theorized. We further examine the attributes of such fields in the following section.

2.2.3 Conceptualizing transition fields

In this paper, we simultaneously conceptualize and empirically examine a transition field. The structure of this type of field implies that the untheorized incoming logic creating complexity is not existing dominantly in another field or within other practices, and that there is a lack of shared understandings of the logic. In this case, logics cannot simply become instantiated, borrowed, or maintained. In a transition field, institutional complexity is high because there is a high level of disagreement between the constituents of the incoming logic. Indeed, the new logic that emerges within the field is represented by uncoordinated organizations or referent audiences, which attribute potentially contradictory meanings to the logic. Further, interest groups are not formally organized and the hierarchical power structure is not clearly centralized thus making it difficult to determine the guiding source of the institutional pressure since this can come from several sources, none of which are dominant.

Hence we ask, how do organizations experience and respond to institutional complexity in such a situation? That is, how does a logic which is not yet theorized, having a high level of fragmentation and a lack of formal structures diffuse within a mature field? Such a situation is especially problematic since, unlike emergent fields, transition fields do not have much flexibility in adapting their practices to a new logic. Yet, it is important to note that due to the transitional nature of the field, some level of mutability exists: a redeeming characteristic that we later illustrate as key to the process of theorization.

It is surprising that no attention has been given to studying this type of field as a structural attribute. A focus on this is important because institutional complexity is *especially* salient for organizations during this period of transition wherein the dynamics of competing logics are at a tension between institutional maintenance and creation. Indeed, it has been pointed out that institutional complexity will be relatively low for mature fields because "given a relatively predictable and consistent set of competing institutional demands, organizations should be better able to respond to institutional complexity by developing appropriate internal structures and practices" (Greenwood et al., 2011:336). Whereas in emergent fields, organizations may also tend to experience a low degree of institutional complexity because they have more discretion in creatively responding to institutional demands given 'the ambiguity and the lack of specification of institutional prescriptions' (Greenwood et al., 2011). In other words, whereas organizations in a mature field – embedded in previous institutional arrangements – can make use of existing logics to make sense of and guide their responses, organizations in an emergent field – lacking institutional models – can easily create new responses due to their minimal anchorage in previous logics.

In a transition field, organizations need to remain embedded in their institutional environment whilst engaging in the creation of new practices. Central to this, we suggest,

is the process of *logic assimilation*, which consists of theorizing the new logic based on the incumbent logic while simultaneously elaborating the incumbent logic and its archetypes based on the characteristics of the new logic. This logic assimilation process is facilitated by an enabling organization, which by taking on both an advocacy-type role and a regulatory-type role provide shared definitions, coordinated action, and legitimacy which facilitated the processes of logic theorization and logic-archetype elaboration, leading to gradual practice transformation.

2.3 Methods

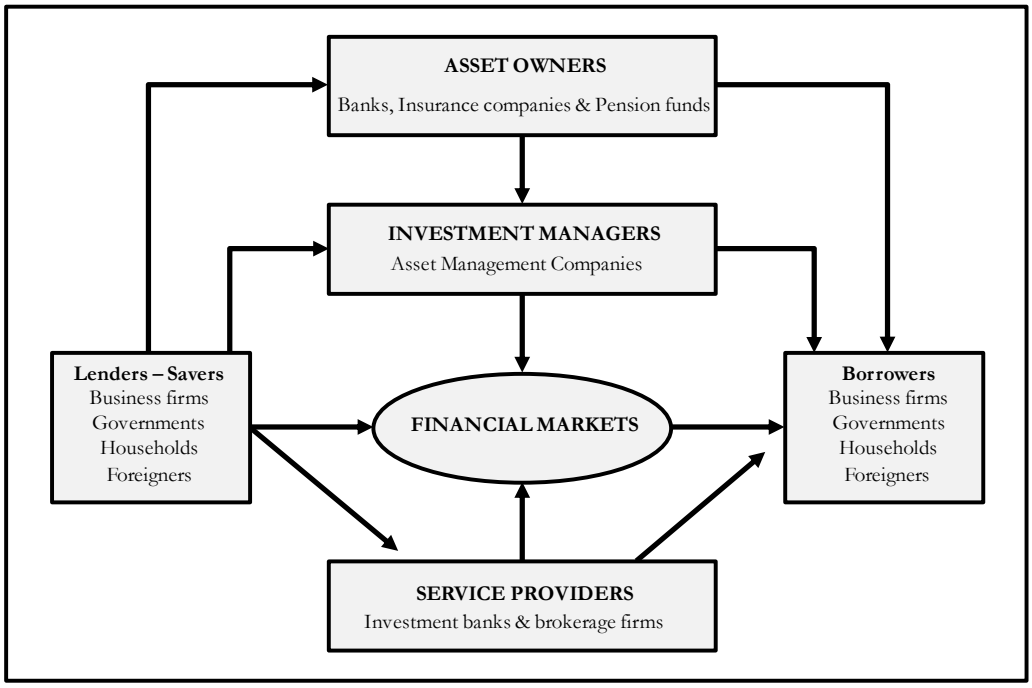
2.3.1 Research Setting

The aim of this research is to elaborate our current theoretical understanding of the processes underlying institutional complexity within a field in transition. Our unit of analysis is the organizational field. DiMaggio and Powell (1983:148-49) defined a field as "sets of organizations that, in the aggregate, constitute an area of institutional life; key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products." Further, such fields become defined by shared systems of meanings or 'institutional logics' (Friedland & Alford, 1991; Thornton et al., 2012). We examine our above research questions through a case study of the development of the phenomenon of Responsible Investment (RI) within the organizational field of the European Asset Management Industry.

At the end of 2010, assets under management (AUM) in Europe was estimated to be worth EUR 14.0 trillion, comprising 33% of the global AUM – the second largest region after the U.S. The U.K. accounts for almost a third of this amount (33%) followed by France (21%) and Germany (11%). To put the significance of this figure into perspective, the ratio of AUM to total GDP in Europe was 104% at the end of 2010. In the U.K., this ratio was at 270%. More than 3,100 asset management companies are

registered in Europe employing about 85,000 people directly (EFAMA, 2012). Asset management firms serve a diverse range of clients which include two broad types: 1) *retail clients* which are individual savers and 2) *institutional clients* which include government "sovereign" wealth, insurance, pension, and corporate funds as well as charities, educational establishments, and the like. Clients are referred to as *asset owners* and play a key role in the selection of the asset management firm and the type of strategies which they want the latter to use in investing their assets (for example, whether to invest in large, medium-sized, or small firms). *Financial intermediaries* such as brokers, ratings, and research agencies act as a third player, providing information to asset management firms and asset owners. Figure 2.1 summarizes the different relationships between these organizations in the industry.

Figure 2.1 Asset Management Industry (Adapted from EFAMA, 2012)



RI in this paper refers to any type of integration of Environmental, Social and Governance (ESG) concerns into funds' investment processes that is combined with investors' financial objectives. Hence, it encompasses specialized Socially Responsible

Investment (SRI) funds, which use screening mechanisms in the construction of the portfolio and ESG integration that consists of integrating non-financial criteria into traditional investment processes. Europe is the leading geography in RI with Assets Under Management (AUM) of EUR 5 trillion, representing more than 46% of the overall investment universe in Europe (Eurosif, 2010), representing a significant and growing amount of the industry that is far from negligible. In Europe, RI is almost exclusively driven by institutional investors, which currently represent 92% of all AUM. While further details about what RI consists of will be elaborated in the rest of the paper, it is important to keep in mind that RI does *not* mean good financial performance and that the link between the two remains highly contested. Further, the field is composed of diverse organizations including pension funds, insurance funds, mutual funds, social and traditional banks, private equity firms, and others.

2.3.2 Case Selection

The European asset management industry is a prime example of a field in transition which is embedded in a dominant financial logic yet is experiencing the increasing penetration of a sustainability logic. Hence, we are examining the industry at a very interesting time: it is a time wherein complexity is *especially* salient as meanings and practices are being constructed thus providing us with an excellent setting to examine institutional complexity as it is being experienced and to understand how responses are formed at the time of their construction. Additionally, we chose the context significantly because examining the role of finance in society is a highly relevant focus of contemporary debate amongst policy makers, practitioners, and scholars especially as Europe undergoes its worst economic crisis since the Great Depression.

2.3.3 Data Collection and Sources

In order to disentangle the processes underlying institutional complexity, we use a qualitative approach. Case study research is used when the research topic has to be defined broadly and needs to include the context as a major part of a study (Yin, 2009). Further, qualitative research is well-suited when causality is not apparent and when links are ill-structured and complex (Garud, Jain, & Kumaraswamy, 2002; Maguire, Hardy, & Lawrence, 2004). We further define our sample geographically, which is a tried and tested sampling method for professional organizations whose operations are contingent on the jurisdiction in which they are active (Greenwood & Suddaby, 2006 cited in Lander, Koene, & Linssen, 2012).

We relied primarily on interview data, which we substantiated with archival data and participant observation over the period 2010 to 2013. The use of multiple data sources is appropriate in order to provide a contextual analysis of change (Creswell, 2009) and triangulate our findings. The fact that the phenomenon is currently happening makes it difficult to peruse historical data; further, currently available and reliable information from third parties remain scarce. This lack of information combined with the complex and exploratory nature of our research question made it imperative for us to contact key persons and retrieve information through direct dialogue.

2.3.3.1 Primary data source: Informants, Interviews, and Questionnaires

Our primary sources of data are interviews with 28 senior-level informants from different asset management organizations in 10 countries within Europe with turnover ranging from EUR 0.45 billion to EUR 562 billion (see Table 2.2). Our informants were theoretically sampled based on the fact that they needed to have insight into the strategic plans of the organizations and more importantly, a strong understanding of the trends occurring within the industry given that we examine changes at the field level. We used

several strategies to engage in contact with the relevant persons for interviews. First, we did online searches to acquire the names of decisive people, cross-checking their positions and industry experience through descriptions in their organization's websites or in their personal LinkedIn pages. We used the list of European PRI signatories – which includes three types: asset owners, investment managers, and service providers – as our preliminary guideline to identifying the major organizations in the asset management industry involved in Responsible Investment. This choice was obvious, the PRI (Principles for Responsible Investment) – an international network of investors working together to put the PRI into practice – being the sole global association of RI. Since membership is voluntary, these signatories explicitly consider themselves as part of this activity. We then used our individual networks to enable contacts wherever possible. All three researchers have experience within the financial industry and this was especially useful in determining protocols and sampling.[1] Second, we attended practitioner events wherein we personally introduced ourselves and presented our research to referents and did follow-up contact through email or telephone correspondence. Third, we requested the assistance of the PRI in both providing us with a list of possible interviewees and formally introducing us. With this strategy, we were able to conduct 25 semi-structured interviews with 28 persons from May 2011 to July 2012 with a variety of respondents: all of which were at a Senior Managerial level with several years of experience in the industry.

While it would have been ideal to mitigate subject biases by using multiple informants, due to the fact that RI teams are relatively new and small (with some not formally existing at all), there was usually only one 'point person' in the organization who had the capability to answer our questions and we tried as much as possible to gain

[1] The first author previously worked as a financial analyst in an investment bank in the Netherlands, the second author previously worked as an RI analyst in an asset management firm in France, and the third author holds non-executive director positions within several asset management firms in Italy.

access to this person. Hence, our sample consists of one interviewee per organization, with the exception of two organizations which had two interviewees each. The interviewees represented asset management companies domiciled in France (5), Finland (1), Germany (1), Italy (3), Netherlands (3), Norway (1), Spain (1), Sweden (1), Switzerland (1), and the U.K. (7) in addition to the Director of the PRI (1). We recognize that while our sample is by no means exhaustive of all the players in the industry, the aim of this study is not to describe the population and the experience of each organization but rather to determine regularities and patterns in the responses. We are nevertheless confident that our interviews represent a sufficiently rich sample for two key reasons: first, because our informants were at the heart of organizational decision making and were key players in the field and second, because in our computations, our sample comprises organizations which cover assets under management of around EUR 2,8 trillion, which is roughly 56% of the total assets under management in Europe engaged in RI, able to capture a significant percentage of the industry and providing us with a rich narrative of the structure of the organizational field.

All interviews, lasting an average of one hour each, were voice-recorded and transcribed verbatim by a professional service. Interviews were conducted mostly in English by the lead author, with the exception of three interviews which were conducted in Italian by the third author.[2] Respondents were provided beforehand with a structure of topics to be discussed, but were not provided with the actual questions. They were also informed beforehand that they would be voice recorded and were assured that their responses would be used solely for academic research purposes, allowing them to freely express their views. We always began by asking for background information on the firm as well as the informant. Hereafter, open-ended questions were used to elaborate. The interviews were semi-structured, following the structuration technique of Myers and

[2] The Italian interviews were translated into English and cross-checked amongst native speakers.

Newman (2007). This means that given our research question, we had several preliminary ideas, which we wanted to discuss. However, the discussion was ultimately guided by the responses of the interviewees and the interview questions evolved over time as our analysis evolved. An outline of the interview questionnaire structure is provided in Table 2.1 while Table 2.2 provides a description of the organizations and corresponding interviewees.

Table 2.1 Semi-structured Interview Questions

Section	**Contents**
Introductions	Explanation of research project Anonymity and recording
Relevant information	Description of the organization Description of the interviewee's previous experience and role within the firm
Personal views on RI	Main drivers of RI Difficulties in integrating RI
Investment Decision-making	Process of RI investment Challenges in the process Interaction of roles and management of divergent interests
Risk-return criteria	Links of practices to financial performance Decision process of ESG criteria
Engagement	Description of engagement process
Future of RI	Views on the evolution of RI Main hindrances

Table 2.2 List of Interviewees

Organization	AUM (EURbn)**	Type of Organization	PRI Classification	Domicile	Interviewee Function	Date of Interview	Record Length
APG	278.00	Pension Fund	Investment Manager	Netherlands	Head of ESG Integration	27/05/11	0h55
Triodos Bank	5.60	Retail Bank	Investment Manager	Netherlands	Sustainability Analyst	05/07/11	0h53
Etica SGR	0.45	Retail Bank	Investment Manager	Italy	Director General	26/07/11	1h03
Generali Investments*	324.30	Insurance Fund	Investment Manager	Italy	Head of SRI	27/07/11	1h34
AMF*	39.93	Pension Fund	Asset Owner	Sweden	Head of Business Development	19/09/11	0h41
Oddo Securities*	13.20	Investment Fund	Service Partner	France	Head of SRI Research	20/09/11	0h51
La Caixa Workers Fund*	3.95	Pension Fund	Asset Owner	Spain	President	21/09/11	0h58
Pioneer Investments	265.00	Investment Fund	Investment Manager	Italy	Head of Communications	28/09/11	0h34
BT Pensions*	55.00	Pension Fund	Asset Owner	U.K.	Trustee Director	13/10/11	1h06
SAM Asset Management*	11.30	Investment Fund	Investment Manager	Switzerland	Senior Analyst	18/10/11	0h36
UNPRI*	None	RI Initiative	None	Global	Executive Director	02/11/11	0h33
MSCI	None	Ratings Agency	Service Provider	U.K.	V.P. Commercial Relationships & Marketing	07/03/12	0h52
Alcyone	0.05	Investment Fund	Investment Manager	France	Head of SRI	07/03/12	1h03
Responsible Investor	None	RI Publication	Service Provider	U.K.	Publisher	08/03/12	0h42
Nordea	187.80	Retail Bank	Investment Manager	Finland	Director of Responsible Investments & Governance	08/03/12	1h05
Schroders	224.20	Investment Fund	Investment Manager	U.K.	Equity Analyst	08/03/12	0h34
Ionis*	8.70	Investment Fund	Asset Owner	France	Head of SRI	12/03/12	0h45
RCM	97.43	Investment Fund	Investment Manager	U.K.	Sustainability Analyst	12/03/12	0h52
Alliance Trust	3.56	Investment Fund	Investment Manager	U.K.	Senior Investment Analyst	19/03/12	0h56
Norwegian Pension Fund	460.00	Pension Fund	Asset Owner	Norway	Ethics Council Members (2)	18/04/12	0h57
West LLB	67.00	Retail Bank	Asser Manager	Germany	Head of SRI	30/05/12	1h13
Novethic*	None	Research Agency	Service Provider	France	Head of SRI Research	04/06/12	0h55
Natixis*	562.00	Investment Fund	Investment Manager	France	Head of SRI	05/06/12	1h12
Rabobank*	263.60	Retail Bank	Investment Manager	Netherlands	Program Manager – Responsible Investing	07/06/12	1h06
Generation Investment Management	7.00	Investment Fund	Investment Manager	U.K.	Director Head of Foundation	12/06/12	1h00
Total AUM	2.818						

*Interviewees for which face-to-face contact was also made

**Details based on interviews and company reports. Latest reported figures as of Dec. 2011.

2.3.3.2 Secondary Data Sources

2.3.3.2.1 Archival data

We perused archival data for three main reasons: first, to ensure more in-depth probing during the interviews; second, to cross-check the accuracy of facts and figures provided during the interviews and mitigate potential subject bias; and third, to substantiate our interview findings. We used three different kinds of archival information. First, we used company reports including publicly available annual reports and sustainability reports, as well as additional reports directly provided to us by the interviewees. Second, we perused online materials such as the companies' websites to uncover any press releases for descriptions of major changes the firms have gone through and general news on Responsible Investment. Finally, we used information drawn from industry publications, in particular the PRI and Eurosif. These reports are official records and represent trustworthy data which is of particular importance in an early stage of practice.

2.3.3.2.2 Participative observation

Finally, to be at the forefront of the innovations occuring within the industry, our analysis is informed by knowledge gained from continuous attendance to several RI-related practitioner events throughout the research period as a form of participant observation. Not only were we able to attend several meetings wherein we took field notes, we also profited from informal discussions in between and after sessions with asset managers. Table 2.3 provides information on different events we attended.

The combination of our data sources allows us to have a comprehensive empirical illustration mainly of what is going on at the field level and provides us with preliminary understandings of the workings at an organizational level.

Table 2.3 Participative observation

Date / Place	Event
June 2010 Brussels, Belgium	Annual conference: International Association of Investors in the Social Economy (INAISE)
June 2010 Florence, Italy	Meeting: Institute for Social Banking/Global Alliance for Banking on Values (ISB/GABV)
June 2011 Paris, France	Meeting with institutional investors: Chaire Finance Durable et Investissement Responsable (FDIR)
September 2011 Paris, France	Meeting: French Social Investment Forum (FIR)-PRI
March 2012 Paris, France	Academic-practitioner workshop (PRI-Mistra)
March 2012 Paris, France	PRI meeting of French signatories
April 2012 Paris, France	Meeting with institutional investors (FDIR)
May 2012 Webinar	ESG integration debate (MSCI)
May 2012 Paris, France	Academic-practitioner workshop (FIR-PRI)
June 2012 Paris, France	Academic-practitioner workshop (FIR-PRI)
June 2012 Paris, France	Meeting with institutional investors (FDIR)
July 2012 Paris, France	Meeting with institutional investors (FDIR)
October 2012 Paris, France	Europlace annual congress
March 2012 London, UK	Visit to the PRI Headquarters

2.3.4 Data analysis

The data analysis, though informed by theory, had a strong emergent character. During the analysis the authors shifted back and forth between raw data and theory. We used open-coding techniques to analyze the emergent themes, groupings, and hierarchies in the data until we reached 'theoretical saturation' (Glaser & Strauss, 1967) and stopped collecting data when we felt that we could confidently predict the responses (Miles & Huberman, 1994). We did this in four steps. The first step was to review all the printed transcripts that led us to generally understand and confirm our initial hypothesis that the field we were looking at was unique in its transitional nature and that conflicting logics existed. The second step was to hand-mark the transcripts, identifying specific emergent themes using codes. In this step, we employed theoretical sampling and pursued data relevant to the themes while at the same time used extant theory, which allowed us to discover new themes, through an abductive manner (cf. Dewey, 1925; Lorino et al., 2011). Specifically: having our research question in mind, we paid close attention to the dynamics of the co-existence of logics and notions of transition while concurrently allowing new themes to emerge. The third step was to transfer the relevant codes and supporting quotes to an organized narrative database which allowed us to efficiently

structure the groupings and hierarchies. We used NVivo 10 coding software to assist us in this step. This software basically makes looking for the codes within the transcripts easier and allowed us to make several maps and linkages between different codes. The fourth and final step was to cross check the accuracy of the data and substantiate our findings with archival sources and to link our findings to theoretical concepts and construct a narrative (Auerbach & Silverstein, 2003). This process of iteration means that we simultaneously collected, analyzed, and sought for new data. All three researchers participated in the coding process.

2.4 The Case Study[12]

2.4.1 Incompatibilities between the financial logic and sustainability within RI

2.4.1.1 Conflicting logics

Towards the end of the first decade of the 2000's, issues surrounding sustainability could no longer be ignored in the asset management industry. As described above, a substantial and growing percentage of assets under management are currently adhering to Responsible Investment practices. However, it was precisely as the implementation began that the incompatibilities between the financial logic and the integration of sustainability as a logic became much more evident.

At an overarching level, there was the incompatibility of the temporal dimension. Asset managers, while usually required to report on performance every 90 days were now expected to take a long-term view assessing sustainability issues at the same time. Taking a long-term horizon meant that asset managers could miss out on the profits provided by short-term trading, especially if he or she is good enough to anticipate the market ups and downs, making it all the more difficult to reconcile the profit motive with the long-termism of sustainability as it was available to asset managers.

[12] Table 2.5 provides additional supporting quotes.

> It's very, very difficult to shift your investment philosophy from a short term one to a long term one. And then I think it's resistance on an intellectual level to believe it is the right thing to do, or a good thing to do, or a profitable thing to do. (Interviewee L)

Additionally, the discrepancies between the financial logic and sustainability that were pointed out by past scholars began to emerge. The notion that by allowing asset managers to pursue non-financial goals such as those embedded in ESG issues, inefficiencies would result due to divergent self-interests and that the additional burden imposed on the managers would distract them from their main roles and ultimately detract from the bottom-line (Friedman, 1970) was reflected in the fact that most of our interviewees admitted to be doing more work than traditionally required, without necessarily seeing tangible benefits. The notion that having more stringent screening criteria because of ESG requirements would limit the fund's ability to diversify, therefore forcing it to bear additional specific risk compared to the portfolios in the efficient return-risk frontier (i.e. those portfolios which are able to fully diversify with no ESG constraints) was reflected in situations of tension wherein the asset managers felt 'restricted' by their new investment universe. Asset managers felt that they were being given incompatible prescriptions regarding the role that was expected of them. On the one hand, they were being pushed to consider ESG issues but on the other hand, they were asked to carry out their usual performance mission.

> It's the kind of (...) make believe land of, you know... we just want fantastic returns and no risk. I am not saying that's what people [necessarily] think, but that is the extreme of it. (Interviewee G)

The integration of sustainability within the traditional investment process was all the more difficult because of the low quality and standardization of information. Listed companies are required to provide financial information to the public on a quarterly basis and additional information is usually readily available either from the company itself or from financial intermediaries such as analysts and brokers. Furthermore, databases are

now extremely rich with data on stock prices. Sustainability information, on the other hand, is often updated annually at best. Most of the data provided by the sustainability ratings agencies is assessed over long periods of time and updated only once there is an important event. Further, while financial information follows certain accounting standards and thus needs to comply with high reporting quality to satisfy legislators, sustainability information, being mostly voluntary, is largely unsystematic and difficult to measure and hence difficult to use in an investment process. Interviewee T mentions that they estimate that only around 25% of companies deliver quality sustainability reporting and that they need to contact companies directly for more information, which takes a lot of time and resources. There was also the feeling that rating agencies could simply manipulate data to arrive at a particular result for whoever would need it and that ratings were based on those who communicate better rather than those actually doing it.

> I remember, at the beginning, twelve years ago, when I started, (...) I mean, we were completely pioneering, and we did not know what we had to do. So, at the beginning we were using hundreds of different key performance indicators, because we did not know where we were going. (Interviewee T)

This goes hand-in-hand with the difficulty to quantify the sustainability logic or the extent to which sustainability parameters could be represented by numbers. Whereas in the financial logic, performance can be measured and compared, in the sustainability logic, decisions were based on anecdotal examples. For instance, Interviewee W – unable to say which criteria delivers the best performance – takes to the winning of awards such as the Lipper prize, or the rating of Morningstar to proxy for performance. All the respondents recognized that evaluating a company from a non-financial perspective was difficult to quantify and judge.

> It's a complex topic, sometimes not easy to understand for interdependencies and linkages. And due to the nature of the information and of the data, it's not easy to integrate this into standard evaluation models and to really show the difference and the value added of this information. (Interviewee E)

Indeed, the situation of institutional complexity was apparent in the existence of two logics that imposed incompatible prescriptions upon the organizations; asset managers were unable to determine the best way to move forward with the practice of RI. However, beyond this situation of conflicting logics, we find that the structure of the field fostered even more salient complexity, as explained in the next section.

2.4.1.2 Transition situation

2.4.1.2.1 The European AM Industry as embedded in a financial logic

The practice of asset management wherein money is pooled into a fund from different sources and managed by a professional financial firm is a widely acceptable means of investing current wealth in anticipation of higher expected future returns. Investing money in the markets entails a substantial amount of time, research, and sophisticated tools in order to understand which sectors and companies are likely to perform best and have lower risks in the future: capabilities and resources which an individual or organization may not have. The idea behind asset management is that it is more effective and less risky to pool money – "assets" – from several individuals or organizations and to outsource the collective management of these assets to a specialized firm. This allows risks to be spread across a diversified portfolio of assets, which would otherwise be more expensive to do due to high transaction costs. Asset managers also monitor developments in the markets and are able to select interesting opportunities. Asset management practices are embedded in what we refer to as the *financial logic,* which has a clear and agreed-upon mission of profit maximization by optimizing risk and return.

This mission mainly subscribes to a 'traditional view' of economic theory going back to expected utility theory which argues that investors are rational and wealth maximizing (Von Neumann, Morgenstern, Rubinstein, & Kuhn, 2007), as manifested in

the ways in which a portfolio is created. Portfolio theory suggests that for fixed probability beliefs, an investor has a choice of various combinations of risk and return depending on his choice of portfolio. The investor would (or should) then want to select one of those portfolios which give rise to the efficient combinations (Markowitz, 1952). Portfolio theory is arguably the most strongly manifested theoretical underpinning in the practice of asset management. Further, this mission is clearly manifested in the identity of asset management as a profit-maximizing business within a Market Capitalistic economic system. Consequently, its basis of norms, attention, and strategy adhere to self-interest, the status gained from profit maximization, and the increase in financial profit, respectively.

The performance of a fund is judged on whether it is able to achieve a return above a certain benchmark (usually a market index such as the S&P 500 in the U.S. or the MSCI Index in Europe) previously identified and whose composition reflects the investment strategy of the fund (for example, whether it focuses on growth, blend or value firms or whether it focuses on small, mid, or large cap firms). Such financial performance provides the fund with its main source of legitimacy within the industry. The financial logic also manifests itself in the *fiduciary duty* of asset managers to act in the interest of their clients in a highly transparent and systematic manner. In many jurisdictions, such as the United States, this fiduciary duty is composed of legally enforced written rules. The clients can determine whether to pull out their assets from a non-performing fund and to a certain extent, can form the investment strategy of the fund. This implies that clients (a fund's shareholders) are the financial logic's main source of authority.

Strong formal and informal governance structures are in place related to the financial logic. The asset management firm charges a fee for its service called the *management fee* which is usually a fixed percentage of the value of the assets under

management whereas the asset manager directly responsible for the fund receives a compensation for his or her ability to select good performing assets and sell bad performing ones which is usually a percentage of the return above the benchmark. Highly sophisticated tools are available for asset managers to use in order to create an efficient portfolio and reporting and disclosure standards are set by regulatory bodies. Thus, not only is the *financial logic* dominant in the industry, it is legally enforced and manifested in the existence of widely accepted forms and structures – archetypes – that typify patterns of behavior and reinforce the strength of the logic. The asset management industry is largely quantitative, having formulas, data to plug into them, computers to calculate them, and electronic networks to connect them all (Beunza & Stark, 2004), reflective of the fact that 'finance theory has become incorporated into the infrastructure of financial markets' (MacKenzie, 2006:250).

2.4.1.2.2 A penetrating, undefined Sustainability Logic

Considering sustainability issues through the usage of ESG criteria in the investment process – what we refer to as the sustainability logic present in the asset management industry – was not considered acceptable practice for mainstream asset managers prior to the mid-2000's. However, the financial sector was aware of an ethical investment niche market (today still existing and referred to as the Socially Responsible Investment (SRI) "niche"), wherein a moral approach to investing is used mostly by religious congregations in America and the U.K. to address their ethical concerns in society by excluding controversial businesses from their portfolio. Since these funds have existed for decades and continue to survive, the financial sector was aware of the existence of combining non-financial and financial issues in a traditional investment process, albeit in a largely religious and moral sense. While this ethical logic existed, it was by no means dominant in the asset management industry.

From the 1960's, the consideration of integrating non-financial issues in asset management started shifting away from religious motivations and a spotlight was shed on pressing societal events. During the Vietnam war, students led a protest against the war and called for the boycott of companies providing weapons used in the war. This brought about the birth of the Pax World fund in 1971, which avoided investing in companies significantly involved in the manufacture of weapons, or weapon-related-products. The rise of the civil rights and racial equality movements in Europe and the U.S. through the Civil Rights Act in 1964 and the Voting Rights Act in 1965 increased the pressure on companies operating in South Africa during the reign of apartheid. Investors were eventually forced to withdraw investments in these firms. Massive environmental disasters including the 1979 accident at the Three Mile Island nuclear power plant in the U.S., the 1986 Chernobyl catastrophe in Ukraine, the 1984 gas tragedy at the Union Carbide pesticide plant in Bhopal, India, and the oil spill of Exxon Valdez near Alaska made companies more aware of the consequences of environmental risks on their revenues, and made investors question their investments from non-financial risk perspectives.[13] These occurrences brought about a global discussion in the late '90s towards sustainable development, defined as "the kind of development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (Brundtland, 1987), which began with a largely environmental agenda.

In the first half of the 2000's, the Parmalat fraud and money laundering scandal by the CEO and managers in 2003 and the audit scandal which led to the collapse of Enron in 2001 severely affected pension and mutual funds in Europe invested in these companies and highlighted the need for better governance controls. Finally, the most recent push for sustainability came during the 2008 financial crisis and the 2012

[13] During the time of writing this paper, the oil spill in the Gulf of Mexico occurred in April 2010, which cost British Petroleum an estimated USD 41 billion.

European sovereign debt crisis. During this period (still on-going at present), looking at risk and governance became even more legitimate and pressing within asset management. Unlike previous crises outlined above, the recent crises have a particular focus on the financial industry itself, which was blamed as the cause for the crises, probing society to pose questions about finance's broader role and future. In short, the financial crisis made the existing complexity and situation of transition ever more visible and tangible.

All of these critical events brought society's attention towards how money is invested and how it could be used for both negative and positive social ends, and cast a spotlight on the asset management sector as instrumental actors for bringing about solutions. Yet, as such, the sustainability logic within the asset management industry was born out of different discussions coming from different fields having different agendas, with the source of authority unclear. With ambiguous definitions of sustainability, the sustainability logic did not adhere to any particular existing economic system and problematically, no clear mission was shared within responsible investment practice. Asset management firms began to craft their own notions of sustainability by identifying themselves as heterogeneous types of responsible investors.

> Well, I think there is an issue of definition, as you are probably aware of. SRI used to have a fairly novel definition in the sense of ethical or thematic investments, and I think most people still tend to regard SRI as being in the ethical area; whereas we tend to say that we are not an SRI investor, but we are a responsible investor. We are a mainstream investor. (Interviewee Q)

Even within organizations themselves, tensions were occurring:

> Even within the group there is not really a consensus on the definition [of RI], and basically that reflects what's happening in the market. (Interviewee B)

Further, the original ethical identity from which it began – that is, as a practice wherein finance should play a societal role, began to fizzle in the background. Organizations did not agree on this particular mission and did not share this same source of identity.

> Okay, if we want to be pragmatic, there are two types of people that are moving into sustainability: ones that are looking for the reputational benefits, and want to have a part of the pie, that looks to be bigger and bigger with the time; and the ones that are actually seeing the necessity of integrating sustainability. (Interviewee P)

This heterogeneity in mission is made apparent in the contestation of sustainability as imposing a societal role on the asset management industry.

> When we have to reflect on the question of the market or how much we should be social actors, which, in whatever measure, takes the responsibility to do things also if they are not requested, it is not shared by all, it is not very clear. (Interviewee R)

The field of asset management, at the onset of the logic of sustainability, was thus not as homogeneous as it appeared to be, with the ways to be legitimate as an RI investor unclear. While most believed that engaging in RI was positive for organizational reputation, organizations knew that this was by no means comparable to the legitimacy gained from financial return.

Another key issue of the sustainability logic within the asset management industry was the weak formal and informal governance mechanisms and as such no clear source of authority for organizations to be subjected to. The practice was highly voluntary with minimal regulation at local and European level. The European Union began to advocate for the importance of standardized reporting of whether and how sustainability issues are integrated in the investment process through calls for more transparency and the creation of the European Transparency code in 2004. However, given that regulations on disclosure are not standardized as of yet, it is not surprising that there is no specific Europe-wide regulation covering the actual integration of ESG issues in investment to date.[14]

[14] However, local government initiatives appear to have had more success in this regard. For instance, after the U.K. led the enforcement of the Pensions Act in 2000, requiring reporting from its pension funds, other member states such as Sweden (2000), France (2001), Germany (2002), Austria (2004), Belgium (2004), Norway (2004), Italy (2005), the Netherlands (2007), and Denmark (2008) followed suit. These legislations, however, have been mostly limited to government pension funds. Some countries have been able to implement RI through supportive legislation at a local level. For instance, the Belgian Parliament has prohibited the investment in companies producing anti-personnel mines, sub munitions and depleted uranium weapons since 2007. This was imitated recently in France in 2010 wherein the French Parliament

2.4.1.2.3 Diversity of organizations contributing to transition situation

The difficulty of this transition situation was exacerbated by the fact that the organizations had very different characteristics. First, as our dataset shows, there was a broad range in terms of the size of assets of the organizations. During the interviews, respondents were quick to label themselves with statements that solidified their central position in the asset management field such as "frontrunners in the financial industry", "one of the three most important banks in Spain", "one of the most important assets in Europe", and "the largest corporate pension scheme in the U.K.", whereas some pointed towards their less central position or the fact that they were in a stage of growth. Second, the internal representation of sustainability varied. The number of people in formal sustainability positions in our sample ranged from those having no internal RI team to those having around ten people with specialized RI positions. Some mentioned that they relied on external research due to resource limitations but recognized that an internal research team would be better, if this were possible. Third, the type of ownership and governance affected the implementation of RI. For example, there could be differences between investment managers such as mutual funds who are driven by client demands and a pension fund, which may be government-owned and operating within a strong political context. Across the organizations, there was often a separation between who creates the broader mandate of which ESG criteria to use and the day-to-day execution. For pension funds, the strategic allocation is set by a board of directors while in other

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enacted a law prohibiting any direct or indirect financial assistance to the production or trading of cluster munitions. In March 2011, the Italian Senate approved a motion similar to that of France. More popularly, Norway's "Petroleum fund" – its government pension fund worth NOK 2.1 billion (c. EUR 460 billion) as of March 2012 (Taken from http://www.nbim.no/) – has had ethical guidelines since 2004 which has prohibited investments in tobacco and arms production, among others. Legislation has passed more easily in some countries than in others: Sweden has been integrating ESG issues in its National Pension fund system since 2000 whereas a 2007 law proposed in Spain to oblige its pension reserve fund (worth around EUR 64 billion as of December 2010: Taken from http://www.seg-social.es/prdi00/groups/public/documents/binario/146674.pdf/) to invest 10% of its assets in a sustainable manner is still pending Parliament approval. On July 3, 2012 the European Commission proposed a regulation on the Key Information Document for investment products (KID), which is linked to a wider EU initiative for a better regulatory environment of package retail investment products (PRIPs).

funds, it is set by a control commission. Ethical committees also exist for some which are formed by a series of experts from different fields (government, academia, environmental world, etc.) and added additional pressure on the fund management. Indeed, it was clear that the organizations with a board and ethical committee highly committed to sustainability issues had a strong influence on the integration of a sustainability logic.

The type of ownership also played a role. Interviewee U which represented a firm owned by the Labor Market Party needed "to be able to stand in public and explain how the pensions are being taken cared of." Interviewee T, a family-owned bank, receives a large support from the fifth generation family owner interested in sustainability issues.

Finally, whether an organization has a pre-existing sustainability-related identity better fostered the receptiveness to sustainability. For instance, we find that the sustainability logic was more compatible with traditional type investors such as pension funds and insurance funds, since the logic is strongly linked to a long-term temporal dimension. Pension funds, for instance, may look at an 80-year horizon of paying out pensions. Other types of investors do not take this type of view and many asset managers still feel under pressure to perform on a quarterly basis which makes their experience of complexity higher.

> "We do RI not because we are good etc. but because it is... it makes good sense. (...) It makes much more sense to do this type of work in an insurance company because (...) the heart of managing risks forms part of the DNA of the insurance company. So that which in reality we do for RI, we already do in some way in insurance." (Interviewee V)

2.4.1.2.4 Lack of tools and models contributing to transition situation

To top it all off, no established tools and financial models existed to support the integration of the sustainability logic and encourage the development responsible investment. Most organizations were largely in the dark regarding their strategies and based performance on anecdotal evidence. It was difficult to be legitimate as a Responsible Investor without clear measurements systems over and above the positive

reputation gained by the organization from engaging in sustainability. Non-standardized reporting and disclosure made it difficult for intra-organizational comparability.

> For me, this is today, really, the point of inquiry also concerning the analysts. That is (...) how can we say that a company is in fact truly sustainable? Because the problem is that we really don't have good, precise parameters for what is sustainable or less [sustainable]. (Interviewee V)

The lack of availability of successful models which asset managers could use created a lot of insecurity and tensions. This is evidenced by the language they would use such as: "we are in the early stages", "I think we've only just started", "this is being put in place now, we are at the beginning of that", "this is a journey, nobody has really done it all yet", "we need to start somewhere", and explicitly "we are in a transition moment."

> I went to the UNPRI conference in Paris last year and one of the biggest things that I took away from the conference was that very few people do know how to integrate ESG issues into the investment process. Maybe again that comes back to the fact that some of the issues are quite nebulous... you know... sort of putting together a process to do what they might think is very difficult. (Interviewee G)

In sum, the situation of conflicting logics between finance and sustainability was all the more difficult to manage because of the structure of the field as one in transition. In the first place, organizations were strongly embedded in the dominant financial logic which made it difficult for actors to change their behaviors. Yet the persistence of sustainability issues became too strong to be neglected, particularly during the current financial crisis. However, whereas the financial logic can be characterized across different ideal type dimensions, the sustainability logic is largely difficult to characterized due to the fact that there was no shared mission of sustainability, it had a weak regulatory environment, and it was undefined in several dimensions; further, the diversity of the characteristics of the organizations and lack of models and tools exacerbated the possibilities of forming common meanings. Table 2.4 summarizes the issues of transition through the adaption of the Thornton (2002) and Thornton et al. (2012) models, to which we add an important dimension – especially relevant in the financial sector: that is,

the existence of tools and financial models that support the logic.

2.4.2 Rethinking Finance and Sustainability

This difficult and uncomfortable situation triggered new ways of sense-making for the organizations. The process of integration of the sustainability logic in the asset management industry is one of constant construction, adoption, and reassessment – akin to an evolution of trial and error rather than one of immediate adoption. They did this process simultaneously in two ways: first, using the financial logic as a frame, they created a common definition for sustainability within RI, simultaneously advocating for the creation of new types of models and tools to support this common definition and second, they redefined the financial logic using sustainability-related characteristics, which consequently reconfigured the logic's existing archetypes.

2.4.2.1 A common definition for Sustainability

Organizations began to create a definition of sustainability that served their needs and would allow them to engage in the practice of RI. This involved finding a definition and mission that the most important people in the asset management industry would agree upon. This mainly involved 'looking at sustainability in a financial way' or to regard sustainability issues as relevant for financial performance, wherein profit maximization remained a clear main objective.

The key idea that emerged was that in defining Responsible Investment, they would reconcile the conflicts by translating the sustainability language into a financial language more understandable to asset managers so that collaboration could take place with the traditional asset managers. In a way, this meant adapting the sustainability logic to serve the interests of the financial logic.

> To be perfectly honest, I think that the responsible investment industry and the responsible investment professionals have failed a bit, when we have not been able to wrap up the responsible investment case in a language or in terms that the traditional asset managers would appreciate. I have never seen an expert or an asset manager, an asset management person, who will not take the ESG issues seriously, when you are able to credibly demonstrate what the

> naturality of these issues is. So, once you have been able to demonstrate that, and we are increasingly doing that; once you are able to demonstrate that, I think everybody takes the issue seriously. (Interviewee K)

They began to veer away from the stigma of sustainability within the asset management industry as linked to "ethical investments" and instead began to argue towards a risk-reduction and long-term approach that was more compatible with finance. Importantly, the most important players in the industry pushed for this definition by being part of the steering committee of the PRI. They engaged external constituents and held numerous seminars and talks, and began funding academic research on the topic of sustainability integration which called for a revision and reconciliation with economic theories. Importantly, they also drew heavily upon the financial crisis and used this as leverage to propose alternative solutions which they presented as a means for crisis prevention.

In doing so, they were able to create a new source of identity as playing both a financial and a social role and created norms that were based upon societal interest as existing within self-interest. To gain status in RI practice, an asset management firm should be genuinely considering sustainability issues but integrating this within an objective of profit maximization. Legitimacy would be gained if good financial performance alongside good sustainability performance of investee firms could be illustrated. Gradually, sources of authority started to be built wherein fiduciary duty remained at the forefront but addressing sustainability-linked institutional pressures became possible. Further, governance mechanisms began to be put in place beyond the scope of the EU through the creation of associations such as Eurosif and the continuing strength of the PRI.

Asset managers also began to advocate for more precise measures of sustainability that they could use in a robust investment process. They began attaching numbers to sustainability parameters, back-testing their models, and trying to understand

the link of different sustainability measures to financial performance. Initiatives began to be put in place for standardized reporting frameworks such as the Global Reporting Initiative (GRI) and the PRI reporting framework and this led to the birth of diffused measurement systems such as the triple bottom-line and sustainability ratings that could be quantified. These tools and models allowed organizations to more clearly define sustainability based on a financial logic frame. Additionally, organizations began to advocate for more precise labels on RI funds to be able to differentiate them from other funds.

> We have this SRI label, which is in a way a strategic tool to implement SRI. (...) [Asset managers] can use it as a benchmark to see whether their SRI processes are well-structured enough, transparent enough and maybe progressively stringent enough. (Interviewee D)

In summary, organizations began to create ideal types of Responsible Investment practice by providing a common definition for sustainability as it was applicable to the Asset Management industry, bringing together a shared mission, regulatory framework, and models and tools that encompassed the diversity of the firms.

2.4.2.2 Redefining the financial logic

Simultaneous to creating a common definition for sustainability, we further observed that organizations began to redefine accepted notions of the dominant financial logic in which they were embedded. As most of the mainstream asset managers began to advocate that the goal of RI was to examine risks which had a financial impact, they began to support the idea that financial risks could also be driven by sustainability issues; an idea that did not exist beforehand, and as such began to think about new sustainability-related sources of risk and return.

> So, the people who believe in what they are doing in this area (...) think that investing in this way controls risk better and that in the long run you will get higher returns and therefore it is a more profitable thing to do – and by the way it should be better for the environment and it should be better from a social point of view. That is the way they kind of have to look at it. They are almost not allowed to look at it from a different perspective. They are not allowed to really look at it from an ethical perspective, even if that's maybe what they think. (Interviewee L)

Proponents of RI thus appealed to academic studies linking Corporate Social Performance (CSP) and financial performance (cf. Donaldson & Preston, 1995; Freeman, 2010; Orlitzky, Schmidt, & Rynes, 2003). For instance, being active in sustainability may be more attractive for employee recruitment and may reduce employee turnover (Turban & Greening, 1997) and protect firms in a legitimacy crisis (Godfrey, Merrill, & Hansen, 2009). That is, when a firm suffers a negative event, it is less likely to be financially penalized by its shareholders if it has had good sustainability practices in the past.[15] Hence, by doing RI, an asset manager is able to have value-relevant information about its investee firms that allows them to manage risk better. As expressed by the Executive Director of the PRI:

> The world is changing very fast; it is changing faster than it ever has before, and environmental issues, political risk, human rights, you know, these kind of issues are now fundamental and really important in the supply chains of companies, in regulatory frameworks and so on (...) these issues are becoming more and more material, more material than they ever have been (...) And if you have people managing your money, (...) do you want the people managing your money to have a really good understanding of the mega trends that are facing the world, or would you prefer that they have a very traditional backward looking, you know, myopic approach of fund managers that look at the small number of financial metrics and then try to predict whether a company is going to be a good buy or not? (Executive Director, PRI)

They also began to highlight the importance of client 'stickiness' or the fact that doing RI was relevant for attracting and retaining clients.

> If you are not doing this kind of analysis and integrating into your investment process, you know, you will be very unlikely to win third party mandates. [We] are increasingly seeing request for proposals (...) containing very detailed questions in this area." (Interviewee G)

This resulted in the restoration of a long-term approach to investing:

> So, it might just be long-term investing that we ultimately get to. And by a long-term, it's sort of explicit in the word, that you have to take into account a broader range of factors that will affect companies over the long term like sustainability issues that are relevant and material for those

[15] Suffice to say that these findings have been largely contested, especially for their lack of generalizability. Several findings have also found no significant effects between ESG criteria and performance (e.g. Renneboog, Terhorst, & Zhang, 2008), that only *some* types of CSP actions affect value (e.g. Hillman & Keim, 2001), or even negative relationships between CSP and financial performance (e.g. Bhagat & Bolton, 2008; Hong & Kacperczyk, 2009).

> companies in that sector. (Interviewee A)

Because of this, the associated organizational forms linked to the financial logic began to change. Organizations began to implement awareness and training programs for financial analysts on sustainability issues, which included for example, doing a thematic presentation and inviting outside experts to show the internal analysts what they were doing and began to hire and create positions for hybrid roles. Further, the organizations created new ways in which to increase their level of commitment to sustainability, particularly by forming internal research teams, joining academic networks, and setting task forces with universities. Instead of purely relying on available sustainability research from third parties, one firm created an internal weighting system to analyze the externally provided data.

> "The data providers are offering data only from publicly available information. That does not mean that what we have is not publicly available, but you need to ask the company in order to get that. And that is the big difference: we go into the trouble to do that. And this year we had about 800 companies report to us." (Interviewee P)

They also elaborated on their shareholder activism practices by including sustainability issues within their dialogues with investee firms. In such a way, they did not completely abandon their traditional organizational forms but rather, guided by their reassessment, elaborated these with sustainability-related issues.

2.4.3 The Role of the PRI in the rethinking process

Throughout our period of study, it was evident that the PRI played a major part in diffusing RI within the mainstream asset management industry. The United Nations-backed Principles for Responsible Investment Initiative is a network of international investors working together to put the six Principles for Responsible Investment into practice (PRI Website).[16] These principles were devised by the investment community,

[16] The six principles are : 1) We will incorporate ESG issues into investment analysis and decision-making processes. 2) We will be active owners and incorporate ESG issues into our ownership policies and practices. 3) We will seek appropriate disclosure on ESG issues by the entities in which we invest. 4) We

driven primarily by some of the largest and the most important global institutional investors. Launched in 2006, it began as an advocacy-type movement led by a handful of large pension funds coordinated by the United Nations Environment Programme Finance Initiative and the UN Global Compact. It has since evolved into an independent non-profit organization with advisory council members consisting of asset owners and UN directors. The goal of the PRI is to look at investor behaviour and to set-up global RI standards without being prescriptive.

We found that the PRI acted in several ways in facilitating the adoption of RI. First, it was key in creating a shared mission and definition of sustainability within asset management through the idea of Responsible Investment. The PRI coined and diffused the now widely accepted term Responsible Investment which encompassed several other pre-existing terms such as sustainable investment and Socially Responsible Investment, the former usually linked to environmental issues and the latter usually linked to ethical or moral issues, in order to be more inclusive towards mainstream asset managers that preferred to have the leeway to position themselves more broadly. This terminology came hand-in-hand with providing a shared onus of seeking the best financial returns. The PRI states that its principles 'reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfill their fiduciary (or equivalent) duty' (PRI Website). Thus, in adhering to this new identity as a Responsible Investor, asset managers subscribed to a new identity distinct from solely environmental and ethical issues and more closely tied to risk management that they could relate better with. By creating a shared, broad definition, the PRI managed to put together firms already involved in sustainability with those wanting to get into it

will promote acceptance and implementation of the Principles within the investment industry. 5) We will work together to enhance our effectiveness in implementing the Principles. 6) We will each report on our activities and progress towards implementing the Principles. Source: http//www.unpri.org/

through simplifying the identification process, which was critical given the diversity of the organizations.

> I think that there is a clear value in having one set of principles, and this is becoming the prime set of principles. And it is a good time and place to meet. One meeting place is better than ten. (Interviewee F)

By adopting a non-prescriptive approach, the PRI provided flexibility in the structuring of the field and in the diffusion of new practices, which was favourable for the starting of a new field and in getting people on board.

> I think, the UNPRI is pretty effective in trying to gain new signatories. Initially the questionnaires which they require the signatories to complete each year was public, I think. And there was a concern thought by many and including [ourselves]that you were opening yourself up too much and that you would sign up for it and then run the risk that because you made some technical mistake you ended up getting booted off, and then, you know, all the negative press that might go with that. So when it became aspirational (…) then it became easier to sign up. (Interviewee G)

In part due to the PRI, the majority of RI investors in Europe (56% of total RI AUM) now adopt is what is known as *ESG integration* wherein ESG criteria is used during traditional financial analysis but in a flexible rather than norm-based approach, providing space for the fund manager to decide. France in particular, mainly adopts the best-in-class approach wherein investee firms within an industry are ranked in function of their ESG performance. Those which either pass a minimum threshold or are the best in their industries are eligible to be included in the investment universe. This method allows bringing in a degree of flexibility in the construction of the portfolio, especially in enabling the inclusion of high-performing companies in controversial industries such as mining or nuclear power.

Second, the PRI provided a platform for coordinated action amongst its signatories. It not only acted as a gatekeeper of its principles, but it provided means for guiding and supporting its members. Each signatory was required to have a dedicated PRI point person and the PRI regularly hosted routine meetings and events, and had a yearly assessment process which allowed the exposure of which areas organizations were

good at and which they had weaknesses in. It also provided training and research programs and the possibility to do shareholder engagement collectively through its Clearinghouse office. This was particularly helpful for smaller funds that previously had difficulty in getting companies to hear their concerns. This role was especially instrumental during this period given the fact that tools and models were scarcely available in the field. In doing so, the PRI supported the bases of norms, attention, and strategy of reconciling sustainability and finance, acted as a source of authority, and provided a governance structure.

> I think, for all of us, and it does not matter if you have a big pension fund, or a small pension fund, or a mainstream asset manager, who is trying to get into responsible investment (…) PRI has provided a global platform for mentoring, for information exchange, and actually allows with fairly little cost, smaller organizations [to participate] that perhaps historically, have not had the means to be a part in those sorts of discussions and those activities. [The PRI] has provided a platform for a collaborated effort. (Interviewee Q)

Finally, the PRI provided legitimacy to its signatories by making them feel that they were part of an important broader social movement that was beneficial for their reputations. This provision of legitimacy was possible due to the fact that the PRI received support from the United Nations and was backed by important institutional investors. Organizations found that by being a signatory to the PRI, they could more easily attract clients and that being so was becoming necessary in responding to requests for proposals.

> I think, the PRI membership of course on the one hand [intensifies] our own brand recognition and showcases our end commitment towards the sustainable or the ESG course so to say (...) And the other hand of course we see the PRI is one of the (...) gatekeepers to the entire industry in order to make new contacts and to gain access to markets where we historically maybe didn't have much of a share. (Interviewee N)

Finally, the PRI was key in supporting the creation of tools and models through its reporting framework and the development of research and other academic programs geared towards this. As such, the PRI played an important role in facilitating both the creation of a common definition of sustainability and the redefinition of finance.

Table 2.4 Ideal Types of the Financial and Sustainability Logic in the European Asset Management Industry (Adapted from Thornton, 2002; Thornton et al., 2012)

	Financial Logic	**Sustainability Logic**	**Responsible Investment as logic assimilation**
Economic System	- Market Capitalism	- Undefined	- New form of Market Capitalism
Mission and extent to which this is agreed upon	- Clear mission of profit maximization by optimizing risk and return - Guided by strong economic theories such as Portfolio theory	- In the asset management industry, sustainability came as a result of a myriad of missions: moral and ethical considerations, environmental agendas, and sustainability as material for financial return - No strong theories guiding sustainability; ambiguous definitions coming from different fields with differing agendas	- Sustainability in RI means steering away from "ethical investing" and moving towards risk reduction and long-termism - Revision of economic theories
Sources of Identity	- Asset Management as profit-maximizing business	- Highly contested identity of Asset management as "good" for society / playing a societal role	- Asset Management can play a societal role as well
Basis of Norms	- Self-interest	- Societal interest	- Societal interest within self-interest
Basis of Attention	- Status gained from profit maximization	- Status within Asset Management gained from "doing good" unclear	- Status gained from doing sustainability but only within an objective of profit maximization
Basis of Strategy	- Increase financial profit	- No clear strategy	- "Looking at sustainability in a financial way"
Sources of Legitimacy	- Net Asset Value and financial return over a benchmark	- Partly organizational reputation gained from engaging in sustainability but not more important than financial return	- Legitimacy gained from doing sustainability but only within an objective of profit maximization
Sources of Authority & Authority Structures	- Shareholder (client) activism - Fiduciary duty	- Scattered: can be the CEO and Management of the organization, NGOs, media, or clients demanding for this but with no clear authority source	- Institutional pressures no longer in conflict with fiduciary duty
Governance and other Informal control mechanisms	- Highly regulated - Strong governance structures in place (e.g. Management fees; reporting and disclosure standards)	- Highly voluntary	- Some regulation at local and European level - Creation of enabling organizations such as the PRI and Eurosif
Tools and Models	- Sophisticated tools and models in place - Reporting and disclosure standards	- Lack of tools and models - Non-standardized (ad-hoc) reporting and disclosure	- Beginning to create standardized reporting - Quantifying sustainability

2.5 Institutional Complexity in a Transition Field

The results of our case study suggest a model that connects the structure, processes, and facilitators underlying institutional complexity in a transition field. Representative quotes that link the empirical findings with the theoretical findings are presented in Table 2.5. The coding structure is presented in Figure 2.2 while the model is presented in Figure 2.3. In this section, we explain our model. We show how the attributes of a field activate certain mechanisms that affect how organizations experience institutional complexity. This experience is facilitated by an enabling organization. That is, due to the structural attributes of the field, organizations in a transition field are pre-disposed to experience institutional complexity through a process of logic assimilation, which has two core recursive mechanisms: 1) logic theorization and 2) logic-archetype elaboration. The process of logic assimilation is facilitated by the presence of an enabling organization. We expect that gradual practice transformation will result from these dynamics.

Figure 2.2 Institutional Complexity in a Transition Field

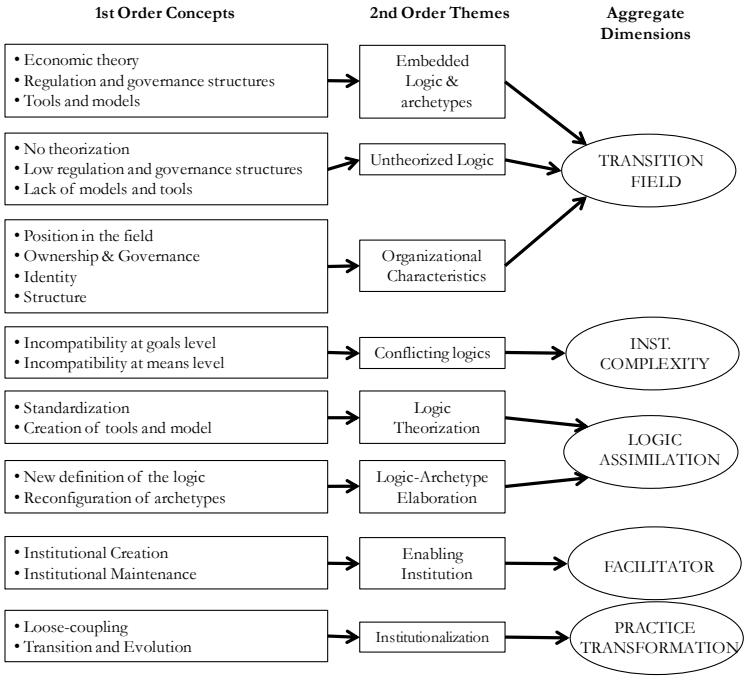
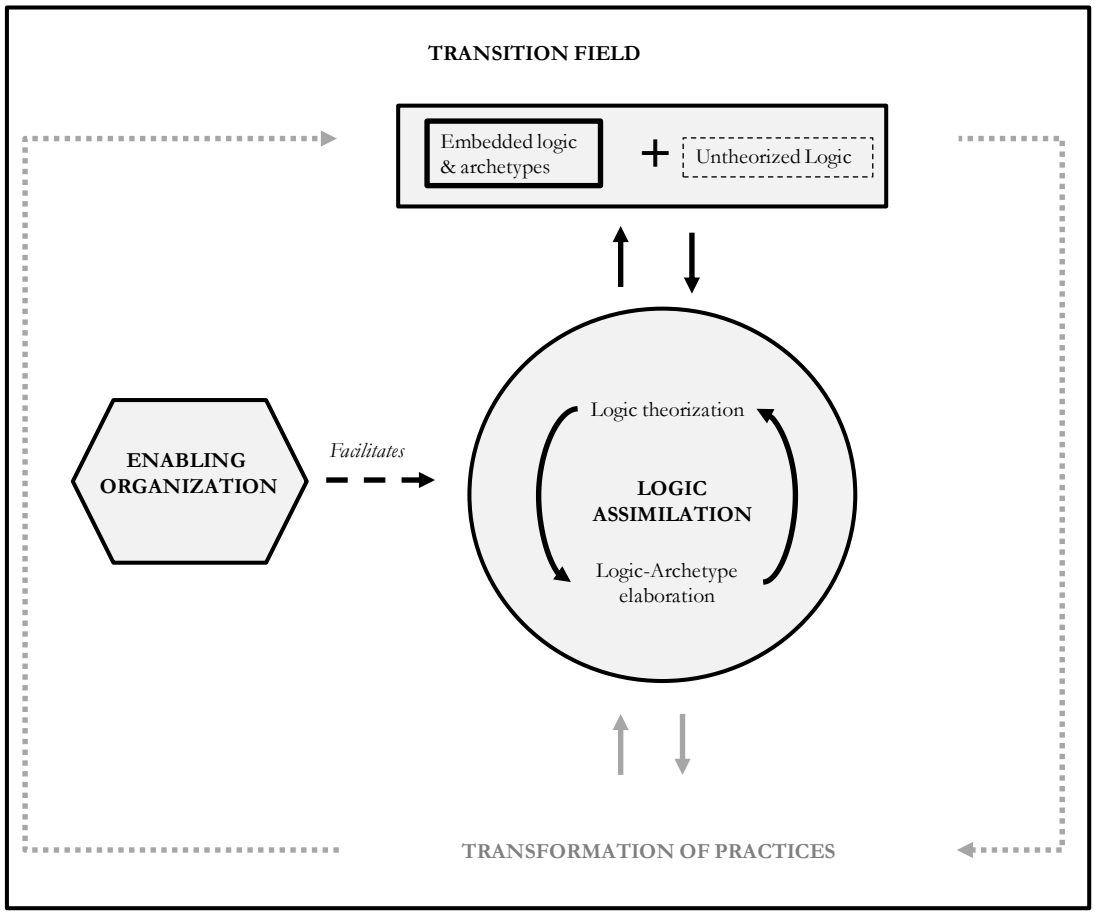


Figure 2.3 Field-level Dynamics in a Transition Field Facing Institutional Complexity



2.5.1 Conceptualizing the Asset Management Industry as a Transition Field

The Asset Management industry in Europe, in its situation of institutional complexity, displays characteristics unique to previous studies examining mature and emergent fields. It is an organizational field embedded in a dominant logic of finance simultaneously experiencing increasing pressures from an *un*theorized logic of sustainability. The financial logic was largely present in the theories and models informing the practices of asset management. The sustainability logic, on the other hand, emerged with the advent of global discussions surrounding sustainable development, yet due to the myriad of sources of the logic, there was no agreed-upon definition of sustainability that would enable its immediate legitimate acceptance within the industry. Unlike other instances of institutional complexity wherein an emerging logic had a high

level of theorization either from another stable field (cf. Reay & Hinings, 2005; Thornton, 2002; Thornton & Ocasio, 1999) or from a social movement by actors within the field (cf. Rao et al., 2003), the sustainability logic was undefined across several fields. That is, most accounts of sustainability can be interpreted not as a true conceptualization of sustainability but rather, as how organizations would *like* to understand sustainability, making it highly mutable. Further, sustainability came to be synonymous with other ideas such as 'corporate social responsibility' or 'environmental management' (Gray, 2010). Potential adopters of the sustainability logic across the asset management industry were heterogeneous with regards to their rationales and practices.

Further, the diversity of organizations contributed to this transition situation. Greenwood et al. (2011) argued that organizational attributes act as 'filters' which moderate the degree to which complexity is experienced, and will consequently influence their responses. Indeed, the variety of organizations contributed to the difficulty in integrating the undefined logic. Finally, there was a lack of tools and models to facilitate institutional change. The stark contrast between the financial logic and the sustainability logic (as seen in Table 2.4), illustrates that not only did the sustainability logic bring with it conflicting objectives to the financial logic enough to foster institutional complexity, it could not be characterized based on typical dimensions used for other logics.

Hence, in the asset management industry, we find an entirely new type of field: a mature field embedded in a dominant logic experiencing the pressures of a new, *un*theorized logic: what we refer to as a *transition field.*

2.5.2 Logic Assimilation in a Transition Field

Experiences of institutional complexity can differ and the structural dimension of fields is one determinant of how organizations 'construct the repertoire of responses available to them' (Greenwood et al., 2011). We find that organizations in a transition

field were pre-disposed to make sense of competing logics in a different way than organizations in a mature field or an emergent field.

Because of the characteristics of the field that they were in, the experience of organizations in the asset management industry differed from previous accounts of institutional complexity. They did so in a form of logic assimilation. Logic assimilation was first defined by Thornton et al. (2012) as consisting of combining elements of an emergent logic into a prevalent logic while maintaining the original logic. This definition, however, lacks empirical substantiation and specification. Through our case study, we are able to significantly enhance this broad definition by empirically illustrating and specifying that in logic assimilation, a recursive process occurs through two core mechanisms: it involves (1) the usage of established (incumbent) logics to frame and translate the undefined logic to align it with the dominant logic in a process of ***logic theorization*** and simultaneously, (2) the redefinition of the incumbent logic and consequently, its archetypes based on the characteristics of the incoming new logic through a process of ***logic-archetype elaboration***. Thus, logic assimilation is the sense-making process imposed upon organizations by an *un*theorized logic and 'feeding back' into the dominant logic, the consequence of which is the elaboration of the incumbent logic and its archetypes that possess new characteristics. An interesting way to think of logic assimilation is through a sociological example of immigrants within a dominant society. The immigrants need to adapt and the norms and archetypes of the dominant society are imposed upon them but at the same time, their presence also gradually changes the dominant society. Such was occurring with the inclusion of sustainability issues within traditional investment practices: the sustainability logic was being 'framed' using the logic of finance (e.g. quantifying sustainability, structuring reports) and asset managers began to rethink whether sustainability issues should be included within the existing financial models.

By specifying these two core mechanisms, as we further expound on below, we address Thornton et al.'s (2012) call for further theoretical fine-tuning among different potential mechanisms of logic transformation and enrich the understanding of the mechanisms underlying logic assimilation, making such a process largely distinct from other forms of change such as the blending of logics. We generally illustrate that logic assimilation encompasses both logic theorization and logic-archetype elaboration in that it entails 'framing' by incumbent logics yet simultaneously leads to new narratives and practices that reinforce the logic (Thornton et al., 2012). As such, our understanding of logic assimilation is much more complex and recursive than was previously laid out.

2.5.2.1 Logic Theorization

The emerging sustainability logic challenged the degree of unification in the field which strongly adhered to the financial logic and questioned its formal structures. Institutional complexity thus became very high wherein ambiguity was brought in and organizations started to become uncoordinated as to whether and how to incorporate sustainability issues. Organizations found that a first way they could manage complexity was to translate the sustainability language into a financial language more understandable to asset managers. By doing so, asset managers were able to form new theoretical conceptions of the untheorized logic that was acceptable to themselves as players embedded in the financial logic. This theorization came about by the usage of the incumbent logic as a framing tool. Organizations needed to do this because they did not have models of change in other sectors or organizations as in other cases. Indeed, at the organizational level, logics can focus the attention of key decision makers on a delimited set of issues and solutions (Ocasio, 1997), leading to logic-consistent decisions that are acceptable to legitimate players. As shown by Greenwood et al. (2002), this process of negotiating and managing debate within the profession – a first crucial step in

theorization – allows the field to legitimate the change to *itself*. Theorization is important because it confers legitimacy, especially crucial within a highly structured setting. Such theorization allowed the players to have a level of agreement regarding their understanding of the sustainability logic within RI practice and this was supported by external constituents and legitimate actors enough to become compelling to relevant audiences referred to as 'culturally legitimated theorists' (Strang & Meyer, 1993) and including: scientists (academics), intellectuals, policy analysts, and professionals.

Yet organizations did not simply specify and develop abstract categories and chains of causes and effect; they also did not simply reflect upon an alternative solution. Instead, they simultaneously used tools and models to assist them in theorizing. This is because in a transition field, increasing complexity leads to an increased need for models, which is particularly the case in the financial sector. This is linked to the acknowledgment of humans' limited information-processing and calculational capabilities and the recognition that standardized tools play a key role in simplifying concepts, particularly in a field with different types of organization. Hence, due to the fact that the practice of RI still remains in construction, the existence of such tools and models simplifies complexity to the point that theory becomes applicable (Callon & Muniesa, 2005). The possibility of this occurrence was pointed out by Strang and Meyer (1993) who posited that general models are needed to support the process of theorization. Literatures in the Social Studies of Finance (SSF) have also shown that while established financial models largely guide and frame action, reflexive agents actively take and transform the usage of existing models to fit their own purposes (Beunza & Stark, 2004; MacKenzie & Millo, 2003; MacKenzie, 2006). These studies illustrate how decisions in financial markets are based not only on financial models but also on calculated reflections of uncertainty (Beunza & Ferraro, 2010), an idea that is largely linked to theorization. When such calculated reflections become diffused as shared beliefs, they become strong enough to trigger the

creation, elaboration, or change of models. Through our findings, we elaborate on previous definitions of theorization by illustrating that through the creation of models and tools, logic theorization – that is, the creation of an interpretative scheme and ideological coherence underlying a logic – and the diffusion of practices happen *simultaneously* in a transition field

2.5.2.2 Logic-Archetype Elaboration

Recursively, asset managers began to rethink the financial logic itself in which they were embedded by examining the drivers of risk and return given the characteristics of the sustainability logic and in doing so began to elaborate the financial logic by introducing characteristics of the new logic. Asset managers began to create and subscribe to the belief that examining non-financial issues would provide informational benefits that would enable them to make better predictions for the future. They also began to believe that it was imperative to engage in the practice of Responsible Investment because of the strong demand from and the 'stickiness' of RI clients. That is, they began to believe in the material benefits of having a clear RI strategy. This became evident in the language that they used, allowing them to elaborate the incumbent logic through shifts in discourses and meanings (Cooper et al., 1996). In doing so, they were able to legitimize the practice by assimilating new sources of performance and risk brought about by the logic of sustainability.

The elaboration of a previously defined logic inevitably led to a change in the underlying interpretative scheme and as we further observed, to a gradual change in its organizational forms, structures, and patterns of behavior, or its so-called 'archetypes'. Organizations slowly began to include sustainability issues within their investment practices and organizational activities such as hiring, training, and learning, that resulted in a new archetype of Responsible Investment: in every way the manifestation of the

logic assimilation that is occurring within the industry. This demonstrates how the experience of institutional complexity is observed in an organization's forms (e.g.Kraatz & Block, 2008; Thornton, 2002) and strategies (e.g. Pache & Santos, 2010; Thornton, 2002; Zajac & Westphal, 2004). An initial working of this mechanism, while not made explicit, was reflected in the study of Beunza and Ferraro (2012). They mention that the most important affordance of Visual's tool was the integration of financial with socially responsible data. This integration took place through the addition of extra fields to the original finance database through Visual terminals. The ESG data could be displayed on the same screen together with financial data. As such, the diffusion was what they called a 'slow institutionalization' or the gradual diffusion of novel investing practices but with much rhetorical allegiance to the principle behind them. This further enabled the sustainability logic to theoretically co-exist alongside the financial logic, downplaying their conflicting demands.

Thus, in a situation of institutional complexity in a transition field, organizations engage in a process of logic assimilation which entails both the theorization of the incoming logic and an elaboration of the dominant logic and its archetypes. In this way, organizations were able to assimilate the financial logic to include the sustainability logic, and this assimilated logic is what informed Responsible Investment. Contrary to previous studies, organizations did not 'borrow' a pre-existing logic from another field nor aimed to design new archetypes, abandoning an institutionalized template. It is also useful to point out that in logic assimilation, radical or divergent change does not occur. The fact that organizations employ ESG integration which allows a high degree of flexibility illustrates that logic assimilation is a gradual process of trial and error, a necessary characteristic of a transition field. This illustration of logic assimilation further emphasizes that different stages of institutional change can occur simultaneously and that because of the structure of the field, institutional change is not necessarily a

straightforward division between institution formation (the birth of a new logic or governance structure), deinstitutionalization (the dissolution of an existing logic or governance structure), or re-institutionalization (wherein an existing logic or governance structure is replaced by a new logic or governance structure) as previous scholars have tended to compartmentalize (cf. Rao et al., 2003).

Further, logic assimilation is not limited to previous simplified definitions of combining elements of an emergent logic into a prevalent logic while maintaining the original logic (cf. Thornton et al., 2012). Instead, this process is much more complex and entails theorization, which includes the simultaneous creation of models and tools and their diffusion and logic-archetype elaboration which redefines the prevalent logic and also reconfigures its archetypes.

2.5.3 Enabling organizations as a facilitator for Logic Assimilation

Finally, we find evidence that the PRI was instrumental in that it acted as a facilitator in the process of logic assimilation. Previous studies have highlighted the role of regulatory agencies and professional associations in institutional change (Greenwood et al., 2002). These external bodies play an important role in this process of theorization by endorsing local innovations and shaping their diffusion; yet, more research on such and other external facilitators is needed. The PRI is unique in that while having some characteristics similar to a regulatory agency or professional associations, it also importantly played an advocacy-type role that called for collective action and provided infrastructure for such action (Gond & Piani, 2012). The PRI is thus an enabling organization which allowed logic theorization and logic-archetype elaboration to take place. It began as an 'advocacy' which mobilized political and regulatory support from the United Nations, and has been involved in creating definitions. Indeed, the PRI coined and diffused the now widely accepted term Responsible Investment. It also

defined the boundaries of RI, encompassing a range of financial institutions as members by creating 'constitutive rules' which – having a non-prescriptive nature – enable rather than constrain institutional action (Scott, 2008). The PRI was also involved in changing normative associations by calling for a redefinition of RI which is strongly linked to risk management rather than ethical grounds, making the practice more closely associated to traditional finance.

The PRI also acted as an authority with its set of created principles whose implementation is then monitored across geographies, guiding and supporting the institution of RI. It also set a policing mechanism by having a dedicated PRI point person in every member organization, by holding routine meetings and events, and by the implementation of an assessment process. Finally, it also engaged in educating through its training and research programmes.

Further, we find that an enabling organization was particularly important in a situation wherein models and tools do not exist and was key in enabling logic assimilation. Because of the initial absence of models and tools related to sustainability, the PRI created ways for asset managers to take financial models and concepts and use these to frame sustainability, providing the latter with the possibility to be defined by the same language.

Through the diffusion of its principles, the PRI in many ways facilitated in the theorization of the sustainability logic and the redefinition of finance. The PRI boosted the adoption of RI in the field by leveraging on its early signatories: powerful pension funds demanding for a new type of finance. They thus allowed integration to occur by providing symbolic legitimacy. Hence, asset managers were forced to consider sustainability issues even in the midst of the complexity and situation of transition.

2.6 Concluding comments and a note on the future of RI

Research on institutional complexity has been of growing importance in the Management literatures. In particular, the proposition that competing institutional logics may co-exist and that one logic does not simply 'replace' another over time has brought to light the notion that organizations make sense of rather than adhere to logics. That is, organizations make decisions on how to manage incompatible prescriptions and respond to complexity in heterogeneous ways by adopting different organizational responses. However, previous research on the role that a field's structural attributes could play in the experience of complexity is lacking, especially in the case of transition fields wherein institutional complexity is especially salient.

Through an in-depth case study of the asset management industry in Europe, we find that in the case of a transition field wherein organizations strongly embedded in existing logics face the emergence of an incompatible *un*theorized logic, organizations engage in a process of logic assimilation which involves two core recursive mechanisms: logic theorization and logic-archetype elaboration. Given the saliency of complexity in this type of field, this process was facilitated by an enabling organization.

The contributions of the paper are several. From an overarching theoretical perspective, the paper addresses the need for more in-depth studies of the underlying processes of institutional complexity (Greenwood et al., 2011; Pache & Santos, 2010) and by doing so, enriches extant studies on institutional logics within an organizational context (e.g. Glynn & Lounsbury, 2005; Marquis & Lounsbury, 2007). It does this in several ways.

First and foremost, the conceptualization and empirical illustration of a transition field brings to light a significant neglect in previous work and answers recent calls to provide attention to field-level structures and their relationship to the underlying processes of institutional complexity (e.g. Glynn & Lounsbury, 2005; Marquis &

Lounsbury, 2007), particularly in situations wherein such complexity is especially salient. Further research can enrich our study by examining other empirical examples of transition fields and further specifying characteristics of such fields.

Second, we substantially enhance previous definitions of logic assimilation by illustrating that the process involves the recursive mechanisms of logic theorization and logic-archetype elaboration. Logic theorization is the creation of ideological coherence for the new logic based upon the incumbent logic. Our specification of this mechanism substantially enhances previous accounts of theorization (Greenwood et al., 2002; Strang & Meyer, 1993; Tolbert & Zucker, 1999) by emphasizing not only the significant role of models and tools in theorization but positing that theorization and the diffusion of ideas occur simultaneously. As was the case in the options pricing model of Black, Scholes and Merton, the model first proposed did not describe an already existing world. However, through the increased use of their measure of 'implied volatility' and material means of calculation using 'Black's sheets', the prices of the financial markets changed in a way that fit the model, which led to even more adoption (MacKenzie & Millo, 2003). We thus emphasize how this may link to studies of performativity in Social Studies of Finance that focus upon the role that tools and models play in the institutionalization of practices (e.g. Arjaliès, 2013; Callon & Muniesa, 2005) and highlight how financial markets are thus *performative* (Callon, 1998) in that theories, beliefs, ideologies, and material artefacts affect their creation and operation (Beunza & Stark, 2004; MacKenzie & Millo, 2003; MacKenzie, 2006). In doing so, we provide a useful starting point that links these two important research areas. We also enhance previous accounts of logic elaboration by emphasizing the fact that upon elaborating a logic, its organizational structures and systems – archetypes – also change. That is, when theorization is successful, it leads to the elaboration of archetypes which reflect a single interpretive scheme and is representative of a structured practice within a field, the existence of which is integral to

institutional stability and institutional change (Greenwood & Hinings, 1993). As such, we uncover a more nuanced description of logic assimilation in a transition field.

Third, through our abductive methodology, we further uncover an external factor – the enabling organization. An enabling organization, unique from regulatory agencies and professional associations, played a key role in supporting logic assimilation through providing definitions, coordinated action, and legitimacy. We encourage further research to tease out the characteristics of an enabling organization and deepen our understanding of their role in the processes of institutional change.

We therefore strongly believe that this paper opens several research avenues and that its constructs can be readily replicated and extended, both qualitatively and quantitatively.

Our findings have several implications in practice and pose important questions about the future of RI. It forces us to consider the temporality of this particular transition field: that is, the fact that this situation will not last and that in order for RI practice to take hold, institutionalization will need to occur. Such an institutionalization follows from successful theorization, which includes the development and diffusion of models and tools in conjunction with an acceptance of a new type of finance: only in such a case will the ideological coherence of ideas, beliefs, and values trickle down towards organizational structures and systems, which will transform practices into routines (e.g. Lawrence & Suddaby, 2006; Pentland & Feldman, 2005) to be institutionalized. Yet the non-prescriptive approach of the PRI, while effective in first getting people on board is not without its share of problems, especially approaching the latter part of the study. Whereas it was beneficial at the early stages of practice diffusion, many signatories later on tended to feel that firms could more easily decouple their practices by simply signing up to the PRI, with no change in actual integration. The general level of anxiety could not be ignored in the tone of signatories when asked about

their idea of the future of RI. Most of our interviewees voiced out how a new wave of change would need to occur, which would involve more structured methodologies including labeling and categorization, together with strong legislative support. Indeed, our results suggest that whereas at the beginning of institutional change, loosely coupled practices and flexible strategies as advocated by the PRI were appropriate, major diffusion and implementation would not occur unless such practices would become more and more structured. Importantly, the effect of the financial crisis on this process of structuration remains to be seen.

We find that our focus on the asset management industry is probably the main strength of this paper. It brings us to question whether sustainability issues will really have a substantial impact on pricing in the long term, thus questioning the strength of the role of asset managers in constructing the field, their ability to influence prices, and whether this effect is consistent and permanent. We highlight the fact this study sheds light on the reality and plausibility of the integration of sustainability in the financial sector – arguably the most important sector today – a sector which, not only due to its complexity but also due to its damaged reputation in the recent crisis can potentially provide real solutions to pressing social concerns despite its seeming to be a most unlikely candidate. Indeed, much more compelling research is needed on the phenomenon of Responsible Investment and in particular, research would largely benefit from longitudinal studies examining the field and the possibility for richer databases. As such, we put on the agenda the challenge to institutional scholars to address pressing, contemporary phenomenon interesting for managers in particular and society in general. The future of Responsible Investment remains to be seen.

> Interviewer: What do you think of the future of Responsible Investment?
> Interviewee G: Fifty-fifty, yeah, probably yeah. Fifty-fifty.

Table 2.5 Representative Quotes

EMPIRICAL FINDINGS	REPRESENTATIVE QUOTES	THEORETICAL FINDINGS
	FIELD STRUCTURE	
Incompatible demands from the financial and sustainability logics	What sometimes is difficult in certain sectors, it is difficult for us [RI analysts] to select companies; and that makes it sometimes difficult for the asset managers, because they want of course to spread and they want to follow the index. And if you have only few companies to choose from within a certain sector or an industry, it becomes more difficult to make a good choice. So, in that sense, it is sometimes difficult for us. (Interviewee X) I think we need to think more about misunderstandings between asset owners and fund managers, because I think, genuinely, I think some fund managers believe that their clients talk about long-term, but actually put fund managers under short-term pressures. (Interviewee Q) Most signatories to the PRI, pension funds, most of them, they may employ asset managers who work for them, they require the asset manager to report on that performance every 90 days. And yet at the same time they apparently expect the asset managers to take a long term view on the market. And that doesn't work. (Interviewee L) In my opinion, it is all a mentality that is still to be changed because there is maybe still an important part of finance, there is still this idea that whoever does ethical funds - which is false - does 'good', so doesn't make money. (Interviewee V) So, I was just going to say in terms of portfolio construction, yeah, the most frustrating thing is that, you know, you have got a company that is performing well and, you know, releasing great earnings, good revenue prospects, growth et cetera blah-blah-blah. But, you know, the management team just sucks, to be honest. And having spent all this time on sustainability I wouldn't want to own them but, you know, performance matters. (Interviewee H) What I am currently a little bit skeptical [about], and that's the biggest obstacle in my view, is the question of short-termism and long term thinking. So, the institutional environment of financial markets is still not paving the ground for further development of responsible investing, of sustainable investment since it makes it more or less be successful in commercial terms. It makes it more or less necessary to look at things on a daily or hourly basis, or even shorter. If you see the development of this very short term trading programs that make up almost or more than 50 per cent of the trading volume at stock exchanges, then I cannot really see how this environment makes a long term thinking at investment managers possible, because still there is on very short term basis, you need to deliver performance, people are measured on a very short term basis against benchmarks. (Interviewee E)	**Institutional complexity from conflicting logics**

	What I see as an obstacle sometimes is that people see this, if I can call it movement, as some sort of risk management tool which limits them in what they can do. (Interviewee B) So we would never stay, say we had an investment with a very positive impact, but with a very poor, much lower than expected return, we would have very big difficulties to remain in that company, if we could get out of the company. That has to do with our fiduciary responsibility - we are obliged to make these returns for our clients. (Interviewee Y)	
Rethinking Finance and Sustainability	**UNDERLYING PROCESSES**	**Logic Assimilation**
A common definition of Sustainability	We cannot build the responsible investment industry simply on the notion that it is a good thing or a right thing to do. There has to be numbers that justify that kind of investment. (Interviewee K) I mean, the fact that you have already done that [traditional financial] job, it means that you know the evaluation models; you know the way they work. So, in order to build the famous bridges (...) between finance and sustainability, I am clearly convinced now, and that was my original conviction, but now, after six-years and a half I am completely sure that you need to have expertise in both. (...) And the success, with modesty, the success we have now internally and with the clients, it is clearly one of the explanations is that we master both worlds. (Interviewee T) When we bring new analysts on board (...) we literally look for analysts who have a very deep understanding of ESG issues and that have also a strong link usually to the financial services sector. (...) I think this sort of hybrid personality you see throughout the key research experts. I think, this is a very [strong] business advantage for MSCI that we have a lot of hybrids so to say in this organization [who] understand both worlds. (Interviewee M) So we start from this [external information] then we take it, we adopt it, transform everything, and in a database which we have created internally, which is truly ours, we made it from scratch, and we transform everything under a methodology which we have created. (Interviewee V) But I think, you know, what needs to take place still is this whole discussion about market valuation and pricing and, you know, accountancy standards (...) you need more integrated reporting processes that obviously also include extra financial factors; and likewise, if you price an investment there should just not be the usual market valuation figures that are adjusted time over time once a day. There should be really a process in place that not only looks at volatility and other sort of type of investment risk, but it also includes ESG issues. (Interviewee M)	**Logic Theorization**

Redefining the financial logic	**New sources of risk and return** Our investment belief is principally that companies are governed properly. A proper governance is the one that pays heed to their social partners, to their employees, to their customers, to their suppliers, to other people in the supply chain, who pay proper heed to the needs of their investors; so, it is includes investmentship. Most companies that are governed properly would do safety properly, are transparent, do not get involved in corruption... These are the companies who, we believe, in the long term will provide the income and the return for our pension scheme. (Interviewee Q) We are owned by the Labour Market Party(...) it is vital for those two owners to be able to stand up in the public before our operations and [say] how invested money that is provided within the pensions that we are taking care of. So, I think it would be a problem if we had made our own rules and had some definitions that no one else can refer to. So, I think for them, it is vital that we do have a transparent set of rules, and that we [a] structured process that is transparent (...) a process that can work. (Interviewee U) They may sit there and say: 'You know, I don't really believe in this, but we are going to have to because our biggest client in Europe is demanding it.' And then somebody else in the organization can say: 'Yeah, but do you know what? I actually believe in this.' And it's much easier to say that when your biggest client is on your side than it was previously. (Interviewee L) So we do implement the responsible investment policies on behalf of our clients. So the clients - pension funds - set their policy and then we implement that policy. (...) Some other funds which would be more "ethically branded" they would also exclude other types of companies such as tobacco companies or maybe even oil companies. And we don't have the freedom to do that. Because ultimately, it is the board that decides if they want to do that or not. (Interviewee Y) The president changed in 2004 and [the new president] tried to change a little bit the firm, so he wanted to give a new direction. And so he began in 2005 to work on these issues and especially to work on SRI and to design SRI funds that would be sensible. (Interviewee M) **Restoring Long-termism** So, if you really want a qualitative change towards sustainable investing, than you need also to have these answers to these questions. You simply cannot expect people in their daily business to look at long term investment success if they are measured against a benchmark on a daily basis. (Interviewee E)	**Logic-Archetype Elaboration**

	What we try to do is to say long-term issues, the capability of a company to integrate long-term issues of course is an indication of the quality of management, and an indication of the performance in the long-term of the company. (Interviewee C) The responsible investor, let's say, must instead go to finance a firm or a country that anyway has a political [situation] which is stable. (...) The firm is a bit the same thing. It tries to go to invest in a firm where my temporal horizon is not of a very short period (...) where I manage to do a reasoning, I manage to do a financing of an activity, or of a sector, or of a firm which anyway I know how to follow certain strategies related also to sustainability, on the attention to the environment, on the attention to the territory. (Interviewee W) One can invest in firms that have a story, that have an idea, that have a vision that in my opinion, a sustainable firm is a firm where the manager is one with a vision who is capable to tell you, in three years, in five, in ten, in fifteen. I see my firm in this way. Today it is a sustainable firm, a firm who for the clients there is a sense to invest in that a firm is secure, that is is not managed in an absurd way. (Interviewee V) The problem in my opinion, the point is that SRI doesn't look short-term. SRI is medium to long term. Which finance should also be. (Interviewee V) We do think that from the simple business as usual approach, it is important to do it. (...) And so, we do simply consider that via our additional ESG approach, we can in the long term (...) help [our clients] to better understand the evolution of business models of sectors and companies; climate change (...) whatever you want. (Interviewee T) But because we want to compete with the best in the world in the mainstream perspective we really try and steer our clients towards thinking about us as just great long-term global equity managers. (Interviewee A) We do SRI not because we are good etc. but because it is... it makes good sense. (...) It makes much more sense to do this type of work in an insurance company because (...) the heart of managing risks forms part of the DNA of the insurance company. So that which in reality we do for SRI, we already do in some way in insurance. (Interviewee V)	

FACILITATOR		
The role of the PRI	**Shared definition** For us, we find [the yearly assessment] it terribly helpful, because it shows to me as a trustee which areas we are good at, but also shows us which areas we have weaknesses in. (Interviewee Q) RCM has been a signatory since 2007, and basically because we have been involved in sustainability since 2000 it was great that finally an initiative came along that really addressed to the needs of asset managers such as ourselves (…) it was sort of an easy fit; there wouldn't be any reason for us not to join in. (Interviewee H) I think you need to do it in a way which is based on some fundamental... uh... shall we say underlying limit that... to what you can accept... what everybody can except; you know, no matter where they stand politically; you need to have a set of principles that is acceptable for everyone. (Interviewee F) **Coordinated action** We have six full-time staff to do [shareholder engagement] and that is the PRI clearinghouse, and there is a huge amount of coordination work that we do. And you know, the investors have the power, but they do not necessarily have the administrative capacity to organize all of these things, so we grease the wheels and we make things easy for them to engage with companies and form coalitions. (Executive Director, PRI) Yeah, in engagement we are active within the PRI (…) we think that it makes sense to do it with larger asset managers and institutional investors, just to not be alone in doing it. (Interviewee M) For me PRI is important because I do believe we would be... in France we cannot do shareholder dialogue by contacting companies. That's unbelievable in a country with such a culture of conflict of interest. So, joining the PRI was for me the best way to provide tools for the shareholder dialogue. (Interviewee I) **Legitimacy** Maybe we will not need that more than half of the investment capital in the world to become signatories, but if we are now approaching twenty percent, when we become one third of the world money, I think there is a force that no government or organization could remain oblivious to. (Interviewee S)	**Enabling organization**

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CHAPTER 3

Responsible Investments: the Assimilation of Sustainability-related Sources of Risk

Abstract

This chapter illustrates how a 'Rethinking' of Finance is occurring within the European Asset Management industry due to the assimilation of sustainability-related issues within traditional financial models. It investigates a dataset of European Socially Responsible mutual funds that employ screening practices or the usage of environmental, social, governance, and controversial business involvement information as part of their traditional investment processes. I find that in line with traditional financial theories, imposing screens on an investment universe limits possibilities for diversification such that idiosyncratic risk increases as screening intensity increases. However, I find that there is a tipping point such that when a fund screens at a very high intensity, idiosyncratic risk begins to decrease. I also find that the same curvilinear relationship exists when examining the volatility of fund flows. I argue that these two findings are representative of the assimilation of two new sources of risk, namely sustainability information and the moral considerations of investors, that become material only in substantive forms of responsible investment. In doing so, I provide a deeper theoretical understanding of the complexities underlying the fast-growing and controversial phenomenon.

Keywords

Responsible Investment – Sustainability – SRI Screening – Idiosyncratic Risk

Estratto

Questo capitolo illustra come un 'ripensamento' della Finanza stia avvenendo nel settore europeo dell'Asset Management dovuto all'assimilazione degli aspetti legati alla sostenibilità nell'ambito dei modelli finanziari tradizionali. È stato analizzato un dataset di fondi comuni europei socialmente responsabili che utilizzano metodi di screening (ambientale, sociale, governance, e settori controversi) come parte dei loro processi di investimento tradizionali. Ritengo che, in linea con le tradizionali teorie finanziarie, imporre degli screenings su un universo d'investimento limiti le possibilità di diversificazione in modo tale che il rischio idiosincratico aumenta con l'aumentare dell'intensità di screening. Tuttavia, sostengo che ci sia un punto critico, quando il fondo raggiunge un livello di screening molto elevato, e il rischio idiosincratico comincia a diminuire. Rilevo anche che la stessa relazione curvilinea esiste quando si esamina la volatilità dei flussi dei fondi. Ritengo che questi due risultati siano rappresentativi dell'assimilazione di due nuove fonti di rischio, vale a dire le informazioni sulla sostenibilità e le considerazioni morali degli investitori, che diventano concrete solo con una presenza considerevole di investimenti responsabili. In questo modo, ho fornito una più profonda comprensione teorica delle complessità alla base di questo fenomeno controverso e in rapida crescita.

> "The world is changing faster than it ever has before, and environmental issues, political risk, human rights, these kinds of issues are now fundamental; these issues are becoming more and more material. And if you have people managing your money, do you want them to have a really good understanding of the mega trends that are facing the world? Or would you prefer that they have a very traditional backward-looking, myopic approach of fund managers that look at the small number of financial metrics and then try to predict whether a company is going to be a good buy or not?"
>
> (Excerpt from an interview with James Gifford, Director of the PRI)

3.1 Introduction

Over recent years, the theme of sustainability has emerged within the context of the financial sector. In particular, asset management firms – professional financial firms responsible for pooling money from different sources and managing portfolios of global wealth for the purpose of maximizing future returns – have been questioned as to whether and how they consider environmental, social, governance (ESG), and controversial business involvement (CBI) issues during their investment processes and how, by financially supporting and/or reprimanding firms based on their performance on sustainability issues, asset management firms can affect the development and well-being of future generations. This has brought about a phenomenon known as Responsible Investment (RI) wherein such sustainability issues are increasingly being integrated as part of traditional asset management processes.

Responsible Investment has often been described as having roots in ethical investing. Indeed, considering sustainability issues through the usage of ESG and CBI criteria in the investment process was not acceptable practice for mainstream asset managers in Europe prior to the mid-2000's. Before then, only a niche market existed (continuing to date) wherein a moral approach to investing was used mostly by religious congregations in the U.S. and the U.K. to address their ethical concerns in society by excluding controversial businesses from their portfolios. While the financial sector was aware of the existence of combining non-financial and financial issues in a traditional investment process, such processes maintained an ethical characteristic and was by no means dominant in the industry.

From the 1960's, the consideration of integrating non-financial issues in asset management started shifting away from religious motivations and a spotlight was shed on pressing societal events such as the boycott of companies providing weapons used in the Vietnam war and the rise of the civil rights movements that put pressure on companies operating in South Africa to stop operations during the reign of apartheid. Massive environmental disasters such as Chernobyl in 1986 and the British Petroleum oil spill in 2011 combined with corporate governance scandals such as the Parmalat money laundering scandal in 2003 the audit scandal which led to the collapse of Enron in 2001 further brought asset managers to question their investments from non-financial risk perspectives. This has been exacerbated even more during the 2008 and 2012 global financial crises. The crises made visible the fact that more in-depth research into sustainability practices of firms was needed for improved risk controls.

Thus, we are currently approaching a 'modern era' of Responsible Investment. RI is now being driven more by the need for better risk controls in a crisis-stricken environment rather than a debate on ethics and the phenomenon continues to grow at a staggering pace. The significance of this movement is best illustrated by the number of signatories to the United Nations-backed Principles for Responsible Investment (PRI), a global association whose onus is to engage large institutional investors in a public commitment towards sustainability integration. The signatories of the PRI are mainstream investors which represent assets under management (AUM) amounting to USD 30 trillion or roughly 40% of global AUM.[1] In many ways, the diffusion of RI has began to change investment logics to such an extent that recent scholars have pointed towards its 'mainstreaming' in particular geographies such as France (cf. Arjaliès, 2010).

[1] Amount of AUM as of April 2012 taken from http://www.unpri.org/. Computation based on USD 79.3 trillion global AUM taken from The City UK Fund Management Report dated October 2011 available at http://www.thecityuk.com/.

In Europe, RI currently represents assets worth EUR 5 trillion, or more than 46% of the overall AUM in the region (Eurosif, 2010).

However, engaging in RI is highly controversial due to the fact that it entails an important departure from accepted traditional practices in asset management. Mainly, limiting the investment universe through the selection and elimination of investee firms based on sustainability issues goes against widely accepted financial theories wherein diversification is required in order to have optimal risk and returns. Indeed, key financial theories assume that only market risk matters since a portfolio manager should be able to 'diversify away' any specific risk coming from an individual firm by including other non-perfectly correlated firms. By doing RI, a fund manager may have his 'hands tied' and be unable to include all the assets that he or she would have usually included. Further, by selecting assets based on sustainability issues of a longer-term nature, one might be missing out on opportunities in the short-run. Combined with a lack of best practice models, asset managers thus have had difficulties in meaningfully reconciling this new sustainability-related practice with the financial models in which they are embedded.

It remains to be seen why and how RI is growing in spite of these apparent impediments. Most previous studies on RI funds have focused on the performance debate to justify the phenomenon (cf. Juravle & Lewis, 2008; Renneboog et al., 2008a for recent literature reviews). Proponents of the so-called "over-performance hypothesis" (Renneboog et al., 2008b) draw on Stakeholder theory (Donaldson & Preston, 1995; Freeman, 2010), which argues that an increase in corporate social performance translates into favorable financial performance. However, the fact remains that such studies have been largely inconclusive and the nature of the relationship remains contested.

Chapter 2 of this dissertation elaborated how *logic assimilation* is occurring in the asset management field and empirically illustrated how asset management firms are theorizing sustainability using the financial logic ("looking at sustainability with a

financial lens") and how the logic of sustainability is gradually elaborating the financial logic and its archetypes by introducing new sources of risk and return. Indeed, to fuel the growth of the practice, proponents of RI have began to center debates away from performance benefits, upon which they have serious doubts, and towards the risk-reducing benefits which appear as a by-product of the information depth and reputational benefits that occur with RI practices. Proponents posit that by having more information, they are able to make better decisions and select more stable and predictable firms. Further, they argue that RI assets tend to be 'stickier' in that their clients value ethical practices and tend to be more committed to such investments in the long-term. While these anecdotal beliefs are triggering a *rethinking* of finance in the field, they have not been addressed by the extant literature.

In this paper, I examine the theoretical motivations underlying these two key beliefs in practice. First, I argue that while limiting the investable universe increases idiosyncratic (specific) risk due to portfolio diversification issues, engaging in *substantive* RI can be risk-reducing due to the fact that informational benefits allow fund managers to be more selective. Second, by drawing on behavioral studies, I argue that because people have moral considerations in investing, engaging in *substantive* RI can make fund flows less volatile. I test my hypotheses using a dataset that encompasses all known European equity RI mutual funds (hereinafter referred to as SRI funds) that employ screening practices – or the usage of sustainability information to eliminate ('negative screening') and/or select ('positive screening') firms in a portfolio based on whether or not they meet certain ESG or CBI criteria, beyond or in conjunction with the fund's financial performance requirements. Specifically, by examining the relationship between the screening intensity of such funds and idiosyncratic risk and flow volatility, I am able to investigate whether selectivity and "stickiness" benefits offset the effects of diversification restrictions. I generally find strong support for my hypotheses that

substantive RI is associated with a reduction in both idiosyncratic risk and flow volatility, providing evidence of how new sources of risk are being increasingly assimilated into traditional models of finance. My results provide evidence that extant models in finance that have neglected sustainability issues are incomplete and that there is a need to consider sustainability-related sources of risk, calling for increased attention towards a risk-based rather than performance-based view of Responsible Investments. These results contribute towards a deeper theoretical understanding of a fast-growing phenomenon and provide empirical evidence of how logic assimilation (in this case, the assimilation of sustainability-related sources of risk) is occurring within an important industry.

This chapter begins by revisiting traditional views on risk and by proposing my alternative hypotheses. It then presents the dataset and methods, results, and finally, discusses and concludes with reflections on the future of Responsible Investment.

3.2 Theoretical Framework

3.2.1 The traditional view: responsible investments as risk-increasing

The practice of asset management is a widely acceptable means of investing current wealth in anticipation of higher expected future returns. Investing money in the markets entails a substantial amount of time, research, and sophisticated tools in order to understand which sectors and companies are likely to perform best and have lower risks in the future: capabilities and resources which an individual or organization may not have. The idea behind asset management is that it is more effective and less risky to pool money – 'assets' – from several individuals or organizations and to outsource the collective management of these assets to a specialized firm. This allows risks to be spread across a diversified portfolio of assets, which would otherwise be more expensive to do individually due to high transaction costs. Asset managers also monitor developments in the markets and are able to select interesting opportunities. Asset management practices

are thus embedded in a clear and agreed-upon mission of profit maximization through risk-return optimization.

This mission subscribes to a 'traditional view' of economic theory going back to expected utility theory which argues that investors are rational and wealth maximizing. An efficient portfolio can only be created through specific combinations of risk and return. The investor would (or should) then want to select one of those portfolios which give rise to the efficient combinations of the two. This theory – Modern Portfolio Theory (Markowitz, 1952) – is arguably the most strongly manifested theoretical underpinning in the practice of asset management. Highly sophisticated tools are available for asset managers to use in order to create an efficient portfolio and the performance of a fund is judged on whether it is able to achieve a return above a previously identified benchmark (usually a market index such as the S&P 500 in the U.S. or the MSCI Index in Europe).

Because an asset manager is expected to be able to fully diversify, Modern Portfolio Theory argues that only risks related to the market ('systematic risk') matter since the risks associated with the volatility of an individual security ('idiosyncratic risk') can be 'diversified away' by including non-perfectly correlated assets within a portfolio. That is, the specific risk carried by any individual security can be offset by the specific risk carried by another. While it has been argued that an asset manager cannot perfectly construct a portfolio that includes the entire market due to several constraints such as transaction costs (Malkiel & Xu, 2002) or exogenous legal or regulatory constraints (Lee & Faff, 2009), a mutual fund can still eliminate most specific risk by including randomly selected stocks (Campbell, Lettau, Malkiel, & Xu, 2001; Statman, 1987). An SRI fund, however, is a key example of a fund having constraints that prevent it from selecting stocks at random. The traditional view thus argues that having more stringent screening criteria related to ESG and CBI issues limits an SRI fund's ability to diversify, thereby

forcing them to bear a substantial degree of idiosyncratic risk. Further, by increasing the intensity of screening, the mean-variance frontier should continue to shift towards lesser favorable risk-return tradeoffs. Thus, the expectation is a positive relationship between an increase in screening and the idiosyncratic risk of a portfolio.

3.2.2 Sustainability-related information as a source of risk-reduction

As the quotes in Appendix A illustrate, asset managers are posing new arguments in support of RI as potentially risk-reducing due to the changing and uncertain market environment at present. They argue that due to the informational benefits of doing RI, they are able to select more predictable and stable firms, thus reducing the idiosyncratic risk in their portfolios. However, the previous focus in the literature on the performance debate has eclipsed theorizing about this idiosyncratic risk-reducing potential. Indeed, it has been pointed out that there is little to no research focusing on idiosyncratic business risk at a firm level and even lesser at a portfolio level (Lee & Faff, 2009).

Several firm-level studies have shown that firms engaging in Corporate Social Responsibility (CSR) practices may reduce the risk inherent in a firm's operations as a result of external or internal factors that can affect a firm's profitability (Jo & Na, 2012). Godfrey, Merrill, & Hansen (2009) illustrate how some types of CSR activities can create goodwill and provide 'insurance-like' protection. By measuring the volatility in stock returns during specific negative events, the authors find that when a firm suffers a negative event, it is less likely to be financially penalized by its shareholders if it has had good CSR practices in the past. Sharfman and Fernando (2008) suggest that improved environmental risk management can lead to a reduction of cost of equity capital, an outcome of reduced firm risk, because such firms can benefit from tax regimes and avoid penalization during environmental disasters. Similarly, Lee & Faff (2009) argue that the activities of leading CSP firms are likely to have a downward influence of their idiosyncratic risk. The authors say that for instance, this lower risk can happen because

these firms have happier, more stable employees, lower fines, and good production levels. While other studies have found that firms may be punished to a greater degree because these events are unexpected (Konar & Cohen, 1997; Rhee & Haunschild, 2006), there nevertheless appears to be some evidence that points towards a *negative* association between company-unique idiosyncratic risk and CSR (Boutin-Dufresne & Savaria, 2004; Lee & Faff, 2009).

Through screening, SRI funds are able to have more information than conventional funds related to CSR and other sustainability-related activities of firms, allowing RI asset managers to better understand which firms are more stable from a financial performance perspective. Through more in-depth and forward-looking information, RI asset managers are able to better understand the evolution of business models in terms of critical issues on a long-term horizon and make better investment decisions based on a more comprehensive knowledge of investment risks. This goes against the traditional idea in finance that these specific risks are generally unpredictable. As such, in spite of a decrease in diversification, SRI funds are able to have an increase in selectivity.

However, if getting useful information on sustainability issues were simple and straightforward enough, then it could be imagined that all asset managers would immediately start using the available sustainability information in the market, thus eliminating the 'edge' of SRI funds over conventional funds. However, due to the nature of sustainability issues as difficult to measure, there is poor quality of sustainability information available from investee firms and specialist research providers fostering a high level of information asymmetry. Thus, relevant and proprietary sustainability information can have significant value to investors, especially in the presence of information asymmetries.

I thus posit that RI practices can only be risk reducing when asset managers engage in *substantive* RI, going beyond market practices to possess quality information unavailable to others. Such practices can include a dialogue with firms or the existence of a dedicated research team to provide valuable information for the fund manager. However, funds are only likely to engage in such substantive practices if they are truly committed to RI. Those with higher screening intensity, representing a higher amount of selectivity and a deeper sustainability-related process, should therefore be able to gain a risk-reduction benefit due to a decrease in information asymmetry.

In sum, the relationship between screening intensity and idiosyncratic risk is by no means straightforward. From the traditional view, increasing screens should minimize the possibilities for diversification and therefore increase idiosyncratic risk. However, it is from a certain level of screening and selectivity wherein sustainability-related information becomes useful and may offset the impact from a loss of diversification. Thus, I posit the below hypothesis:

H1: The relationship between screening intensity and risk is positive and concave.

That is, idiosyncratic risk will be lower for funds with a lower screening intensity since these funds, subject to the least amount of portfolio restrictions, are able to diversify firm-specific risks almost in line with non-SRI funds. This risk increases as more and more screens are added as the fund begins to decrease possibilities of investing in other assets to diversify risks. However, from a certain level of screening, new benefits come into play which then counter the increased risk, in particular, having the possibility to select more stable firms due to increased research and monitoring.[2]

[2] To the best of my knowledge, Lee et al. (2010) is the only study which empirically tests the curvilinear relationship between screening intensity and risk. In their study, they find counter results (i.e. the relationship between screening intensity and risk is negative and convex). However, their results are neither motivated nor discussed.

3.2.3 Type of screens and idiosyncratic risk

In addition to the heterogeneity in the intensity of screening, SRI funds vary greatly in the *type* of screens applied to their investments. Previous empirical work has found that some types of social responsibility are linked to higher financial performance than others and that the type of screening may enhance or erode performance (Barnett & Salomon, 2006; Lee, Humphrey, Benson, & Ahn, 2010; Renneboog et al., 2008b). One of the strongest arguments is for the exclusion of so-called 'sin stocks' (in this paper, represented by the CBI category). A recent study by Hong and Kacperczyk (2009) has shown that excluding controversial businesses from a portfolio may be negatively related to performance, with a significant price effect to the order of 15-20% from large institutional investors shunning 'sin stocks' (in particular, alcohol, tobacco and gambling). Essentially, because sin stocks are neglected by an important set of investors, the prices of these stocks are depressed relative to their fundamental values. Further, the increased litigation risk increases expected returns. Jo and Na (2012) further contend that sin stocks have relatively less concern for risk-reduction than conventional firms. That is:

H2a: The relationship between CBI exclusions and idiosyncratic risk is positive.

In the same vein, it makes sense to assume that an increase in the number of eliminations (negative screens) would significantly increase the idiosyncratic riskiness of the portfolio. Indeed, negative screens should most notably increase portfolio risk because the exclusion of stocks, sectors, and countries can result in a significant reduction in diversification benefits (Langbein and Posner, 1980). Thus:

H2b: The relationship between negative screening and idiosyncratic risk is positive.

3.2.4 Moral properties of investments as a source of risk-reduction

> "The fact that environmental, ethical, and responsible investment money is a bit more picky and has a bit more long-term thinking (...) then, it probably makes our shareholder base a bit "stickier", in a way not to bail out and lack trust that the [asset manager] is doing a good thing." (Excerpt from interview with Investment Manager, Nordea)

The second key argument in support of a rationale for engaging in RI is that clients of RI appear to be more 'sticky' thus making fund flows less volatile and more predictable. This is evidenced by the fact that the RI movement continues to grow in spite of inconclusive evidence of a performance benefit. Indeed, practitioner studies have highlighted the fact that SRI investments are 'stickier' than non-SRI investments during moments of crises. According to a report from the Social Investment Forum which mentions a Lipper study, the first nine months of the 2001 U.S. downturn saw a 94% drop in the dollars investors put into all mutual funds, compared to just a 54% drop for socially screened funds (SIF, 2007). Similarly, from the start of 2007 to the opening of 2010, a three-year period when broad market indices such as the S&P 500 declined and the broader universe of professionally managed assets increased less than 1 percent, SRI assets in the U.S. increased by more than 13 percent (SIF, 2007).

The theoretical argument in support of this can be traced to the idea that moral attributes produce high levels of stability which links to several studies in behavioral finance. Such studies argue that individuals make decisions based on cognitive limitations of their minds (cf. Simon, 1955) and through framing (Kahneman & Tversky, 1979, 1984; Statman & Caldwell, 1987). Individuals may willingly choose immaterial utility such as happiness or satisfaction gained from moral considerations within their utility maximization (Beal et al., 2005; Gao & Schmidt, 2005). These behavioral studies form much of the research on why investors deviate from the value maximizing principle and incorporate other decision variables (such as extra-financial variables) into their investment decisions. For instance, Nilsson (2007) found that apart from financial return, Social, Environmental, and Ethical issues are important determinants of investment

while Lewis and Juravle (2009) found that investors are driven by a wide range of values. Other studies have found that having a negative ethical stance toward the stock market is a significant negative predictor of willingness to invest in stocks (Keller & Siegrist, 2006), that holding profit constant, people are willing to pay more for moral shares (Hofmann, Hoelzl, & Kirchler, 2007) or accept lower financial returns for their investments in exchange for positive social returns (Glac, 2008), and that the strength of investors' personal values is important in determining their investment choices (Pasewark & Riley, 2009).

Related to this, displaying commitment to sustainability is positive for the legitimacy of the SRI fund if its clients value such moral attributes. A sociological perspective of organizations posits that organizations tend to conform to norms in order to gain legitimacy in their field (DiMaggio & Powell, 1983; Lounsbury, 2001). With the onset of sustainability as a strategy that may increase firm legitimacy, organizations will engage in sustainability to be part of the norm and to not lose its reputation (Philippe & Durand, 2011).

As is evident in the signatories to the PRI, the RI movement in Europe is strongly driven by asset owners (clients) such as pension funds with a strong social contract and political agenda. As the financial industry started to become more transparent, these investors – oftentimes having the obligation to make public statements on their investment policies – have increasingly included questions on how sustainability issues are taken into consideration in the investment processes of asset managers when making requests for proposals (RFPs). Because these clients are driving demand due to moral considerations and have a reputational benefit to gain, it is expected that these types of investors will tend to support SRI funds even when they are underperforming; that is, they will not easily sell their shares in funds whose sustainability strategy they are advocates of, making the money flow of such funds less volatile. In addition to this, the

fact that RI is long-term oriented provides asset managers with a longer timeframe on which to be measured; hence, clients take longer to pull-out of bad performing funds.

However, similar to the information asymmetry argument, it is only at a high level of screening (a substantive level of RI) that this can occur. A high level of screening is related to a high level of 'ethicalness', which translates into a higher ability to attract and retain investors with moral considerations. Without this, investors will maintain preference over a well-diversified portfolio. Additionally, investors may even penalize SRI funds that are merely 'greenwashing' or doing SRI symbolically and not substantively.

Thus, I put forward the below hypotheses:

H3: The relationship between Screening intensity and fund flow volatility is positive and concave.

That is, flow volatility will be lower for funds with a lower screening intensity since these funds, being closer to traditional funds, will be favored by typical investors. Flow volatility increases as more and more screens are added as the fund begins to decrease its possibilities of diversification without having a clear ethical identity. However, from a certain level of screening, investors become morally committed to the fund.

3.3 Dataset and Methods

3.3.1 Dataset

I test my hypotheses on a dataset of European SRI Mutual funds that employ screening practices. Such a screening process may be a very 'black box' approach wherein financial analysts make use of a list of exclusions provided by external ratings agencies or internal sustainability analysts. It may also be more integrated wherein financial analysts work together with internal or external sustainability analysts during different phases of the investment process to determine inclusions or eliminations; in some such cases, the same person(s) are responsible for both sustainability and financial analyses. Funds that

fall within this latter approach tend to perform more in-depth research and engage in dialogue with investee firms regarding sustainability issues. Screening practices are thus widely heterogeneous. Processes range from simple to highly complex and implementation can range from ad-hoc to highly systematized. Given that 38% and 7% of all RI assets in Europe are negatively and positively screened, respectively (Eurosif, 2010), screening funds represent an important sub-group of Responsible Investment.

The dataset is manually constructed using a primary list of 529 SRI Mutual Funds domiciled in Europe as identified by The European Social Investment Forum (Eurosif). Of these funds, information on the screening criteria is available for 263 funds and is provided by Avanzi[3]. To ensure homogeneity, I focus mainly on equity funds by eliminating funds that identified themselves by name as bond funds as well as those with more than 85% of their assets as non-equity. This focus on equity mutual funds is in line with previous studies (Lee et al., 2010; Renneboog et al., 2008b). Further, I eliminated funds which had more than 80% of their assets invested outside of Europe. The data was then adjusted for outliers and errors relating to fund age, fund manager years, and net asset value. Finally, funds engaged in short-selling were eliminated. Ultimately, I reach a final unbalanced panel of 187 European SRI screening mutual funds invested mainly in equities.

Historical data is provided by Morningstar and includes: monthly fund returns, monthly net asset values, domicile, fund age, sectors, geographies, and securities splits, as well as Morningstar investment styles from December 2002, the earliest available date of complete coverage, to March 2012. I focus on the 9-year period of April 2003 to March 2012, separating these into three periods of April 2003 to March 2006 ('Period 1'), April 2006 to March 2009 ('Period 2'), and April 2009 to March 2012 ('Period 3'). Informally, Period 2 captures the U.S. mortgage crisis and Period 3 captures the European debt crisis.

[3] Acquired in 2006 by Vigeo.

This brings the total number of observations for monthly fund returns at 20,304 (108 months x 187 funds). Finally, data for the Fama-French and Carhart factors for European equities are obtained from the online Kenneth French Data Library. Table 3.1 summarizes the sources and uses of data.

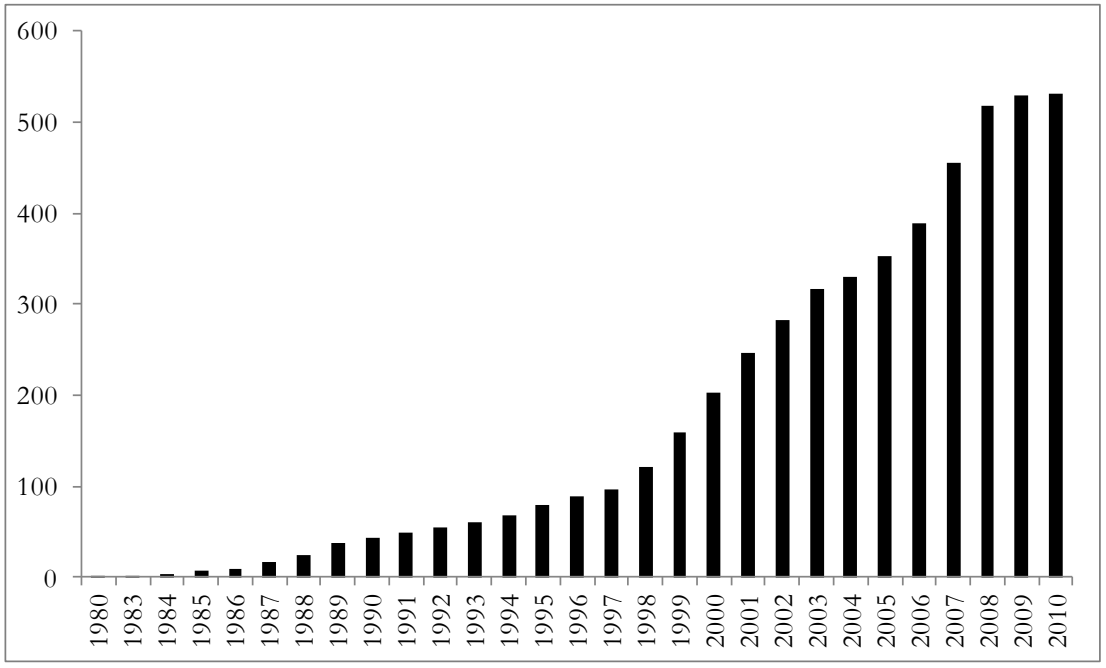
Figure 3.1 illustrates the growth of SRI funds based on the inception dates of the original sample of 529 funds. The figure shows that the SRI boom happened in the late '90's. As such, the final panel I take focuses on a more recent time period of high but rather stable growth and captures the period of the current financial crisis, which has not been previously examined in the literature. The dataset is unique compared to previous studies in that it is focused on Europe[4], the most relevant geography for Responsible Investment. This dataset is the most complete European dataset to the best my knowledge.

Table 3.1 Sources and Uses of Data

Data	Uses	Source
Initial list from Eurosif	529 funds	Taken from http://www.eurosif.org/
Historical data coverage from Morningstar	April 2003 to March 2012 (108 months)	Data provided to the researcher by Morningstar
Funds for which screening criteria from Avanzi available	263 funds	Data provided to the researcher by Avanzi
Final number after adjustments for outliers	187 funds	
Historical data for Fama French and Carhart models	April 2003 to March 2012 (108 months)	Taken from Kenneth French website: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html/
Historical data for Market return (MSCI Europe Index)	April 2003 to March 2012 (108 months)	Taken from MSCI Europe website: http://www.mscibarra.com/products/indices/international_equity_indices/gimi/stdindex/performance.html/
Historical data for Risk Free rate	April 2003 to March 2012 (108 months)	Taken from Bundesbank website: http://www.bundesbank.de/Navigation/EN/Statistics/Time_series_databases/Macro_economic_time_series/its_details_value_node.html?tsId=BBK01.WZ9807&listId=www_s140_it03a/
Total monthly fund return observations (187 funds x 108 months)	20,304 fund month observations	

[4] Barnett and Salomon (2006) and Lee et al. (2010) focus on the U.S. while Renneboog et al. (2008b) have a global dataset.

Figure 3.1 Number of European SRI Funds Per Year Based on Inception Date (Total Initial Sample) adapted from Morningstar data



3.3.2 Variables

3.3.2.1 Screening Intensity and Risk

3.3.2.1.1 Independent variables

To investigate the relationship between a fund's selectivity and idiosyncratic risk, I use *Screening Intensity* as the independent variable, which is the number of screens, either positive or negative, implemented by the fund (1 if the screen, either negative or positive, was implemented, 0 otherwise). The Avanzi database provides 24 screening criteria. These are divided into negative screening criteria where funds exclude investments in these areas (16 criteria) and positive screening criteria where funds are required to include investments in these areas (8 criteria). I then categorize the criteria (provided in Table 3.2) into four broader areas, namely Environmental, Social, Governance, and Controversial Business Involvement with 4, 6, 3, and 11 criteria respectively. I follow in the same vein as previous studies (cf. Barnett & Salomon, 2006; Lee et al., 2010; Renneboog et al., 2008b) who use this measure and contend that doing so provides a more accurate and

complex picture of the variation between SRI funds as opposed to previous studies which examined the dichotomy between SRI and non-SRI funds. This study is an improvement over the aforementioned studies in the use of more screening criteria thereby allowing for more variation in screening intensity.[5]

The information on screening is the outcome of a long-term evaluation process and thus has not changed over time. In line with the notion that SRI funds examine more long-term sustainability issues, it is useful to understand screening criteria as part of a long-term strategy of a fund rather than one that frequently changes. Given that the funds in the dataset can be considered to be quite young with a mean age of 8 years, it is reasonable to assume that these screening strategies have not changed dramatically.

3.3.2.1.2 Dependent Variables

I would like to test the relationship between Screening Intensity and the dependent variable idiosyncratic risk.[6]

To derive measures of risk, I first take measures of financial performance, in particular Risk Adjusted Performance (RAP), Fama-French model alphas (Fama & French, 1993), and Carhart model alphas (Carhart, 1997). For additional analyses on financial performance, I also examine Sharpe and Information ratios.

I construct the monthly RAP using the CAPM methodology (cf. Sharpe, 1964) in line with Barnett & Salomon (2006) wherein RAP is defined as the average monthly return, measured as the percentage change in a fund's market value from the beginning to the end of a given month, adjusted by the fund's specific beta. It is the fund's return over and above what is expected based upon its beta. Specifically:

$$RAP_{it} = (R_{it} - Rf_t) - \beta_i * (Rm_t - Rf_t)$$

[5] Renneboog et al. (2008b) use 21 criteria, Barnett and Salomon (2006), 12 criteria, and Lee et al. (2010), 11 criteria.

[6] I also examine the relationship between screening intensity and market risk (measured by beta) and find no significant results.

where R is the return on fund i in month t; Rf is the risk-free rate of return in month t, in this case, the historical monthly returns of the 6-month German treasury bond; Rm is the return on the market portfolio in month t, in this case, the historical monthly returns of the MSCI Europe Index; and β is the beta of fund i, in this case calculated as a regression from returns on the market index. Following Lee et al. (2010), I use a moving 3-year beta to address the significant time variation in beta estimates and to make it better aligned with the 3-year minimum investment horizon typically required for equity funds. I then compute annualized RAPs for 3 periods of 3 years.

As cross-checks, I also perform cross-sectional regressions on average unadjusted returns as well as on average RAP across the total period, and sensitize using a static beta over the 9-year period. The results are similar and are not presented here.

The Fama-French and Carhart alphas (a measure of abnormal return) are the intercept terms (*aFF* and *aCarhart*, respectively) for fund i in month t from the following Ordinary Least Squares regression equations:

$$R_{it}\text{-}Rf_t = aFF_{it} + \beta 1*Mkt_t + \beta 2*SMB_t + \beta 3*HML_t + \varepsilon_{it}$$

$$R_{it}\text{-}Rf_t = aCarhart_{it} + \beta 1*Mkt_t + \beta 2*SMB_t + \beta 3*HML_t + \beta 4*WML_t + \varepsilon_{it}$$

where R and Rf are as described above; *Mkt* is excess return on the market, *SMB* ("Small minus Big") is the return on the mimicking size portfolio, *HML* ("High minus Low") is the return on the mimicking book-to-market portfolio and *WML* ("Winners minus Losers") is the return on the mimicking momentum factor. I compute annualized alphas for each of the 3-year periods.

Idiosyncratic risk cannot be observed directly and a proxy needs to be used. I follow in the same vein as previous studies (Casavecchia & Hulley, 2010; Lee & Faff, 2009; Lee et al., 2010; Malkiel & Xu, 2002) and use the residual variance (the standard deviation of the residuals) of the estimated Fama-French and Carhart model residuals.

The residual captures the deviation of the sample from the estimated (theoretical) function value and provides an observable estimate of the unobservable statistical errors. The Mean Squared Error (MSE) as reported by Stata is the variance computed from the sum of squares of the residuals which adjusts for the influence of the endpoints in a regression function. As per Lee et al. (2010), I use the 3-year standardized residual variance. As a secondary measure, I compute the 3-year annualized standard deviation of RAP. Since RAP is beta-adjusted (thus eliminating the market risk), the standard deviation provides a proxy measure of the volatility of excess returns.

3.3.2.1.3 Control Variables

The control variables used are similar to those of Barnett & Salomon (2006) and are typically employed in studying mutual funds. *Fund age* is the number of years since the inception of the fund, which addresses the learning effect of SRI funds (Bauer, Koedijk, & Otten, 2005). *Fund size* has also been found to affect fund performance (Chen, Hong, Huang, & Kubik, 2004). Malkiel and Xu (1997) find that large firms are associated with lower idiosyncratic risk. Investments in *Equity* are typically associated with higher levels of risk (Wermers, 2002). Given that firm risks are significantly affected by its industry association (Jo & Na, 2012), I control for sector differences as well as geographical differences. I also control for the fact that the residual variance may be a measure of the aggressiveness of fund strategies (Casavecchia & Hulley, 2010) and include the investment styles of Morningstar (Small growth, Small blend, Small Value, Mid-growth, Mid-blend, Mid-value, Large growth, Large blend, and Large value). This addresses the need to disentangle the effect of sustainability performance of the investee firms from the fund manager's performance (Lee & Faff, 2009). Finally, I include period fixed effects dummies to control for the time variation. Each period dummy is the difference

in the conditional expected value of the dependent variable between the base year t=1 and the year t=j.

The risk equation is estimated as an unbalanced pooled cross-sectional regression:

$$Risk_{it} = a_{it} + \beta 1*SI_i + \beta 2*Fundage_{it} + \beta 3*Size_{it} + \beta 4*[Geography_{it}] + \beta 5*[Sector\ Variables_{it}] + \beta 6*[Equities_{it}] + [Investment\ Style_i] + [Period\ fixed\ effects] + \varepsilon_{it}$$

where *Risk* is the 3-year annualized idiosyncratic risk measure for fund *i* in period *t, SI* is the screening intensity for fund *i* measured as the number of screens, *Fundage* is the number of months since inception of fund *i* at the beginning of period *t*, *Size* is the standardized average 3-year net asset value in Euros of fund *i*, *Geography* is the average 3-year percentage of investments in Europe, *Sector Variables* are the average 3-year percentage of investments in the Financial Services, Healthcare, Real Estate, Energy & Utilities, Information, and Manufacturing sectors, *Equities* is the average 3-year percentage of investments in Equities, and *Investment Style* relates to the Morningstar investment styles. To test the hypothesis that the relationship between screening intensity and idiosyncratic risk is curvilinear, the square of *SI* is introduced into the regressions. To test the specific effects of the type of screening criteria on idiosyncratic risk, the totals for environmental, social, governance, and CBI criteria are introduced as is the total amount of negative screens per fund.

3.3.2.2 Screening Intensity and Fund flow

To determine whether screening practices related to sustainability impact the volatility of fund flows, I first calculate *fund flow* using data from December 2002 to March 2013. This is the variation in percentage of the fund size due to the money

inflow or outflow. I was provided with monthly fund size by Morningstar[7]. I follow Qian (2006) and Renneboog, Ter Horst, & Zhang (2008b) and define the growth rate of the fund size beyond asset appreciation – flow – as follows:[8]

$$Flow_{i,t} = \frac{(TNA_{i,t} - TNA_{i,t-1} * (1 + R_{i,t}))}{TNA_{i,t-1}}$$

where *TNA* is the total net assets of fund *i* in month *t* and *R* is the return of fund *i* in month *t*. I use both unadjusted returns *R* and *RAP*, noting that investors consider excess returns rather than risk adjusted performance (Del Guercio & Tkac, 2002; Ippolito, 1992).

I then compute the standard deviation *SDF* of flow for both unadjusted returns and *RAP* as our dependent variable for each of the three non-overlapping three-year periods. Following Qian (2006), we control for past fund returns, fund fees, and investment style, which have been previously shown to affect money flow and estimate the below equation:

$$SDF_{it} = a_{it} + \beta 1 * [Screening\ Variable]_i + \beta 2 * [Fund\ Past\ Return_{i,t}] + \beta 3 * Fund\ fee_i + \beta 4 * [Investment\ Style_i] + \varepsilon_{it}$$

where the *Screening Variable* is the screening intensity, the total amount of negative criteria, or the totals of each criteria type. The *Fund Past Return* is composed of the average monthly cumulative return of fund i at the end of each period and of the square value of this return.[9]

[7] I was provided with two types of information which we merged to reduce the number of missing data. *Raw fund size* is sourced directly from fund companies and includes both public and non-public share classes and *Fund size estimated* is the sum of all share-class TNAs for a given fund at the end of a given month. In general, raw fund size is more accurate than fund size estimated and we used the former where available.

[8] I assume that new money is invested at the end of each month.

[9] The convex relationship in the mutual fund industry between the flow and performance motivates a quadratic term in the regression (Sirri & Tufano, 1998).

3.3.2.3 Additional analysis: Screening Intensity and Fund performance

As an additional analysis, I measure the relationship between screening intensity and fund performance and estimate the below equation, as an unbalanced pooled cross-sectional regression:

$$Performance_{it} = a_{it} + \beta 1*SI_i + \beta 2*Fundage_{it} + \beta 3*Size_{it} + \beta 4*[Geography_{it}] + \beta 5*[Sector\ Variables_{it}] + \beta 6*[Equities_{it}] + [Investment\ Style_i] + [Period\ fixed\ effects] + \varepsilon_{it}$$

where *Performance* is the 3-year annualized performance measure for fund *i* in period *t*, and all other variables are as previously described. When the performance measure is the Fama-French and Carhart alpha, the alpha of each fund is first calculated over each non-overlapping 3-year period for each fund, annualized and then used as the dependent variable in the performance equation.

Due to the fact that the relationship of the dependent variable and at least some of the explanatory variables is constant over time (i.e. my main independent variable *Screening Intensity* is not time-varying) I chose to use a pooled cross-sectional analysis which combines time-series regressions for several cross-sections. This is also useful to increase the number of observations and to solve the imbalance between the number of explanatory variables and the number of firms.

All models are run, checked, and corrected for normality and heteroskedasticity using Stata software. Following Lee et al. (2010), weighted least squares with robust standard errors was used to estimate the Fama-French and Carhart equations using the reciprocal of the residuals as the weights and Ordinary least squares with robust standard errors was used for all other equations. Table 3.3 summarizes the list and operationalization of variables.

Table 3.2 Screening Criteria Provided by Avanzi

	SCREENING CRITERIA	Type of Screen*	% of funds with screen
	Environmental (4 Screens)		
1	Excludes excessive negative Impact	Negative	33.21
2	Excludes products dangerous to health or environment	Negative	29.46
3	Includes innovative and beneficial products and services for the environment	Positive	21.43
4	Includes Environmental protection	Positive	26.60
	Social (6 Screens)		
5	Excludes human rights violations	Negative	51.43
6	Excludes labor rights violations	Negative	40.18
7	Excludes oppressive regimes	Negative	26.79
8	Includes human rights protection (measures to prevent and control human rights violations)	Positive	58.21
9	Includes promotion of economic and social development of local communities	Positive	49.29
10	Includes innovative and beneficial products and services for the quality of life (e.g. Health care, social housing)	Positive	13.93
	Governance (3 Screens)		
11	Includes good corporate governance	Positive	56.61
12	Includes responsible management of relations with customers (policies management and monitoring systems in terms of transparent communication with customers, product safety, fair competition, responsible advertisement, etc.)	Positive	52.00
13	Includes responsible management of employees (policies, management monitoring systems)	Positive	26.07
	Controversial Business Involvement (11 screens)		
14	Excludes firearms	Negative	70.54
15	Excludes weapons and military contracting	Negative	72.68
16	Excludes Nuclear energy	Negative	50.89
17	Excludes Tobacco	Negative	70.00
18	Excludes Gambling	Negative	45.89
19	Excludes Pornography	Negative	46.43
20	Excludes Alcohol	Negative	49.11
21	Excludes Animal Testing	Negative	28.93
22	Excludes Factory farming	Negative	16.61
23	Excludes Furs	Negative	10.71
24	Excludes Genetically Modified Organisms	Negative	28.93

*8 positive screens; 16 negative screens

Table 3.3 List of Variables

Variable	Operationalization
	Independent Variables
Screening Intensity	Total number of screens (ESG and CBI) whether positive or negative
Envtot	Total number of Environmental screens
Soctot	Total number of Social screens
Govtot	Total number of Governance screens
CBItot	Total number of Controversial Business Involvement screens
Negative	Total number of negative screens
	Measures of Risk
FFResa	Standard deviation of the residuals of the Fama-French model annualized for each non-overlapping 3-year period
CarResa	Standard deviation of the residuals of the Carhart model annualized for each non-overlapping 3-year period
SDRa (1)	Standard deviation of Risk-adjusted performance (RAP) annualized for each non-overlapping 3-year period
Beta	Regression of fund returns over the index MSCI Europe for each non-overlapping 3-year period
SDa (1)	Standard deviation of unadjusted Returns annualized for each non-overlapping 3-year period
	Measures of Flow Volatility
SD Flow	Standard deviation of the flow of assets using 3-month, 6-month, and 12-month cumulative returns
	Measures of Performance
RAP (2)	Annualized Risk Adjusted performance for each non-overlapping 3-year period
FF Alpha	Alpha from the Fama-French model annualized for each non-overlapping 3-year period
Car Alpha	Alpha from the Carhart model annualized for each non-overlapping 3-year period
Sharpe (3)	Sharpe ratio
InfoR (4)	Information ratio
	Control Variables
NAV	Average of Net asset value in euros at the end of the month for each non-overlapping 3-year period
FundAge	Number of months since inception at the end of each non-overlapping 3-year period
% equity	Average %equity at the end of the month for each non-overlapping 3-year period
%Europe	Average % of equity invested in Europe at the end of the month for each non-overlapping 3-year period
%FinServ	% of equity invested in Financial Services at the end of the month
%Healthcare	% of equity invested in Healthcare at the end of the month
%RealEstate	% of equity invested in Real Estate at the end of the month
%EnergyUtilities	% of equity invested in Energy and Utilities at the end of the month
%Info	% of equity invested in Technology and Communication Services at the end of the month
%Mfg	% of equity invested in Basic Materials, Consumer (Cyclical), Consumer (Defensive), and Industrials at the end of the month
MSCat	Morningstar Investment Styles

(1) Takes SD for each year starting April and then annualizes for 3 years = SD3y*RADQ(3); (2) **First take geometric product of monthly returns. Then: 3y annualized return is [(RAP3yTotal)^(1/3)]-1; (3) Sharpe ratio: Take Rfund-Rf, average then Sharpe=Average return/Std. Dev of excess return; (4) Information ratio for period 1. Information ratio: Take Rfund-RmMSCI, average then Info=Average return/Std. Dev of excess return

3.4 Results

3.4.1 Descriptive Analysis

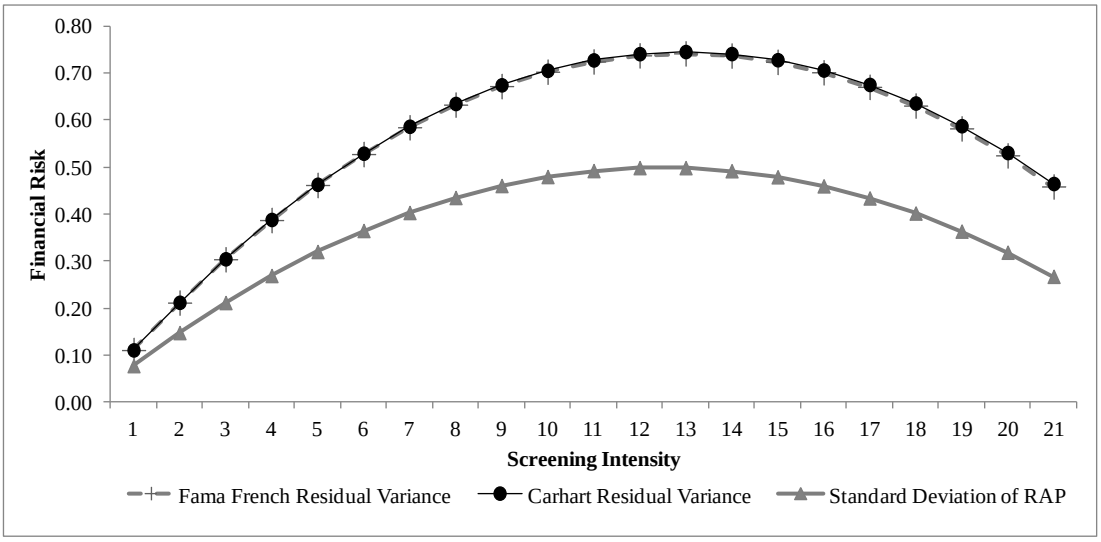
The funds are domiciled in 13 European Countries with the majority of the funds coming from Luxembourg (20.86%), the United Kingdom (19.79%), and France (18.72%). The mean age of the funds is 7.9 years old, with the oldest fund starting at April 1983 and the youngest November 2008. The fund size, as represented by net asset value, is highly fragmented ranging from 0,43 million Euros to 1,4billion Euros. As expected, the majority of the funds' investments are in Europe (75.14%) with the second largest geography being the U.S. A majority of investments (83.21%) are in equities of which the largest percentage is in the Manufacturing sector followed by financial services and the information sector. 50.33% of the funds are categorized as large blend funds by Morningstar. Table 3.4 presents the correlation matrix and Table 3.5 presents these descriptive statistics in detail. The funds implement on average 10 out of 24 screens with more than 70% of the funds excluding firearms, weapons and military contracting, and tobacco.

3.4.2 The Assimilation of Sustainability-related Sources of Idiosyncratic Risk

Table 3.8 presents the regression results for the relationship between Screening Intensity on three measures of idiosyncratic risk for the simple linear model (Model 1) and the model with the squared Screening Intensity variable (Model 2). My findings suggest strong support for a positive linear relationship between Screening Intensity and idiosyncratic risk at a 99% confidence level for both the Fama-French and Carhart model residual variances and at a 95% confidence level when the standard deviation of RAP is used as the idiosyncratic risk measure and stronger support for a curvilinear relationship (an inverted U-shape) at a 99% confidence level across all three measures of idiosyncratic risk. The increase in fit from the linear to the curvilinear models suggests that the latter

presents a more robust explanation for the relationship, thereby supporting *H1: The relationship between Screening intensity and idiosyncratic risk is positive and concave.* This curvilinear relationship is illustrated in Figure 3.2. Funds with the least amount of screens have lower risk; the risk increases with each screen at an average of 0.0526, 0.0529, and 0.0383 for the Fama-French, Carhart, and RAP Standard Deviation models, respectively until reaching a peak of 13 screens for the Fama-French and Carhart models and 12 screens for the RAP SD model. The risk then begins to decrease by a slightly lesser average of 0.0354, 0.0351, and 0.0257. A fund which screens at the highest levels begins to have a similar risk as those which screen at the lowest level.

Figure 3.2 Curvilinear Relationship between Screening Intensity and Idiosyncratic Risk



3.4.3 Negative screening and CBI exclusions as risk-increasing

Table 3.9 presents the regression results of the relationship between Criteria type and Idiosyncratic Risk. Model 1 introduces the total number of screens for each group of environmental, social, governance, and CBI criteria while Model 2 includes the variable *negative* which is the total number of negative screens. I find strong evidence that a higher number of exclusions of CBI is positively related to idiosyncratic risk and that the negative exclusions is positively related to idiosyncratic risk. These findings provide

strong support for *H2a: The relationship between CBI exclusions and idiosyncratic risk is positive* and *H2b: The relationship between negative screening and idiosyncratic risk is positive.*

3.4.4 Control variables results

In general, the significant results on Control variables are consistent with previous studies and are both interesting and sensible given the period under study of 2003 to the first quarter of 2012. As expected, a lot of the volatility is accounted for by unexplained factors which are captured by the crisis period 2 (April 2007 to March 2009) and to a lesser extent, period 3 (April 2009 to March 2012). I find consistent findings across all models that being a larger fund is *negatively* related to idiosyncratic risk (similar to Lee & Faff, 2009 and consistent with Malkiel and Xu, 1997) whereas being invested in equities is risk-increasing, in line with the majority of previous findings. Being invested in Europe during the period of investigation appears to have been risk reducing. As a developed capital market, there was less of a boom and bust in Europe as compared to Americas or Asia during this period. Being invested in the Healthcare sector was also risk reducing, the defensive sectors having been the most resilient during the crisis which more severely affected the real estate sector. Surprisingly, however, being invested in Financial services appears to have been risk-reducing. Equities in general were especially volatile. It is notable that the influence of screening intensity is significant even controlling for investment strategies, as represented by the Morningstar Investment styles. The investment strategies did not appear to be significantly related to idiosyncratic risk, with some evidence that having mid-blend, large-growth, and large-value strategies were risk reducing, however only in the RAP SD model.

3.4.5 Screening intensity and fund flow volatility

Table 3.10 presents the regression results for the relationship between Screening Variables and fund flow volatility for the simple linear model (Model 1) and the model

with the squared Screening Intensity variable (Model 2) as well as two additional models: one that considers total negative exclusions (Model 3) and another that considers total criteria type (Model 3) for each of the dependent variables, Standard deviation of the flow of unadjusted returns and Standard deviation of the flow of risk-adjusted returns. My findings suggest strong support for a positive linear relationship between Screening Intensity and fund flow volatility at the 99% confidence level and stronger support for a curvilinear relationship (an inverted U-shape) at a 95% confidence level. The increase in fit from the linear to the curvilinear models suggests that the latter presents a more robust explanation for the relationship, thereby supporting *H3: The relationship between Screening intensity and fund flow volatility is positive and concave.* This curvilinear relationship is illustrated in Figure 3.3. Funds with the least amount of screens have lower fund flow volatility; the volatility increases with each screen until reaching a peak of between 13-15 screens. The volatility then begins to decrease as a fund screens at high levels.

Although no hypotheses were motivated, I further find that an increase in the number of negative exclusions is positively related to flow volatility at a 95% level for the SD unadjusted returns model and at a 99% level for the SD RAP model. I also find evidence that CBI exclusions were associated with high levels of volatility at a 99% level for both dependent variables. Finally, I find that cumulative returns, fund fees, large-blend investment strategies, and unexplained factors related to period 2 and period 3 were positively related to fund flow volatility.

Figure 3.3 Curvilinear Relationship between Screening Intensity and Fund Flow Volatility

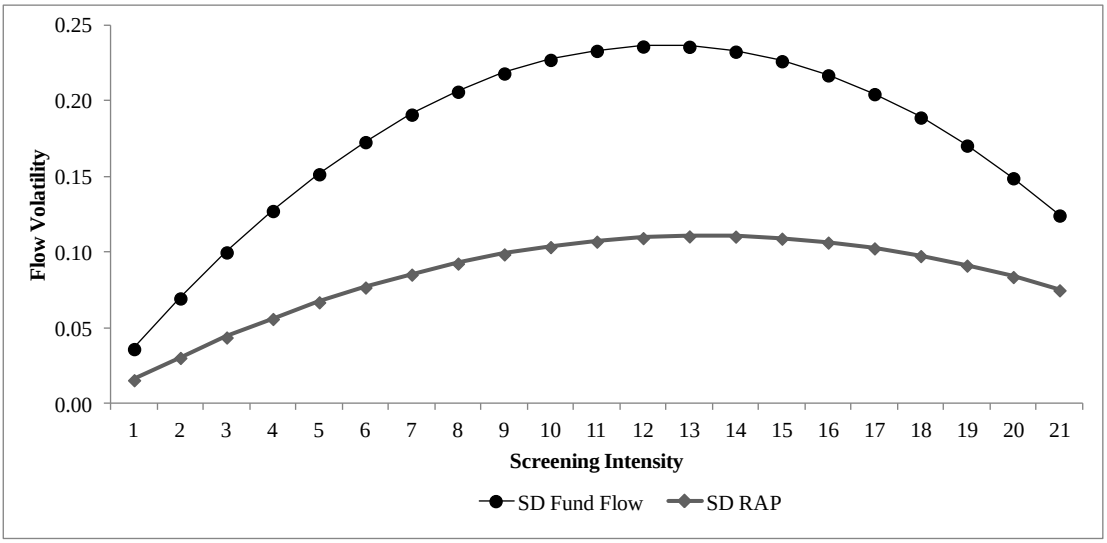


Table 3.4 Distribution of funds according to domicile and MS category

Domicile	%	MS Category	%
Austria	30.00%	Small growth	0.00%
Belgium	30.00%	Small blend	0.00%
France	18.72%	Small value	0.00%
Germany	5.88%	Mid-growth	11.92%
Ireland	0.53%	Mid-blend	0.66%
Italy	2.14%	Mid-value	0.00%
Luxembourg	20.86%	Large growth	16.56%
Netherlands	2.67%	Large blend	50.33%
Norway	0.53%	Large value	20.53%
Spain	2.14%		
Sweden	12.83%		
Switzerland	3.21%		
U.K.	19.79%		

Table 3.5 Correlation Matrix

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 SD of RAP	1																	
2 Fama French Residual Variance	0.5469	1																
3 Carhart Residual Variance	0.5463	0.9962	1															
4 Screening Intensity	0.1550	0.1771	0.1840	1														
5 Age	0.0491	0.0324	0.0231	-0.0042	1													
6 Size	-0.1245	-0.1242	-0.1216	-0.0286	-0.0433	1												
7 % Equity	0.1753	0.7419	0.7446	0.0604	-0.0636	-0.0303	1											
8 % Europe	0.0321	-0.2470	-0.2642	-0.2232	0.0218	-0.0386	-0.1507	1										
9 % Financial Services	-0.1739	-0.3467	-0.3566	-0.0119	-0.1084	-0.0704	-0.1765	0.4069	1									
10 % Healthcare	-0.1135	-0.1264	-0.1142	0.0526	0.1370	-0.0256	-0.0004	-0.1527	-0.1090	1								
11 % Real Estate	0.2608	0.2430	0.2194	0.0519	0.2022	-0.1119	0.0739	0.1532	0.1384	-0.2202	1							
12 % Energy & Utilities	0.1294	0.0069	0.0031	-0.0541	-0.0490	0.1172	-0.0355	-0.0306	-0.1863	-0.2277	-0.0439	1						
13 % Information	-0.1162	-0.0058	-0.0106	-0.0553	-0.1227	-0.0832	-0.0412	-0.2117	-0.0929	0.0063	-0.2213	-0.1732	1					
14 % Manufacturing	0.1311	0.3033	0.3149	0.0464	0.0990	0.0534	0.1815	-0.1488	-0.6146	-0.1757	-0.0135	-0.3243	-0.3383	1				
15 Mid-blend	-0.1035	-0.0289	-0.0410	-0.0665	-0.0204	0.0078	0.0601	0.0826	0.0757	0.0283	-0.0382	0.0245	-0.0530	-0.0560	1			
16 Large-growth	-0.0892	-0.1891	-0.1850	0.0614	0.0379	0.3107	-0.1392	0.1231	0.0513	-0.1204	-0.0488	0.2312	-0.1477	-0.0552	-0.0444	1		
17 Large-blend	0.1794	0.1908	0.1801	-0.1420	0.2120	-0.3256	0.1360	0.2609	0.0639	-0.1141	0.2149	-0.1873	0.0295	0.0775	-0.0902	-0.4511	1	
18 Large-value	-0.1007	0.0317	0.0384	-0.0011	-0.2092	0.1248	0.0750	-0.3414	-0.1738	0.1519	-0.1376	0.1375	0.1253	-0.0693	-0.0526	-0.2631	-0.5341	1
Minimum	0.01	0.85	0.81	1.00	0.87	0.43	7.85	13.25	0.00	0.00	0.00	0.00	0.00	2.15				
Maximum	3.72	9.90	9.54	21.00	316.83	1408.79	99.82	100.00	42.35	96.90	19.90	51.56	37.97	83.50				
Mean	1.02	4.72	4.68	9.80	95.00	94.27	83.37	75.09	17.95	9.96	1.30	12.65	16.94	41.20				
Standard Deviation	0.67	1.72	1.73	5.40	62.49	174.59	23.82	26.43	8.77	8.11	2.18	7.65	6.03	11.21				

Table 3.6 Correlation Matrix of Screening Criteria Variables

Variable	1	2	3	4							
1 Negative env. impact	1										
2 Products dangerous to env.	0.6423	1									
3 Innovative and beneficial to env.	0.1312	-0.0219	1								
4 Env. Protection	0.1135	-0.0187	0.8635*	1							
Variable	**5**	**6**	**7**	**8**	**9**	**10**					
5 Human rights violations	1										
6 Labor rights violations	0.7531*	1									
7 Oppresive regimes	0.3464	0.3685	1								
8 Human rights protecion	0.3481	0.3824	0.2170	1							
9 Community development	0.0379	0.0677	0.0097	0.5071	1						
10 Quality of life	0.0511	0.1127	0.2112	0.2773	0.1301	1					
Variable	**11**	**12**	**13**								
11 Good corporate governance	1										
12 Responsible external relations	0.5619	1									
13 Responsible internal relations	0.3000	0.3793	1								
Variable	**14**	**15**	**16**	**17**	**18**	**19**	**20**	**21**	**22**	**23**	**24**
14 Firearms	1										
15 Weapoms	0.7115*	1									
16 Nuclear energy	0.5151	0.5022	1								
17 Tobacco	0.5517	0.6482	0.4075	1							
18 Gambling	0.4073	0.4446	0.4144	0.5330	1						
19 Pornography	0.3668	0.4027	0.4247	0.4694	0.5376	1					
20 Alcohol	0.3770	0.4105	0.1126	0.6201	0.4870	0.2401	1				
21 Animal Testing	0.3336	0.2577	0.4854	0.2620	0.3827	0.3046	0.2699	1			
22 Factory Farming	0.1615	0.1761	0.3812	0.1973	0.2811	0.2761	0.1366	0.6361	1		
23 Furs	0.1474	0.0954	0.2367	0.0752	0.1320	0.1282	0.0056	0.3904	0.4506	1	
24 GMO	0.3595	0.2842	0.5326	0.2363	0.3827	0.3283	0.1282	0.4532	0.4458	0.2758	1

*Correlation is above 0.70

Table 3.7 Descriptive Statistics and Relationship to Screening

No. of screens	No. of funds	Age (months)		Size (EUR)		% Europe		% Non-manufacturing		% Equity	
		Average	SD	Average	SD	Average	SD	Average	SD	Average	SD
1	13	115.19	69.73	140.29	196.47	81.39	23.33	58.84	10.89	78.40	22.96
2	2	101.73	44.52	45.00	27.21	80.46	17.72	53.39	6.76	92.27	4.21
3	7	61.42	34.52	45.92	47.78	73.75	27.87	61.59	7.60	79.00	29.66
4	19	90.68	49.07	86.34	125.26	92.06	19.78	60.62	11.28	86.01	22.05
5	11	92.42	89.93	68.28	82.93	61.11	30.89	60.48	17.43	92.92	14.51
6	10	92.39	59.45	146.83	235.79	63.92	24.23	56.34	16.15	83.20	27.55
7	14	121.97	63.04	29.45	31.24	80.21	29.03	55.24	10.04	90.44	18.74
8	5	73.07	33.70	113.62	117.49	77.69	26.78	56.59	15.65	86.78	19.00
9	14	92.71	55.66	36.02	49.68	78.90	22.58	61.58	9.04	77.76	29.15
10	9	109.13	58.30	37.23	41.90	74.21	21.55	63.20	7.12	76.78	25.31
11	7	65.40	36.73	63.54	48.63	60.07	20.43	60.93	5.06	83.30	23.11
12	13	99.88	61.40	260.66	451.48	84.27	23.31	56.94	9.99	81.08	28.19
13	5	64.58	34.67	39.38	34.65	79.52	24.64	64.39	5.62	61.99	35.63
14	14	131.85	93.52	55.14	53.98	78.33	24.95	55.47	8.39	84.96	20.29
15	13	88.16	61.25	90.61	201.87	75.69	21.34	59.51	7.46	88.42	18.58
16	6	74.18	37.69	227.98	160.82	70.94	29.51	58.12	9.95	92.11	8.93
17	10	61.70	33.09	178.38	200.71	54.87	23.24	59.61	8.49	89.15	17.86
18	2	58.98	36.53	25.54	21.69	41.39	9.95	59.93	6.11	45.44	26.57
19	10	93.58	44.79	58.39	92.88	80.16	29.14	63.78	8.98	74.29	29.22
20	2	199.83	39.53	1.91	0.49	47.33	19.14	31.65	12.57	93.72	6.12
21	1	58.77		83.36		36.64		32.92		94.75	
All funds	187	94.89	62.47	94.21	174.41	75.14	26.43	58.83	11.22	83.21	24.07

Table 3.8 Screening Intensity and Idiosyncratic Risk[a]

	Fama-French Residual Variance		Carhart Residual Variance		Standard Deviation of RAP (log)	
	Model 1	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**
Screening Intensity (SI)	0.0239 (2.58)*	0.1141 (3.07)***	0.0242 (2.62)***	0.1145 (3.09)***	0.0149 (2.48)**	0.0798 (3.18)***
SI-squared		-0.0044 (-2.63)***		-0.0044 (-2.66)***		-0.0031 (-2.77)***
Age	0.0000 (0.07)	0.0001 (0.22)	-0.0000 (-0.02)	0.0001 (0.13)	-0.0001 (-0.33)	-0.0001 (-0.17)
Size	-0.1279 (-4.52)***	-0.1292 (-4.64)***	-0.1301 (-4.67)***	-0.1314 (-4.79)***	-0.0466 (-2.52)**	-0.0476 (-2.64)***
% Equity	0.0479 (24.25)***	0.0474 (24.24)***	0.0478 (24.2)***	0.0474 (24.22)***	0.0037 (2.7)***	0.0034 (2.53)**
% Europe	-0.0057 (-2.84)***	-0.0062 (-3.15)***	-0.0065 (-3.29)***	-0.0070 (-3.62)***	0.0001 (0.1)	-0.0001 (-0.12)
% Financial Services	-0.0451 (-7.13)***	-0.0453 (-7.08)***	-0.0461 (-7.36)***	-0.0464 (-7.3)***	-0.0170 (-4.23)***	-0.0171 (-4.3)***
% Healthcare	-0.0498 (-3.82)***	-0.0474 (-3.64)***	-0.0478 (-3.67)***	-0.0454 (-3.49)***	-0.0085 (-1.18)	-0.0067 (-0.97)
% Real Estate	0.1620 (4.89)***	0.1465 (4.31)***	0.1395 (4.51)***	0.1239 (3.99)***	0.0727 (4.81)***	0.0615 (3.82)***
% Energy & Utilities	-0.0035 (-0.33)	-0.0028 (-0.26)	-0.0053 (-0.5)	-0.0045 (-0.43)	0.0025 (0.43)	0.0031 (0.53)
% Information	0.0084 (0.98)	0.0034 (0.4)	0.0038 (0.45)	-0.0010 (-0.12)	-0.0081 (-1.37)	-0.0117 (-1.96)*
Mid-blend	-0.4105 (-1.17)	-0.4299 (-1.22)	-0.6464 (-1.5)	-0.6658 (-1.54)	-2.1176 (-1.9)*	-2.1315 (-1.91)*
Large-growth	-0.2956 (-1.31)	-0.1802 (-0.81)	-0.2848 (-1.24)	-0.1692 (-0.75)	-0.2267 (-1.65)*	-0.1437 (-1.02)
Large-blend	-0.1611 (-0.72)	-0.1043 (-0.48)	-0.1766 (-0.78)	-0.1197 (-0.54)	-0.1181 (-0.89)	-0.0772 (-0.58)
Large-value	-0.1837 (-0.83)	-0.1172 (-0.54)	-0.1924 (-0.86)	-0.1259 (-0.57)	-0.2428 (-1.88)*	-0.1950 (-1.5)
Period 2	0.8072 (5.93)***	0.7782 (5.65)***	0.7785 (5.78)***	0.7494 (5.48)***	0.6363 (6.5)***	0.6155 (6.37)***
Period 3	0.3162 (2.07)**	0.2830 (1.86)*	0.2584 (1.74)*	0.2251 (1.52)	-0.0367 (-0.33)	-0.0606 (-0.56)
Constant	2.0590 (4.86)***	1.8424 (4.21)***	2.2537 (5.41)***	2.0367 (4.71)***	-0.1651 (-0.55)	-0.3211 (-1.07)
R-squared	0.7391	0.7432	0.7393	0.7435	0.3991	0.4103
Obs.	341	341	341	341	341	341

[a] $Idiosyncratic\ Risk_{it} = a_{it} + \beta1*SI_i + \beta2*Size_{it} + \beta3*Age_{it} + \beta4*\%Equity + \beta5*\%Europe + \beta6*[Sector\ Variables_{it}] + MS\ Category\ Variables + Period\ fixed\ effects + \varepsilon_{it}$ where *Idiosyncratic Risk* is the 3-year annualized idiosyncratic risk measure for fund *i* in period *t*, *SI* is the screening intensity for fund *i* measured as the number of screens, *SI-squared* is the squared variable of *Screening Intensity*; *Size* is the standardized average 3-year net asset value in Euros of fund *i Age* is the number of months since inception of fund *i* at the beginning of period *t*, *%Equity* is the average 3-year percentage of investments in Equities, *%Europe* is the average 3-year percentage of investments in Europe, *Sector variables* are the average 3-year percentage of investments in the Financial Services, Healthcare, Real Estate, Energy & Utilities, Information, and Manufacturing (dropped) sectors, *MS Category variables* related to the Morningstar investment styles. Numbers in parentheses are the values for the T-test.
*p-value < 0.10; **p-value < 0.05; ***p-value < 0.01

Table 3.9 Individual Effects of Screening Intensity and Risk[a]

	Fama-French Residual Variance		Carhart Residual Variance		Standard Deviation of RAP (log)	
	Model 1	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**
negative		0.0409 (3.45)***		0.0421 (3.57)***		0.0208 (2.68)***
envtot	0.0124 (0.23)		0.0194 (0.35)		-0.0051 (-0.15)	
soctot	-0.0360 (-0.9)		-0.0340 (-0.84)		0.0126 (0.46)	
govtot	-0.0115 (-0.17)		-0.0328 (-0.47)		-0.0039 (-0.09)	
cbitot	0.0706 (3.25)***		0.0718 (3.26)***		0.0282 (2.19)**	
Age	-0.0000 (-0.05)	-0.0000 (-0.1)	-0.0001 (-0.12)	-0.0001 (-0.2)	-0.0002 (-0.45)	-0.0002 (-0.48)
Size	-0.0859 (-2.3)**	-0.1011 (-3.26)***	-0.0821 (-2.19)**	-0.1021 (-3.32)***	-0.0335 (-1.47)	-0.0356 (-1.76)*
% Equity	0.0485 (24.83)***	0.0483 (25.18)***	0.0486 (24.66)***	0.0482 (25.12)***	0.0039 (2.8)***	0.0040 (2.88)***
% Europe	-0.0059 (-2.94)***	-0.0055 (-2.79)***	-0.0068 (-3.4)***	-0.0063 (-3.23)***	0.0000 (0.05)	0.0001 (0.07)
% Financial Services	-0.0423 (-6.46)***	-0.0433 (-6.97)***	-0.0428 (-6.62)***	-0.0443 (-7.22)***	-0.0159 (-3.87)***	-0.0160 (-4)***
% Healthcare	-0.0504 (-3.79)***	-0.0486 (-3.75)***	-0.0484 (-3.64)***	-0.0466 (-3.61)***	-0.0083 (-1.16)	-0.0078 (-1.1)
% Real Estate	0.1519 (4.48)***	0.1572 (4.66)***	0.1286 (4.02)***	0.1344 (4.31)***	0.0702 (4.6)***	0.0705 (4.62)***
% Energy & Utilities	0.0003 (0.04)	-0.0011 (-0.11)	-0.0007 (-0.07)	-0.0028 (-0.27)	0.0040 (0.68)	0.0036 (0.61)
% Information	0.0064 (0.69)	0.0083 (0.98)	0.0017 (0.18)	0.0038 (0.44)	-0.0089 (-1.45)	-0.0084 (-1.41)
Mid-blend	-0.1798 (-0.49)	-0.3562 (-1.03)	-0.4141 (-0.94)	-0.5881 (-1.38)	-2.0865 (-1.86)*	-2.1043 (-1.89)*
Large-growth	-0.2284 (-1.01)	-0.2473 (-1.1)	-0.2172 (-0.92)	-0.2347 (-1.03)	-0.1944 (-1.38)	-0.2048 (-1.5)
Large-blend	-0.1314 (-0.59)	-0.1165 (-0.52)	-0.1526 (-0.67)	-0.1284 (-0.57)	-0.1033 (-0.79)	-0.1090 (-0.83)
Large-value	-0.1885 (-0.87)	-0.1729 (-0.8)	-0.2059 (-0.92)	-0.1799 (-0.81)	-0.2387 (-1.88)*	-0.2456 (-1.93)*
Period 2	0.8052 (5.88)***	0.8099 (5.97)***	0.7777 (5.75)***	0.7811 (5.83)***	0.6392 (6.47)***	0.6389 (6.53)***
Period 3	0.3329 (2.17)**	0.3366 (2.23)**	0.2776 (1.85)*	0.2794 (1.9)*	-0.0259 (-0.23)	-0.0262 (-0.24)
Constant	1.8050 (4.36)***	1.7937 (4.37)***	1.9704 (4.85)***	1.9714 (4.87)***	-0.2593 (-0.86)	-0.2447 (-0.8)
R-squared	0.7450	0.7430	0.7462	0.7437	0.4018	0.4010
Obs.	341	341	341	341	341	341

[a] $Idiosyncratic\ Risk_{it} = a_{it} + [\beta 1 * Criteria\ Variables_i] + \beta 2 * Size_{it} + \beta 3 * Age_{it} + \beta 4 * \%Equity + \beta 5 * \%Europe + \beta 6 * [Sector\ Variables_{it}] + MS\ Category\ Variables + Period\ fixed\ effects + \varepsilon_{it}$ where variables are similar to those in Table 5 and *criteria variables* are the total of environmental screens (envtot), social screens (soctot), governance screens (govtot), and controversial business involvement screens (cbitot) and negative is the total number of negative screens. Numbers in parentheses are the values for the T-test. *p-value < 0.10; **p-value < 0.05; ***p-value < 0.01

Table 3.10 Screening and Flow Volatility[a]

	Standard Deviation of Rf flow				Standard Deviation of RAP flow			
	Model 1	**Model 2**	**Model 3**	**Model 4**	**Model 1**	**Model 2**	**Model 3**	**Model 4**
Screening Intensity (SI)	0.0066 (2.7)***	0.0326 (2.87)***			0.0041 (3.87)***	0.0168 (2.68)***		
SI-squared		-0.0012 (-2.26)**				-0.0006 (-2.03)**		
negative			0.0078 (2.44)**				0.0068 (4.37)***	
envtot				-0.0070 (-0.49)				0.0079 (1.14)
soctot				-0.0156 (-1.22)				-0.0118 (-1.8)*
govtot				0.0443 (2.33)**				-0.0007 (-0.06)
cbitot				0.0162 (2.93)***				0.0112 (4.06)***
cumulative returns	-0.0626 (-0.54)	-0.0251 (-0.21)	-0.0738 (-0.63)	-0.0297 (-0.27)	0.0805 (3.85)***	0.0781 (3.82)***	0.0801 (3.83)***	0.0807 (3.99)***
cumulative returns^2	0.1770 (1.69)*	0.1529 (1.48)	0.1811 (1.74)*	0.1659 (1.58)	0.0086 (1.3)	0.0089 (1.34)	0.0090 (1.37)	0.0106 (1.74)*
fee	7.9245 (2.01)**	8.9034 (2.29)**	7.5449 (1.92)*	7.1617 (1.78)*	2.1568 (0.95)	2.4879 (1.09)	2.0897 (0.95)	1.2448 (0.54)
Mid-blend								
Large-growth	0.0433 (0.58)	0.0707 (0.87)	0.0526 (0.7)	0.0437 (0.58)	-0.0494 (-1.28)	-0.0356 (-0.84)	-0.0369 (-0.94)	-0.0399 (-0.99)
Large-blend	0.1312 (1.92)*	0.1366 (1.93)*	0.1246 (1.76)*	0.1398 (2.05)**	-0.0075 (-0.21)	-0.0044 (-0.12)	-0.0057 (-0.16)	-0.0166 (-0.47)
Large-value	0.0646 (0.86)	0.0757 (0.96)	0.0638 (0.83)	0.0706 (0.92)	-0.0500 (-1.32)	-0.0434 (-1.09)	-0.0458 (-1.18)	-0.0528 (-1.4)
Period 2	0.2638 (3.26)***	0.2779 (3.41)***	0.2577 (3.13)**	0.2783 (3.46)***	0.0312 (1.21)	0.0303 (1.18)	0.0293 (1.14)	0.0278 (1.09)
Period 3	0.1217 (2.55)**	0.1248 (2.61)***	0.1197 (2.48)**	0.1243 (2.59)**	-0.0192 (-0.85)	-0.0197 (-0.86)	-0.0208 (-0.91)	-0.0222 (-0.97)
Constant	-0.0562 (-0.49)	-0.1821 (-1.29)	-0.0294 (-0.25)	-0.0886 (-0.71)	0.0777 (1.4)	0.0223 (0.34)	0.0723 (1.41)	0.1064 (1.65)
R-squared	0.1627	0.1721	0.1626	0.1732	0.1674	0.1760	0.1822	0.1912
Obs.	384	384	384	384	383	383	383	383

[a] $SD\ Flow_{it} = a_{it} + [\beta 1 * Screening\ Variables_i] + \beta 2 * CumRet_{it} + \beta 3 * CumRet2_{it} + \beta 4 * Fee + MS\ Category\ Variables + Period\ fixed\ effects + \varepsilon_{it}$ where *SD Flow* is the standard deviation of the flow of fund *i* in period *t*, *Screening Variables* includes: the screening intensity for fund *i* measured as the number of screens *(*as well as *SI-squared* , the squared variable of *Screening Intensity)*, *negative*, the number of negative exclusions for fund *i,* or totals for environmental, social, governance, and CBI criteria *(envtot, soctot, govtot,* cbitot respectively); *CumRet* is the average cumulative returns for fund *i* at the end of period *t* (*CumRet2* is the squared variable of *CumRet*; *fee* is the fees of fund *i; MS Category variables* related to the Morningstar investment styles. Numbers in parentheses are the values for the T-test.
*p-value < 0.10; **p-value < 0.05; ***p-value < 0.01.

3.4.6 Additional analyses

3.4.6.1 Screening intensity and Performance

Appendix B presents the regression results for the relationship between Screening Intensity and different measures of returns for the simple linear model (Model 1) and the model with the squared Screening Intensity variable (Model 2). My findings suggest that there is no significant relationship between screening intensity and financial performance, whether linear or curvilinear. Further, there is no conclusive evidence as to the direction of the effect. This finding, in particular, the fact that an increase (decrease) in idiosyncratic risk is not directly related to an increase (decrease) in financial performance needs to be examined further in future studies.

3.4.6.2 Individual Screening criteria, idiosyncratic risk, and return

Finally, as presented in Appendix C, I include all the Screening Criteria as dummy variables and test their relationships with idiosyncratic risk and return. Highly correlated variables were merged.[26] I find some evidence that screening for firms involved in nuclear energy was risk-reducing but in general find no other significant recurring effects.

3.5 Concluding Comments

This paper addresses the need for more comprehensive research on the theoretical motivations underlying the growing phenomenon of Responsible Investment; moving away from the performance debate and the dichotomy between SRI and non-SRI funds and instead, focusing on the more complex assimilation of sustainability issues occurring within financial capital markets in terms of the drivers of financial risk. I theorize and empirically test two strong arguments underlying the mainstreaming of the practice: namely, the informational benefits leading to a decrease in idiosyncratic risk at a

[26] In particular, the third and fourth Environmental criteria listed in Table 3.2 were merged as "negative environmental impact", the first and second Social criteria as "human and labor rights violations" and the first and second CBI criteria as "firearms/weapons."

substantive level of SRI and the 'stickiness' from moral considerations and normative legitimacy leading to lower levels of fund volatility, also at a substantive level of SRI. My findings strongly support the two key hypotheses of the paper, which has been rather neglected in prior literature and which, on the practitioner side, has hitherto relied mostly on anecdotal evidence. First, I find empirical evidence for a curvilinear (inverted U-shaped) relationship between screening intensity and idiosyncratic risk, illustrating how *rethinking* is occurring within financial markets through the assimilation of new (sustainability-related) sources of idiosyncratic risk. These findings evidence the fact that contrary to traditional asset pricing models that propose that only systematic risk matters, idiosyncratic risk is priced by the market. More importantly, I concur with Derwall et al. (2005) and Lee and Faff (2009) in proposing that financial markets factor in the economic consequences of sustainability into current share prices. However, my results provide a substantial addition in that they show that the assimilation of sustainability issues within financial models is by no means a 'yes' or 'no' question. Instead, the assimilation of sustainability as a new source of risk depends largely on the depth of information that the fund manager possesses and this assimilation does not occur in all types of SRI funds. Further, I find that negative screening and screening for CBI is positively related with idiosyncratic risk, supporting the notion that reducing these defensive stocks reduces possibilities for diversification and addresses the call for a closer examination of screening strategies (Barnett & Salomon, 2006).

Second, I find evidence of client 'stickiness' at a substantive level of RI, illustrated by the fact that the level of screening intensity affects the volatility of fund flows. Similar to my results on idiosyncratic risk, I find a significant positive concave relationship between screening intensity and fund flow volatility. These findings evidence the fact that moral attributes potentially provide high levels of stability and are priced by the market. Similar to my results on idiosyncratic risk, I highlight that these results show that the

assimilation of sustainability issues within financial models is not straightforward. Instead, the assimilation of sustainability as a new source of risk (in this case, in terms of volatility) depends largely on the level of *ethicalness* of the fund which provides its legitimacy. Again, importantly, this assimilation does not occur in all types of SRI funds.

My results illustrate that sustainability issues are being assimilated into traditional financial models and that current asset pricing models are currently inadequate in that they are unable to fully capture the influence of sustainability-related issues. I further contribute towards an illustration of how new practices can become assimilated within embedded logics and how assimilation is not a straightforward process; instead, organizations apply discretion on the issues that matter to them, pointing towards how markets are socially constructed. Due to the fact that the industry is undergoing a period of learning and transition, the questioning of the economic motivation of having one or the other of these processes has been more pressing than ever and organizations make sense of the conflicting demands imposed upon them, adopting practices to serve their needs. Future studies can further investigate how this occurs.

Finally, my findings present an interesting case for asset managers. Engaging in RI remains attractive because of its unique risk profile, which however, mainly supports a case for a deep level of commitment. That is, the commitment of the investor to a deeper engagement with firms and a better understanding of sustainability issues. Given that doing RI may produce information externalities, implications of this in practice point towards increased standardization of performance measures, the creation of models and tools, and increased specialization of sustainability roles through training and other knowledge-building practices. There are also implications, perhaps, on the role of better marketing, communication, and transparency of RI funds in order to attract and retain 'sticky' clients.

These results are an initial support for a better understanding of the controversial yet rapidly growing practice of Responsible Investment in general and SRI screening in particular. The findings stress how traditional models of finance *remain* dominant yet new ideas related to sustainability are *gradually* penetrating and manifesting their presence. This is a clear example of logic assimilation wherein the logics and archetypes of finance, encompassing traditional notions of risk and return are being elaborated. By engaging in substantive RI, investors can take on a broader role in society without necessarily harming their performance and yet potentially even decreasing their risk, pointing towards the notion that the future of Finance *can* be responsible, and that the integration of sustainability in investing is indeed, a plausible proposition. This contribution is opportune given the uncertain future of Responsible Investment.

3.6 References

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Table 3.11 Illustrative Quotes

More information allows for better company choices	"For us, integration is not about taking a rating and then overweighting a company on the basis of a rating or changing a discount on the basis of a rating. It is in-depth research and understanding how ESG has an impact on the business and on the investment case and to act in accordance with that." (Interviewee Y) "We also are different I think in the thoroughness of the research that we do ourselves. So, we look very carefully at the companies. We always look, we always try to discuss the results with the companies to see if we have not foreseen something." (Interviewee X) "We take this data [from the data providers]. So we start from this, (...) then we take it, we adopt it, transform everything, and in a database which we have created internally, which is truly ours, we made it from scratch, and we transform everything under a methodology which we have created. (...) So for us, what most of our competitors do does not make sense. It doesn't make sense to take a rating for all the various elements of ESG. One instead needs to identify the key risk criteria and on this we are going to see what the company does." (Interviewee V) "I think [doing SRI] is decreasing the uncertainty of the organizations, because everyone knows what is around (...) it gives you sort of hard facts that you can act upon." (Interviewee U) "So, the objective is to have more companies delivering relevant, consolidated and lasting ESG information. So, how do we proceed in practice? We do contact the companies directly, via the investor relations team, and then, we require to meet the sustainability team, but it can be also an R&D team, it can be a production team; it can be a human resources team. It depends on the sectors and the companies; because in the vast majority the fact that you can meet the company directly is very, very, very, very helpful." (Interviewee T) "But when you then go at the individual company level, you can only use [ratings] as a starting point. And when you want to link it to company strategy to the financial information that is in the account of the company, you will have to research each and every company on an individual basis and use this information only as a starting point." (Interviewee E) "It's probably rare that our analysts would pick up a sustainability report from a company for example and try and understand that. You know, they think it's important, we think it's important that companies have these types of reports. But we are much more focused in having conversations with management teams around what is the strategy and is it aligned with the longer term trends in his space. In fact, we don't mind if they don't even talk about sustainability, and how they interpret it, it's really up to them. But we are just trying to understand and look for companies that we know understand the longer term, factors that they have to, you know, deal with in their business plans; and whether or not they sustainability oriented or not (and how they express that in reports) is not that important to us." (Interviewee A) "Because today, this is an argument that then I also do with the firms, I want to say, us when we meet, based on these seven important criteria we ask: let's not talk about what you are doing now, not what you did yesterday, because this I can read, I can find at least in the sustainable development report of the annual report, but let's talk about these criteria, these risks which we've identified as the most important, about what you will do in three and five years." (Interviewee V)

'Stickiness' of responsible investments	"...the industry started to become much more transparent into providing insight in which companies we are invested, to make a public statement on responsible investment policy, to produce responsible investment reports, to report on engagement we have with companies, and also we had at that point, more and more questions from clients, asking for specific issues and how and what are our opinions are on these issues and what we do to address those issues." (Interviewee Y) "Today it is a bit different because the firms realize that there are always more and more investors that take these things into consideration, that attract new investors, that by entering into sustainable indices, one becomes very important therefore the firms, even if they don't believe in it, in whatever way, they must do it because if not, they are cut out from one part of the market." (Interviewee V) "What is happening today? It's that (...) in the investment mandates which are entrusted to the managers, it is requested, in an increasing way (...) that the process of investment, in whatever way, takes into consideration ESG aspects." (Interviewee R) "If you are an investment manager, the drive is coming from a group of clients, who really cares about this. And so, if they can say, "Well, our clients want this", then, it is very easy for them to do it." (Interviewee O) "Looking at the institutional side, it is quite clear that the activities of asset managers can be seen as a reaction to client demand. So, as more and more pension funds or whatever include ESG-requirements into their requirements for giving mandates, then the asset management industry has to react to that." (Interviewee E) "I think the drawback is not that we have fewer clients. I think the clients that we have really encourage the strict criteria we set. They really think that it is good." (Interviewee X)

Table 3.12 Screening Intensity and Performance

	Carhart Alpha		RAP		Sharpe		Info	
	Model 1	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**
Screening Intensity (SI)	0.0074 (1.84)*	0.0145 (0.84)	0.1231 (1.49)	0.1072 (0.37)	0.0045 (1.57)	0.0018 (0.15)	0.0022 (1.01)	0.0140 (1.42)
SI-squared		-0.0003 (-0.4)		0.0007 (0.05)		0.0001 (0.25)		-0.0005 (-1.2)
Age	0.0011 (2.42)**	0.0011 (2.45)**	-0.0031 (-0.39)	-0.0031 (-0.39)	0.0000 (0.27)	0.0000 (0.25)	0.0001 (0.61)	0.0001 (0.68)
Size	-0.0200 (-1.33)	-0.0204 (-1.35)	-0.0253 (-0.08)	-0.0250 (-0.08)	0.0033 (0.31)	0.0034 (0.32)	-0.0088 (-1.14)	-0.0090 (-1.16)
% Equity	-0.0005 (-0.55)	-0.0005 (-0.58)	0.1997 (8.59)***	0.1997 (8.52)***	0.0120 (9.19)***	0.0120 (9.19)***	0.0018 (2.8)***	0.0017 (2.73)***
% Europe	-0.0007 (-0.66)	-0.0008 (-0.67)	0.0433 (2.53)*	0.0434 (2.52)**	0.0020 (2.54)**	0.0021 (2.56)**	0.0008 (1.57)	0.0008 (1.44)
% Financial Services	0.0003 (0.1)	0.0003 (0.1)	-0.2408 (-3.95)***	-0.2407 (-3.95)***	-0.0072 (-3.93)***	-0.0072 (-3.91)***	-0.0017 (-0.94)	-0.0018 (-0.96)
% Healthcare	-0.0013 (-0.25)	-0.0012 (-0.22)	-0.4001 (-4.08)***	-0.4005 (-4.02)***	-0.0110 (-3.41)***	-0.0111 (-3.45)***	-0.0056 (-1.88)*	-0.0053 (-1.78)
% Real Estate	-0.0528 (-1.52)	-0.0538 (-1.53)	0.3645 (0.8)	0.3672 (0.8)	0.0139 (0.81)	0.0144 (0.83)	-0.0248 (-1.74)*	-0.0269 (-1.84)*
% Energy & Utilities	-0.0093 (-1.91)*	-0.0092 (-1.87)*	-0.1304 (-1.53)	-0.1305 (-1.53)	-0.0058 (-2.33)**	-0.0059 (-2.35)*	-0.0034 (-1.64)	-0.0033 (-1.6)
% Information	-0.0125 (-2.65)***	-0.0130 (-2.52)**	-0.0926 (-1.06)	-0.0917 (-1)	-0.0043 (-1.66)	-0.0041 (-1.5)	-0.0058 (-2.49)**	-0.0064 (-2.61)***
Mid-blend	-0.1734 (-0.46)	-0.1789 (-0.47)	2.4764 (1.04)	2.4797 (1.03)	0.0837 (1.18)	0.0843 (1.18)	0.0955 (1.32)	0.0930 (1.28)
Large-growth	0.0463 (0.42)	0.0512 (0.45)	0.9265 (0.48)	0.9060 (0.47)	0.0586 (0.8)	0.0550 (0.74)	-0.0196 (-0.37)	-0.0046 (-0.08)
Large-blend	0.0255 (0.22)	0.0263 (0.23)	0.1997 (0.11)	0.1897 (0.11)	0.0276 (0.4)	0.0258 (0.37)	-0.0431 (-0.87)	-0.0357 (-0.7)
Large-value	0.1438 (1.33)	0.1484 (1.34)	1.1155 (0.66)	1.1039 (0.65)	0.0874 (1.49)	0.0854 (1.44)	0.0034 (0.07)	0.0120 (0.25)
Period 2	-0.7650 (-13.45)***	-0.7683 (-13.21)***	-1.1183 (-1)	-1.1134 (-0.99)	-0.8365 (-18.06)***	-0.8356 (-18.16)***	0.2838 (6.71)***	0.2800 (6.58)***
Period 3	0.3465 (5.27)***	0.3439 (5.14)***	2.6201 (2.47)**	2.6256 (2.45)**	0.4623 (9.98)***	0.4633 (10.02)***	0.1143 (2.66)***	0.1100 (2.53)**
Constant	0.5157 (2.1)	0.5001 (2.06)**	-12.107 (-2.79)***	-12.068 (-2.79)***	-1.2453 (-7.78)***	-1.2386 (-7.51)***	-0.0637 (-0.53)	-0.0918 (-0.77)
R-squared	0.5887	0.5889	0.4067	0.4067	0.8545	0.8545	0.2760	0.2792
Obs.	341	341	343	343	342	342	342	342

[a] $Performance_{it} = a_{it} + \beta1*SI_i + \beta2*Fundage_{it} + \beta3*Size_{it} + \beta4*[Europe_{it}] + \beta5*[Sector\ Variables_{it}] + \beta6*[Equities_{it}] + $ $+ MS\ Category\ Variables + Period\ fixed\ effects + \varepsilon_{it}$ where *Performance* is the 3-year annualized performance measure for fund *i* in period *t;* all other variables are similar to those in Table 3.8. Numbers in parentheses are the values for the T-test. *p-value < 0.10; **p-value < 0.05; ***p-value < 0.

Table 3.13 Individual Screening Criteria, Risk and Return

	Carhart Res	SD of RAP	RAP	FF Alpha	Carhart Alpha	Sharpe	Info
Negative env. impact	-0.0721 (-0.46)	-0.0189 (-0.16)	-3.1284 (-2.03)**	-0.1464 (-0.47)	-0.1245 (-0.44)	-0.0423 (-0.85)	-0.0527 (-1.13)
Products dangerous to env.	0.2551 (1.71)*	0.0759 (0.66)	1.1002 (0.67)	0.1143 (0.35)	0.1994 (0.71)	-0.0573 (-1.14)	0.0221 (0.44)
Positive env. Impact	-0.0081 (-0.05)	-0.0325 (-0.3)	-1.0464 (-0.6)	-0.4718 (-1.24)	-0.5485 (-1.49)	-0.0236 (-0.45)	-0.0386 (-0.86)
Human/Labor rights violations	0.0020 (0.01)	-0.0184 (-0.19)	3.6182 (2.34)**	-0.1444 (-0.48)	-0.2171 (-0.77)	0.1273 (2.49)**	0.0343 (0.89)
Oppresive regimes	-0.0399 (-0.27)	0.0923 (0.89)	-1.3391 (-0.96)	0.4542 (1.47)	0.5313 (1.93)*	-0.0527 (-1.13)	-0.0275 (-0.7)
Human rights protecion	-0.1162 (-0.74)	-0.0725 (-0.66)	-0.8389 (-0.68)	0.7326 (1.34)	0.7448 (1.4)	-0.0007 (-0.02)	0.0568 (1.34)
Community development	-0.1428 (-0.89)	0.0634 (0.55)	-0.8840 (-0.71)	-0.4590 (-1.28)	-0.3953 (-1.18)	-0.0521 (-1.2)	-0.0528 (-1.25)
Quality of life	0.0046 (0.02)	0.0257 (0.17)	2.4088 (1.03)	0.3191 (0.77)	0.4019 (1.03)	0.0690 (1.01)	0.0304 (0.51)
Good corporate governance	-0.0672 (-0.49)	0.0390 (0.41)	1.8206 (1.4)	-0.2916 (-0.69)	-0.3256 (-0.81)	0.0496 (1.08)	-0.0387 (-0.93)
Responsible external relations	0.3035 (1.96)*	0.0566 (0.55)	2.5168 (1.71)*	-0.4977 (-0.95)	-0.5187 (-1.01)	0.0093 (0.24)	0.0312 (0.68)
Firearms/weapons	0.4898 (2.48)**	0.1956 (1.51)	1.3377 (0.73)	0.0535 (0.16)	-0.0362 (-0.11)	-0.0698 (-1.29)	-0.0143 (-0.27)
Nuclear energy	-0.4301 (-2.46)**	-0.2850 (-2.5)**	-0.4308 (-0.24)	-0.1411 (-0.41)	-0.1540 (-0.49)	0.0501 (0.97)	0.0000 (0)
Tobacco	0.1172 (0.47)	-0.0892 (-0.52)	-1.2076 (-0.47)	0.3074 (0.67)	0.3653 (0.85)	-0.0355 (-0.38)	0.0612 (0.89)
Gambling	-0.1471 (-0.64)	0.1084 (0.73)	-0.4527 (-0.25)	-0.4800 (-1.21)	-0.4038 (-1.08)	0.0825 (1)	-0.0409 (-0.83)
Pornography	-0.0900 (-0.5)	0.0136 (0.12)	-1.2108 (-0.65)	0.7349 (1.61)	0.6971 (1.59)	-0.0580 (-1.12)	0.0058 (0.12)
Alcohol	0.1711 (0.74)	0.0345 (0.24)	1.5273 (0.87)	-0.2119 (-0.49)	-0.2601 (-0.66)	-0.0139 (-0.28)	0.0207 (0.41)
Animal Testing	0.6565 (3.24)***	0.2440 (1.5)	1.7874 (0.71)	0.2073 (0.47)	0.2740 (0.66)	0.1490 (2.28)**	0.0033 (0.05)
Factory Farming	-0.2548 (-1.12)	-0.2041 (-1.15)	1.4262 (0.67)	-0.2313 (-0.42)	-0.3380 (-0.71)	0.0080 (0.16)	0.0305 (0.47)
Furs	0.2836 (1.61)	0.0368 (0.26)	-0.6750 (-0.39)	-0.4394 (-0.99)	-0.4322 (-1.16)	-0.0310 (-0.72)	-0.0037 (-0.07)
GMO	0.0170 (0.1)	0.1694 (1.68)*	-0.4362 (-0.25)	0.2805 (1.03)	0.1765 (0.74)	0.0004 (0.01)	0.0309 (0.67)
Age	-0.0004 (-0.47)	-0.0000 (-0.02)	0.0038 (0.49)	0.0034 (1.51)	0.0032 (1.51)	0.0001 (0.53)	0.0002 (0.89)
Size	-0.1130 (-2.79)***	-0.0619 (-2.59)***	-0.3749 (-0.9)	0.1266 (1.05)	0.1333 (1.15)	0.0017 (0.15)	-0.0008 (-0.07)
% Equity	0.0479 (22.53)***	0.0033 (2.81)***	0.2152 (10.22)***	0.0102 (0.88)	0.0130 (1.12)	0.0125 (9.86)***	0.0020 (2.63)***
% Europe	-0.0073 (-3.15)***	0.0022 (1.46)	0.0563 (2.82)***	-0.0059 (-1.34)	-0.0070 (-1.69)*	0.0026 (2.51)**	0.0009 (1.48)
% Financial Services	-0.0414 (-5.8)***	-0.0187 (-4.15)***	-0.2883 (-3.78)***	0.0228 (0.81)	0.0281 (1.01)	-0.0079 (-3.73)***	-0.0009 (-0.43)
% Healthcare	-0.0409 (-3)***	-0.0095 (-1.15)	-0.4086 (-3.81)***	-0.0654 (-1.83)*	-0.0640 (-1.82)*	-0.0100 (-3.27)***	-0.0047 (-1.62)
% Real Estate	0.1176 (3.03)***	0.0835 (3.1)***	0.0277 (0.1)	-0.4552 (-1.52)	-0.4144 (-1.4)	-0.0009 (-0.11)	-0.0250 (-1.57)
% Energy & Utilities	-0.0062 (-0.61)	0.0102 (1.26)	-0.1393 (-1.49)	-0.0082 (-0.58)	-0.0092 (-0.68)	-0.0083 (-2.52)**	-0.0017 (-0.73)
% Information	0.0025 (0.24)	-0.0047 (-0.72)	0.0295 (0.21)	-0.0674 (-2.17)**	-0.0616 (-1.98)**	-0.0018 (-0.7)	-0.0066 (-2.74)***
Mid-blend	-0.5898 (-1.19)	-0.7134 (-2.86)***	-1.6508 (-0.47)	0.4004 (0.82)	0.3697 (0.7)	-0.0629 (-0.66)	0.0590 (0.69)
Large-growth	-0.3397 (-1.37)	-0.2428 (-1.73)*	0.2491 (0.11)	0.3950 (1.02)	0.2991 (0.89)	0.0468 (0.63)	-0.0006 (-0.01)
Large-blend	-0.3875 (-1.66)*	-0.2437 (-1.73)*	-0.9733 (-0.45)	0.3595 (0.87)	0.3172 (0.93)	0.0040 (0.06)	-0.0310 (-0.54)
Large-value	-0.2729 (-1.23)	-0.2400 (-1.8)*	1.4076 (0.74)	0.4945 (1.38)	0.4259 (1.41)	0.0920 (1.45)	0.0014 (0.03)
Period 2	0.7582 (5.72)***	0.4647 (5.31)***	-0.6710 (-0.54)	-0.9152 (-2.17)**	-0.4264 (-1.02)	-0.8347 (-18.45)***	0.2808 (6.8)***
Period 3	0.2691 (1.78)*	-0.1646 (-1.7)*	2.6833 (2.39)**	1.0113 (2.1)**	0.9744 (2.03)**	0.4720 (9.88)***	0.1133 (2.58)***
Constant	2.2395 (5.07)***	0.9917 (3.47)***	-15.427 (-3.33)***	0.3288 (0.3)	0.0256 (0.03)	-1.2921 (-7.57)***	-0.1646 (-1.22)
R-squared	0.7702	0.4306	0.4375	0.3494	0.3170	0.8733	0.3071
Obs.	341	341	343	343	343	342	342

[a] $Performance\ or\ Idiosyncratic\ Risk\ measure_{it} = a_{it} + \beta 1*[Criteria]_{it} + \beta 2*Fundage_{it} + \beta 3*Size_{it} + \beta 4*[Europe_{it}] + \beta 5*[Sector\ Variables_{it}] + \beta 6*[Equities_{it}] + \ + MS\ Category\ Variables + Period\ fixed\ effects + \varepsilon_{it}$ where *Performance* is the 3-year annualized performance measure for fund *i* in period *t* and *Idiosyncratic Risk* is the 3-year annualized idiosyncratic risk measure for fund *i* in period *t;* all other variables are similar to those in Table 3.8. Numbers in parentheses are the values for the T-test. *p-value < 0.10; **p-value < 0.05; ***p-value < 0.01

CHAPTER 4

Rethinking Finance: Sustainability Governance in Responsible Investment

Abstract

This chapter illustrates how a 'Rethinking' of Finance is occurring within the European Asset Management industry due to the assimilation of sustainability-related issues within traditional financial models. It investigates the effect of sustainability governance on financial performance and fund attractiveness in the context of European Socially Responsible mutual funds that employ screening practices or the usage of environmental, social, governance, and controversial business involvement information as part of their traditional investment processes. We find that sustainability disclosure is value enhancing only when it does not jeopardize the competitive positioning of the fund and that providing too much information reduces the fund's attractiveness to investors. Further, we find that a deep level sustainability activism is negatively related to performance and fund attractiveness. We find moderate support that having an in-house sustainability research team increases the attractiveness (money flow) of the fund. Finally, we find that while having a high level of governance is negatively related to performance, it increases fund attractiveness. Overall, we contribute to a discussion which extends the literature on governance to include non-financial (sustainability-related) issues. We show in a first attempt that governance practices related to sustainability issues – often overlooked in the literatures – are value-relevant and should be considered as part of the overall governance strategy of a fund, illustrating how the financial logic is increasingly assimilating sustainability issues.

Keywords

Responsible Investment – Sustainability Disclosure – Fund Governance – Shareholder Activism

Estratto

Questo capitolo illustra come un 'Ripensamento' della Finanza stia avvenendo all'interno del settore dell'Asset Management in Europa, dovuto all'assimilazione degli aspetti legati alla sostenibilità nell'ambito dei modelli finanziari tradizionali. In questo ambito è stato analizzato l'effetto della governance legata alla sostenibilità sulla performance finanziaria e sull'attrattività del fondo di un dataset di fondi comuni europei socialmente responsabili, che utilizzano metodi di screening (ambientale, sociale, governance, e settori controversi) come parte dei loro processi di investimento tradizionali. Sulla base di questa analisi riteniamo che la divulgazione della sostenibilità aumenta valore solo se non compromette il posizionamento competitivo del fondo e che fornire troppe informazioni riduce l'attrattività del fondo per gli investitori. Inoltre, osserviamo che un profondo livello di attivismo sulla sostenibilità è negativamente correlato alla performance e all'attrattività del fondo. Constatiamo anche che avere un gruppo di ricerca interno dedicato alla sostenibilità aumenta l'attrattività del fondo (in termini di flusso di denaro). Infine troviamo che, anche se un alto livello di governance è correlato negativamente alla performance, l'attrattività del fondo aumenta. Nel complesso, contribuiamo ad una discussione che accresce la letteratura sulla governance e include questioni non finanziarie (legate alla sostenibilità). In questo primo sforzo analitico mostriamo che le pratiche di governance relative alla sostenibilità - spesso trascurate nella letteratura - sono di valore rilevante e devono essere considerate come parte della strategia di governance di un fondo, e illustriamo come la logica finanziari assimila sempre più i temi della sostenibilità.

4.1 Introduction

The European Asset Management industry has been experiencing substantial changes in recent years. Due to pressing sustainability concerns that have emerged within the financial sector, asset management firms – professional financial firms responsible for pooling money from different sources and managing portfolios of global wealth for the purpose of maximizing future returns – have been questioned as to whether they consider sustainability issues during their investment processes and how their practices affect the development and well-being of future generations. This has led to the birth of Responsible Investment (RI), in this paper, a general term referring to any type of investment process that combines investors' financial objectives with their concerns about Environmental, Social, Governance (ESG), and Controversial Business Involvement (CBI) issues.

Chapter 2 of this dissertation examined how *logic assimilation* is occurring through a 'rethinking' of finance – particularly through the assimilation of new sustainability-related sources of risk and return – which has two recursive mechanisms: first, the theorization of a logic of sustainability using the financial logic as a frame and second, the elaboration of the financial logic using characteristics of the sustainability logic. Chapter 3 provided an example of the assimilation of new sources of risk, in particular as coming from the informational benefits of sustainability and the 'stickiness' of clients having moral concerns. This chapter attempts to provide an illustration of the assimilation of new sources of return stemming from fund governance practices that occurs as the industry begins to "look at sustainability with a financial lens". In doing so, these last two chapters challenge conventional financial theory and bring to light how traditional investment models are inadequate in capturing the increasing importance of sustainability issues as the asset management industry evolves and illustrate how such

issues are gradually being assimilated within the industry's established logics and archetypes.

Most studies on RI funds[1] have focused on the performance debate surrounding these novel investment strategies, ignoring other aspects of this new practice such as how these funds are governed. Governance at a firm level – Corporate Governance – involves internal or external systems of laws, rules, and factors that control operations at a company (Gillan & Starks, 1998). The idea of governance mainly stems from agency theory which posits that control is required to prevent important conflicts of interests between the principal (the shareholder) and the agent (the manager). Without this control, the latter may diverge from his duties to the former and pursue practices which benefit his own interests at the expense of those of the former's (Eisenhardt, 1989; Jensen & Meckling, 1976).

At a firm level, corporate governance has been shown to both *reflect* corporate performance, in that it serves as a signal of the managerial quality of a firm, and also *affect* corporate performance, in that having good governance practices such as better monitoring may allow for the improved selection of Net Present Value-positive projects and minimize 'shirking' or the pursuit of private benefits from managers. The governance mechanisms usually deemed relevant for performance at a firm level are thus those which address the information asymmetry problem related to financial issues; for instance, how management incentives and board structure can affect the distribution of returns to shareholders.[2]

[1] Hereafter to be referred to as SRI (Socially Responsible Investment) funds to distinguish with the broader field of RI.

[2] Gillan and Starks (2006) provide a framework for understanding all the issues researched in corporate governance. Issues include managerial incentives (e.g. equity-based stock options), capital structure (e.g. debt as a disciplinary mechanism), bylaw and charter provisions (e.g. poison pills, shareholder rights plans), internal control (Internal governance), law/regulation (relationship between governance, law, and finance), ownership structure and corporate governance, capital markets information, and services markets.

The fund context differs from a firm context in that a fund's shareholders are also its clients. As such, one can think of governance in a fund context as related to the fund manager's *fiduciary duty* to provide the best returns for its clients. In a fund management context, the most widely studied forms of governance include mechanisms for share redemption, fund management fees, and board composition and their relationships to performance (Del Guercio et al., 2003; Tufano & Sevick, 1997). By exercising a redemption of shares, shareholders deprive the managers of control on the assets, which can be perceived as a partial liquidation or takeover. The repricing of the securities on the capital market provides a signal about the performance of the agent's decisions (Fama & Jensen, 1983). The management fee can serve as a measure of board effectiveness in that higher fees provide evidence of an ineffective board (Del Guercio et al., 2003; Tufano & Sevick, 1997). Finally, the board of the directors are able to oversee issues such as fraud that share redemption cannot address. Similar to corporate governance mechanisms, having such fund governance mechanisms in place may serve as a signal for the propensity of the asset manager to make optimal investment decisions for its portfolio. It may also play a role in the fund's attractiveness to investors. Wellman and Zhou (2007) found that investors pull money out of poorly governed funds in order to invest in funds with effective governance. Chou, Ng, and Wang (2007) show that funds with better governance tend to have better performance and larger total net asset values.

Less attention has been paid towards governance mechanisms which relate to non-financial issues, and in particular, sustainability issues. As such, the current conception of governance has limited power in explaining the alignment of the agent's control over sustainability-related decisions which may have a significant impact on value and consequently, on shareholder returns. This is an important neglect given that several studies in the accounting literatures have argued that governance factors related to

sustainability such as disclosure, activism, and research may have financial consequences, highlighting the need to further examine these facets of governance. These studies, however, have been mostly limited to a firm level and to the best of our knowledge, none have so far focused on a fund level.

Using a dataset of all known European SRI mutual funds with data provided by Vigeo and Morningstar over the nine-year period 2003-2012, we examine whether and how SRI fund governance practices affect fund performance and attractiveness, opportune with the current rapid growth of Responsible Investments. In particular, we examine the financial impact of the following three mechanisms: 1) *sustainability disclosure* (disclosure related to ESG and CBI investment criteria and strategy) 2) *sustainability activism* (using power as a shareholder to improve corporate sustainability practices) and 3) *sustainability research* (having in-depth research practices on ESG and CBI issues). We further extend our analyses to examining governance intensity as a whole. In doing so, we address the following question: *do sustainability governance practices affect financial performance within a fund context?* and provide further evidence of logic assimilation that occurs as asset management firms begin to consider sustainability issues as a new source of financial return. We find that governance practices related to sustainability issues are value-relevant, but that investors are discerning regarding which type of sustainability governance practices should be rewarded (penalized), highlighting the need to consider such practices as part of the overall strategy of a fund.

4.2 Theoretical Context

4.2.1 Sustainability Governance and Financial Performance

4.2.1.1 Sustainability Disclosure and Financial Performance

Disclosure in this paper refers to the public provision of information. It can be mandatory (regulated by law) or voluntary. Voluntary disclosure in the empirical

accounting literature mostly refers to the financial communication which firms provide in addition to mandatory financial reports. Examples of these include management forecasts, press releases, internet sites, and analyst presentations (Healy & Palepu, 2001) which are considered to be relevant in making investment decisions. Previous literature highlights several motives for managers to disclose financial information which is not legally required (cf. Botosan & Plumlee, 2002 for a review). Healy & Palepu (2001) argue that managers who anticipate making capital market transactions have incentives to voluntarily provide information to their potential investors in order to reduce the information asymmetry problem and so reduce the cost of external financing (cost of capital). Essentially, providing more information should increase the investment's attractiveness to investors and this reduction in the cost of capital will lead to an increase in firm value. Similarly, studies have found a positive association between voluntary financial disclosure and stock returns due to increased stock price *informativeness* – or the ability of current stock prices to contain better information about future earnings changes (Gelb & Zarowin, 2002; Healy, Hutton, & Palepu, 1999). Conversely, Ge and Zheng (2006) argue that funds with higher stock turnover, higher expenses ratio, and a higher likelihood to commit a fraud disclose less frequently. It is thus expected that firms with positive information will have every incentive to disclose this information given that investors will interpret non-disclosure as a firm's trying to hide negative information.

Increasingly, studies have began to extend this idea when looking at voluntary non-financial communication of firms related to sustainability, such as environmental (Blacconiere & Northcut, 1997; Blacconiere & Patten, 1994) and Corporate Social Responsibility (CSR) (Dhaliwal et al., 2011; Richardson & Welker, 2001) reporting. Patten (1990) argues that investors might use sustainability information in making investment decisions for two reasons.

First, sustainability information may be used as a surrogate for other information, such as a firm's stakeholder relationships. Stakeholder theory argues that if legitimate interests exist apart from financial interests of shareholders, relationships with these stakeholders will largely affect firm value. That is, firms with poor stakeholder relations are more risky and susceptible to crises and better relations with stakeholders increases financial performance (Donaldson & Preston, 1995; Freeman, 2010). Several firm-level studies have shown that firms engaging in Corporate Social Responsibility (CSR) practices may reduce the risk inherent in a firm's operations as a result of external or internal factors that can affect a firm's profitability (Jo & Na, 2012). Lee & Faff (2009) argue that the activities of leading CSP firms are likely to have a downward influence on their idiosyncratic risk. The authors say that for instance, this lower risk can happen because these firms have happier, more stable employees, lower fines, and good production levels. In a meta-analysis of 52 quantitative studies on the relationship between corporate social performance (a proxy for stakeholder relations) and financial performance published from 1970 to 2002, Orlitzky, Schmidt, & Rynes (2003) find that the two are positively correlated.

Second, social responsibility information may serve as a measure of potential public or regulatory sanctions against firms. Spicer (1978) speculates that "when severe and costly sanctions are invoked, the expected economic impact on the affected corporation may be sufficient to induce a direct relationship between its social performance on certain key issues and the worth of its securities." Godfrey, Merrill, & Hansen (2009) illustrate how some types of CSR activities can create goodwill and provide 'insurance-like' protection. By measuring the volatility in stock returns during specific negative events, the authors find that when a firm suffers a negative event, it is less likely to be financially penalized by its shareholders if it has had good CSR practices in the past. Sharfman and Fernando (2008) suggest that improved environmental risk

management can lead to a reduction of cost of equity capital, an outcome of reduced firm risk, because such firms can benefit from tax regimes and avoid penalization during environmental disasters.

These studies essentially provide us with two strong assumptions: (1) that better sustainability performance is positively related to better financial performance due to improved stakeholder relationships and a decreased risk of regulatory sanctions and (2) that better sustainability performance will lead to increased disclosure since firms are incentivized for doing so given that investors value sustainability information. These assumptions are intuitive. Suppose you have a firm that puts in place an energy plan which is likely to improve efficiency and reduce costs. The firm would want to disclose this information because doing so will boost its share price since the market believes it will perform well in the future. If they do not disclose this information, they will not get this extra reward priced-in. Indeed, empirical tests support this notion: Blacconiere and Patten (1994) find that increased disclosure can provide information about the effect of future regulatory costs on firm value. An absence of extensive environmental disclosures is posited to be a negative signal concerning the firm's exposure to environmental risk and future regulatory costs. They found that firms with more extensive environmental disclosures in their financial reports experienced a less negative market reaction to the Bhopal chemical leak. Similarly, Blacconiere (1997) found that firms with more extensive environmental disclosures in their financial reports experienced a less negative market reaction to the legislative events leading to the Superfund Amendments and Reauthorization Act of 1986.

In the case of SRI funds, disclosure or non-disclosure of sustainability information provides an indication of the overall level of the stakeholder relationships and regulatory risks of its investee firms, thereby acting as a proxy for the sustainability performance of firms. Given that a fund having positive information is more likely to

disclose this information, an SRI fund which provides information about the sustainability practices of its investee firms signals a high level of sustainability performance of its investee firms. If the relationship between sustainability and financial performance is positive, then the disclosure of sustainability information should have a positive relationship with financial performance.

However, if disclosing sustainability information were undoubtedly positive for financial performance, then all SRI managers would simply disclose all available information. What we observe in practice, however, is that fund managers exercise discretion in disclosure. The proprietary cost hypothesis posits that the reason for this is that firms are reluctant to disclose information due to a concern that such a decision may damage their competitive position in product markets (cf. Darrough, 1993; Gigler, 1994; Verrecchia, 1983; Wagenhofer, 1990). A fund's competitors may imitate its strategy if it is a successful product, may withdraw the strategy if it was unsuccessful, or may use the information to come up with retaliation strategies. An alternative explanation for this is in signaling theory (Akerlof, 1970; Spence, 1973) wherein a firm may limit its disclosure in order to mislead shareholders on its true sustainability performance. As such, when a bad event occurs, a firm will be able to mitigate shareholder pressure. This illustrates that by *not* limiting disclosure, shareholder reaction might be even worse than with limited disclosure. To wit, in some cases, voluntary disclosure may also be detrimental to firm value. Hence, a manager exercises discretion in the *type* of information he discloses, such that not all types of disclosure is considered beneficial. We thus argue that the positive effect of sustainability disclosure will be conditioned by the extent to which this imposes a proprietary cost. This is especially the case for an SRI fund for which its investment process of selecting investee firms based on sustainability characteristics forms a key part of its strategy. Indeed, an SRI fund is under much more scrutiny from investors with a social concern as compared to most firms for whom a sustainability identity is of

secondary importance. As such, disclosing too much information on how it selects and analyzes its investee firms will lead to competitors following this strategy and ultimately have a negative impact on performance. That is, there is a limit to the type of disclosure that is beneficial for an SRI fund.

We thus posit that there is a positive relationship between financial performance and the disclosure of *SRI criteria* – the list of ESG and CBI criteria it uses in including or eliminating investee firm – wherein a fund is able to signal its investee firms' positive sustainability performance without providing too much information that can affect its competitive position whereas disclosing the *SRI strategy* – details on how a fund selects and analyzes its investee firms – will impose a proprietary cost and have an overall negative relationship with financial performance:

H1a: Disclosure of SRI criteria is positively related to fund performance.

H1b: Disclosure of SRI strategy is negatively related to fund performance.

4.2.1.2 Sustainability Activism and Financial Performance

Shareholder activism is a broad term which represents a continuum of shareholder responses to corporate performance. It is a highly relevant component of governance because it provides shareholders with a monitoring role and related mechanisms, particularly when they are dissatisfied with the actions of the board of directors to whom they have entrusted control. The most common definition is that of an investor who tries to change the status quo through 'voice' *without* a change in control of the firm (Gillan & Starks, 1998). Historically, the primary emphasis of investor activist shareholders was to focus on poorly performing firms in their portfolio, pressuring the management of such firms to improve financial performance, usually through changes in corporate governance structures such as the repeal of antitakeover amendments, changes in voting rules, and increased board independence (Gillan & Starks, 2000).

Reviews of empirical studies on the link between shareholder activism and performance have shown largely conflicting results (cf. Gillan & Starks, 1998; Karpoff, 2001). The consensus in the literature is that there are a number of costs associated with shareholder activism which may not outweigh the benefits. In particular, a 'free-rider' problem arises when a shareholder takes on a costly monitoring role because all shareholders benefit from the actions of the monitoring shareholder without incurring the costs and relationship risks (Becht, Franks, Mayer, & Rossi, 2010). Second, there is a problem of determining whether any organizational changes that do occur are due to the activism or to other political or economic reasons (for example, in a poorly performing firm, restructuring would have been inevitable even without activism). Finally, the authors point out a difficulty in assessing the impact on stock returns. The problem with using short-term stock returns is that it is unclear whether an announcement related to activism is good news because it means that there is increased monitoring, or bad news because it means that the investors could not come to a negotiated agreement with management. In assessing sustainability-related activism, long-term studies of stock returns as well as studies using operating performance are not any clearer. These results are in line with the notion that doing so is harmful to the bottom line since one is incurring too many additional sustainability-related burdens without reaping substantial financial benefits (Friedman, 1970). In the same vein, Renneboog, Terhorst, & Zhang (2008b) do not find evidence of a positive nor negative impact of sustainability activism on financial performance in a dataset of global SRI mutual funds.

We thus posit that engaging in too much sustainability activism – a 'deep' level of activism – will incur additional burdens (Friedman, 1970) that will detract from the bottom line:

H2: Deep sustainability activism is negatively related to fund performance.

4.2.1.3 Sustainability Research and Financial Performance

A key consideration today in RI practice is whether the analysis for sustainability of the firms should be done in-house or should be outsourced to a third-party service provider. Typically, fund managers rely on external research intermediaries, analysts, and brokers for information. However, when a fund outsources information, it faces an agency problem because it has less possibilities to monitor the accuracy of this information. Further, it may lose out on possible externalities produced by in-house research. Having an internal research team provides valuable information for the fund manager and increases his or her depth of knowledge on risk factors.

Through screening, SRI funds are able to have more information than conventional funds related to CSR and other sustainability-related activities of firms, allowing SRI fund managers to better understand which firms will perform better from a financial performance perspective. Through more in-depth and forward-looking information, SRI fund managers are able to better understand the evolution of business models in terms of critical issues on a long-term horizon and make better investment decisions based on a more comprehensive knowledge of investment risks. However, if getting useful information on sustainability issues were simple and straightforward enough, then it could be imagined that all fund managers would immediately start using the available sustainability information in the market, thus eliminating the 'edge' of SRI funds over conventional funds. However, due to the nature of sustainability issues as difficult to measure, there is poor quality of sustainability information available from investee firms and specialist research providers fostering a high level of information asymmetry. Thus, relevant and proprietary sustainability information can have significant value to fund managers, especially in the presence of information asymmetries.

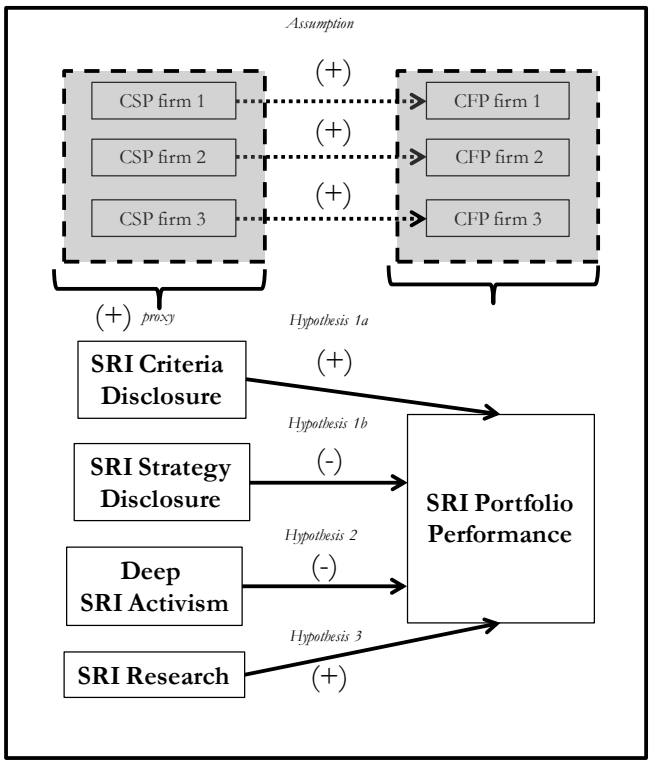
We thus posit that an increased amount of internal specialization, through the development of in-house research skills is likely to have a positive effect on performance.

That is, having an internal research team can allow the fund manager to have more information that increases his selectivity, allowing him to make better investment decisions. This notion is supported by (Renneboog et al., 2008b) who find that funds which have an in-house ESG research team perform better than those who outsource. Hence, we expect that producing internal sustainability research will be positively related to financial performance.

H3: Sustainability research conducted internally is positively related to financial performance.

Figure 4.1 illustrates the above mentioned hypotheses.

Figure 4.1 Underlying Assumptions for Hypotheses H1 to H3



4.2.2 Sustainability Governance and Fund Attractiveness

Additionally, when a fund explicitly labels itself as an SRI fund, it automatically positions itself towards investors that have non-financial (sustainability) concerns, providing it with increased legitimacy to this target set of investors. This is evidenced by the fact that the RI movement continues to grow in spite of inconclusive evidence of a

performance benefit. Indeed, practitioner studies have highlighted the fact that SRI investments are 'stickier' than non-SRI investments during moments of crises. According to a report from the Social Investment Forum which mentions a Lipper study, the first nine months of the 2001 U.S. downturn saw a 94% drop in the dollars investors put into all mutual funds, compared to just a 54% drop for socially screened funds (SIF, 2007). Similarly, from the start of 2007 to the opening of 2010, a three-year period when broad market indices such as the S&P 500 declined and the broader universe of professionally managed assets increased less than 1 percent, SRI assets in the U.S. increased by more than 13 percent (SIF, 2007).

The theoretical argument in support of this can be traced to the idea that individuals make decisions based on cognitive limitations of their minds (cf. Simon, 1955) and through framing (Kahneman & Tversky, 1979, 1984; Statman & Caldwell, 1987). Individuals may willingly choose immaterial utility such as happiness or satisfaction gained from moral considerations within their utility maximization (Beal et al., 2005; Gao & Schmidt, 2005). These behavioral studies form much of the research on why investors deviate from the value maximizing principle and incorporate other decision variables (such as extra-financial variables) into their investment decisions. For instance, Nilsson (2007) found that apart from financial return, Social, Environmental, and Ethical issues are important determinants of investment while Lewis and Juravle (2009) found that investors are driven by a wide range of values. Other studies have found that having a negative ethical stance toward the stock market is a significant negative predictor of willingness to invest in stocks (Keller & Siegrist, 2006), that holding profit constant, people are willing to pay more for moral shares (Hofmann et al., 2007) or accept lower financial returns for their investments in exchange for positive social returns (Glac, 2008), and that the strength of investors' personal values is important in determining their investment choices (Pasewark & Riley, 2009).

Related to this, displaying commitment to sustainability is positive for the legitimacy of the SRI fund if its clients value such moral attributes. A sociological perspective of organizations posits that organizations tend to conform to norms in order to gain legitimacy in their field (DiMaggio & Powell, 1983; Lounsbury, 2001). With the onset of sustainability as a strategy that may increase firm legitimacy, organizations will engage in sustainability to be part of the norm and to not lose its reputation (Philippe & Durand, 2011).

4.2.2.1 Sustainability Disclosure and Fund Attractiveness

The disclosure of SRI criteria is a way of signaling that a fund is 'truly' an SRI fund and not 'greenwashing' – or merely engaging in symbolic rather than substantial SRI – and should lead to its being more attractive to SRI investors. Indeed, sustainability disclosure could represent higher commitment to better stakeholder relationships, which would translate to increased fund attractiveness if stakeholders support sustainable firms (Mitchell, Agle, & Wood, 1997). However, given that investors maintain a concern for financial performance, they will be wary to reward an SRI fund whose strategy can be easily replicated and would lose its competitive advantage in the long term. Concerned that too much disclosure can be detrimental to fund performance, such investors will tend to pull out their money from such funds. We thus posit the below:

H4a: Disclosure of SRI criteria is positively related to fund attractiveness.

H4d: Disclosure of SRI strategy is negatively related to fund attractiveness.

4.2.2.2 Sustainability Activism and Fund Attractiveness

As is evident in the signatories to the PRI, the RI movement in Europe is strongly driven by asset owners (clients) such as pension funds with a strong social contract and political agenda. As the financial industry started to become pressured to become more transparent, these investors – oftentimes having the obligation to make

public statements on their investment policies – have increasingly included questions on how sustainability issues are taken into consideration in the investment processes of asset managers when making requests for proposals (RFPs). Because these clients are driving demand due to moral considerations and have a reputational benefit to gain, it is expected that these types of investors will tend to support SRI funds even when they are underperforming; that is, they will not easily sell their shares in funds whose sustainability strategy they are advocates of. In addition to this, the fact that RI is long-term oriented provides asset managers with a longer timeframe on which to be measured; hence, clients take longer to pull-out of bad performing funds.

Indeed, in spite of the ambiguity of the relationship between shareholder activism and financial performance, it is surprising to note that the amount of shareholder activism relating to sustainability issues continues to increase. Institutional investors – driven by recent issues such as the British Petroleum oil spill – have become increasingly concerned with sustainability risks which carry a potential value impact. The U.S. Social Investment Forum reports an increase in the number of shareholder resolutions on ESG issues in 2010, which usually receive the support of more than 30% of the votes, particularly for issues addressing climate change and environmental risks, reporting on sustainability, and ensuring fair employment practices. This activism is further propelled by institutional demands: for instance, the requirements of the Principles for Responsible Investment (PRI) whose Principle 2 states: "We will be active owners and incorporate ESG issues into our ownership policies and practices."[3] Investors – and especially Responsible Investors – are also under pressure to change the ways in which they perform activism, favoring dialogue over submitting shareholder proposals (Gillan

[3] Possible actions for this principle include the exercise of voting rights or monitoring compliance with voting policy, developing an engagement capability, participating in the development of policy, regulation, and standard setting, filing shareholder resolutions consistent with long-term ESG considerations, engaging with companies on ESG issues, participating in collaborative engagement initiatives, and asking investment managers to undertake and report on ESG-related engagement (taken from UNPRI website: http://www.unpri.org/).

& Starks, 1998). Further, they act more and more collectively through associations such as the Institutional Investors' Group on Climate Change, the Pharmaceutical Shareowner Group, and the Carbon Disclosure Project, in addition to the PRI. It is likely that these investors are under institutional pressures to do so, the compliance (non-compliance) of which may increase (decrease) their legitimacy and consequently, the fund's attractiveness to their clients.

H5: Deep sustainability activism is positively related to fund attractiveness

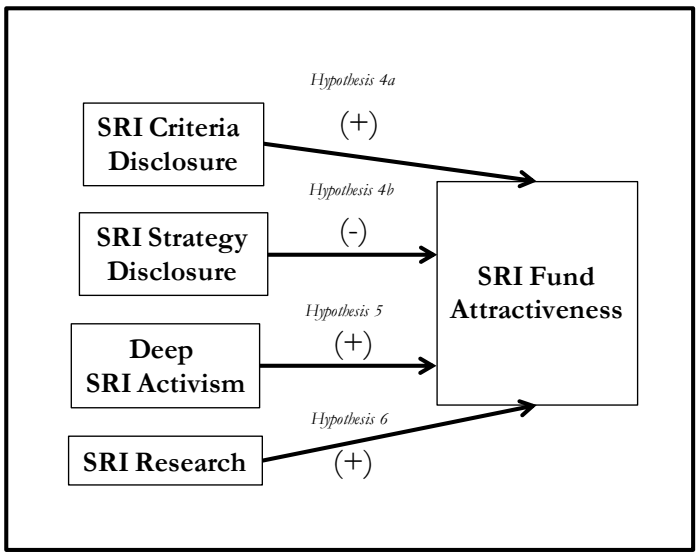
4.2.2.3 Sustainability Research and Fund Attractiveness

Further, we expect that having a structured internal team displays a real commitment of a fund to SRI and provides an important signal of legitimacy for an SRI fund, which should be positively related to its fund attractiveness to its target set of investors. Thus, we posit:

H6: Sustainability research conducted internally is positively related to fund attractiveness.

Figure 4.2 illustrates the above mentioned hypotheses.

Figure 4.2 Underlying Assumptions for Hypotheses H4 to H6



4.3 Empirical Design

4.3.1 Dataset

We test our hypotheses on a dataset of European SRI Mutual funds that employ screening practices. That is, apart from their usual investment strategy, these funds use screening mechanisms, or the selection of investee firms based on pre-defined ESG and CBI criteria. By focusing on a dataset of SRI funds, we are able to minimize the issue of confounding effects which plagues other studies of SRI versus non-SRI funds (Barnett & Salomon, 2006). Further, by concentrating on one particular practice – that of screening, we avoid the problem of heterogeneity in RI practices and definitions. Given that 38% and 7% of all RI assets in Europe are negatively and positively screened, respectively (Eurosif, 2010), screening funds form an important sub-group of Responsible Investment.

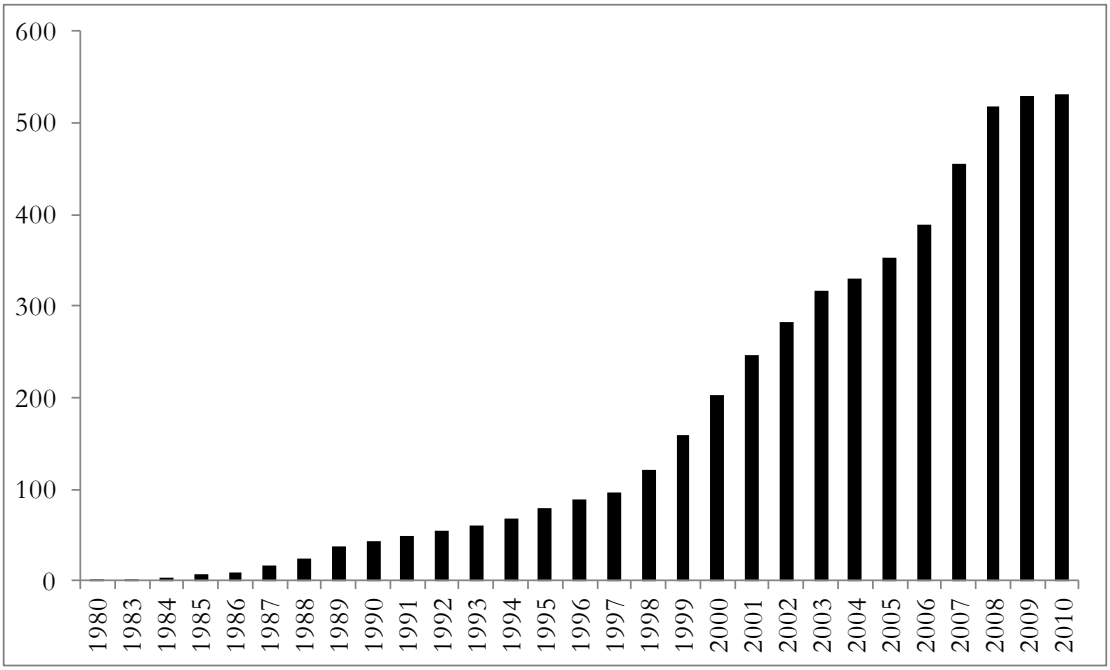
The dataset is manually constructed using a primary list of 529 SRI Mutual Funds domiciled in Europe as identified by The European Social Investment Forum (Eurosif). Of these funds, information on the fund governance criteria is provided by Avanzi[4] but is not available for all the funds. To ensure homogeneity, we focus mainly on equity funds by eliminating funds that identified themselves by name as bond funds as well as those with more than 85% of their assets as non-equity. This focus on equity mutual funds is in line with previous studies (Lee et al., 2010; Renneboog et al., 2008b). Further, we eliminated funds which had more than 80% of their assets invested outside of Europe. The data was then adjusted for outliers and errors relating to fund age, fund manager years, and net asset value. Finally, funds engaged in short-selling were eliminated. Ultimately, we reach a final unbalanced panel of 88 European SRI screening mutual funds invested mainly in equities.

[4] Acquired in 2006 by Vigeo.

Historical data is provided by Morningstar and includes: monthly fund returns, monthly net asset values, domicile, fund age, sectors, geographies, and securities splits, as well as Morningstar investment styles from December 2002, the earliest available date of complete coverage, to March 2012. I focus on the 9-year period of April 2003 to March 2012, separating these into three periods of April 2003 to March 2006 ("Period 1"), April 2006 to March 2009 ("Period 2"), and April 2009 to March 2012 ("Period 3"). Informally, Period 2 captures the U.S. mortgage crisis and Period 3 captures the European debt crisis. This brings the total number of observations for monthly fund returns at 9,504 (108 months x 88 funds). Finally, data for the Fama-French and Carhart factors for European equities are obtained from the online Kenneth French Data Library. Table 4.1 summarizes the sources and uses of data.

Figure 4.3 illustrates the growth of SRI funds based on the inception dates of the original sample of 529 funds. The figure shows that the SRI boom happened in the late '90's. As such, the final panel we take focuses on a more recent time period of high but rather stable growth and captures the period of the current financial crisis, which has not been previously examined in the literature. The dataset is unique compared to previous studies in that it is focused on Europe, the most relevant geography for Responsible Investment. This dataset is the most complete European dataset to the best my knowledge.

Figure 4.3 Number of European SRI Funds Per Year Based on Inception Date (Total Initial Sample) adapted from Morningstar Data



4.3.2 Variables

4.3.2.1 Independent variables

To measure fund governance, we use each fund governance criteria as the independent variables (1 if the criteria was implemented, 0 otherwise). The Avanzi database provides 13 governance criteria. The criteria (provided in Table 4.2) are then categorized into three broader areas, namely Disclosure (4 criteria), Activism (7 criteria), and Research (either outsourced, partly internal, and fully internal). Of the Disclosure variables, *SRI Criteria* (which merges disclosure of criteria and disclosure of changes in criteria) relates to our conception of low sustainability disclosure wherein general information of a fund's practices is provided by the fund to its clients but this information is not highly detrimental to its competitive position. The variable *Strategy*, on the other hand, relates to a high level of sustainability disclosure wherein the type of information provided is much more specific and potentially detrimental to its competitive position. In terms of sustainability activism, we assume that a deeper amount

of sustainability activism such as through the provision of SEE profiles translates to higher related additional burdens and costs. In terms of research, the variable *Fully* relates to whether a fund does the sustainability research in-house and represents an increased amount of informational benefits for the fund. *Governance Intensity* is the total number of variables implemented (from 0 to 14).[5]

The information on governance criteria is the outcome of a long-term evaluation process and thus has not changed over time. In line with the notion that RI funds examine more long-term, sustainability issues, it is useful to understand governance criteria as long-term governance practices of a fund rather than ones that frequently change. Given that the funds in the dataset can be considered to be quite young with a mean age of 8.5 years, we assume that these governance practices have not changed dramatically.

4.3.2.2 Fund Performance Dependent Variables

We would like to test the relationship between Governance criteria and the dependent variable Performance, using measures of Risk Adjusted Performance (RAP), Fama-French model alphas (Fama & French, 1993), Carhart model alphas (Carhart, 1997), Sharpe, and Information ratios.

We construct the monthly RAP using the CAPM methodology (cf. Sharpe, 1964) in line with Barnett & Salomon (2006) wherein RAP is defined as the average monthly return, measured as the percentage change in a fund's market value from the beginning to the end of a given month, adjusted by the fund's specific beta. It is the fund's return over and above what is expected based upon its beta. Specifically:

$$RAP_{it} = (R_{it} - Rf_t) - \beta_i * (Rm_t - Rf_t)$$

[5] The total of 14 is derived from 4 for disclosure, 7 for activism, and then we separate the type of research by adding 1 for partially internal research and 2 for fully internal research.

where *R* is the return on fund *i* in month *t; Rf* is the risk-free rate of return in month *t*, in this case, the historical monthly returns of the 6-month German treasury bond; *Rm* is the return on the market portfolio in month *t*, in this case, the historical monthly returns of the MSCI Europe Index; and β is the beta of fund *i*, in this case calculated as a regression from returns on the market index. Following Lee et al. (2010), we use a moving 3-year beta to address the significant time variation in beta estimates and to make it better aligned with the 3-year minimum investment horizon typically required for equity funds. We then compute annualized RAPs for 3 periods of 3 years. As cross-checks, we also perform cross-sectional regressions on average unadjusted returns as well as on average RAP across the total period, and sensitize using a static beta over the 9-year period. The results are similar and are not presented here.

The Fama-French and Carhart alphas (a measure of abnormal return) are the intercept terms (*aFF* and *aCarhart*, respectively) for fund *i* in month *t* from the following Ordinary Least Squares regression equations:

$$R_{it}\text{-}Rf_t = aFF_{it} + \beta 1*Mkt_t + \beta 2*SMB_t + \beta 3*HML_t + \varepsilon_{it}$$

$$R_{it}\text{-}Rf_t = aCarhart_{it} + \beta 1*Mkt_t + \beta 2*SMB_t + \beta 3*HML_t + \beta 4*WML_t + \varepsilon_{it}$$

where *R* and *Rf* are as described above; *Mkt* is excess return on the market, *SMB* ("Small minus Big") is the return on the mimicking size portfolio, *HML* ("High minus Low") is the return on the mimicking book-to-market portfolio and *WML* ("Winners minus Losers") is the return on the mimicking momentum factor. Similar to RAP, we then compute annualized alphas for the 3-year periods.

4.3.2.3 Fund Performance Control Variables

The control variables used are similar to those of Barnett & Salomon (2006) and are typically employed in studying mutual funds. *Fund age* is the number of years since the

inception of the fund, which addresses the learning effect of SRI funds (Bauer et al., 2005). *Fund size* has also been found to affect fund performance (Chen et al., 2004). Investments in *Equity* are typically associated with higher levels of performance (Wermers, 2002). Given that firm risks are significantly affected by its industry association (Jo & Na, 2012), we control for sector differences as well as geographical differences. We also control for the fact that a fund's strategy affects its performance and include the investment styles of Morningstar (Small growth, Small blend, Small Value, Mid-growth, Mid-blend, Mid-value, Large growth, Large blend, and Large value). This addresses the need to disentangle the effect of sustainability performance of the investee firms from the fund manager's performance (Lee & Faff, 2009). Finally, we include period fixed effects dummies to control for the time variation. Each period dummy is the difference in the conditional expected value of the dependent variable between the base year t=1 and the year t=j.

4.3.2.4 Fund Performance and Governance Equation

The performance equation is estimated as an unbalanced pooled cross-sectional regression:

$$Performance_{it} = a_{it} + \beta 1*[Governance\ Variables]_i + \beta 2*Fundage_{it} + \beta 3*Size_{it} + \beta 4*Europe_{it} + \beta 5*[Sector\ Variables_{it}] + \beta 6*[Equities_{it}] + [Investment\ Style_i] + [Period\ fixed\ effects] + \varepsilon_{it}$$

where *Perfromance* is the 3-year annualized performance measure for fund *i* in period *t, Governance Variables* include the Disclosure, Activism, and Research criteria or the total number of governance variables *(Governance Intensity)* for fund *i*, *Fundage* is the number of months since inception of fund *i* at the beginning of period *t*, *Size* is the standardized average 3-year net asset value in Euros of fund *i*, *Europe* is the average 3-year percentage of investments in Europe, *Sector Variables* are the average 3-year

percentage of investments in the Financial Services, Healthcare, Real Estate, Energy & Utilities, Information, and Manufacturing sectors, *Equities* is the average 3-year percentage of investments in Equities, and *Investment Style* relates to the Morningstar investment styles. When the performance measure is the Fama-French and Carhart alpha, the alpha of each fund is first calculated over each non-overlapping 3-year period for each fund, annualized and then used as the dependent variable in the performance equation.

4.3.2.5 Fund Attractiveness Dependent Variables

To determine whether governance practices related to sustainability impact the attractiveness of the fund to investors, we calculate fund flow sensitivity as the dependent variable for 3 periods of 3 years. This is the variation in percentage of the fund size due to the money inflow or outflow. We were provided with monthly fund size by Morningstar[6]. We follow Qian (2006) and Renneboog, Ter Horst, & Zhang (Renneboog et al., 2008b) and define the growth rate of the fund size beyond asset appreciation – flow – as follows:[7]

$$Flow_{i,t} = \frac{(TNA_{i,t} - TNA_{i,t-1} * (1 + R_{i,t}))}{TNA_{i,t-1}}$$

where *TNA* is the total net assets of fund *i* in month *t* and *R* is the return of fund *i* in month *t*. We use both *RAP* and unadjusted returns as *R*, noting that investors consider excess returns rather than risk adjusted performance (Del Guercio & Tkac, 2002; Ippolito, 1992).

[6] We were provided with two types of information which we merged to reduce the number of missing data. *Raw fund size* is sourced directly from fund companies and includes both public and non-public share classes and *Fund size estimated* is the sum of all share-class TNAs for a given fund at the end of a given month. In general, raw fund size is more accurate than fund size estimated and we used the former where available.

[7] We assume that new money is invested at the end of each month.

4.3.2.6 Fund Attractiveness and Governance Equation

Following Qian (2006), we control for past fund returns, fund fees, and investment style, which have been previously shown to affect money flow and estimate the below equation:

$$Flow_{it} = a_{it} + \beta 1*[Governance\ Variables]_i + \beta 2*[Fund\ Past\ Return_{i,t}] + \beta 3*Fund\ fee_i + \beta 4*[Investment\ Style_i] + \varepsilon_{it}$$

The *Fund Past Return* is composed of the average monthly cumulative return of fund i at the end of each period and of the square value of this return.[8]

Due to the fact that the relationship of the dependent variable and at least some of the explanatory variables is constant over time (i.e. our main independent variable *Governance Variables* is not time-varying), we chose to use a pooled cross-sectional analysis for all equations which combines time-series regressions for several cross-sections. This is also useful to increase the number of observations and to solve the imbalance between the number of explanatory variables and the number of firms.

All models are run, checked, and corrected for normality and heteroskedasticity using Stata software. Following Lee et al. (2010), weighted least squares with robust standard errors was used to estimate the Fama-French and Carhart equations using the reciprocal of the residuals as the weights and Ordinary least squares with robust standard errors was used for all other equations. Table 4.3 summarizes the list and operationalization of variables.

[8] The convex relationship in the mutual fund industry between the flow and performance motivates a quadratic term in the regression (Sirri & Tufano, 1998).

4.4 Results

4.4.1 Descriptive analysis

The funds are domiciled in 13 European Countries with the majority of the funds coming from the United Kingdom (23.83%) and Luxembourg (22.73%). The mean age of the funds is 8.7 years old, with the oldest fund starting at January 1987 and the youngest November 2009. The fund size, as represented by net asset value, is highly fragmented ranging from 0,48 million Euros to 1,409 million Euros. As expected, the majority of the funds' investments are in Europe (73.17%) with the second largest geography being the U.S. A majority of investments (85.28%) are in equities of which the largest percentage is in the Manufacturing sector (42.01%).

Tables 4.5a and 4.5b presents the correlation matrix and Table 4.6 presents these descriptive statistics in detail. The funds implement on average 7.8 out of 13 governance criteria. In referring to Table 4.2, a large proportion of funds in the sample have a high sustainability disclosure policy towards their clients. A majority of the funds (89.77%) disclose the SRI criteria used to build the portfolio. More than 76% of the funds disclose the sources and methods used to acquire information about the level of sustainability of the companies included in its portfolio. Hence, more than the two-thirds of the funds disclose information related to strategy. In terms of disclosure intensity, funds apply 3 criteria out of 4 on average. In terms of activism intensity, funds apply 3.7 criteria out of 7 on average. Finally, the variable research corresponds to three levels of ESG analysis performed internally namely 'fully', 'partly', and 'outsourced'. The division is split almost equally amongst the three categories.

4.4.2 Sustainability Governance and Financial Performance Results

4.4.2.1 Sustainability Disclosure and Financial Performance Results

Table 4.7 presents the results for the governance variables and performance for the pooled cross sectional model spanning 9 years. We find that the provision of details about the SRI criteria used to select the portfolio and the provision of information relating to changes in the criteria (*Criteria*), is significantly positively related to performance at a 5% level in the Fama French and Carhart models but has no significant relationship with other measures of performance. These findings moderately support *H1a: Disclosure related to sustainability investment criteria is positively related to fund performance.* However, we find no evidence that too much disclosure *(Strategy)* is harmful to performance and reject *H1b: Disclosure related to sustainability investment strategy is negatively related to fund performance.*

4.4.2.2 Sustainability Activism and Financial Performance Results

We find that providing information on its social, environmental, and ethical profile (*SEE Info*) is significantly negatively related to performance at a 1% level for the RAP model, but not for all other measures of performance, leading us to only weakly accept *H2: Deep sustainability activism is negatively related to fund performance.* Additionally, we find that doing CSR resolutions is negative and significant for the RAP models at a 10% level. We do not find any significant recurring results for other types of sustainability activism.

4.4.2.3 Sustainability Research and Financial Performance Results

We do not find support for *H3: Non-financial research conducted internally is positively related to financial performance.*

4.4.3 Sustainability Governance and Fund Attractiveness Results

4.4.3.1 Sustainability Disclosure and Fund Attractiveness Results

When we peruse Panel B of Table 4.8, we do not find evidence that the disclosure of SRI criteria is positively related to fund attractiveness. We do find however, that disclosing SRI strategy is significantly negatively related to fund attractiveness at a 5% level for all three models of unadjusted returns. We thus reject *H4a: Disclosure related to sustainability investment criteria is positively related to fund attractiveness* and accept *H4b: Disclosure related to sustainability investment strategy is negatively related to fund attractiveness.*

4.4.3.2 Sustainability Activism and Fund Attractiveness Results

We find interesting results when looking at fund attractiveness. Contrary to our hypothesis, we find that SEE Info is significantly *negatively* related to fund attractiveness at a 1% level for all three models. Further, we find that *Write Concerns* is significantly positively related to fund attractiveness at a 1% level for all three models whereas CSR Resolutions is significantly negatively related to fund attractiveness at least at a 10% level. As such, we strongly reject *H5: Deep sustainability activism is positively related to fund attractiveness.*

In our attempt to understand such results as contradictory to our hypothesis, we find that there is a significant difference between the average fees of the funds which apply the *SEE Info* criterion and those which do not. The estimate mean difference is equal to 0.0023 and is superior to zero at the 5% level. This finding lends support to the argument that funds sending their SEE profile to their investee firms (i.e. have a high level of shareholder activism) ask for higher fees from their clients.

4.4.3.3 Sustainability Research and Fund Attractiveness Results

We find moderate support for a significantly positive relationship between fully internalizing research and fund attractiveness at a 5% level for Model 1 and at a 10%

level for Model 2, supporting *H6: Non-financial research conducted internally is positively related to fund attractiveness.*

4.4.4 Governance Intensity, Performance, and Fund Attractiveness

While we did not motivate any hypotheses, we test the relationships between governance intensity and performance and between governance intensity and fund attractiveness. Governance intensity is significantly negatively related to performance at a 1% level for the RAP and Sharpe models and at a 5% level for the Information ratio model. We find a curvilinear (negative and convex) relationship for the RAP, Fama French and Carhart models at a 5% level.

Interestingly, while an increase in governance is negatively related to performance, we find that it is significantly positively related to fund attractiveness at least at a 5% level. Thus, we support the notion that an increase in fund flows will not simply depend on past performance but also on the sustainability governance practices of the fund.

Finally, we find that being invested in Equities and Europe was performance-increasing, whereas being invested in the manufacturing sector and healthcare was negative for performance. Period 2 shows a highly significant negative effect and period 3, a highly significant positive effect. In terms of fund attractiveness, cumulative past returns and fees play a significant role in the level of attractiveness. These findings are all in line with expectations and previous research.

Table 4.1 Sources and Uses of Data

Data	Uses	Source
Initial list from Eurosif	529 funds	Taken from http://www.eurosif.org/
Historical data coverage from Morningstar	April 2003 to March 2012 (108 months)	Data provided to the researcher by Morningstar
Funds for which governance criteria from Avanzi available	263 funds	Data provided to the researcher by Avanzi
Final number after adjustments for outliers	88 funds	
Historical data for Fama French and Carhart models	April 2003 to March 2012 (108 months)	Taken from Kenneth French website: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html/
Historical data for Market return (MSCI Europe Index)	April 2003 to March 2012 (108 months)	Taken from MSCI Europe website: http://www.mscibarra.com/products/indices/international_equity_indices/gimi/stdindex/performance.html/
Historical data for Risk Free rate	April 2003 to March 2012 (108 months)	Taken from Bundesbank website: http://www.bundesbank.de/Navigation/EN/Statistics/Time_series_databases/Macro_economic_time_series/its_details_value_node.html?tsId=BBK01.WZ9807&listId=www_s140_it03a/
Total monthly fund return observations (88 funds x 108 months)	9,504 observations	

Table 4.2 Governance Criteria provided by Avanzi

Categories	Criteria	Definition	% of funds with criteria
Disclosure	Change Portfolio	Fund provides information about changes in its portfolio, explaining why companies have been admitted/excluded	67.05
	Strategy	Fund discloses sources and methods used to acquire information about the degree of sustainability	76.14
	Criteria		89.77
	SRI Criteria	Fund provides clients with details of SRI criteria used to select its portfolio	88.64
	Change Criteria	Fund informs clients about changes in SRI criteria	85.23
Activism	Decisions	Companies are regularly informed about the fund's decisions	65.91
	SEE Information	Ethical/Socio-environmental profiles sent to screened companies	62.50
	CSR Issues	Fund manager/analysts include Corporate Social Responsibility (CSR) issues in routine meetings	64.77
	Write Concerns	Fund manager has written to companies about issues of concern in the last 12m	59.10
	Special Meetings	Fund manager has arranged special meetings with companies in the last 12m	61.36
	Press	Fund manager released press briefings and statements in the last 12m	47.73
	CSR Resolutions	Fund manager proposed CSR related resolution in the last 12m	15.91
Research	Full Analysis	Fund manager fully performs environmental and social analysis	32.95
	Partial Analysis	Fund manager partially performs environmental and social analysis	39.77
	Outsourced	Fund manager outsources environmental and social analysis	27.27

Table 4.3 List of Variables

Variable	Operationalization
	Independent Variables
Governance Intensity	Total number of governance screens
Disclosure Variables	Includes binary variables related to disclosure
Activism Variables	Includes binary variables related to activism
Research Variables	Includes binary variables related to research
	Measures of Fund Attractiveness
Fund Flow	Flow of the assets using 3-month, 6-month, and 12-month cumulative returns
	Measures of Performance
RAP (1)	Annualized Risk Adjusted performance for each non-overlapping 3-year period
FF Alpha	Alpha from the Fama-French model annualized for each non-overlapping 3-year period
Car Alpha	Alpha from the Carhart model annualized for each non-overlapping 3-year period
Sharpe (2)	Sharpe ratio
InfoR (3)	Information ratio
	Control Variables
NAV	Average of Net asset value in euros at the end of the month for each non-overlapping 3-year period
FundAge	Number of months since inception at the end of each non-overlapping 3-year period
% equity	Average %equity at the end of the month for each non-overlapping 3-year period
%Europe	Average % of equity invested in Europe at the end of the month for each non-overlapping 3-year period
%FinServ	% of equity invested in Financial Services at the end of the month
%Healthcare	% of equity invested in Healthcare at the end of the month
%RealEstate	% of equity invested in Real Estate at the end of the month
%EnergyUtilities	% of equity invested in Energy and Utilities at the end of the month
%Info	% of equity invested in Technology and Communication Services at the end of the month
%Mfg	% of equity invested in Basic Materials, Consumer (Cyclical), Consumer (Defensive), and Industrials at the end of the month
MSCat	Morningstar Investment Styles

(1) **First take geometric product of monthly returns. Then: 3y annualized return is [(RAP3yTotal)^(1/3)]-1
(2) Sharpe ratio: Take Rfund-Rf, average then Sharpe=Average return/Std. Dev of excess return
(3) Information ratio for period 1. Information ratio: Take Rfund-RmMSCI, average then Info=Average return/Std. Dev of excess return

Table 4.4 Distribution of funds according to domicile and MS category

Domicile	%	MS Category	%
Austria	5.7%	Small growth	0.0%
Belgium	8.0%	Small blend	0.8%
France	9.1%	Small value	0.0%
Germany	5.7%	Mid-growth	8.3%
Italy	3.4%	Mid-blend	9.5%
Luxembourg	22.7%	Mid-value	0.0%
Netherlands	4.6%	Large growth	15.5%
Norway	1.1%	Large blend	41.7%
Spain	2.3%	Large value	24.2%
Sweden	9.1%		
Switzerland	4.6%		
U.K.	23.9%		

Table 4.5a Correlation Matrix

Variable	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
1 RAP	1																			
2 Fama French Alpha	0.3349	1																		
3 Carhart Alpha	0.3589	0.9758	1																	
4 Sharpe Ratio	0.5720	0.5543	0.5376	1																
5 Information Ratio	0.2805	0.2539	0.2766	-0.0463	1															
6 Governance Intensity	-0.1869	-0.1142	-0.1231	-0.1769	-0.1737	1														
7 Fund age	0.1309	0.1621	0.1879	0.1741	0.1675	-0.1618	1													
8 Fund size	-0.0573	-0.0441	-0.0473	-0.0664	0.0525	0.0070	-0.0282	1												
9 % equity	0.5636	0.0163	0.0635	0.4546	0.2050	-0.0425	0.0043	-0.0472	1											
10 % europe	0.0167	-0.0189	-0.0572	-0.0673	0.1515	0.0693	0.1322	0.0506	-0.1356	1										
11 % finserv	-0.2613	-0.1167	-0.1105	-0.1605	-0.1410	0.1020	-0.1680	0.0508	-0.1526	0.3850	1									
12 % healthcare	-0.1663	-0.0712	-0.0626	-0.0174	0.0137	-0.1148	0.0375	-0.0595	0.0030	-0.0971	-0.0289	1								
13 % reales	0.0827	-0.0017	0.0441	0.0688	0.0991	0.0281	0.5124	-0.0793	0.0909	0.1687	0.0040	-0.1162	1							
14 % eneruti	-0.0944	-0.0641	-0.0626	-0.0861	-0.0586	-0.0653	-0.1742	0.0725	-0.0927	-0.1059	-0.0992	-0.3219	0.0065	1						
15 % info	-0.0206	-0.0420	-0.0722	-0.0251	-0.1914	0.0445	-0.0933	-0.0905	-0.0594	-0.2181	-0.1012	-0.0310	-0.1946	-0.0192	1					
16 % mfg	0.3285	0.1798	0.1817	0.1890	0.2255	-0.0111	0.2219	-0.0063	0.1942	-0.0829	-0.6186	-0.1634	0.0475	-0.4274	-0.3899	1				
17 Mid-blend	0.0854	0.0446	0.0619	0.0514	0.0867	-0.0326	0.1660	-0.0354	0.0676	-0.1526	-0.0434	0.0197	0.0511	0.0072	0.0131	0.0081	1			
18 Large-growth	-0.0817	0.0043	0.0285	0.0670	-0.1673	0.0631	-0.0138	-0.0118	-0.0661	-0.0731	-0.0144	0.0347	-0.0799	-0.0160	-0.0373	0.0329	-0.1395	1		
19 Large-blend	-0.0555	0.0416	0.0256	0.0943	-0.0178	-0.0782	0.0604	0.0314	0.0544	0.0417	0.0683	0.0435	-0.0135	0.0932	0.0194	-0.1380	-0.2967	-0.3582	1	
20 Large-value	0.1052	0.0283	0.0192	-0.0730	0.1194	-0.0544	-0.1269	0.0393	-0.0538	0.1034	-0.0078	-0.1243	0.0965	-0.0429	-0.0480	0.1011	-0.1833	-0.2213	-0.4706	1
Minimum	-28.74	-7.29	-6.25	-3.09	-0.65	0.00	2.03	0.48	7.85	21.42	0.00	0.09	0.00	0.00	1.45	15.41				
Maximum	64.77	10.94	10.94	0.53	0.43	13.00	303.30	1408.79	99.81	100.00	37.87	39.02	8.23	51.56	37.97	83.50				
Mean	-0.28	0.10	0.22	-0.44	0.03	7.81	104.59	112.55	85.28	73.17	17.27	10.27	0.96	12.19	17.22	42.10				
Standard Deviation	10.43	1.52	1.33	0.68	0.24	3.55	66.43	205.46	22.33	26.65	8.86	5.44	1.24	7.57	6.13	11.74				

Table 4.5b Correlation Matrix of Governance Criteria Variables

Variable	1	2	3	4	5	6	7	8	9	10	11	12
1 disc_change	1											
2 disc_strategy	0.6284	1										
3 disc_sricriteria	0.5107	0.3876	1									
4 disc_changecriteria	0.5257	0.5934	0.7591	1								
5 act_decisions	0.0568	0.216	0.0446	0.1735	1							
6 act_seeinfo	0.3059	0.3373	0.3883	0.4713	0.3838	1						
7 act_csrissues	0.2927	0.2569	0.4106	0.4305	0.373	0.2641	1					
8 act_writeconcerns	0.4492	0.5102	0.4303	0.5004	0.4255	0.5968	0.4025	1				
9 act_specialmeet	0.2381	0.4318	0.3042	0.3274	0.2663	0.2531	0.4897	0.5265	1			
10 act_press	0.3795	0.3748	0.3421	0.3978	0.3512	0.1762	0.5142	0.5637	0.5246	1		
11 act_csrreso	0.1067	0.0248	0.1557	0.1811	0.3128	0.1444	0.3208	0.1723	0.3451	0.4552	1	
12 fully	-0.0228	0.0522	0.0987	0.2238	-0.0568	0.0437	0.1628	0.1408	0.2088	0.0561	0.1577	1

*Given the high correlation between disc_sricriteria and disc_changecriteria, these two variables were merged into disc_criteria.

Table 4.6 Descriptive Statistics and Relationship to Governance Criteria

No. of gov. Criteria	No. of funds	Age (months)		Size (EUR)		% Europe		% Manufacturing		% Equity	
		Average	SD	Average	SD	Average	SD	Average	SD	Average	SD
0	4	108.52	54.72	48.18	113.02	89.56	15.73	42.64	13.13	84.02	21.95
1	3	165.21	57.85	61.49	102.35	69.68	29.50	45.79	11.10	69.57	33.25
2	3	76.47	36.77	175.62	367.25	80.42	27.64	41.51	15.86	83.09	27.11
3	4	165.09	100.06	37.26	49.76	61.29	30.08	42.22	6.66	82.84	25.92
4	3	88.82	87.40	100.79	143.45	68.54	23.13	41.17	10.07	95.31	4.71
5	4	122.26	61.53	192.53	233.54	63.26	24.55	39.63	13.35	83.02	25.53
6	9	95.51	57.65	122.97	173.98	58.19	25.49	41.48	11.36	93.16	11.04
7	3	35.73	44.91	8.22	19.77	79.10	25.61	36.87	7.28	85.94	14.95
8	12	93.98	47.66	128.51	200.62	72.11	26.54	43.76	14.24	90.45	17.11
9	6	119.80	57.63	147.85	293.46	77.56	26.84	42.88	8.75	88.56	16.27
10	15	114.17	65.22	135.44	269.07	79.02	23.39	42.50	11.28	85.36	23.09
11	13	94.00	76.64	114.55	196.04	66.73	28.80	41.51	10.25	80.69	27.23
12	2	136.81	26.63	95.36	127.74	92.91	13.03	41.62	12.90	70.53	36.21
13	7	81.95	59.86	71.99	87.91	86.25	25.55	42.01	16.54	80.90	23.46
All funds	88	104.59	66.43	112.55	205.46	73.17	26.65	42.10	11.74	85.28	22.33

Table 4.7 Full model and performance

	RAP	Fama French Alpha	Carhart Alpha	Sharpe Ratio	Information Ratio
disc_change	2.9874 (1.21)	-0.1203 (-0.37)	-0.1148 (-0.42)	0.0860 (1.24)	0.0333 (0.65)
disc_strategy	-2.3822 (-1.08)	-0.0967 (-0.26)	-0.1056 (-0.33)	-0.0552 (-0.69)	-0.0316 (-0.52)
disc_criteria	3.7777 (1.27)	0.9850 (2.27)**	0.7968 (2.16)**	0.0953 (0.96)	0.1261 (1.55)
act_decisions	0.3890 (0.27)	0.1324 (0.58)	0.1635 (0.85)	0.0293 (0.49)	0.0034 (0.08)
act_seeinfo	-4.8097 (-2.82)***	-0.1653 (-0.64)	-0.1300 (-0.59)	-0.1182 (-1.85)	-0.0467 (-0.78)
act_csrissues	-1.4054 (-0.76)	-0.0098 (-0.05)	-0.0126 (-0.08)	-0.0640 (-1.27)	-0.0266 (-0.65)
act_writeconcerns	3.5924 (2)**	0.1251 (0.45)	0.1038 (0.45)	0.0751 (0.88)	0.0549 (0.91)
act_specialmeet	-0.4388 (-0.26)	-0.3745 (-1.22)	-0.3040 (-1.16)	-0.0331 (-0.52)	-0.0331 (-0.74)
act_press	0.6087 (0.35)	0.2173 (0.97)	0.2508 (1.24)	-0.0066 (-0.12)	-0.0068 (-0.14)
act_csrreso	-4.1844 (-1.87)*	-0.3152 (-1.04)	-0.3213 (-1.26)	-0.0271 (-0.25)	-0.0262 (-0.42)
fully	1.9820 (1.18)	0.2666 (1.38)	0.2653 (1.49)	0.0621 (1.11)	0.0512 (1.25)
Age	0.0050 (0.4)	0.0010 (0.55)	0.0008 (0.53)	0.0004 (1.06)	0.0003 (1.05)
Size	-0.2832 (-0.66)	-0.0533 (-1.02)	-0.0344 (-0.78)	-0.0038 (-0.23)	-0.0038 (-0.36)
% Equity	0.2507 (8.66)***	-0.0015 (-0.65)	0.0005 (0.32)	0.0125 (7.69)***	0.0019 (2.29)**
% Europe	0.0826 (3.89)***	0.0002 (0.05)	-0.0017 (-0.5)	0.0012 (1.49)	0.0020 (3.28)***
% Financial Services	-0.2199 (-2.76)***	-0.0022 (-0.23)	0.0024 (0.29)	-0.0045 (-1.59)	-0.0032 (-1.37)
% Healthcare	-0.2654 (-2.02)**	-0.0291 (-1.78)*	-0.0236 (-1.7)	-0.0001 (-0.03)	0.0011 (0.29)
% Real Estate	-0.5787 (-0.87)	-0.1328 (-1.15)	-0.0717 (-0.73)	-0.0027 (-0.13)	-0.0164 (-0.92)
% Energy & Utilities	-0.0060 (-0.04)	-0.0010 (-0.08)	-0.0000 (-0.01)	0.0018 (0.54)	0.0000 (0.03)
% Information	0.1717 (0.84)	-0.0132 (-1.22)	-0.0123 (-1.33)	-0.0015 (-0.42)	-0.0032 (-1.34)
Mid-blend	3.9398 (1.69)*	-0.0223 (-0.07)	0.0259 (0.09)	0.0014 (0.02)	0.1248 (1.84)*
Large-growth	0.4440 (0.18)	-0.2768 (-0.95)	-0.1402 (-0.59)	-0.0486 (-0.67)	-0.0121 (-0.17)
Large-blend	0.3239 (0.16)	-0.0234 (-0.1)	-0.0117 (-0.06)	-0.0449 (-0.67)	0.0536 (0.84)
Large-value	3.3502 (1.19)	0.0586 (0.22)	0.0549 (0.24)	-0.0317 (-0.37)	0.1001 (1.47)
Period 2	0.6762 (0.38)	-0.8501 (-5.29)***	-0.5134 (-4.2)***	-0.9049 (-16.67)***	0.1801 (3.95)***
Period 3	4.4846 (2.85)***	0.7018 (3.49)***	0.6505 (3.85)****	0.3527 (4.75)***	0.0896 (1.81)*
Constant	-28.031 (-3.48)***	0.3275 (0.52)	0.0963 (0.19)	-1.3624 (-5.99)***	-0.4168 (-2.56)**
R-squared	0.5100	0.3915	0.3634	0.8508	0.2882
Obs.	223	222	222	222	222

Numbers in parentheses are the values for the T-test. *p-value < 0.10; **p-value < 0.05; ***p-value < 0.01

Table 4.8 Sustainability governance and fund attractiveness

PANEL A: RELATIONSHIP OF GOVERNANCE INTENSITY AND FUND ATTRACTIVENESS

	Flow Rf			Flow RAP		
	Model 1	**Model 2**	**Model 3**	**Model 1**	**Model 2**	**Model 3**
Governance Intensity (GI)	0.0057 (1.98)**	0.0063 (1.92)*	0.0065 (2.16)**	0.0022 (1.85)*	0.0020 (1.18)	0.0024 (1.93)*
cumulative return	-0.5840 (-1.28)	0.3092 (1.06)	0.0397 (5.63)***	1.1053 (1.65)*	-0.6927 (-1.63)	-0.0472 (-5.66)***
cumulative return-squared	-2.0175 (-4.26)***	-0.0899 (-1.89)*	-0.0035 (-14.28)***	2.7055 (3.18)***	0.1474 (2.14)**	0.0032 (11.11)***
fee	8.9375 (2.97)***	10.752 (3.14)***	9.3779 (3.05)***	3.5565 (2.56)**	1.2420 (0.67)	2.5921 (1.72)*
Mid-blend	0.0042 (0.12)	0.0039 (0.11)	0.0030 (0.09)	-0.0050 (-0.38)	-0.0052 (-0.3)	-0.0052 (-0.42)
Large-growth	-0.0483 (-1.45)	-0.1124 (-1.79)*	-0.1133 (-1.23)	0.0386 (1.32)	0.1108 (1.46)	0.1490 (1.08)
Large-blend	-0.0468 (-1.83)*	-0.0681 (-2.24)**	-0.0535 (-2.03)**	-0.0263 (-2.2)**	0.0189 (0.75)	-0.0067 (-0.56)
Large-value	-0.0068 (-0.26)	-0.0237 (-0.82)	-0.0125 (-0.48)	-0.0142 (-1.18)	0.0121 (0.77)	-0.0061 (-0.66)
Period 2	0.1206 (2.49)**	0.3048 (2.5)**	0.2219 (6.91)***	0.1474 (1.99)**	-0.2673 (-1.51)	-0.0641 (-3.03)***
Period 3	0.0856 (4.07)***	0.1987 (2.16)**	0.1559 (4.39)***	0.0580 (3.11)***	-0.1911 (-1.43)	-0.0830 (-2.24)**
Constant	-0.0181 (-0.32)	-0.1838 (-1.69)*	-0.1163 (-1.87)*	-0.1040 (-1.82)*	0.2298 (1.62)	0.0758 (2.28)**
R-squared	0.6429	0.4170	0.4420	0.8007	0.4942	0.2868
Obs.	222	223	223	222	223	223

PANEL B: RELATIONSHIP OF GOVERNANCE CHARACTERISTICS AND FUND ATTRACTIVENESS

	Flow Rf			Flow RAP		
	Model 1	**Model 2**	**Model 3**	**Model 1**	**Model 2**	**Model 3**
disc_change	0.0522 (1.81)*	0.0634 (1.85)*	0.0817 (1.7)*	-0.0280 (-1.09)	-0.0304 (-0.9)	-0.0728 (-1.07)
disc_strategy	-0.0795 (-2.53)**	-0.1212 (-2.85)***	-0.1266 (-2.25)**	0.0034 (0.18)	0.0424 (1.06)	0.0839 (1.03)
disc_criteria	0.0631 (1.25)	0.0281 (0.54)	0.0346 (0.74)	-0.0116 (-0.52)	0.0526 (1.3)	0.0124 (0.5)
act_decisions	0.0233 (0.91)	0.0477 (1.51)	0.0482 (1.29)	-0.0158 (-1.31)	-0.0432 (-1.52)	-0.0575 (-1.2)
act_seeinfo	-0.1197 (-4.63)***	-0.1299 (-3.42)***	-0.1453 (-3.64)***	-0.0099 (-0.51)	0.0107 (0.29)	0.0320 (0.62)
act_csrissues	-0.0260 (-1.02)	-0.0154 (-0.56)	-0.0238 (-0.67)	0.0167 (0.83)	-0.0186 (-1.15)	0.0273 (0.65)
act_writeconcerns	0.0896 (2.95)***	0.1254 (3.02)***	0.1306 (3.01)***	0.0259 (2.17)**	-0.0274 (-0.67)	-0.0308 (-0.61)
act_specialmeet	0.0165 (0.62)	0.0131 (0.39)	0.0056 (0.19)	0.0203 (1.67)*	0.0343 (1.18)	0.0278 (1.35)
act_press	0.0275 (1.03)	0.0295 (1.01)	0.0368 (1.24)	0.0015 (0.14)	0.0099 (0.59)	-0.0076 (-0.37)
act_csrreso	-0.0582 (-2.28)**	-0.0581 (-1.89)*	-0.0660 (-2.4)**	-0.0071 (-0.61)	-0.0178 (-0.88)	0.0010 (0.07)
fully	0.0559 (2.48)**	0.0456 (1.74)*	0.0340 (1.29)	0.0224 (2.36)*	0.0375 (1.68)*	0.0483 (1.82)*
cumulative return	-0.6656 (-1.57)	0.2842 (1.05)	0.0453 (6.48)***	1.1279 (1.68)*	-0.6960 (-1.73)*	-0.0428 (-7.13)***
cumulative return-squared	-2.0493 (-4.56)***	-0.0826 (-1.93)*	-0.0036 (-10.87)***	2.7091 (3.17)***	0.1447 (2.29)**	0.0029 (14.12)***
fee	7.4700 (2.17)**	8.1393 (2.38)**	7.0562 (2.13)**	2.5241 (2.01)**	1.2990 (0.62)	2.8496 (1.25)
Mid-blend	-0.0066 (-0.2)	-0.0093 (-0.26)	-0.0090 (-0.25)	-0.0059 (-0.44)	-0.0019 (-0.09)	-0.0020 (-0.11)
Large-growth	-0.0034 (-0.1)	-0.0550 (-1)	-0.0447 (-0.68)	0.0321 (1.48)	0.0897 (1.64)	0.1073 (1.15)
Large-blend	-0.0498 (-1.88)*	-0.0788 (-2.43)**	-0.0621 (-2.19)**	-0.0345 (-2.39)**	0.0226 (0.76)	-0.0121 (-0.65)
Large-value	-0.0287 (-1.29)	-0.0497 (-1.75)*	-0.0361 (-1.49)	-0.0215 (-1.81)*	0.0052 (0.29)	-0.0077 (-0.5)
Period 2	0.1117 (2.48)**	0.2920 (2.57)**	0.2497 (7.27)***	0.1474 (1.99)**	-0.2687 (-1.6)	-0.0534 (-2.53)**
Period 3	0.0826 (4.32)***	0.1881 (2.21)*	0.1812 (5.16)***	0.0559 (3.06)***	-0.1916 (-1.51)	-0.0722 (-2.23)**
Constant	0.0259 (0.32)	-0.0881 (-0.87)	-0.0587 (-0.74)	-0.0659 (-1.28)	0.2076 (1.79)*	0.0490 (0.85)
R-squared	0.7099	0.5047	0.5402	0.8127	0.5274	0.3395
Obs.	222	223	223	222	223	223

Numbers in parentheses are the values for the T-test. *p-value < 0.10; **p-value < 0.05; ***p-value < 0.01

Table 4.9 Fund governance intensity and Performance

	RAP		Fama French Alpha		Carhart Alpha		Sharpe		Info	
	Model 1	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**	**Model 1**	**Model 2**
Governance Intensity (GI)	-0.4790 (-2.94)***	-1.9136 (-2.54)**	0.0026 (0.16)	0.1474 (2.53)**	-0.0005 (-0.04)	0.1206 (2.53)**	-0.0188 (-3.07)***	-0.0491 (-2.52)*	-0.0083 (-1.93)**	0.0118 (0.72)
GI-squared		0.1100 (2.13)**		-0.0109 (-2.65)***		-0.0091 (-2.69)***		0.0023 (1.5)		-0.0015 (-1.23)
Age	-0.0009 (-0.1)	-0.0042 (-0.44)	0.0015 (0.87)	0.0019 (1.13)	0.0013 (0.87)	0.0016 (1.14)	0.0001 (0.31)	0.0000 (0.11)	0.0001 (0.56)	0.0002 (0.73)
Size	-0.1071 (-0.47)	-0.0426 (-0.19)	-0.0193 (-0.59)	-0.0291 (-0.89)	-0.0134 (-0.49)	-0.0199 (-0.74)	-0.0023 (-0.26)	-0.0010 (-0.12)	0.0002 (0.04)	-0.0005 (-0.09)
% Equity	0.2590 (9.13)***	0.2738 (9.17)***	0.0002 (0.08)	-0.0014 (-0.57)	0.0022 (1.11)	0.0009 (0.48)	0.0125 (8.01)***	0.0128 (8.14)***	0.0021 (2.51)*	0.0019 (2.17)**
% Europe	0.0703 (3.57)***	0.0638 (3.16)***	-0.0005 (-0.17)	0.0000 (0.03)	-0.0018 (-0.76)	-0.0015 (-0.64)	0.0012 (1.42)	0.0010 (1.23)	0.0019 (3.14)***	0.0020 (3.31)***
% Financial Services	-0.2528 (-3.19)***	-0.2554 (-3.26)***	-0.0091 (-1.13)	-0.0077 (-0.97)	-0.0038 (-0.55)	-0.0022 (-0.35)	-0.0047 (-1.95)*	-0.0048 (-2.02)*	-0.0044 (-2.06)**	-0.0043 (-2.05)**
% Healthcare	-0.4991 (-3.83)***	-0.5066 (-3.86)***	-0.0228 (-1.72)*	-0.0229 (-1.73)	-0.0181 (-1.59)	-0.0184 (-1.64)	-0.0060 (-1.48)	-0.0062 (-1.51)	-0.0014 (-0.47)	-0.0013 (-0.44)
% Real Estate	-0.5407 (-0.77)	-0.4388 (-0.62)	-0.1155 (-1.04)	-0.1338 (-1.24)	-0.0527 (-0.56)	-0.0744 (-0.81)	0.0019 (0.09)	0.0041 (0.2)	-0.0150 (-0.89)	-0.0165 (-0.97)
% Energy & Utilities	-0.1932 (-1.77)*	-0.1986 (-1.89)*	-0.0109 (-1.22)	-0.0099 (-1.07)	-0.0086 (-1.09)	-0.0078 (-0.96)	-0.0031 (-1.36)	-0.0033 (-1.43)	-0.0024 (-1.03)	-0.0023 (-0.99)
% Information	0.0959 (0.54)	0.1281 (0.7)	-0.0135 (-1.61)	-0.0172 (-1.97)*	-0.0128 (-1.78)*	-0.0151 (-1.99)	-0.0019 (-0.66)	-0.0012 (-0.42)	-0.0035 (-1.49)	-0.0039 (-1.72)*
Mid-blend	1.4568 (0.66)	1.7717 (0.79)	-0.1115 (-0.36)	-0.1447 (-0.48)	-0.0447 (-0.18)	-0.0741 (-0.29)	-0.0542 (-0.63)	-0.0476 (-0.56)	0.0942 (1.43)	0.0898 (1.36)
Large-growth	-0.8479 (-0.36)	0.0024 (0)	-0.2053 (-0.75)	-0.3286 (-1.18)	-0.0800 (-0.36)	-0.1773 (-0.8)	-0.0797 (-1.04)	-0.0617 (-0.81)	-0.0100 (-0.14)	-0.0220 (-0.3)
Large-blend	-1.2509 (-0.58)	-0.7466 (-0.34)	-0.0231 (-0.09)	-0.0906 (-0.36)	-0.0060 (-0.03)	-0.0676 (-0.33)	-0.0932 (-1.43)	-0.0825 (-1.28)	0.0398 (0.61)	0.0327 (0.51)
Large-value	1.8896 (0.7)	2.4057 (0.87)	0.0617 (0.22)	-0.0111 (-0.04)	0.0609 (0.27)	-0.0062 (-0.03)	-0.0779 (-1)	-0.0672 (-0.88)	0.0898 (1.27)	0.0827 (1.17)
Period 2	0.7875 (0.44)	2.2171 (1.02)	-0.8756 (-5.78)***	-1.0335 (-6.25)***	-0.5354 (-4.57)***	-0.6719 (-5.23)***	-0.8971 (-17.41)***	-0.8665 (-14.91)***	0.1827 (4.16)***	0.1624 (3.57)***
Period 3	4.5635 (3.05)***	5.8601 (3.33)***	0.6185 (3.19)***	0.5223 (2.72)***	0.5626 (3.38)***	0.4901 (3.01)***	0.3618 (5.15)***	0.3895 (4.93)***	0.0912 (1.96)**	0.0728 (1.47)
Constant	-14.251 (-2.56)**	-13.666 (-2.61)***	0.9383 (1.43)	0.8970 (1.41)	0.6413 (1.22)	0.5934 (1.17)	-0.9808 (-4.84)***	-0.9686 (-4.88)***	-0.1759 (-1.1)	-0.1840 (-1.15)
R-squared	0.4863	0.4995	0.3356	0.3471	0.2952	0.3094	0.8526	0.8540	0.2686	0.2740
Obs.	223	223	222	222	222	222	222	222	222	222

Numbers in parentheses are the values for the T-test. *p-value < 0.10; **p-value < 0.05; ***p-value < 0.01

4.5 Concluding Comments

At the wake of the growing phenomenon of Responsible Investment within the European Asset Management industry, the objective of this chapter was to provide an illustration of the assimilation of new sources of financial return stemming from sustainability-related fund governance practices. We bring forward that previous research has neglected examining fund governance practices related to sustainability issues and that by focusing on firms, there is a need for more studies situated within a fund context. In particular, we investigate whether and how fund governance issues related to sustainability – sustainability disclosure, sustainability activism, and sustainability research – have an impact on financial performance and fund attractiveness within a dataset of European SRI mutual funds.

We find that providing information related to a fund's SRI criteria – or the ESG and CBI criteria it uses to include or eliminate investee firms in its portfolio – is positively related to financial performance. This finding is in line with previous literature which posits that sustainability disclosure signals positive sustainability performance and such sustainability performance is rewarded by capital markets. This finding indirectly supports the generally positive link between corporate sustainability performance and corporate financial performance. As such, we add to previous findings that argue that sustainability disclosure should be taken into consideration as part of a firm's overall disclosure strategy (Richardson & Welker, 2001) since it plays a role in investors' evaluations of investment desirability (Patten, 1990). However, we do not find evidence that 'too much' disclosure through the provision of information related to SRI strategy – details on the investment process of how a fund selects and analyzes its investee firms – is negatively related to financial performance. This finding perhaps illustrates that the SRI investment strategy in itself is not yet a clear competitive advantage for these firms;

indeed, due to the fact that the practice is new and in construction and that successful models and tools are yet to be diffused, clear results on the relationships between specific SRI methodologies and their impact on performance remain fuzzy as asset managers engage in trial and error. Investors then tend to focus on the underlying business case of the investee firms rather than on the novel but untested strategies of SRI fund managers.

We find that engaging in a deep level of sustainability activism, such as the practice of regularly providing investee firms with profiles detailing their Social, Ethical, and Environmental situation, detracts from the bottom line and is negatively related to performance. This contributes to previous accounts of shareholder activism that have provided similar negative results, highlighting that such activities may impose substantial costs and further distract managers from their main tasks which could be detrimental for performance.

Finally – and much to our surprise – we do not find evidence that having an internal sustainability research team is significantly positively related to financial performance. This may again be a reflection of the fact that the field and its practices are still in construction and the costs of investing in such a team outweigh its benefits, particularly given the low level of quality of sustainability reporting from firms.

Our results on fund attractiveness, or the ability of a fund to attract more assets from clients, are more interesting. We posited that due to the fact that SRI investors have a moral concern, they are more likely to support a fund that displays a strong amount of commitment to sustainability, above and beyond the financial performance of the fund. We do not find evidence that the disclosure of SRI criteria is positively related to fund attractiveness. This may be due to the fact that simply disclosing SRI criteria presents more of a technical issue rather than a signal of strong commitment to the fund. We do find, however, that disclosing the SRI strategy has a negative relationship with fund attractiveness, showing that such type of disclosure has a negative effect on the

legitimacy of the fund. That is, investors are largely concerned with the capabilities of the fund manager to maintain its fiduciary duty whilst engaging in this new practice. While we expected that a deep level of sustainability activism would increase fund attractiveness, we find evidence to the contrary. Instead, we find that funds engaging in a deep level of activism are those with a very high level of screening and tend to ask for higher client fees. As such, this activism appears to drive down the attractiveness of the fund to a broader set of investors. Finally, we find evidence that having an internal sustainability research team is positively related to fund attractiveness. This finding supports the notion that having an internal team provides an important signal of legitimacy for an SRI fund.

When we examine governance mechanisms as a whole, we find that the relationship between governance intensity (the total amount of sustainability governance practices a fund engages in) and financial performance has an overall negative trend whereas the relationship between governance intensity and fund attractiveness is positive. These findings point towards a rather interesting illustration of assimilation; it appears that despite a negative underlying impact, investors are willing to support a well-governed fund. The performance impact, however, remains largely dominant.

Our results have the following implications: at the beginning stages of the development of Responsible Investment, investors maintain a focus on legitimacy, particularly on the depth of commitment to sustainability of the fund, rather than on its SRI strategy. This can be partially attributed to the fact that the underlying assumptions – particularly the relationship between sustainability performance and financial performance – remain subject to debate. We also find that not all sustainability practices provide legitimacy for an SRI fund. To facilitate further assimilation and the development and diffusion of practices, there is an increased need for the creation of models and tools to support this process. We thus show in a first attempt that

governance practices related to sustainability issues – often overlooked in the literatures – are value-relevant, but that such results are by no means straightforward. Investors are discerning regarding which type of sustainability governance practices should be rewarded (penalized), highlighting the need to include such issues as part of the overall strategy of a fund. While our results are primary, they illustrate how a rethinking has indeed began.

The contributions of this paper are several. First, from an overarching level, we show how sustainability issues are significantly related to financial performance and thus, provide and illustration of how logic assimilation is currently manifested in financial market models. Second, we provide attention towards examining governance mechanisms which relate to non-financial issues, and in particular, sustainability issues, which have been neglected in previous literature. Third, we extend firm level studies to a fund context and examine a significant phenomenon, that of Responsible Investment. In doing so, this chapter challenges conventional financial theory and brings to light how traditional investment models are inadequate in capturing the increasing importance of sustainability issues as the asset management industry evolves and illustrates how such issues are gradually being assimilated within the industry's established logics and archetypes.

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APPENDIX A

Responsible Investment in Different Cultural Contexts

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While Socially Responsible Investing (SRI) appears to have become a global phenomenon, the pace of growth has been largely heterogeneous across geographies, given the different cultural and legislative environments in which it has emerged. The objective of this chapter is to provide a brief overview of the current state of SRI across relevant regional contexts, highlighting how society plays a role in shaping SRI strategy.

Europe[1]

The European SRI market caught up with the U.S. market in 2007 and has since surpassed it as the leading geography with Assets Under Management (AUM) of EUR 5 trillion, representing more than 46% of the overall investment universe in Europe. As is commonly expressed, Europe is by no means a homogeneous region. Although the

[1] All figures are taken from the Eurosif 2010 report unless otherwise stated.

European Union has advocated for the importance of standardized reporting of whether and how Environmental, Social, and Governance (ESG) issues are integrated in the investment process through calls for more transparency[2] and the creation of the European Transparency code in 2004[3], local government initiatives appear to have had more success in this regard, creating a varied institutional environment for SRI. For instance, after the U.K. led the enforcement of the Pensions Act in 2000, requiring reporting from its pension funds, other member states such as Sweden (2000), France (2001), Germany (2002), Austria (2004), Belgium (2004), Norway (2004), Italy (2005), the Netherlands (2007), and Denmark (2008) followed suit. These legislations, however, have been mostly limited to government pension funds except for France whose Grenelle II policy (2007) is directed towards all investment management companies and the Netherlands' Financial Supervision Act, enforced in the same year, which is directed towards all institutional investors (European Commission, 2010).

However, while communication through disclosure is increasing, actual implementation remains highly voluntary and is practiced to a significantly lesser extent. Given that regulations on disclosure have yet to be standardized, it is not surprising that there is no specific Europe-wide regulation regarding the integration of ESG issues in investment to date. Some countries have nevertheless been able to carry out this practice through supportive legislation at a local level. For instance, the Belgian Parliament has prohibited the investment in companies producing anti-personnel mines, sub munitions and depleted uranium weapons since 2007. This was imitated recently in France in 2010 wherein the French Parliament enacted a law prohibiting any direct or indirect financial assistance to

[2]e.g. Article 16 describes the European Parliament's recognition of the important role of the investors as stakeholder in the CSR debate and that "there must remain the opportunity for a sustained dialogue to achieve agreed goals", Article 27 of the European Commission calls for adding social and environmental reporting to financial reporting, and Article 33, calls for the European Commission "to think about" a statement of interest principles for investment funds for ESG reporting (European Parliament, 2007).

[3] In 2004 the European Commission developed a European Transparency Code whose onus is to harmonize across Europe the disclosure of extra financial information and to improve the clarity on principles and processes of SRI mutual funds. As of January 2011, 350 mutual funds were signed up to the Transparency Code.

the production or trading of cluster munitions (French Parliament, 2010). In March 2011, the Italian Senate approved a motion similar to that of France (Italian Senate, 2011). In some way, all investment managers domiciled in these three aforementioned countries are "automatically" doing some form of SRI. More popularly, Norway's "Petroleum fund" – its government pension fund worth NOK 2.1 billion (c. EUR 460 billion) as of March 2012[4] – has had ethical guidelines since 2004 which has prohibited investments in tobacco and arms production, among others. Integration has occurred more easily in some countries than in others: Sweden has been integrating ESG issues in its National Pension fund system since 2000 whereas a 2007 law proposed in Spain to oblige its pension reserve fund (worth around EUR 64 billion as of December 2010[5]) to invest 10% of its assets in a sustainable manner is still pending Parliament approval (European Commission, 2010).

The countries in Europe take on different strategic approaches to SRI based on their cultural rootedness. For instance, Germany has a strong environmental focus, promoting nature conservation, nuclear safety, and energy efficiency through thematic funds. The Netherlands also has a similar approach, providing tax exemption mechanisms introduced in its Green Funds Scheme. Italy on the other hand, has a strong focus on governance, particularly on protecting its smaller investors following the 2003 Parmalat scandal. What is clear is that best practices in one country are key for SRI adoption, and this is most evident in the fact that government pension funds are leading the example for other institutional investors. For instance, the Norwegian pension fund's ethical code was recently adopted by Italian insurer Assicurazioni Generali – one of the top five largest insurers in the world which makes up 95% of all SRI in Italy. Swedish pension funds have also adopted the ethics council approach.

This pension fund leadership has formed the key trend in Europe wherein the SRI market is almost exclusively driven by institutional investors, which currently represent 92%

[4] Taken from http://www.nbim.no/
[5] Taken from http://www.seg-social.es/prdi00/groups/public/documents/binario/146674.pdf/

of all assets under management. The main approach of these investors is what is referred to as ESG integration wherein ESG criteria is used during traditional financial analysis. While the Nordic countries are those mostly involved in screening[6], ESG integration has boomed in the last years especially in France, the Netherlands, and Belgium representing EUR 2.8 trillion or 56% of total AUM. France in particular, adopts the best-in-class approach, a hybrid of positive screening and ESG integration wherein investee firms within an industry are ranked in function of their ESG performance. Those which either pass a minimum threshold or are the best in their industries are eligible to be included in the investment universe. This method allows bringing in a degree of flexibility in the construction of the portfolio, especially in enabling the inclusion of high-performing companies in extractive industries such as mining or controversial industries such as firms involved in nuclear power production.

Other types of retail investments such as ethical type investments, those driven by High Net Worth Individuals (HNWI), or impact investments such as Microfinance – albeit growing, represent a marginal portion in Europe. Shareholder activism strategies are mainly used in the U.K., the Netherlands, and Nordic countries but not in the rest of the continent. It appears that Europe has shifted away from an ethical approach and takes a highly pragmatic and non-prescriptive approach to SRI, attempting to use sustainability criteria to meet its financial goals from a largely risk-reduction perspective rather than imposing a moral stance on its citizens. The ESG integration approach makes European SRI much less stringent in that "the extra-financial requirements imposed on the assets subject to ESG integration are not as strict as those imposed on SRI [screening] funds, and practices can vary widely from one manager to another. […] These approaches are spreading but the concepts behind them remain elusive." (Novethic, 2010). While this makes ESG issues somewhat easier to translate into a financial language and more readily integrated by

[6] 38% and 7% of all SRI assets in Europe are negatively and positively screened, respectively.

traditional asset managers, a fundamental question remains as to whether these "loosely-coupled" practices will truly have a positive and material impact on society.

United States and Canada

The United States is one of the oldest and most traditional SRI markets. SRI assets comprise more than 12% of total AUM – a total of USD 3.1 trillion (Social Investment Forum, 2010). Historically, a moral approach to investing was used mostly by religious congregations in America to address their concerns in society by excluding controversial businesses from their portfolio. In the 1700's, the Religious Society of Friends (Quakers) prohibited its members from participating in investing in the slave and weapon trade. During the same period, the founder of Methodism, John Wesley, preached a famous sermon calling on its faithful to avoid investing in companies engaged in alcohol, tobacco, gambling, and weapons. The Pioneer Fund in 1928 was the first mutual fund which used "sin screens" to appeal to these types of individuals and congregations.

From the 1960's, the consideration of integrating non-financial issues in asset management started shifting away from religious motivations and a spotlight was shed on pressing societal events. During the Vietnam war, students led a protest calling for the boycott of companies providing weapons used in the war. This brought about the birth of the Pax World fund in 1971, which avoided investing in companies significantly involved in the manufacture of weapons or weapon-related products. The rise of the civil rights and racial equality movements in Europe and the U.S. through the Civil Rights Act in 1964 and the Voting Rights Act in 1965 increased pressure on companies operating in South Africa during the reign of apartheid. In 1986, a law of California State required that the state's pension funds divest from companies with activities in South Africa, a period which saw an acceleration in the creation of SRI mutual funds. Finally, massive environmental disasters including the 1979 accident at the Three Mile Island nuclear power plant in the U.S., the 1986 Chernobyl catastrophe in Ukraine, the 1984 gas tragedy at the Union Carbide pesticide

plant in Bhopal, India, the oil spill of Exxon Valdez near Alaska, and the BP oil spill in the Gulf of Mexico in 2010 have made companies more aware of the consequences of environmental risks on their revenues, and subsequently pushed investors – in particular, institutional investors with large ownership stakes in the firms involved in the catastrophes – to question their investments from non-financial risk perspectives.

Given the shift from religious to civil society motivations and an increasing ethical consumerism movement wherein the consumer is willing to pay a premium for products (or services) produced in a way consistent with his or her personal values, investment strategies of retail SRI funds have evolved from negative to positive screening. With the increasing interest in a risk-reduction approach, sparked by environmental disasters and which gained momentum since the creation of the U.N.-backed Principles for Responsible Investment (PRI) in 2005, institutional investors are now the major player in the U.S. representing USD 2.3 trillion (74%) of AUM, with ESG integration now becoming the preferred approach, as in Europe (Social Investment Forum, 2010).

The Canadian SRI market, on the other hand, is fairly strong with 20% of total AUM as of 2010. SRI AUM is worth USD 530 billion of which pension funds manage 86% (USD 453.4 billion), investment funds manage about 9% (USD 46 billion), and the remaining 5% (USD 25.3 billion) are managed by SRI retail funds, which are mostly invested in renewable energy income trusts, retail venture capital funds, and mutual funds (Social Investment Organization Canada, 2011). Similar to Europe and the U.S., SRI is currently driven by institutional investors, specifically pension funds. Out of more than 1,100 pension funds in Canada, 17 are signatories to the PRI. However, levels of actual implementation have remained low. An interesting feature of Canada is that it is the North American leader in terms of market share of credit unions and savings banks with 46% of its economically active population being a member (World Council of Credit Unions, 2010). Vancity, the

country's second largest credit union and savings bank with AUM of USD 14.6 billion[7] is the largest member of the Global Alliance for Banking on Values, the only global association of ethically driven financial institutions. This shows that the investment climate is strongly ethics focused, as in the U.S.

In contrast to Europe, the U.S. and Canada maintain rootedness in an ethical and societal approach to SRI given their religious history. The creation of SRI funds in this region was historically driven by civil society pressure rather than from traditional investors seeking a risk-reduction approach. This remains at present with concerns today related to investments in companies with activities in Sudan due to the latter's involvement in genocide in Darfur. Hence, as institutional investors gain traction through the ESG integration approach, moral concerns cannot be ignored and are made explicit in this market.

Latin America[8]

Latin America is seeing tremendous growth and boasts highly developed stock markets such as Mexico's BMV, Brazil's BM&FBOVESPA, the Chilean Santiago Stock Exchange, and the Colombian Stock Exchange.[9] However, the region is not without its problems. Argentina (which nationalized its local pension funds in 2008) and Venezuela (with the continuing rule of Hugo Chavez) experience a lack of investor confidence due to their economic and politic instability, producing a less favorable investment environment in general and less developed SRI markets in particular. In 2008, AUM of Latin American mainstream funds which announced commitment to ESG integration amounted to USD 5 billion[10] (IFC and Mercer, 2009) – a meager amount considering the growth in this region.

[7] As stated in the website, accessed on 17 May 2012. http://www.vancity.com/
[8] Data for Mexico taken from Montes, forthcoming 2013. Data for South America taken from Yamahaki and Gaban, forthcoming 2013.
[9] At the end of 2010, Domestic equities were worth: Mexico (USD 454 million), Brazil (USD 1.5 trillion), Chile (USD 341 million), and Colombia (USD 208 million) taken from http://www.world-exchanges.org. In 2011, the Chilean, Colombian and Peruvian stock exchanges integrated their operations through the Integrated Latin American Market (MILA) creating the second largest stock exchange in South America.
[10] Including Argentina, Brazil, Chile, Colombia, Mexico and Peru.

Although Mexico is the 14th largest economy in the world in terms of GDP[11], its SRI market is very nascent, with the first "Green Funds" launched by Monex Financial Goup very recently in 2006, and eventually discontinued in 2010. The early funds had a characteristic of donating some of its proceeds to social purposes such as environmental conservation projects and educational scholarships. In 2011, the Mexican Stock Exchange created a Sustainable Index which had the effect of boosting SR reporting for companies. In the same year, the Mexican pension funds regulator CONSAR published a recommendation for disclosure of SR practices.[12] While RI is not yet a trending topic in Mexico, social responsibility, particularly in the financial sector, is gaining traction – seemingly a promising first step. Most banks have corporate social responsibility strategies. Also, while there is no local signatory to the PRI, the top banks in the country such as Bancomer (a subsidiary of BBVA) and Santander are owned by entities which are international signatories. This means that the practice should eventually penetrate through a top-down approach. Finally, shareholder activism is not a common practice in Mexico. This is not surprising given that most companies are family-owned and hence the market percentage of stocks floating freely is relatively small.

Similar to Mexico, SRI in South America is fairly incipient, with the majority of SRI initiatives taking place in Brazil. As of 29 February 2012, 30 funds were considered as SRI funds with AUM equivalent to RD 1.4 billion (or USD 814 million), a minor 0.07% of total AUM in Brazil. SRI funds in the region usually follow corporate governance or sustainability indices such as the Corporate Sustainability Index (ISE) and the Carbon Efficient Index (ICO2) of Brazil and the Corporate Governance Index (IBGC) of Peru. A few institutional investors are adopting a positive screening approach through the creation of private equity

[11] Based on 2011 IMF and World Bank estimates.
[12] Savings in Mexico are mainly held by commercial banks operating in Mexico and foreign savings (National Commission of Banking and Brokerage), with pension and investment funds accounting for only 8% and 7% of national savings respectively. However, the restructuring of the retirement system in 1997 to a defined benefit scheme surged assets under management to funds managed of USD 124.01m in 2011 representing almost 11% of GDP (Montes, forthcoming 2013).

funds which invest in companies that have a high social and environmental impact, or that donate a part of their revenues to fund community projects. This type of approach – referred to as "Impact Investing" is especially important in a region where poverty and inequality are prevalent and the issues in the region are usually related to addressing the problems of carbon emissions and deforestation.[13]

Due to the fact that legislation is new, ESG integration by institutional investors is much less and is mostly composed of PREVI, the largest pension fund in Latin America which has incorporated ESG issues into its investment policies since 2007. In 2009, however, the National Monetary Council, the highest deliberative body of the Brazilian Financial System Council issued a Resolution requiring all Brazilian pension funds to disclose whether they consider ESG issues in their investment decisions. In 2010, it was reported that 44% of the 50 largest pension funds included ESG criteria in their investment policies, and it is expected that this percentage will increase (BCB, 2009).

Mainly colonized by the Iberics, most countries in Latin America adopt a Roman Catholic religion, which is a possible explanation for the prevalent philanthropic-type SRI with a focus on the donation of proceeds and the encouragement of positive CSR norms. Beginning from private impact investing to address developmental issues, investors are shifting into a markets approach employing newly-created indices as tools for SRI screening. With the new pension fund disclosure regulations, institutional investors, which have not been instrumental in the development of SRI so far, will be more likely play a role in the near future.

[13] Examples are Colombian Fondo de Capital Privado Inversor launched in 2011 and the Equitas Ventures funds launched in 2009 and 2011 which fund social enterprises; Investment funds that adopt a philanthropic approach include HSBC's FIC Referenciado DI Solidariedade (donates 50% of its management fees to social and environmental projects), Itaú's DI Ecochange (donates 30% of its fees to environmental projects that contribute to the reduction of carbon emissions), Itaú Unibanco's Social Excelence Fund (donates 50% of its fees to social projects) and Banco do Brasil's DI Social 50 and DI Social 200 (donate 50% of their fees to social projects).

Africa[14]

SRI AUM in 2010 for the leading countries in North Africa, namely Egypt, Morocco and Tunisia was equivalent to USD 2.6 billion and 1.6% of total AUM (IFC, 2011). While SRI remains a marginal practice, several signs of positive future prospects are visible in terms of two key factors: first, as the region develops its financial markets, SRI is likely to follow suit because it caters to calls for a greater need of transparency. According to the Business Indicator Index, the three countries rank very low in terms of transparency with Egypt and Tunisia ranking 56th globally and Morocco 65th with corruption scores at 2.8, 4.2, and 3.3, respectively out of a scale of 10 (0 being the most corrupt). SRI can help address significant governance issues in the region's companies, which are an important focus of investors.

Second, SRI can be tailored to be Shari'ah-compliant. The dominant religion of the population base in the three countries is Islam. Post the Arab Spring, it is expected that the new regimes being formed will have a stronger Islamic bias. Shari'ah compliant investing adheres to Islamic finance principles which exclude involvement in sinful activities such as alcohol and tobacco, advocate "no exploitation" and equal risk-sharing wherein full disclosure and symmetric information is required from two transacting parties (i.e. similar to having good corporate governance), as well as "materiality", wherein a financial transaction should have a positive impact on the community. These are very similar to employing negative and positive SRI screens. These two factors have led to the launching of corporate governance codes by the OECD in 2005 and the creation of two indices which cover SRI stocks: the S&P, Hawkamah ESG Index[15] and the Dow Jones Islamic Market MENA Index.

[14] Data for North Africa taken from Saleh, forthcoming 2013. Data for South Africa taken from Mans & deViliers, forthcoming 2013.

[15] The S&P, Hawkamah ESG Index includes the top 50 MENA companies based on their performance on nearly 200 ESG metrics, when compared to their regional peers. Constituents are drawn from a universe of the 150 largest and most liquid companies listed on the national stock exchanges of 11 markets: Bahrain, Egypt, Jordon, Lebanon, Kuwait, Morrocco, Oman, Qatar, Kingdom of Saudi Arabia, Tunisia and the United Arab Emirates. As of January 2012, Egypt had a 10.53% weight in the index and Morocco a 7.33% weight (Press release taken from http://www.hawkamah.org/).

The largest economy in the continent is South Africa, also its biggest institutional investment market with AUM worth more than ZAR 4 trillion (approximately USD 500 billion), of which SRI represents around 20%. The apartheid regime was a double-edged sword to the development of SRI: on the one hand, it spurred awareness for SRI in the rest of the world, on the other hand, South Africa suffered in receiving foreign direct investment in the country. In the first couple of years after the democratic elections of 1994, South Africa received foreign capital averaging one per cent of GDP. This is obviously detrimental to a country which faces a high amount of social challenges such as the HIV/AIDS epidemic which has direct costs for companies (e.g. higher health care and training costs) and indirect costs (e.g. lower revenue due to absenteeism and lower productivity) as well as basic energy needs and access to water. Healthcare and education are also becoming increasingly important focus areas. It is therefore unsurprising that the themes surrounding socially responsible investment in this region are strongly of a developmental nature.

Still in its nascent form, there are currently 64 funds in South Africa, 13 of which were discontinued. Impact investing is by far the most important SRI strategy in South Africa, either on its own or in combination with positive screening. Hence the type of investments are usually private or of a venture capital nature. More than a third of active RI funds in South Africa also employ ethical criteria, mostly based on Shari'ah law. However since 2011, several legislative initiatives have pointed towards the inclusion of institutional investors and the markets in SRI. In this year, Regulation 28 of the Pension Funds Act was amended to require that investing take into account ESG issues[16] and through integrated reporting, the King III Report made it mandatory for JSE-listed companies to include ESG analysis in their corporate reporting.

SRI in Africa is at a very early stage and exhibits a unique characteristic related to the dominant Islam religion which advocates Shari'ah compliant investing and is in many ways

[16]Pension Funds Act, 1956: Amendment of Regulation 28 of the Regulations made under section 36 2011 available at http://www.compliancesa.com/library/lib_doc_0068.pdf (accessed 5 May 2012).

similar to applying negative and positive screens. Doing this type of investing in the region also has a good fit, given the increasing attention being paid to transparency as the capital markets develop in tandem with possibilities for private equity to tackle pressing societal problems through impact investing. Similar to Latin America, institutional investors are less involved, but first steps made in 2011 towards their inclusion appear promising.

Asia-Pacific[17]

Asia-Pacific is composed of countries with highly diverse cultures and languages. It is interesting to note however that several government owned funds in the emerging economies are leading the SRI movement, creating momentum across the region. The Government Pension Fund of Thailand (GPF), a founding member of the PRI, the South Korean National Pension Service (NPS), and Malaysia's Sovereign Wealth Fund Khazanah are examples of local SRI champions. NPS began investing in SRI funds in 2006 and has committed to invest USD 10 billion by 2016. Since NPS publicized its commitment, more local pension funds have expressed their interest in SRI. Khazanah, on the other hand, has a USD 46 million joint venture with UK Camco to explore clean energy investment opportunities in South East Asia, and is committed to investing USD 150 million in waste-to-energy projects in China and other green urban projects[18]. Hong Kong and China, however, do not have the same story. The main reason is that corporate pension funds are still in their infancy in China. PRI signatories in Hong Kong are mostly private equity (PE) firms and AUM in HK considered SRI retail funds amount to USD 10 billion as of December 2011. Amongst the PE projects, infrastructure investments are the focus (e.g. social infrastructure including public facilities such as schools and hospitals, utilities such as energy, water and waste management companies, and transport including Mass transport systems, toll roads, and railways.) Because of the urbanization of this region, these types of

[17] Data for Emerging markets taken from Chow, forthcoming 2013. Data for Australia taken from Responsible Investment Association Australasia, 2011.
[18] Taken from company website: http://kperspectives.khazanah.com.my/ (Accessed 17 May 2012)

investments are fundamental in growing cities and satellite towns in Asia, where rapidly expanding populations put a strain on local resources and infrastructure.

Due to the high presence of foreign direct investments in the region, those who are driving SRI awareness and practice in Asia are foreign fund managers, unlike in Europe and the U.S. where local asset owners are the major drivers in the SRI market. For instance BNP Paribas established the first Asian environmental equity fund "Green Tiger" and the first Greater China Environmental Fund. Nevertheless, these Asia-focused SRI funds are small. Further, the concept of shareholder activism is not well developed in most Asian jurisdictions. Foreign fund managers usually engage privately, especially in countries where family ownership dominates the business model, as in Hong Kong.

Recently, however, initiatives towards getting the markets more involved have began. Bursa Malaysia and the Shanghai Stock Exchange recently introduced a mix of best practice ESG guidelines, sustainability indexes, awards and specialist market services (IFC, 2011) and 2010 saw the launch of the Hang Seng Corporate Sustainability Index (HKCSI) Series covering large and liquid listed companies in Hong Kong and Mainland China. The Hang Seng Corporate Sustainability Index Fund, which tracks the HKCSI, was launched in 2011. There thus appears to be a plausible movement towards the creation of funds based on sustainability indices.

The state of SRI in Australia is much more advanced than those of its emerging economy neighbors and is one of the most well-developed globally. Core responsible investment[19] in 2011 amounted to AUD 19.6 billion whereas broad responsible investment assets are estimated to be AUD 148.9 billion, an increase of 99% from 2010. Market players come from across the board: government funds, corporate funds, and pension funds and approximately half of the funds under management of Australian asset managers fall under UNPRI commitments to ESG integration, representing 13% of the number of global

[19] Including managed responsible investment portfolios, community finance, responsible investment portfolios of charities and client portfolios of financial advisers.

signatories and 3% of AUM. Australia also boasts a very developed SRI indices market.[20] The substantial amount of SRI activity in Australia reflects the resilience of its economy as compared to its peers.

It appears that SRI practice in Asia-Pacific, just like the diverse character of the region, has no clear trend. Whereas South Korea, Malaysia and Thailand have practice coming from the public sector, SRI in Hong Kong is mostly related to infrastructure PE investments and funds driven by foreign fund managers based on sustainability indices. Australia is much more developed and advanced, at par or even overtaking its Anglo-Saxon counterparts. The main consideration in Asia-Pacific will be to find SRI products which can keep up with the fact pace of urbanization in the region whilst addressing pressing societal concerns.

Conclusion

This chapter has attempted to present how SRI adoption and practice is largely dispersed at present and to explain how the types of strategies being used differ based on the cultural context as related to religion, events in the institutional environment, social problems, development levels of the capital markets, and the pace of urbanization. In a similar vein, this chapter has highlighted that the key promoters of SRI vary across geographies. In Europe, government-wide initiatives adopted by asset owners are driving a non-prescriptive ESG integration approach. In the U.S. however, SRI was born in response to religious teachings and civil societal pressures following catastrophic events, making the landscape more akin to investment considerations based on moral concerns. In Latin America, a largely Catholic region, SRI is developing from a philanthropic approach wherein funds donate a percentage of their profits towards charitable purposes. In Northern Africa,

[20] Some examples are ACT Australian Cleantech, ALTEXAustralia, Carbon Disclosure Leadership Index (CDLI) Corporate Responsibility Index (CRI), Ethinvest Environmental Share Price Index, FTSE4Good Australia 30, FTSE Shariah Australia, GS/ASX 300 Socially Responsible Accumulation Index, IPD Green Property Investment Index, Reputex Climate Change Opportunity, Reputex Environment Opportunity, Reputex Future Energy, Reputex Governance Leaders, Reputex Sustainability 120 Index.

negative screening is the norm, which adheres to Islamic finance principles of Shar'iah. In both Latin America and Africa, impact investing plays a crucial role for development. Finally, Asia is an interesting market with differing levels of adoption. In some geographies such as Malaysia, South Korea, and Thailand, government initiatives are driving SRI whereas in Hong Kong, foreign fund managers are leading the practice. These differences are necessary to consider when studying the phenomenon, in order to avoid strong generalizations, to enable a clear understanding of cultural embeddedness and propensity for change, and to create proper tools, favorable legislation, and successful strategies for each institutional environment.

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APPENDIX *B*

L'investimento responsabile in differenti contesti geografici e culturali

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Nonostante l'investimento responsabile[1] sia diventato ormai un fenomeno globale, caratteristiche e livelli di crescita variano ampiamente da continente a continente, a causa dei diversi contesti culturali e normativi in cui é emerso. Il seguente capitolo ha l'obiettivo di fornire una panoramica complessiva di tale fenomeno e presentare i maggiori fattori di influenza per determinarne le caratteristiche nelle diverse regioni del mondo.

[1] Unicamente in questo paragrafo, si farà riferimento alla definizione "investimenti responsabili" e non "investimenti sostenibili e responsabili – SRI" seguendo un approccio tipico dei PRI. Secondo i PRI, è la responsabilità applicata a tutte le attività di investimento ad essere rilevante e non soltanto quella relativa ai prodotti SRI. Si tenga inoltre presente che i Principi prendono in considerazione approcci, come l'azionariato attivo e l'integrazione degli aspetti ESG nell'analisi degli investimenti, che sono caratteristici degli asset manager che praticano l'SRI.

Europa[2]

Il mercato europeo degli investimenti responsabili ha raggiunto e sorpassato il mercato statunitense nel 2007, rappresentando nel 2010 un patrimonio gestito di 5 mila miliardi di Euro, equivalente al 46% dell'universo degli investimenti nella regione. L'Europa non può però essere considerata un'area omogenea nell'approccio verso tale tematica. L'Unione Europea promuove da tempo una forma di standardizzazione nella reportistica da parte degli investitori sulla metodologia e sulla misura in cui tematiche ESG sono prese in considerazione nei processi di investimento[3]. Ciononostante, le iniziative governative a livello locale sembrano essere i veri fattori trainanti per l'investimento responsabile in Europa.

Per esempio, dopo l'istituzione nel 2000 del *Pensions Act* nel Regno Unito, nel quale si richiede maggiore informazione da parte dei fondi pensione britannici, altri Stati Membri hanno approvato simili provvedimenti[4].

Mentre questi sforzi di promozione di maggiore trasparenza hanno portato a livelli più alti di informazione, l'applicazione di pratiche di investimento responsabile rimane volontaria e poco sviluppata. Dato che una forma di standardizzazione della reportistica non é ancora stata raggiunta, non sorprende il fatto che non esista a livello europeo neanche una forma di legislazione per considerare parametri ESG nelle decisioni di investimento.

In ogni modo, alcuni Paesi sono stati in grado di promuovere forme di investimento responsabile attraverso legislazioni o linee guida locali. Per esempio, il parlamento belga, dal 2007, proibisce gli investimenti in aziende produttrici di mine e munizioni antiuomo e armi a base di uranio. Un provvedimento simile é stato istituito in Francia (French Parliament, 2010) ed è in discussione in Italia (Senato Italiano, 2011). Allo stesso modo, il ben noto fondo

[2] Se non esplicitamente precisato, i dati forniti in questo paragrafo sono tratti dalla relazione 2010 di Eurosif.
[3] Nel 2004, la Commissione Europea ha approvato un Codice di Trasparenza Europeo per gli Investimenti Responsabili allo scopo di armonizzare lo status della reportistica su tematiche extra-finanziarie in Europa e migliorare la qualità delle informazioni da parte dei fondi di investimento sui principi e processi usati negli investimenti responsabili. Secondo dati risalenti a gennaio 2011, 350 organizzazioni hanno firmato e si sono impegnate a rispettare il codice (Eurosif, 2011).
[4] La Svezia (nel 2000), la Francia (nel 2001), la Germania (nel 2002), l'Austria (nel 2004), il Belgio (nel 2004), la Norvegia (nel 2004), l'Italia (nel 2005), i Paesi Bassi (nel 2007) e la Danimarca (nel 2008).

pensione del governo norvegese, dal 2004 adotta linee guida etiche che proibiscono investimenti nei settori, oltre ad altri, del tabacco e produzione di armi. Tali linee guida hanno influenzato simili politiche da parte di investitori istituzionali in altri paesi: Assicurazioni Generali, una delle cinque compagnie assicuratrici più grandi al mondo, nella propria strategia fa riferimento al fondo norvegese, mentre i fondi pensione nazionali AP, in Svezia, hanno istituito un Consiglio Etico sul modello di quello norvegese. Va inoltre notato che provvedimenti locali sono stati approvati o implementati più facilmente in alcuni paesi che in altri: in Svezia l'integrazione di informazioni ESG é pratica comune nel sistema pensionistico nazionale dal 2000 mentre, in Spagna, un progetto di legge del 2007 non é ancora stato approvato dal parlamento (European Commission, 2010).

I paesi europei hanno adottato diversi approcci verso l'investimento responsabile, anche a causa di forti differenze culturali. Per esempio, in Germania e nei Paesi Bassi, il fenomeno ha un taglio prettamente ambientale. In Italia, invece, maggiore attenzione é dedicata alla governance aziendale e alla protezione dei piccoli azionisti, dopo il noto scandalo di Parmalat nel 2003.

Nel descrivere lo scenario europeo, é utile notare che il mercato degli investimenti responsabili é quasi esclusivamente rappresentato dagli investitori istituzionali, corrispondenti al 92% del totale del patrimonio gestito. L'approccio più comune da parte di queste organizzazioni é la pratica meglio conosciuta come "integrazione di criteri ESG nell'analisi finanziaria tradizionale". Mentre i paesi nordici tendono ad applicare a priori un tipo di *screening* sugli investimenti[5], i metodi di integrazione sono diventati particolarmente comuni in paesi come in Regno Unito, la Francia, i Paesi Bassi e il Belgio.

L'azionariato attivo, che cerca di influenzare le politiche di gestione di tematiche ESG delle imprese quotate, attraverso l'esercizio coerente dei diritti di voto e il dialogo continuo con il *management* aziendale, é particolarmente comune nel Regno Unito, nei Paesi

[5] Il 38% e 7% degli investimenti responsabili in Europa é gestito applicando rispettivamente un tipo di *screening* negativo e positivo.

Bassi, in Francia e nei paesi del Nord Europa, ma non così tanto nel resto del continente (PRI, 2010).

Appare chiaro che l'approccio europeo si sia allontanato da concetti prettamente morali o etici, evolvendosi verso pratiche più pragmatiche e meno prescrittive che considerano fattori di sostenibilità allo scopo di raggiungere maggiori rendimenti e ridurre rischi finanziari.

Stati Uniti e Canada

Gli Stati Uniti rappresentano uno dei mercati più maturi e tradizionali per quanto riguarda gli investimenti responsabili, i quali rappresentano 3,1 mila miliardi di dollari e più del 12% del totale di patrimonio gestito nella regione (Social Investment Forum, 2010). Il fenomeno ha origine da un approccio morale verso gli investimenti da parte di congregazioni religiose, come i *Quakers (*Religious Society of Friends) o la Chiesa Metodista, che decisero di escludere dai portafogli imprese coinvolte in affari eticamente discutibili.

Agli inizi degli anni '60, l'inclusione di parametri extra-finanziari nella gestione dei patrimoni incominciò ad evolvere da considerazioni unicamente religiose verso motivazioni più ampiamente sociali, scatenate dagli eventi dell'epoca (ad esempio la guerra in Vietnam e l'*apartheid* in Sudafrica che aumentarono le pressioni sulle aziende produttrici di armi o operanti nel paese sudafricano). Il risultato fu il sorgere di numerosi fondi di investimento etici. Una forma crescente di consumo consapevole da parte di cittadini propensi a pagare un prezzo più alto per essere sicuri di acquistare prodotti o servizi in linea con i propri valori personali, ha anche gradualmente comportato il passaggio da forme di *screening* negativo a pratiche di *screening* positivo.

Negli ultimi tre decenni, numerosi disastri ecologici[6] hanno creato molta più consapevolezza dell'impatto economico di rischi ambientali negli investitori istituzionali con

[6] Tra cui gli incidenti nucleari del 1979 nella *Three Mile Island* e del 1986 a Chernobyl in Ucraina, la tragedia della fuga di gas del 1984 presso gli impianti di pesticidi della Union Carbide a Bhopal, in India, le fuoriuscite di

partecipazioni significative in aziende coinvolte in tali catastrofi, i quali hanno iniziato ad analizzare i propri investimenti anche secondo parametri ESG. Questi avvenimenti, insieme alla nascita dell'iniziativa dei PRI a cui hanno aderito fin da subito numerosi fondi pensione statunitensi, hanno spiegato il ruolo sempre più dominante degli investitori istituzionali nel mercato degli investimenti responsabili e l'applicazione graduale di strategie di investimento basate sul concetto di integrazione, come in Europa (Social Investment Forum, 2010).

Il mercato degli investimenti responsabili in Canada rappresenta il 20% del totale del patrimonio finanziario della regione, per un ammontare complessivo di 530 miliardi di dollari canadesi (Social Investment Organization Canada, 2011). Come nel caso degli Stati Uniti, il fenomeno interessa principalmente investitori istituzionali[7]. Inoltre, gli investimenti responsabili in Canada sono ancora prevalentemente associati ad approcci di tipo etico come negli Stati Uniti.

Le attività di azionariato attivo in Nord America sono particolarmente diffuse e spesso guidate da motivazioni morali, oltre che economiche. Inoltre, regole amministrative particolarmente favorevoli hanno reso la pratica di presentare mozioni su tematiche ESG durante le assemblee degli azionisti molto più frequente che in altre aree del mondo.

America Latina[8]

L' America Latina é una regione caratterizzata da una generale crescita economica e uno sviluppo promettente delle borse valori nazionali. Nonostante questi andamenti positivi, la regione non rimane senza problemi. Sia l'Argentina, che nel 2008 ha nazionalizzato tutti i fondi pensione locali, che il Venezuela, con il governo pluriennale di Hugo Chavez, hanno sperimentato un continuo deterioramento della fiducia degli investitori nella stabilità

petrolio in Alaska da parte della Exxon Valdez e la più recente catastrofe di British Petroleum nel golfo del Messico.

[7] Una caratteristica particolare del Canada é la posizione di rilievo in Nord America per quanto riguarda le banche di risparmio e di credito, a cui aderisce il 46% della popolazione (World Council of Credit Unions, 2010).

[8] I dati sul Messico sono tratti da Montes (da pubblicarsi nel 2013). Le informazioni per l'America del Sud sono state ricavate dalle pubblicazioni di Yamahaki and Gaban (in uscita nel 2013).

economica e politica nazionale, creando così un ambiente molto più sfavorevole per gli investimenti in generale. L'ammontare del patrimonio gestito considerando criteri ESG, che nel 2008 equivaleva solo a 5 miliardi di dollari[9], conferma tale valutazione (IFC and Mercer, 2009). Nonostante il Messico sia il quattordicesimo mercato nazionale più grande al mondo[10], gli investimenti responsabili sono ancora in una fase nascente. I primi fondi tematici ambientali sono stati costituiti nel 2006, per poi essere dissolti nel 2010. Nel 2011, la borsa valori messicana ha creato il primo indice di investimento sostenibile allo scopo di promuovere maggiore trasparenza da parte delle imprese su tematiche di responsabilità sociale d'impresa. Nello stesso anno, l'organismo regolatore del settore pensionistico, CONSAR, ha pubblicato una serie di raccomandazioni per migliorare la reportistica dei fondi pensione sulle pratiche di responsabilità sociale.[11] Mentre gli investimenti responsabili non sono ancora una tendenza in Messico, il concetto di responsabilità sociale nel settore finanziario sta prendendo piede, creando le condizioni favorevoli per la creazione di un futuro mercato. La maggior parte delle banche messicane, infatti, ha adottato strategie di responsabilità sociale d'impresa. Inoltre, pratiche di investimento responsabile potrebbero essere importate gradualmente dagli operatori internazionali operanti nel paese (ad esempio BBVA o Santander). Infine, l'azionariato attivo non é una pratica comune in Messico, soprattutto a causa della struttura societaria delle stesse aziende che tendono ad essere a conduzione familiare e con una percentuale molto piccola di azioni disponibili sul mercato.

La maggior parte delle attività di investimento responsabile della regione si svolge in Brasile. Secondo dati di febbraio 2012, 30 fondi sono considerati di investimento responsabile per un valore complessivo di 814 milioni di dollari di capitale, equivalenti a 0,07% del totale del patrimonio gestito nel paese. Questo tipo di fondi, di solito, segue indici

[9] Includendo Argentina,Colombia, Messico e Perù.
[10] Secondo stime del 2011 del FMI e della Banca Mondiale.
[11] Il risparmio in Messico é per lo più gestito da banche commerciali o investito all'estero, mentre i fondi di pensione e di investimento coprono solo rispettivamente l'8 e 7% del risparmio nazionale. Ciononostante, la riforma del sistema pensionistico nel 1997 ha portato ad una crescita del corrispondente patrimonio gestito, arrivando ad un ammontare nel 2011 di 124,01 milioni di dollari, equivalenti all'1,1% del PIL nazionale (Montes, 2013).

di governance aziendale o sostenibilità[12]. Le pratiche di integrazione dei criteri ESG da parte degli investitori istituzionali non sono ancora comuni e per lo più sono riconducibili a PREVI, il fondo pensione più grande in America Latina che ha stabilito politiche di investimento responsabile nel 2007. Comunque, é importante citare la promulgazione di una risoluzione da parte del Consiglio Monetario Nazionale, l'organismo più autorevole del Consiglio Brasiliano del Sistema Finanziario, nel 2009, che richiede a tutti i fondi pensione brasiliani di fornire informazioni periodiche sulle pratiche di considerazione di tematiche ESG nelle decisioni di investimento[13]. Un ruolo determinante nella promozione degli investimenti responsabili in questo paese continua ad essere svolto da BM&FBOVESPA. La borsa valori ha infatti sviluppato un meccanismo per aumentare gli standard di governance aziendale al di sopra dei requisiti di legge da parte delle aziende quotate, il cosiddetto *Novo Mercado*[14]. Dopo un'intensa consultazione, la borsa ha anche annunciato un nuovo requisito per le aziende quotate che devono produrre un bilancio di sostenibilità o fornire relative spiegazioni nel caso in cui non lo facciano.[15]

Alcuni investitori istituzionali in America Latina hanno creato fondi di *private equity* che investono in aziende ad alto impatto sociale e ambientale o che donano parte dei propri profitti a progetti comunitari. Questo tipo di approccio verso gli investimenti responsabili, chiamato *impact investing*, risulta particolarmente importante in una regione dove povertà, disuguaglianza e impatti ambientali negativi sono ancora prevalenti.[16]

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[12] Alcuni esempi sono l'Indice di Sostenibilità Aziendale (ISE) e l'Indice per l'efficienza nella gestione delle emissioni (ICO2) in Brasile o l'Indice di Governance aziendale (IBGC) in Perù.

[13] Di conseguenza, nel 2010 é risultato che il 44% dei 50 maggiori fondi pensione per dimensione hanno incluso criteri ESG nelle loro politiche di investimento e ci si aspetta che questa percentuale continui a crescere (BCB, 2009).

[14] *Novo Mercado* costituisce un segmento di elite di quotazione sul mercato locale, accessibile solo alle imprese che rispettano determinate linee guida di governance Secondo una relazione recente di Responsible Research sul ruolo delle borse valori nella promozione della sostenibilità dei mercati, *Novo Mercado* ha aiutato la borsa brasiliana ad attrarre più investimenti internazionali. Si stima che il 75% delle Offerte Pubbliche di Acquisto aspirano ad entrare in tale segmento (Responsible Research, 2012).

[15] Secondo un approccio *comply or explain*.

[16]Esempi sono il *Fondo de Capital Privado Inversor* istituito nel 2011 in Colombia e *Equitas Ventures funds* create nel 2009 e 2011 per finanziare imprese sociali; fondi di investimento che adottanto un approccio filantropico sono *FIC Referenciado DI Solidariedade* di HSBC (che dona il 50% delle proprie commissioni a progetti sociali e ambientali), *DI Ecochange* di Itaú (che dona il 30% delle commissioni a progetti ambientali che contribuiscono alla riduzione di emissioni di gas ad effetto serra), *Social Excelence Fund* di Itaú (che dona il 50%di commissioni a

Infine, va sottolineato che la maggior parte dei paesi dell'America Latina ha legami storici molto forti con la Spagna, un paese di tradizione fortemente cattolica. Questo potrebbe spiegare la tendenza nella regione ad abbracciare una filosofia più filantropica e un incoraggiamento generale verso donazioni di fondi e pratiche di responsabilità sociale d'impresa da parte delle istituzioni finanziarie.

Africa[17]

Secondo dati del 2010, nei maggiori paesi del Nord Africa quali Egitto, Marocco e Tunisia, il totale del patrimonio gestito secondo principi di investimento responsabile equivale a 2,6 miliardi di dollari, corrispondenti al 1,6% del totale (IFC, 2011a). Anche se i dati mostrano che il fenomeno éancora marginale, esistono diversi segnali positivi per una crescita in futuro. In primo luogo, questi paesi stanno perseguendo una promozione generale dei mercati finanziari. Per poter godere di maggiore fiducia da parte degli investitori, sarà quindi necessario introdurre riforme per aumentare la trasparenza e governance aziendale nella regione. Un impulso ad adottare pratiche di investimento responsabile potrebbe nascere da tali riforme[18]. In secondo luogo, gli investimenti responsabili potrebbero definirsi in modo da rispettare la legge islamica o *Shari'ah*. L'Islam é la religione dominante nella regione e, dopo la primavera araba, si prevede che più partiti politici con forte radice religiosa prenderanno il potere. Investimenti allineati alla *Shari'ah* aderiscono ai principi della finanza islamica[19]. Tali requisiti potrebbero essere facilmente categorizzati come forme di *screening* negativo e positivo.

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progetti sociali) e *DI Social 50* and *DI Social 200* del Banco do Brasil's ((che dona il 50%di commissioni a progetti sociali).

[17] Le informazioni sull'Africa del Nord sono tratte da Saleh (da pubblicarsi nel 2013) . I dati sul Sudafrica hanno origine da Mans & deViliers (da pubblicarsi nel 2013).

[18] Secondo il *Business Indicator Index* della Banca Mondiale, i tre paesi figurano nei quartili più bassi: l'Egitto e la Tunisia sono al 56esimo posto su scala globale, mentre il Marocco é al 65esimo con indici di corruzione equivalenti rispettivamente a 2.8, 4.2 e 3.3 su 10 (0 indica livelli massimi di corruzione).

[19] Escludendo finanziamenti ad attività produttive nei settori dell'alcol e del tabacco, aderendo al concetto di "non sfruttamento e divisione equa del rischio" per cui piena informazione é richiesta da entrambe le parti coinvolte in una transazione (in modo simile ad avere una buona struttura di governance aziendale) e definendo in modo specifico la "materialità" come capacità di una operazione finanziaria di avere un impatto sociale positivo.

La maggiore economia nazionale nel continente é il Sudafrica, paese che ospita anche il più ampio mercato di investimenti istituzionali con un totale di patrimonio equivalente a circa 500 miliardi di dollari, il 20% dei quali é gestito secondo criteri di investimento responsabile. Il regime dell'*apartheid* ha avuto conseguenze contrastanti sul paese e sul mondo. Da una parte, ha scatenato maggiore interesse verso gli investimenti responsabili da parte di investitori esteri. Dall'altra, per un lungo periodo non ha permesso al Sudafrica di beneficiare dell'afflusso di investimenti diretti esteri. La mancanza di investimenti é stata dannosa per una nazione flagellata da deteriorate condizioni sociali e ambientali. Tali condizioni spiegano come tuttora i temi maggiormente toccati dagli investimenti responsabili siano legati allo sviluppo sociale.

L'*impact investing* rimane la strategia più comune, in combinazione o no con tecniche di *screening* positivo. Gli investimenti responsabili tendono perciò ad interessare aziende non quotate o *venture capital*. Più di un terzo dei fondi attivi applica criteri di tipo etico, anche se dal 2011 diverse iniziative legislative hanno promosso il coinvolgimento di investitori istituzionali. Ad esempio, gli emendamenti al Regolamento 28 della legge sui fondi pensione hanno incluso il requisito che gli investimenti tengano in considerazione tematiche ESG (Pension Funds Act, 1956). In modo altrettanto rilevante, l'ultimo Rapporto King III sulla governance aziendale ha reso obbligatorio[20] per tutte le aziende quotate sulla borsa di Johannesburgh (JSE) l'inserimento di analisi della sostenibilità nei bilanci, attraverso forme di reportistica integrata[21]. É utile anche sottolineare il ruolo svolto da JSE che, oltre a includere requisiti di reportistica per le aziende, ha istituito un indice di sostenibilità, una delle iniziative di maggior successo tra le imprese nazionali (Responsible Research, 2012).

[20] Secondo l'approccio del *comply or explain* per cui le aziende che non forniscono tale reportistica devono fornire rilevanti motivazioni.
[21] Il concetto di *integrated reporting* si riferisce alla produzione di un bilancio aziendale che includa informazioni finanziarie e di sostenibilità spiegando le relazioni e interdipendenze tra queste due dimensioni.

Asia e Oceania[22]

L'Asia e l'Oceania sono composte da paesi altamente diversificati per quanto riguarda lingue e culture. É interessante, comunque, notare come nei paesi emergenti molti fondi di origine governativa stiano promuovendo e influenzando il fenomeno degli investimenti responsabili. Il fondo pensione del governo della Thailandia, un membro fondatore dei PRI, il fondo di pensione nazionale della Corea del Sud e il fondo sovrano della Malaysia, Khazanah, sono esempi di istituzioni ambasciatrici degli investimenti sostenibili[23].

La situazione in Hong Kong e Cina sembra invece differente. La ragione principale é che in Cina i fondi pensione aziendali sono ancora allo stato nascente. I firmatari dei PRI localizzati in Hong Kong sono per lo più fondi di *private equity* che dedicano maggiore attenzione ad investimenti infrastrutturali[24] , essenziali per un paese con crescente urbanizzazione e numerose città in espansione.

Data la forte presenza di investimenti diretti esteri nella regione, i promotori degli investimenti responsabili sono per lo più gestori di fondi stranieri, diversamente da altre aree del mondo dove i fondi pensione sono i maggiori attori nell'influenzare tale mercato[25]. Inoltre, il concetto di azionariato attivo non é molto sviluppato nella regione. I gestori stranieri normalmente hanno un dialogo informale o privato con le aziende locali che seguono normalmente un modello di proprietà familiare.

[22] Dati sui Paesi Emergenti sono tratti da Chow (da pubblicarsi nel 2013). Le informazioni sull'Australia provengono da Responsible Investment Association Australasia (2011).
[23] Il fondo coreano ha istituito fondi di investimento responsabile nel 2006 e si é formalmente impegnato a investire secondo tali criteri 10 miliardi di dollari entro il 2016. Da quando tale fondo ha reso ufficiale questa intenzione, altri fondi pensione locali hanno espresso interesse verso questo tipo di investimenti. Khazanah, invece, ha allocato 46 milioni di dollari in una joint venture con Camco per sfruttare opportunità nel settore dell'energia pulita nel Sud-Est Asiatico e intende investire 150 milioni di dollari in progetti per la produzione di energia dai rifiuti in Cina e altri progetti ambientali urbani, dal sito aziendale: http://kperspectives.khazanah.com.my/ (consultato il17 maggio del 2012)
[24] Tra cui scuole, ospedali, impianti di energia, acqua, smaltimento dei rifiuti e sistemi di trasporto di massa, strade e autostrade.
[25] Ad esempio, BNP Paribas ha istituito i primi fondi a tema ambientale in Asia: il *Green Tiger* e il *Greater China Environmental Fund*. Va comunque notato che le dimensioni di tali fondi sono molto ridotte.

È importante comunque sottolineare che recentemente alcune iniziative per ampliare il mercato degli investimenti responsabili hanno preso piede. La borsa valori della Malesia (*Bursa Malaysia*) e la borsa valori di Shanghai hanno introdotto diverse misure per promuovere il fenomeno: linee guida e buone pratiche in tematiche ESG, indici di sostenibilità, premi e servizi speciali per il mercato (IFC, 2011b). Nel 2010, in particolare, é stata inaugurata una serie di indici specializzati[26].

Lo stato degli investimenti responsabili in Australia é molto più avanzato che nei paesi limitrofi, tanto da potersi considerare uno dei mercati più sviluppati globalmente. Secondo dati del 2011, il totale degli investimenti sostenibili ammonta a 168,5 miliardi di dollari australiani, mostrando un incremento notevole rispetto al 2010. Si calcola che all'incirca metà del patrimonio in mano ai gestori australiani segua i PRI e strategie di integrazione di criteri ESG. In Australia esiste anche un mercato sviluppato di indici di sostenibilità[27] e l'azionariato attivo è una pratica comune.

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[26] Quali *Hang Seng Corporate Sustainability Index* (HKCSI), relativi a grandi aziende quotate in Cina e Hong Kong. Il fondo che segue tali indici, il *Hang Seng Corporate Sustainability Index Fund* é stato successivamente istituito nel 2011 indicando una nuova tendenza a creare fondi legati agli indici di sostenibilità.

[27] Alcuni esempi sono: ACT Australian Cleantech, ALTEXAustralia, Carbon Disclosure Leadership Index (CDLI) Corporate Responsibility Index (CRI), Ethinvest Environmental Share Price Index, FTSE4Good Australia 30, FTSE Shariah Australia, GS/ASX 300 Socially Responsible Accumulation Index, IPD Green Property Investment Index, Reputex Climate Change Opportunity, Reputex Environment Opportunity, Reputex Future Energy, Reputex Governance Leaders, Reputex Sustainability 120 Index.

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Tabella B.1 Specifiche pratiche di investimento sostenibile regolamentate

Paese	Specifiche pratiche regolamentate (per fondi pensione)
EUROPA	
Austria	Nessuna
Belgio	I fondi pensione governativi non possono investire in aziende produttrici di mine anti-uomo, munizioni e armi contenenti uranio.
Danimarca	I fondi pensione governativi non possono investire in aziende operanti in paesi soggetti a sanzioni dalle Nazioni Unite Gli investitori istituzionali devono fornire informazioni seguendo un approccio "comply or explain" sulle attuali pratiche di investimento responsabile nel proprio bilancio annuale o rispondere al questionario annuale dei PRI come da regolamento della commissione di supervisione finanziaria danese (2009)
Francia	I fondi pensione governativi selezionano le aziende in cui investire in base a criteri tra cui: adesione all'iniziativa del Global Compact delle Nazioni Unite, rispetto e promozione dei diritti umani e dei lavoratori, creazione di impiego, protezione dell'ambiente, rispetto del consumatore, pratiche di commercio equo e buoni standard di *governance* aziendale.
Germania	Nessuna
Italia	Nessuna
Paesi Bassi	Fondi pensioni governativi non possono investire in aziende produttrici di mine anti-uomo, bombe a grappolo e armi chimiche o biologiche.
Norvegia	Fondi pensioni governativi non possono investire in aziende che producono armi che violano principi umanitari fondamentali e tabacco o che vendono armi e materiale militare a Stati elencati nelle linee guida.
Spagna	Nessuna
Svezia	Fondi pensioni governativi selezionano aziende in cui investire in base all'adesione all'iniziativa del Global Compact delle Nazioni Unite e alle linee guida per imprese multinazionali dell'OSCE; Fondi pensioni governativi escludono dall'universo degli investimenti aziende coinvolte nello sviluppo o produzione di armi nucleari o bombe a grappolo.
Svizzera	Nessuna
Regno Unito	Fondi pensione sono incoraggiati ad applicare, seguendo un approccio "comply or explain", lo *Stewardship Code*, formulate dal Financal Reporting Council sull'esercizio dei diritti di voto e attivita' di azionariato attivo (2010)
STATI UNITI E CANADA	
Canada	In Manitoba, una delle province del Canada, la legislazione federale specifica che la considerazione di informazioni non finanziarie da parte di fondi pensione non e' proibita, se i doveri fiduciari degli investitori sono rispettati.
Stati Uniti	Il *Sudan Accountability and Divestment Act* del Congresso (2007) appoggia legislazioni federali per disinvestimenti da aziende con operazioni e affari in Sudan. 35 stati federali hanno adottato tali politiche per fondi pensione pubblici. Diciotto stati federali hanno adottato legislazioni per il disinvestimento da aziende con legami finanziari nel settore petrolifico, militare e nucleare dell'Iran da parte di fondi pensione pubblici.

AMERICA LATINA	
Brasile	Nessuna
Messico	Nessuna
AFRICA	
Egitto	Nessuna
Marocco	Nessuna un insieme di principi o line guida
Sudafrica	Investitori istituzionali sono incoraggiati ad applicare, seguendo un approccio "comply or explain" , il codice *CRISA - Code for Responsible Investing in South Africa* un insieme di linee guida per l' analisi di investimento e l'esercizion dei diritti di voto in rispetto dei PRI e per la promozione della *governance* aziendale delle imprese nei portafogli (2012)
Tunisia	Nessuna
ASIA E OCEANIA	
Australia	Nessuna
Hong Kong e Cina	Nessuna
Malesia	Nessuna
Thailandia	Nessuna

Tabella B.2 Strategie di investimento responsabile (IR)

Regione	Dati ($ indica dollari statunitensi)	Motivazioni e attori influenzanti	Strategie di investimento responsabile
Europa	- Mercato IR: €5 mila miliardi - 46% del patrimonio totale - Numero di firmatari dei PRI: 549	- Società civile - Riduzione del rischio e protezione degli investimenti	- *Screening* negativo (soprattutto basato sui principi delle Nazioni Unite: alcuni paesi escludono investimenti in armi e munizioni); più comune nei paesi nordici - Integrazione di criteri ESG in decisioni di investimento (pratica più comune) - Azionariato attivo (esercizio di diritto di voto e dialogo con il *management* aziendale) - Fondi tematici ambientali in Germania e Paesi Bassi
Stati Uniti e Canada	- Mercato IR negli USA: $3.1 mila miliardi, 12% del patrimonio totale - Mercato IR negli USA: $530 miliardi, 20% del totale del patrimonio - Numero di firmatari dei PRI: 199	- Religione - Società civile	- Esistenza di fondi etici con approcci misti per clienti diversi - Crescente interesse verso l'integrazione di criteri ESG in decisioni di investimento (per riduzione del rischio) – approccio attualmente preferito nel mercato dell'IR - Azionariato attivo (esercizio di diritto di voto, presentazione di risoluzioni durante le assemblee generali e dialogo con il *management* aziendale)
America Latina	- Mercato IR (Argentina, Brasile, Cile, Colombia, Messico e Perù): $5 miliardi - Numero di firmatari dei PRI: 63	- Filantropia	- Politiche di responsabilità sociale d'impresa, come la donazione di una % dei profitti dei fondi - *Screening* basato su indici di sostenibilità - *Impact investing*
Africa	- Mercato IR (Egitto, Marocco, Tunisia): $2.6 miliardi, 1.7% del totale del patrimonio - Mercato IR South Africa: $115 miliardi, 20.7% del totale del patrimonio - Numero di firmatari dei PRI: 45	- Religione (Shari'ah) - Sviluppo locale	- Screening negative basato sui principi di finanza islamica - *Impact investing* - *Screening* basato su indici di sostenibilità
Asia e Oceania	- Mercato IR Australia:168.5 miliardi di dollari australiani, 8% del totale del patrimonio - Mercato IR Hong Kong: $10 miliardi su $2.3 mila miliardi di mercato finanziario - Numero di firmatari dei PRI (Asia): 69 - Numero di firmatari dei PRI (Oceania):139	- Pratiche di gestori stranieri (Hong Kong) - Infrastrutture (Hong Kong) - Riduzione del rischio e protezione degli investimenti - (Oceania)	- Approcci molto diversi - Integrazione di criteri ESG in decisioni di investimento (pratica più comune) (Oceania) - Azionariato attivo (esercizio diritti di voto e dialogo con il *management* aziendale) (Oceania)

Tabella B.3 Ruolo delle borse valori nel mondo per la promozione degli investimenti responsabili e la sostenibilità (tratto da Responsible Research, 2012)

Nome della borsa valori	Paese	Ha firmato i PRI?	Ha istituito indici di investimento di sostenibilità?	Ha offerto linee guida e condiviso buone pratiche di sostenibilità tra le aziende quotate nel mercato locale?	Ha promosso lo sviluppo di piattaforme di scambio legate alle emissioni di carbonio?
Australian Securities Exchange	Australia	NO	NO	NO	SI
BM&FBOVESPA	Brasile	SI	SI	SI	SI
BME Spanish Exchanges	Spagna	NO	SI	Non disponibile	Non disponibile
Bolsa de Santiago	Cile	NO	NO	NO	NO
Bolsa Mexicana de Valores	Messico	NO	SI	SI (fonte informale)	NO
Bombay Stock Exchange	India	NO	SI	SI (fonte informale)	NO
Bursa Malaysia	Malesia	NO	NO, ma pianificato per il futuro	SI	NO
Deutsche Borse AG	Germania	NO	SI	SI	SI
Hong Kong Exchanges and Clearing	Hong Kong	NO	NO	SI	NO
Indonesia Stock Exchange	Indonesia	NO	SI	Non disponibile	Non disponibile
Istanbul Stock Exchange	Turchia	SI	NO, ma pianificato per il futuro	NO	Non disponibile
Johannesburg Stock Exchange	Sudafrica	SI	SI	SI	NO
Korea Exchange	Corea del Sud	NO	SI	SI	NO
London Stock Exchange Group	Regno Unito	NO	SI	NO	NO
Moscow Interbank Currency Exchange	Russia	NO	NO	Non disponibile	Non disponibile
NYSE Euronext	Stati Uniti, Francia, Paesi Bassi, Portogallo, Belgio, Regno Unito	NO	SI	Non disponibile	Non disponibile
Nasdaq OMX	Stati Uniti, Finlandia, Danimarca, Svezia, Islanda	NO	SI	Non disponibile	Non disponibile

National Stock Exchange of India	India	NO	SI	NO	NO
Philippine Stock Exchange	Filippine	NO	NO, ma pianificato per il futuro	NO	NO
Saudi Stock Exchange - Tadawul	Arabia Saudita	NO	NO	Non disponibile	Non disponibile
Shanghai Stock Exchange	Cina	NO	SI	SI	NO
Shenzhen Stock Exchange	Cina	NO	SI (fonte informale)	SI (fonte informale)	NO
Singapore Exchange	Singapore	NO	NO, ma pianificato per il futuro	SI	NO
SIX Swiss Exchange	Svizzera	NO	NO, ma in considerazione	NO	NO
The Stock Exchange of Thailand	Tailandia	NO	NO, ma pianificato per il futuro	SI	NO
Tokyo Stock Exchange	Giappone	NO	SI	NO	NO, ma pianificato per il futuro
Toronto Stock Exchange	Canada	NO	SI	SI	SI
Leader nel settore (con 3 o 4 dei parametri selezionati)					

Vitae

Daniela Laurel completed her Ph.D studies in Management, Economics, and Industrial Engineering at the Politecnico di Milano in Italy in 2013, 18 months of which were spent as a visiting scholar to the department of Accounting and Control at HEC Paris in France. Her current research centers on a rethinking of finance by investigating the increasing importance of sustainability issues within financial markets. During her doctoral studies, Daniela was also a teaching fellow of Corporate Finance at the Politecnico di Milano. Daniela has served as an adjunct professor of the Ateneo de Manila University School of Government since 2010 where she helped develop a Leadership and Social Entrepreneurship certificate program for Filipino overseas foreign workers in Europe.

Prior to pursuing a career in academia, Daniela worked as an Investment Banker (Mergers and Acquisitions) at the Royal Bank of Scotland (formerly ABN AMRO headquarters) in the Netherlands and at Credit Suisse in the Philippines. She holds an MBA from the Universidad Carlos III de Madrid in Spain and a BSc. in Management from the Ateneo de Manila University in the Philippines.

Born and raised in Manila, the Philippines, Daniela is married to an Italian, Stefano Fois. The couple is based in Paris, France.