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Accepting responsibility

The absence of tools to assess the performance of sustainable investing is a barrier to its adoption

Of SA's R4 trillion asset management industry, investment mandates for socially responsible investments (SRI) are a mere 1%. This is a sobering statistic given the need for sustainable growth in our economy. The challenges have been articulated in the National Development Plan and range from energy security and infrastructure development, to health, housing and education issues.

But why has SRI failed to entrench itself in the mainstream financial community? Why do the boards of trustees of pension funds not look more seriously at SRI and what are the barriers to sustainable investing? There seems little point to focus solely on financial returns if pension fund members will retire into a society whose fabric is crumbling.

There is an abundance of overlapping terminology: responsible investing; ethical investing; environmental, social and governance (ESG); SRI; and more recently impact investing. Strip away the jargon and you are left with a simple imperative: invest with a long-term, sustainable view that seeks to deliver a good financial return, as well as address societal issues.

It's a no-brainer that long-duration debt-funded investments of 15-20 years are ideally suited to pension funds that are aiming to match pension liabilities, as they provide an amortising repayment profile and natural inflation hedge.

Sustainable investing is gaining attention worldwide as the public mindset shifts to preserving scarce resources. In June 2013, the G8 Social Impact Investing Forum launched the concept of development impact bonds and at the February 2014 World Economic Forum in Davos, the work of the WEF Mainstreaming Impact Investing initiative was taken further.

In a proposal for my PhD thesis, I examined three barriers to sustainable investing: a reinterpretation of fiduciary duty; a lack of evaluation tools for sustainable investments; and the accountability gap between corporate stakeholders.

According to the Pension Funds Act, fiduciary duty prescribes that trustees, fund managers and investment consultants act "in the best interest" of their beneficiaries. Globally, this has been interpreted as maximising risk-adjusted returns. Since the turn of the century, a new approach to fiduciary duty, led by academics and economists in the US, arose. It states that institutional shareholders represent a proxy for the entire economy and that it is precisely because of fiduciary duty that ESG factors must be considered when there is long-term potential for financial gain from them.

However, the absence of a unitary framework to assess the financial value of an SRI investment is a major impediment. Ratios such as p:e and ROE are common in the traditional investment industry, but no equivalent metrics exist for SRI.

In the early 2000s, academic Jed Emerson developed the term "social return on investment", and proposed tools to track performance of what he calls the "blended value proposition" — which combines social and financial return. Such models are part of an emerging line of work to rectify the limitations of traditional accounting statements.

A third impediment to shifting SRI from the margins to the mainstream lies in the "accountability gap" between corporate executives, shareholders, and other stakeholders. Executives are overwhelmingly motivated by short-term profitability, which ultimately determines their compensation. SRI initiatives are often long-term in nature. Direct and immediate recognition in monetary terms might not occur within their term of office.

In SA the debate on sustainable investing has just begun. Yet there are encouraging signs of what might be possible. To date the private sector has invested R82bn in government's renewable energy Independent Power Producer programme. Let's hope this leads to investment in other sectors too. ■

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