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# Socially Responsible Investment in South Africa

## Naledi Pension Fund Unit

## Research Paper Series

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## Introduction

Socially Responsible Investment (SRI) or more accurately dis-investment has a long history in SA in the form of the anti-apartheid sanctions movement that resulted in major trans-national companies disinvesting from South Africa is an attempt to place economic and moral pressure on the apartheid government. In more recent years some companies have moved towards triple bottom line accounting[1] in an effort to make themselves more transparent as well as attractive to socially responsible investor. This move has in recent months (October 2003) been given further impetus by the Johannesburg Stock Exchange's (JSE) publication of a background document outlining the selection criteria for the development of an SRI Index. This move in South Africa is situated within a global move towards more socially responsible investing patterns. Indeed as Table One below shows socially responsible investment enjoys a considerable presence in most of the world's major markets.

**Table 1: Global trends in SRI (Source: Social Investment Forum 2003)**

**FIGURE 16: GLOBAL TRENDS IN SRI**

| | Common screens/ approaches | Legal/ Regulatory Environment | Relative SRI Market Size *(U.S. Dollars)* |
|---|---|---|---|
| NORTH AMERICA | Tobacco, alcohol, and gambling, followed by environmental and human rights, are the most common screens; growing participation in shareholder advocacy and capitalization of community investing. | Recent disclosure and transparency requirements by the Securities and Exchange Commission in U.S., amid overall increased regulatory attention. | **Canada**: $38.2 billion total in SRI (June 2002), with 53 retail mutual funds.<br>**U.S.**: $2.16 trillion total in SRI (Dec. 2002), with 200 retail mutual funds. |
| EUROPE | Environmental and labor screens are most popular; "SRI" perceived as more than applying single exclusionary screen; shareholder engagement strategy commonly used. | Leadership through new laws and SRI tax-free schemes by country and EU governments boost pro-SRI policy and participation growth. | 280 retail and institutional funds available as of 2001.<br>$260 billion (including retail, pension, and shareholder advocacy). |
| ASIA | Community investing active at local level; growing number of funds in Japan, Hong Kong and Australia, which provide opportunity for pension funds; environmental screens dominate. | **Australia:** Disclosure requirements on social and environmental issues in investment decisions.<br>**Rest of Asia:** No real SRI-related policy in place, but there is increasing attention, especially among multinational fund managers. | **Australia:** $14.3 billion (August 2003, with $2.2 billion in managed SRI funds). 74 funds total (31 percent increase in total number of funds in one year).<br>**Rest of Asia:** $2.5 billion total (December 2002). |

It is in this context that Cosatu is contemplating the more active pursuit of SRI in the South African economy. This paper aims to inform the strategies adopted by Cosatu and Naledi in this process.

This paper has two key objectives. The first is to determine whether or SRI is an economically viable strategy to be pursued by Cosatu- Affiliated Pension Funds i.e. do these funds give a rate of return that is comparable to general investment vehicles. The second is to assess what constitutes SRI in terms of existing practice. This will enable an assessment of whether Cosatu's support of existing SRI funds will have a positive impact on Cosatu's pursuit of certain economic and social development objectives.

The first section of the paper briefly outlines some definitions of SRI and related concepts like Corporate Social Responsibility and social reporting. The paper then moves on to discuss some of the broad trends in socially responsible investment. In the third section of the paper we examine the South African landscape paying particular attention to the development of a social responsibility index on the JSE as well as to the funds that operate as socially responsible investors in the SA context. In this third section we examine the performance of select SRI funds against both the JSE all share index and some of the top performing funds on the JSE. This information will be useful to Cosatu in guiding its decisions around investing in SRI funds. The fourth section of the paper examines the actual companies that JSE listed SRI funds are investing in and attempt to provide some information on each of those companies. Through providing this information we hope to develop an analytical framework that will enable Cosatu to reach decisions as to whether or not support for SRI will in fact further their own socio-economic agenda. In conclusion we examine various socially responsible indices and screen with a view to providing Naledi with the basis to assess the feasibility of establishing their own SRI benchmarking competency.

[1] Triple bottom line accounting refers to the increasing trend of companies to report not only on the financial performance but also on the impact on economic, social and environmental sustainability.

## Defining Socially Responsible Investment

Before diving into the detail of what constitutes socially responsible investment (SRI), it is worth pausing to examine related concepts all of which fall within the broad ambit of efforts to ensure that private companies act with greater sensitivity to social and environmental sustainability.

The oldest form of responsible behaviour from corporations falls in the arena of corporate social responsibility. Traditionally this refers to initiatives undertaken by the corporation, **outside** of their core operations to contribute to the greater good of society. Perhaps the most prominent example of this in the South African landscape would be the Anglo American Chairman's Fund that undertakes a whole range of socially responsible activities from supporting education to sponsoring sports development. Theoretically, it is possible for a company to have a strong corporate social responsibility programme whilst being socially irresponsible as it chooses to manufacture in environmentally unfriendly ways.

Concurrent with the rise in SRI has been a rise in social reporting by companies. Simply, this is reflected in companies' efforts to report on the progress they have made in contributing to the 'triple bottom line'. For instance South African Breweries both in its local incarnation as well as in its international version SABMiller plc report on their social, environmental and economic impact in a standalone report that is often regarded as a leading example of social reporting. Included in this report are details for example on their compliance with emission standards, health and safety incidents and water utilisation. In other words they report on their efforts within their core operations to advance social responsibility.

Socially responsible investment falls within this broad universe and probably reflects the most recent of developments in initiatives to advance private sector social responsibility. A review of the literature on social responsibility investment makes it clear that there is a wide range of behaviours that are considered to be "socially responsible". The definitions vary from being exclusionary to inclusive. The former definitions define what areas a fund **will not** invest in. For example, the Domini 400

Funds[2] apply a series of social screens as the first step in their investment decision-making process.

*"We seek to avoid investment in certain industries whose practices, we believe, are detrimental to society. The Domini Funds do not invest in companies or other issuers that manufacture tobacco or alcohol, or derive revenues from gambling operations, or the ownership or operation of nuclear power plants. We also exclude major military contractors and firearms manufacturers" (www.domini.com)*

Until November 1993 this fund also excluded companies that invested in South Africa.

The inclusive definitions of SRI try to define a set of activities, investments or corporate policies that are perceived to be critical to social responsibility. These behaviours can take a wide range of forms from being environmentally sustainable practices, to the adoption of employment equity programmes, to investing in areas such as infrastructure that are seen as critical to the development of a country.

This inclusive approach is adopted by Alexander Forbes Asset Management Consultants (2003) in their quarterly review of 'targeted development investment vehicles'. They define SRI in the following manner:

*" Targeted development investments aim to achieve improvement of human life and social infrastructure to ensure broad based economic empowerment of people. The nature of this type of investment includes:*

- *Construction of roads, bridges and dams;*
- *Building of schools, hospitals, correctional facilities with adequate capacity;*
- *Job creation through expansion plans;*
- *Broad based economic and social empowerment; and*
- *Employment equity through affirmative action"*

[2] "The Domini 400 Social Index℠ is a market capitalization-weighted common stock index. It monitors the performance of 400 U.S. corporations that pass multiple, broad-based social screens. The Index consists of approximately 250 companies included in the Standard & Poor's 500 Index, approximately 100 additional large companies not included in the S&P 500 but providing industry representation, and approximately 50 additional companies with particularly strong social characteristics" (Source: www.domini.com)

The Social Investment Forum (2003) defines SRI as follows, "Whether described as social investing, ethical investing, mission-based investing, or socially aware investing, SRI reflects an investing approach that integrates social and environmental concerns into investment decisions".

Thus in the broadest sense socially responsible investment can be deemed to be that investment which seeks to better the social fabric. It may do so in a fairly minimalist fashion excluding certain investment areas or it may take a considerably more active approach to social responsibility defining investment practices and corporate behaviours that are deemed by the funds owners to be socially responsible. This latter area takes us into the area of socially responsible indexes, an issue to which we will return in the concluding section of this paper.

## Socially Responsible Investment Trends

### *What is it?*

There are essentially 3 broad approaches to socially responsible investing namely:

- **Screening.** Screening seeks to include, rate and / or exclude particular types of investment. Thus for instance screening may result in investments in a company seeking to build primary health care facilities but may exclude investments in a construction company that has a reputation for building dams that displace rural communities. Tobacco and Alcohol are overwhelmingly the two most popular screens in the US accounting for over $200 billion of screened funds;
- **Shareholder Advocacy.** This approach seeks to use shareholder votes to influence corporate behaviour towards socially responsible goals; and
- **Community Investment.** This seeks to make capital available to communities and / or individuals that may otherwise not receive financing from mainstream corporate finance sources.
  (Social Investment Forum, 2003)

### *Is it worth it?*

The perennial question surrounding SRI is the rather simple one of is it worth it? Geoffery Chandler, founder chair of Amnesty International Business Group between

1991 and 2001, and a senior executive with the Royal Dutch/Shell Group, argues, "The moral argument for doing good should be reason enough for companies to behave responsibly". Undoubtedly there exists a similar argument for investing that runs along the lines of "investments that create a better, more sustainable life over the long-term are worth the short-term sacrifice in direct financial returns to the investor". While this paper does not question the validity of this formulation, it does concern itself with the narrower question of do socially responsible investments give investors similar or better returns than conventional investments? In doing so it does not seek to prioritise financial over social returns, but merely to provide some clear financial benchmarks to aid decision making processes that may be informed by this paper.

In a briefing paper written for the Business Map Foundation, Heese (2003) notes:

*"There is an air of triumph as the SRI industry has managed to prove a definitive financial case for ethically based investments. Although market performance has lagged over the past three years, 65% of the 51 screened funds tracked by the Social Investment Forum earned top ratings from both Lipper, Inc. and Morningstar at the end of 2002".*

This 'air of triumph' continues to pervade much of the public commentary on SRI funds as they generally continue to outperform the market. In the most recently available analysis of the performance of US SRI funds, the Social Investment Forum (2003) notes that over the period 1995-2003 SRI funds have grown 40% quicker than all other professionally managed investment assets. Of course some of this growth is attributable to the fact that more and more people are turning to SRI vehicles as their investment destination of choice. In other words the better performance reflects a form growth that is both related to the performance of the funds in and of themselves as well as the fact that more investors are putting their money into SRI related areas.

Nevertheless in the final analysis, the US SRI story is definitely one of growth.

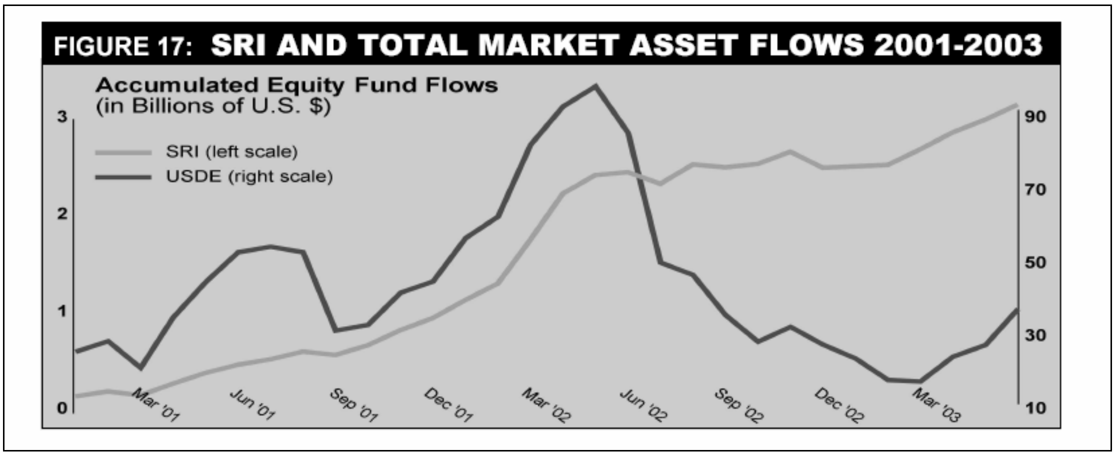


**Figure 1: US SRI and Total Market Asset Flows 2001-2003 (Source: Social Investment Forum 2003)**

As Figure 1 shows, investment flows have definitely swung towards SRI over the past 2 years. This trend is also reflected in the performance of individual funds. Figure 2 below shows the performance of the Domini 400, part of the US's oldest social investment funds. As is clear from the graph this portfolio has consistently out performed that of the Standard and Poor's 500, an index that includes the 500 leading companies in the U.S. economy.

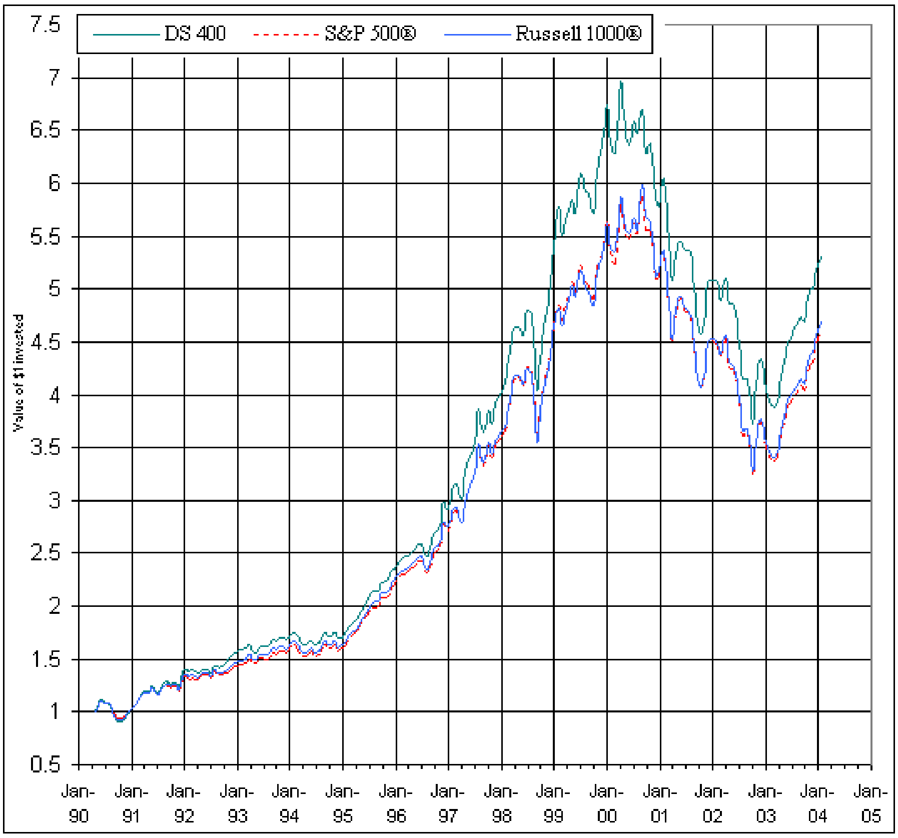


**Figure 2: Returns of the Domini 400 benchmarked against the S&P 500 (Source: www.domini.com 13/02/04)**[3]

However it is important to recognise that, notwithstanding the bullishness of some commentators, there is no necessary relationship between SRI and above-average or even average financial performance. At the same time as US SRI funds were expanding, Canadian funds were experiencing a slightly different environment – indeed they were losing market share. During the first 6 months of 2002 SRI fund assets declined by 8%. Indeed the President of the Social Investment Organisation, Eugene Ellman is quoted as saying, "I read the U.S. stats and it surprises me because it's been a down market for the last six months. I guess they've had more luck than we have had" (www.meritas.ca 02/08/02). Yet even within this environment of general decline, the main SRI fund companies had mixed fortunes. Ethical Funds' assets under management fell from $1.9 to $1.8 billion from January to June, while Acuity's dropped from $383 million to $370 million. Meritas' assets grew from $13 million to $18 million over the same period.

[3] Note: Domini Fund is the line that out performs the others (for black and white printers).

These contrasting experiences lead to a, perhaps rather obvious but nevertheless important, conclusion namely that there is no such thing as a 'sure thing'. The success of SRI funds is subject to all the usual variables of management, general market performance, fund strategy etc etc. In other words there is no necessary link between SRI and above-average market performance. Simultaneously the reverse applies that well managed SRI funds are capable of delivering above average financial returns. Thus there is no a priori economic reason that Cosatu and its affiliates should not explicitly adopt some measure of SRI principles in informing their investment decisions. Simply put it is not given that pursuing an SRI strategy will result in returns that are below the general performance of the market. It is possible to advance both socially responsible objectives through an investment strategy while ensuring that workers pension funds deliver suitable returns. That said it is critical to recognise that there is no guarantee that these funds will always perform above market averages, that is ultimately contingent on the skill of the fund managers and the manner in which the portfolios are constituted.

### *Social responsibility at the company level*

Of course for pension funds and trust funds to undertake socially responsible investments there have to be a variety of investment classes open to them to undertake these investments. Central to most of these funds is a focus on investing in private sector companies; accordingly it is worth briefly examining the performance of these companies.

Oekom Research, a German based sustainability rating[4] company, recently undertook a comprehensive study of 602 companies together with Morgan Stanley Dean Witter to assess the impact of social responsibility on companies' share price performance between December 1999 and October 2003 (Global Finance 2004). In this study they compared those companies that received the highest Oekom ratings versus those that ranked lowest on the ranking system and found that the best of class performers

[4] Sustainability rating refers to the rating / scoring of a company's performance across a range of criteria that are deemed to contribute to sustainability. Crudely, a high rating implies a high contribution to sustainability and vice versa.

outperformed the bottom of the pack by 23.4%. Furthermore by December 2003 the leading sustainability performers share price had outperformed that of the Morgan Stanley Capital International World Index by 3.8% (ibid). Thus providing further empirical evidence for the desirability of social responsibility.

Notwithstanding these results and the general hype around the performance of socially responsible companies it is important not to overstate the case. Indeed although the number of companies reporting CSR activities has risen to a few thousand globally, there are more than 50 000 registered multinational companies.

### *Summary*

In summary it is clear that, on a global basis:

- There is an increasing move towards socially responsible investment;
- Although not always outperforming general share indices there is strong evidence that socially responsible investment yields positive financial returns (over and above all the societal benefits that no doubt accrue from this strategy); and
- That companies that pursue these strategies are likely to yield positive financial returns to their investors.

Accordingly on the basis of global trends in share prices and financial performance there is no compelling reason for Cosatu Pension Funds not to prioritise the adoption of socially responsible criteria to guide their investment decisions.

## SRI in South Africa

Outside of Cosatu and its affiliates explicitly pursuing the adoption of socially responsible investment criteria, there already exist a variety of SRI Funds in the SA context. Furthermore the practice of companies reporting on non-financial issues such as corporate social responsibility and health, safety and environmental in separate reports is rising, indicating a growth in awareness of the importance of social responsibility issues. KPMG (2003) reports that 20% of companies surveyed now produce a stand-alone report. It is the purpose of this section of the paper to map out the South African landscape with the primary intentions of assessing the:

- Performance of these funds;
- Extent to which the companies in which the funds ultimately invest might be deemed to be socially responsible.

## *South African SRI Funds*

*Share price performance*

Alexander Forbes Asset Management Consultants (AFAC) reported in March 2003 that there were 14 funds with a total of R8.3 billion assets under management included in its targeted development investment survey[5]. As is indicated in Figure 3 below most of those funds were performing at levels commensurate to or better than that of the JSE All Share Index (ALSI) at that stage, although not necessarily better than the All Bond Index.

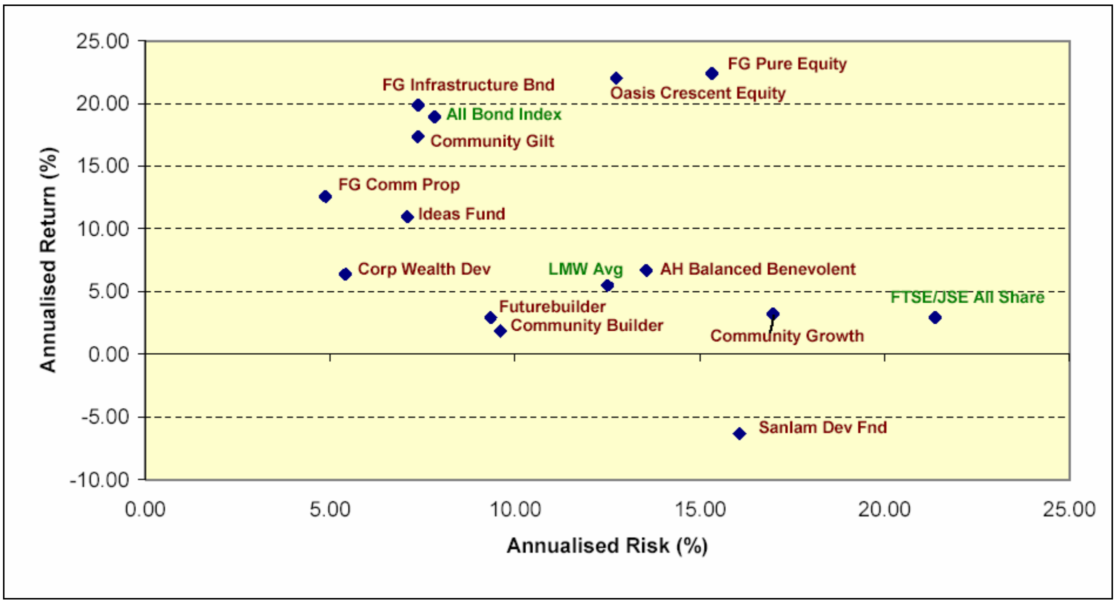


**Figure 3: Target Development Investment Portfolios 3 years ended 31 March 2003 (Source: AFAC 2003)**

[5] The survey excluded the AMB Empowerment Fund as it no longer wished to participate and the Sanlam / Oasis Fund on the basis that it had not yet operated for 12 months.

However since the publication of this report it appears that SRI vehicles on the JSE have suffered a rocky time, generally performing beneath the ALSI and well below that of the exchanges top performer, the Sanlam Select Fund.

| **Fund Name** | **Share performance relative to ALSI** |
|---|---|
| Fraters Earth Equity | 10.93% |
| Community Gilt Fund | -5.75% |
| Futuregrowth Infrastructure Bond Fund | -2.10% |
| Community Growth Fund | - |
| Futuregrowth Albaraka Equity Fund | - |
| Oasis Crescent Equity Fund | - |
| ALSI | 12.09% |
| Sanlam Select (best performer) | 41.70% |

**Table 2: Updated performance of JSE listed SRI vehicles (Source: RMB Asset Management; 8/03/2004)**

The current performance of these funds need not weigh against the decision to pursue an SRI strategy but serves to strengthen the earlier point that there is no given relationship between socially responsible investment and a leading market performance. Nevertheless, a year ago the analysis conducted by AFAC 2003 reflected in Figure 3 above shows that the annualised return of these funds over a 3 year period significantly outperformed the JSE ALSI. Thus when assessing the performance of the SA SRI funds one has to keep in mind the effects of temporary downturns in the markets or the fortunes of particular funds. As was said in the review of international trends, the evidence weighs on the side of suggesting that these funds are currently consistently out performing the market, and in the case of funds like the Domini 400 even outperform leading indices such as the S&P 500.

### *Profiles of South African SRI funds*

Table 3 below provides a detailed description of the various SRI funds that currently invest in companies on the JSE. These funds run the full gamut of SRI funds from those that adopt an exclusionary approach like the Futuregrowth Albaraka Equity Fund and the Oasis Crescent Equity Fund to those that adopt a more inclusive approach like the Community Growth Fund that seek to promote particular types of investment. Most of these funds adopt some kind of screening approach. Although

SRI funds like the African Harvest Women's Initiative Managed Flexible Fund invests across a range of asset classes but makes its socially responsible contribution through the donation of support money for the "protection, safety and ultimately the advancement of women and children". In other words it seeks to advance social responsibility not, in the first instance through its, investment approach but rather through the disbursement of profit. Accordingly it may be viewed to be consistent with the community investment approach described above.

**Table 3: Profiles of all listed JSE SRI funds (Source: Adapted from http://www.profile.co.za)**

| Fund Name | Description of SRI focus | Top Companies |
|---|---|---|
| Community Growth Fund | Concentrates on investing in those companies that are concerned with job creation, training and skills development, employment equity, economic and social empowerment, good conditions of employment, high health and safety standards, sound environmental practices and effective corporate governance | ❑ BHP Billiton;<br>❑ MTN;<br>❑ Sasol;<br>❑ Impala Platinum;<br>❑ First Rand;<br>❑ Standard Bank;<br>❑ Imperial Holdings;<br>❑ Delta;<br>❑ AECI. |
| Fraters Earth Equity Fund | Shares are selected based on bottom-up research conducted by Fraters. The investment process has an overlay of shareholder activism in the sphere of corporate citizenship. | ❑ Remgro;<br>❑ Gold Fields;<br>❑ Anglo Gold;<br>❑ Sasol;<br>❑ Venfin;<br>❑ Altech;<br>❑ Tongaat;<br>❑ Tiger Brands;<br>❑ SAB Miller |
| Futuregrowth Albaraka Equity Fund | The fund is strictly managed in accordance with Shari'ah Law and therefore does not invest in shares that have an association with alcohol, gambling, non-halaal foodstuffs or interest-bearing instruments. | ❑ Sasol;<br>❑ Iscor;<br>❑ Tongaat;<br>❑ Anglo;<br>❑ Nampak;<br>❑ Barloworld. |
| Oasis Crescent Equity Fund | The portfolio excludes companies that are involved in gambling, insurance or other financial services companies, as well as companies that are highly geared. In addition, any non-permissible income earned by the portfolio may be donated on behalf of the investors to charity. | ❑ Afrox,<br>❑ Sasol;<br>❑ Anglo;<br>❑ Nampak;<br>❑ NuClicks;<br>❑ Barloworld;<br>❑ Venfin;<br>❑ Medclin;<br>❑ U-Oasmmkt |

| Fund Name | Description of SRI focus | Top Companies |
|---|---|---|
| Community Gilt Fund | Invests funds into longer term fixed interest instruments with an emphasis on institutions and projects that contribute to the development of South Africa, through meaningful social impact, commitment to development, community participation and support. | ❑ R157 (Bond);<br>❑ R153 (Bond;<br>❑ R194 (Bond);<br>❑ DV07 (Bond). |

For the most part these funds invest in the domestic equity market i.e. companies that are listed on the JSE, with the exception of the Community Gilt Fund that invests in bonds.

*SRI status of investment destinations*

Given that there currently exists no social responsibility index for companies listed on the JSE nor does Cosatu have any other measure to assess the social responsibility of companies, this paper has sought to use a number of proxy indicators to at least give a flavour for the extent to which these companies may be deemed to be socially responsible investment destinations. These are:

1. Whether or not the company publishes a stand-alone non-financial report. Whilst in and of itself this proves nothing about the extent to which a company takes social responsibility seriously, it is probably fair to conclude that if they take these issues seriously enough to publish a separate report then social issues are at least a major part of their strategic considerations;
2. Whether or not social issues are incorporated as separate issues within the main annual report; and
3. The company's performance in the Deloitte and Touche "Best Company to Work For" competition. This competition is purely voluntary, but the assumption is that the companies that have entered the competition do so because they take issues of employee welfare seriously. Companies' rankings in the competition are based on the results of an extensive employee survey that tests employee satisfaction within a range of dimensions.

Forty (40) percent of the companies invested in by South African SRI funds produce stand-alone social responsibility reports. This is double the 20% average reported by

KPMG (2003) and is probably a fairly good indication of the extent to which all the these companies take social responsibility or corporate citizenship issues seriously. Of the remaining 60% all but 3 companies have explicit sections in their annual reports dealing with issues of social responsibility and one of these – Tiger Brands has an ex explicit CSR project; "Unite against Hunger".

Only one of the companies, SAB was listed in the Top 20 of the Deloittes and Touche "Best Company to Work For" competition. SAB finished number 2 in this competition. This does not mean that the other companies do not take employee issues seriously. They may simply have chosen not to enter the competition or had chosen to enter it but did not finish in the top 20.

**Table 4: Social responsibility reporting behaviour of SRI fund destination companies (Sources: Adapted from KPMG 2003 and individual Annual Reports)**

| Top Companies | Stand-alone non-financial report | Other means of addressing SR issues |
|---|---|---|
| AECI. | - | Adopted Global Reporting Initiative guidelines for reporting on environmental issues |
| | | Signatory to "Responsible Care" |
| | | Implementing ISO 14001 |
| | | Winner 2003 Good Governance Awards |
| Afrox, | - | Code of conduct guiding social, environmental and good governance business principles |
| Altech | - | - |
| Anglo Gold | AIDS report Social Report | |
| Anglo | Towards Sustainable Development | |
| Barloworld. | Corporate Citizen Report | |
| BHP Billiton | Health, Safety, Envrionment and Community Report | |
| Delta Electrical Holdings | - | |
| First Rand | Corporate Social Investment Report | |
| Gold Fields | Sustainable Development Report | |
| Impala Platinum | Environment, Health, Safety and Community Report | |
| Imperial Holdings | - | - |
| Iscor | - | Implementing ISO 14001 |
| Mediclinic | - | ISO 14001 implemented |
| | | SR section in Annual Report |
| MTN | - | MTN Foundation |

| Top Companies | Stand-alone non-financial report | Other means of addressing SR issues |
|---|---|---|
| Nampak | - | Sustainability section in Annual Report |
| NuClicks | - | Corporate Citizen section in Annual Report |
| Remgro | Sustainability Report | |
| SAB Miller | Corporate Accountability Report | |
| Sasol | Sustainable Development Report | |
| Standard Bank | - | Corporate and Social Investment Section in Annual Report |
| Tiger Brands | - | - |
| Tongaat-Hulett | - | SHE; BEE and CSR component to Annual Report |
| Venfin | - | Corporate Citizen section in Annual Report |

Whilst it is clearly impossible to conclude, in the absence of a systematic application of some index, that these companies are socially responsible it would certainly seem that at the reporting level and at the level of actual activities (reflect in Table 5 below) there is recognition of the importance of these issues. Albeit only a proxy this may in the first instance be an initial indication of the companies approach to social responsibility. However it would only be through the systematic and independent application of some index would one be able to establish the veracity of the statements made in the various reports.

| Company | Example of Socially Responsible Activity |
|---|---|
| SABMiller | Newland's Brewery one of the first sites in SA to receive Investor in People accreditation. |
| Barloworld | Implementation of HIV / Aids policy as well as strategies to encourage employees to 'know their status' and support those that are HIV+ |
| FirstRand | Through the First Rand Foundation funds various environmental projects. |

**Table 5: Selected examples of socially responsible behaviours in some SA SRI fund destination companies**

### *The Johannesburg Stock Exchange and SRI*

The Johannesburg Stock Exchange is currently investigating implementing a social responsibility index. The implementation of this Index mirrors similar indices on other stock exchanges, including the Dow Jones Sustainability Index on the New York Stock Exchange and the FTSE4Good on the London Stock Exchange. To be considered for inclusion on the FTSE4Good companies first have to show a commitment to:

- Environmental Sustainability;
- Upholding and Supporting Universal Human Rights; and
- Developing positive relations with Stakeholders.

Beneath these broad criteria the there are a range of practices that must be complied with in order for a company to be included in this index. For example, companies need to donate in excess of £50,000 per annum to charitable causes.

The Dow Jones launched two sustainability indices in 1999 in response to growing shareholder demand for such vehicles. Dow Jones argues that they have adopted this approach "Because 'What gets measured, gets done', they (companies) will be motivated to increase long-term shareholder value by integrating economic, environmental and social factors in their business strategies". In adopting this approach the DJSI is demonstrating a philosophical congruence with the results of the Oekom research cited above, namely that individual companies pursuing socially responsible behaviours are likely to deliver better long-term results.

The implementation of the JSE SRI index was given considerable impetus by the Second King report on Corporate Governance that encouraged companies to incorporate triple bottom line thinking into their way of doing business. The JSE SRI Index will be composed of 3 pillars that reflect the ethos of triple bottom line reporting:

1. Environmental sustainability;
2. Economic sustainability; and
3. Social sustainability

For each of these pillars companies will be expected to be able to demonstrate that they have policies, management and reporting systems in place to advance the objectives defined for each pillar. In addition companies will be expected to show that they have good corporate governance practices in place.

To be included in the Index, companies will have to achieve a minimum of the following scores:

- Twelve in relation in corporate governance practices;
- Twenty-two in relation to social sustainability practices;
- Eighteen in relation to economic sustainability practices; and
- In relation to environmental practices
    - Twenty for a high impact company[6] (eg construction);
    - Fourteen for a medium impact company (eg retail); and
    - Eight for a low impact company (eg: banks).

| **Practice** | **Example of company activity measured by the SRI Index** |
|---|---|
| Corporate Governance | Do separate individuals hold positions of chairman and CEO? |
| | What percentage of overall costs are spent on Hiv / Aids programmes; Health and Safety Programmes. |
| Social Sustainability | Does the company have is place policies that cover corporate governance, ethics, corruption, stakeholder engagement, black economic empowerment, human resources, health and safety, HIV / Aids, Employment Equity, Human Rights, Community Development and Consumers and Consumer Groups? |
| Economic Sustainability | Employee Share Ownership Scheme. |
| Environmental Sustainability | Does the company have an environmental policy? |
| | Are any threatened and / or endemic species of fauna and flora impacted upon, directly or indirectly, by the company's activities? If so, please state which and what measures are in place to protect these? |

**Table 6: Examples of activities assessed by the JSE SRI Index**

6 See Appendix A for a full outline of high / medium and low impact companies.

In addition companies will be expected to achieve a minimum of 70 points for all 3 pillars and the corporate governance aspect. Points are gained as outlined in Table 7.

**Table 7: Points system for the FTSE/ JSE Social Index**

| Score | Level of adoption / implementation |
|---|---|
| 0 | **None**<br>*There is no policy / system in place and only sporadic or ad hoc activity takes place, if any* |
| 1 | **Partial or efforts**<br>*There is a policy / system in place, but does not meet the level set by the Criteria; or*<br>*Evidence exists that regular / systematic efforts are being made to implement a policy / system* |
| 2 | **Full / Complete**<br>*There is a policy / system in place which fully meets the level set by the Criteria* |
| 3 | **Exceeding**<br>*There is a policy / system in place which exceeds the level set by the Criteria, or which is certified by or registered in terms of an accepted international or other standard e.g. ISO, AA, EMAS etc.* |

The assessment of companies is achieved using a comprehensive 50 + page questionnaire that covers all the above elements in substantial detail. In addition to this quantitative assessment approach the JSE has convened a SRI Advisory Committee, which will assess major events or controversies surrounding companies on the index to assess whether or not they should continue to be included on the Index. This is in keeping with the approach of most major SRI funds that reserve the right to exercise discretion in rejecting a company on the basis of a major controversy.

The adoption of this approach by the JSE is a considerable advance towards providing a more systematic measurement of SRI activity within the country.

### *Summary*

The above section has covered the following points:

- Socially Responsible Investment is a feature of the South African landscape;
- It occurs across most asset classes but appears to be concentrated in the general equity and bond markets;

- Like in the international context various SRI funds have had mixed performances – some better than the ALSI, some worse;
- The best performing fund on the JSE does not restrict itself to investing on the basis of social responsibility; and
- The adoption of a Social Responsibility Index by the JSE is a considerable advance in the monitoring of social responsibility in South Africa.

## Naledi and Social Responsibility

In this following section, the paper draws on a substantive review of different approaches to social responsibility investment to try and map out a path for Cosatu / Naledi. While the JSE’s adoption of an SRI Index should ideally make it easier for union pension funds to identify preferred investment destinations, there may in fact be union-specific concerns that are not addressed by the SRI Index. Accordingly it is worth discussing how Naledi / Cosatu might engaged in promoting socially responsible investment by union pension funds. However before diving into the practicalities of such an approach it is worth addressing an issue of principle, namely that of shareholder activism.

### *Shareholder Activism*

Crudely put, shareholder activism is the attempt by shareholders to influence the direction of companies in directions that they consider to be commensurate with their best interests. Most often associated with minority shareholders that are battling it out against a majority or with shareholders fighting management there is an increasing move for socially responsible investors to adopt this role. In doing so they seek to influence the development of society not only through channelling funds towards socially responsible companies but also by influencing the behaviours of socially ‘irresponsible firms’. Although this paper has no answers to the question of whether Cosatu Pension Funds should adopt this approach it is certainly a subject for debate. For instance, should the Pension Funds seek to invest in large employers with a view to ensuring that they can play a role in protecting employment in these strategic companies, whether or not they are currently deemed to be socially responsible? However there may be areas in which generalised advocacy is not as contentious thus Cosatu could actively lobby for all recipients of SRI to publish separate corporate citizenship (or similar) reports. Such an approach would be a first step in increasing the levels of transparency surrounding companies that receive such investment.

### *Social screening*

As noted in the introduction to this paper some SRI funds select their portfolios by upfront rejecting companies engaged in certain activities and or sectors. Thus the Domini 400 eliminates companies that:

- Derive two percent or more of sales from military weapons systems;
- Derive any revenues from the manufacture of alcoholic or tobacco products;
- Derive any revenues from the providing of gaming products or services; or
- Are electric utilities that own interests in nuclear power plants or derive electricity from nuclear power plants in which they have an interest.

The difficulty with such an approach for Cosatu is that for example if it adopted the “alcoholic manufacture” screen it would not be able to invest in South African Breweries, a company that accounts for a significant number of union jobs as well as being a fore-runner in issues of social responsibility reporting. Thus the selection of such screens would need to be quite cautiously with wide-spread communication with the affected union as there are very few sectors of the economy that Cosatu would be able to screen without it appearing as if they were discriminating against some of their membership.

Nevertheless the creation of a list of ‘forbidden’ sectors or companies may well be a useful place to start simply because of its ease of administration. It would be a fairly easy process to brief pension fund trustees to interrogate administrators on investments in these areas and seek to block them should they be occurring. Indeed this would lay the basis for a version of the shareholder activism discussed above, as Cosatu would be able to use the threat of blacklisting particular companies to ensure greater compliance with union objectives.

### *Using the JSE Index*

The implementation of any social indexing mechanism appears to be associated with considerable infrastructure and HR investment, which outside of the creation of a purpose built Cosatu Investment Fund, may be beyond the current scope of activities. No doubt the implementation of the JSE Index will make the adoption of a SRI strategy by Cosatu considerably easier. However companies scores on the SRI Index will need to be correlated with their financial performance otherwise Cosatu runs the risk of being over-exposed in socially well but financially poor performing companies. Although much of the evidence discussed in this paper points to a strong link between social responsibility and financial performance, it is also clear that that is not an immutable relationship. Perhaps the easiest approach would be for Naledi to adopt a "Top 50" approach that identified the ranked the top socially performing companies and the top financially performing companies within the Index and then conduct an 'overlap' assessment before they circulated the names of these companies to all union trustees.

## Way Forward

Advancing the agenda of socially responsible investment requires a competence that rests at the heart of Cosatu, namely activism. However giving operational expression to that competence within the investment arena is perhaps slightly more complicated. Nevertheless one cannot lose sight of the fact that in its earliest forms, and indeed still today, SRI was characterized by an element of declaring 'we will not invest in companies that…'. It is this element that can potentially form the bedrock of Naledi's contribution to empowering Cosatu Pension Fund representatives to advance SRI objectives within their respective pension funds.

The first step in the process could be driving companies to participate in the JSE SRI Index by simply blacklisting companies that have not participated in the process. As of the beginning of March 2004, 70 of the 160 companies listed on the JSE had responded to the SRI questionnaire that forms the basis of participation in the Index. By promoting participation in the Index, Cosatu would ultimately have access to a sustainability ranking of all listed companies in the country.

A second, potentially more complicated, step would be to establish a set of commonly agreed screens. The complication rests in the fact that it is likely that Cosatu has membership in most companies that are traditionally ‘screened-out’ by SRI funds, for example alcohol and tobacco companies. Other screens might be more appropriate for instance, Cosatu could blacklist companies if they did not participate in designated Labour Relations Structures like bargaining councils even if those companies scored high on the SRI Index.

This approach would allow Naledi and Cosatu to ‘piggy-back’ off the work being done by the JSE while further empowering trade union representatives to adopt a shareholder activist role on Boards of Trustees. In effect it would serve to increase the level of engagement with and influence over the investment decisions driving Pension Funds without placing an enormous research and administrative burden on the Federation.

A longer-term strategy for Cosatu may be to have a representative appointed to the JSE SRI Advisory Committee as this would enable the federation to shape the development of the instruments (questionnaires etc) used to assess SRI performance as well as to further heighten the activist role. Thus for instance if a company is identified by Cosatu as recently having participated in some gross contravention of principles driving social responsibility, they may be able to use this platform to have them removed from the SRI Index.

## Conclusion

This paper set out with two major objectives, to assess:

- Whether SRI is a viable economic strategy for Cosatu Pension Funds to pursue; and
- What constitutes SRI in terms of existing practice in the South African market-place.

SRI is clearly a viable economic strategy. We have reviewed the growing international evidence that points to a strong correlation between performance on socially responsible indices and overall economic performance. However it is important to note that this is not always the case, thus in adopting an approach to SRI in South Africa care will to be given to balancing the assessment of social and financial performance given, for instance, that the top performing fund on the JSE is not an SRI fund.

We have reviewed both the funds and companies that constitute SRI in the SA marketplace. In the first instance the funds do appear to be underpinned by companies that have some level of commitment to advancing social responsibility. However it is equally clear that these currently constitute a minority in the South African corporate landscape. The advances made both in legislation (driven by the King reports) as well as the establishment of an SRI Index on the JSE will no doubt further these processes. The key for Cosatu will be defining exactly where it wishes to insert its not inconsiderable financial muscle into this terrain.

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## *SRI Internet Resources*

www.asria.org

www.eia.org.au

www.socialinvestment.ca

www.uksif.org

www.calvert.com

www.meritas.ca

www.sri-advisor.com

http://www.aflcio.org/corporateamerica/capital/toolbox.cfm

http://www.ethicalperformance.com/

http://www.sustainability.com

http://www.ftse.com/ftse4good/

http://www.sustainability-index.com/

http://www.oekom.de/index_english.html