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Responsible Investors: Who They Are, What They Want

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Responsible investors in increasing numbers are asking corporations to disclose data on their environmental, social, and governance policies and practices. These investors put this data to use in analyzing companies' financial prospects, assessing stakeholder relations (and the potential risks and rewards associated with them), making buy-sell decisions, and, when necessary, engaging with management as owners. Such investors also seek to identify companies where management has invested in credible and effective environmental, social and governance (ESG) initiatives that, broadly speaking, aim to create environmental and societal value.

Who are these investors? What types of ESG initiatives do they expect corporate managers to create, monitor, and report on? Will companies whose managers invest in such initiatives be rewarded in the marketplace? These are the kinds of questions this paper seeks to answer.

Background on Responsible Investment: Exit, Voice and Loyalty

Responsible investment in its modern form traces its origins to the 1970s, when a limited number of retail investors and small, often faith-based institutions began incorporating concerns about social and environmental issues such as civil rights, peace, and environmental pollution into their investment practices. In Japan it was also retail investors—primarily those concerned with environmental issues—who drove its early development in the 1990s. Since the 1990s, however, institutional investors in increasing numbers have entered the field, first in the United Kingdom and Europe, and then throughout the world.[1] The Principles for Responsible Investment (PRI), a worldwide coalition of asset owners and asset managers with over 1,000 signatories representing some $35 trillion in assets, exemplifies this trend. In the preamble to its six core principles, signatories to the PRI state that

> *As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognize that applying these Principles may better align investors with broader objectives of society.*[2]

Among the PRI signatories are many investors who have adopted a long-term view of the investment process. This long-term approach typically implies stricter attention to the social and environmental impacts of their investments than has been the historical norm on Wall Street. It also suggests a reduced willingness to resort to the old "Wall Street Walk" rule that relied primarily on the selling and buying of stock to indicate disapproval or approval with management in favor of more direct engagement with corporations.

In some ways, the approach of these responsible investors differs little from that of traditional value investors, who are willing not only to buy and hold, but to engage actively with corporate management as they wait for a turnaround in company fortunes. Graham and Dodd, for example, bemoaned the tendency of investors to walk away from their commitments without directly expressing their dissatisfactions to management and so helping bring about appropriate reforms. According to Graham and Dodd, this approach has the effect of "perpetuating bad management and bad policies." And as they went on to say,

> *In quixotic fashion perhaps, we wanted to combat the traditional but harmful notion that if a stockholder doesn't like the way his company is run he should sell his shares, no matter how low their price may be.*[3]

Many responsible investors with an ESG focus view corporate management's decisions from the point of view of the stakeholder model of the corporation rather than that of stockowner primacy or value maximization. This predisposition stems in part from the often disproportionately negative effects of environmental and social issues on non-investor corporate stakeholders such as employees and local communities—and from the related conviction that long-term value-maximization involves significant investment in all of a company's critical

1. For an overview of the development of responsible investment, see Louche, Céline and Steve Lydenberg, "Responsible Investing" in *Finance Ethics: Critical Issues in Theory and Practice* John R. Boatright, ed. (Hoboken, New Jersey: John Wiley & Sons, Inc.) 2010: 393-417.

2. See the website for the Principles for Responsible Investment at http://www.unpri.org/about-pri/the-six-principles/ Last visited February 19, 2013.

3. B. Graham and D.L. Dodd, *Securities Analysis* 3d ed. (New York: McGraw Hill) 1951: 616. As cited in Albert O. Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge, Massachusetts: Harvard University Press) 1970: 46.

stakeholders. A substantial body of academic research has argued that, in the long run, strategic management that takes account of, and devotes resources to, non-investor stakeholders produces companies that both perform well financially and are "built to last."[4] In addition, a number of legal scholars have recently come to question the bases in corporate law upon which the stakeholder primacy doctrine has been constructed.[5]

In short, responsible investors tend to be committed investors, long-term in their goals and loyal to the companies they choose to invest in. In addition, because of their interest in a broad range of corporate policies and practices—including ESG—these investors tend to be well-informed about the strategic direction, business models, and corporate cultures of their holdings. Corporations seeking to attract well-informed, long-term investors should presumably want to seek them out, and attract and retain them.

Four Types of ESG Investors

With an increasing number of responsible investors demanding data on an increasing number of ESG issues, corporate managers are often confused about which ESG issues are in fact most useful for these investors and why. This confusion arises because responsible investors have a variety of goals as they seek ESG data and urge corporations to perform well on the basis of ESG criteria. These different goals are not necessarily incompatible, but they do stem from different conceptual investor frameworks. Companies either adopting ESG policies and practices either for the first time or with well-established programs will want to understand these different frameworks. This understanding can help corporate managers clarify which approach they want to emphasize, as well as how, and to whom, they can most effectively target their communications.

We can identify four distinct models of responsible investment:

Focus on norms and standards: Responsible investors may seek data to help them understand whether corporations meet or exceed certain fundamental, widely recognized norms or standards of conduct in areas such as the environment, employee relations, product safety and marketing, human rights, and other stakeholder concerns. This is the approach that has been adopted by the "FTSE4Good" family of global indexes. FTSE designed these indexes, which were launched in 2001, with the aim of "objectively measur[ing] the performance of companies that meet globally recognized corporate responsibility standards."[6] Among the issues it identified were environmental sustainability, human rights, labor rights, bribery, and climate change. For each, FTSE4Good sets thresholds that a company's policies and practices must pass to be included in its indexes. These thresholds are based on internationally recognized norms and standards. FTSE4Good, working with the London-based ESG research firm EIRIS, gathers the pertinent ESG data for each company to determine if it passes these thresholds and engages with those that don't encourage improved practices.

This model promotes best practices based on widely accepted ESG norms and sets clear goals for progress in these areas. In choosing international norms and standards as its basis for judgment, FTSE4Good adopts criteria that are, by any objective measure, broadly recognized.[7]

Focus on Ratings and Rankings: Other responsible investors may seek data to help identify the companies in each industry with the best ESG and sustainability practices. This is the approach taken by the Dow Jones Sustainability Indices, which reflects the belief that "sector-specific sustainability opportunities and risks can play a key role in companies' long-term success."[8] Using a scoring system that rates and ranks corporations' ESG performance by stakeholder, Dow Jones, working with the ESG research and investment firm RobecoSAM, includes in its indexes the top 10% of companies by score in each industry.[9]

This system calls management's attention to a wide range of sustainability issues, half of which are industry-specific and half of which apply to all companies. Through communications with corporate management on its scoring system, it encourages them to make specific changes in policy and practice that will increase their sustainability scores. This approach appeals particularly to companies' competitive instincts to be judged best in their industry.[10]

Focus on Integration with Stock Valuation: Other responsible investors may seek environmental, social, and governance data to help identify stocks that are over- or undervalued. This is the approach that signatories to the UN Principles for Responsible Investment (as reflected in their statement quoted earlier) have committed themselves to pursue as part of their fiduciary duty. In addition, a number of investment banks such as Goldman Sachs, Société Générale, and Unicredit have developed proprietary systems for integrating ESG factors into stock valuation.[11]

4. See for example James E. Post, Lee E. Preston, and Sybille Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Stanford, California: Stanford University Press) 2002, and James C. Collins and Jerry I. Porras, *Built to Last: successful Habits of Visionary Companies* (New York: HarperBusiness) 1994.

5. See Lynn Stout, *The Shareholder Myth: How Putting Shareholders First Hurts Investors, Corporations and the Public* (San Francisco, California: Berrett-Koehler) 2012.

6. See the FTSE4Good website at http://www.ftse.com/Indices/FTSE4Good_Index_Series/index.jsp Last visited March 27, 2013

7. For further details on the inclusion criteria for the FTSE4Good indexes see "FTSE4Good Index Series: Inclusion Criteria." Available at http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/FTSE4Good_Inclusion_Criteria.pdf Last visited March 27, 2013.

8. See the Dow Jones Sustainability Index website at http://www.sustainability-index.com/dow-jones-sustainability-indices/index.jsp Last visited March 27, 2013.

9. In February 2012, Robeco, along with RobecoSAM, was acquired by the Japanese firm Orix Corporation.

10. For further details on RobecoSAM's ESG assessment process see http://www.sustainability-indexes.com/sustainability-assessment/corporate-sustainability-assessment.jsp Last visited March 27, 2013.

11. See the website of GS Sustain at http://www.goldmansachs.com/our-thinking/topics/gs-sustain/gs-sustain-2011/ Last visited March 27, 2013. See also Société Générale's 2011 publication *SRI—Beyond Integration: From Satellite to Core;* and Unicredit's *Environmental, Social and Governance Research—the Halo's Creed* available at https://www.unicreditgroup.eu/en/sustainability/responsible-investing/esg-research.html Last visited March 27, 2013.

Assuming that ESG data not yet recognized in the market as indicators of potential risks and rewards can give them an edge in stock-picking, these investors also look for companies that recognize and manage to these potentials. This approach also assumes that ESG costs currently "externalized" and borne by society will eventually become incorporated into markets and be borne by corporations themselves. As a consequence, this approach implicitly encourages corporate managers to consider social and environmental factors in their long-term financial and strategic planning as soon as possible.

Focus on Alignment of Business Models and Societal Goals: Still others identify themselves as "impact" investors. According to the definition used by JP Morgan Chase in its 2010 publication *Impact Investments: An Emerging Asset Class,* these are "investments intended to create positive impact beyond financial return."[12] Impact investors use ESG data to identify corporations whose products or services are closely aligned with broadly recognized societal aspirations, such as those embodied in the United Nations Millennium Development Goals. This is an approach similar to that of "shared value" creation.[13] It focuses on underserved populations and products in areas such as agriculture, water, housing, health, energy, education, and financial services. Mainstream investment houses such as Morgan Stanley are increasingly dedicating units to serve this market.[14] This approach encourages managers to focus on how their business models can target both social and financial returns.

In practice, these four frameworks are not always clearly distinguishable. Norms are implicit in ratings and rankings. Business models have implications for stock valuation. Arguments are made that the stocks of top-ranking ESG companies will perform well in the long run. Nevertheless, each approach differs in its primary emphasis and is likely to lead corporate managers, as they implement ESG policies, practices, and communications, to emphasize different strategies and tactics. In addition, managers' understanding of these different investment approaches can lead them to formulate and target their communications differently.

Three Types of ESG Approaches

Like investors approaching ESG issues, corporations may differ in their tactics when formulating and implementing corporate social responsibility programs. For the purpose of matching corporations' ESG approaches with investors' SRI expectations, it is useful to distinguish three different goals that corporate managers adopt as they implement ESG.

Enriching Stakeholder Relations: Managers who believe that investing in their stakeholders will strengthen their company and help generate long-term financial rewards may address the full range of ESG issues for each stakeholder group. The overarching goal is successful management of relations with employees, consumers, communities, suppliers, and regulators, as well as action that addresses environmental challenges. This approach is broad in scope, with all stakeholders considered key to the long-term success of the firm. For comprehensive sets of ESG indicators for each stakeholder, managers should consult ESG frameworks such as those developed by the Global Reporting Initiative or RobecoSAM.

This approach covers the broadest range of issues and stakeholders. At the same time, however, it runs the risk of spreading corporate resources thin or giving equal weight to issues of varying importance. It can also fail to place sufficient emphasis on disparities between companies' business models and social goals. On the other hand, this approach is likely to be particularly attractive to investors who favor the norms/standards or ratings/rankings approaches to ESG.

Developing Shared-Value Business Models: Managers who believe in pursuing new business opportunities that are both profitable and help address society's major challenges are likely to be attracted to the concept of creating "shared value"—that is, identifying products and services that "reconnect company success with social progress."[15] This may involve directing research and development, product development, marketing, and other aspects of its core business to addressing the needs of underserved markets and major social and environmental sustainability challenges. For example, companies addressing issues of access in developing markets to information technology, health care, and finance can serve previously neglected markets while developing a new and profitable customer base. Similarly, sustainability challenges such as energy efficiency, clean technologies, and water resource management offer substantial shared value opportunities.

This approach focuses on the core business model of the company, as opposed to stakeholder relations, and offers opportunities for partnering with non-profit organizations and governments at various levels. The challenges of developing profitable business models that accomplish these goals, however, are substantial and can involve high-risk undertakings. This approach will find particular favor with impact investors, as well as with investors incorporating social and environmental considerations into fundamental stock valuation.

Addressing Industry-Specific Materiality Key Performance Indicators: Managers who believe that they are best served by focusing on a limited number of ESG issues that represent the greatest sustainability challenges for their industry may choose a targeted approach. Recognizing that resources are limited

12. JP Morgan Global Research , *Impact Investments: An Emerging Asset Class"* November 29, 2010. p. 5. Available at http://www.rockefellerfoundation.org/uploads/files/2b053b2b-8feb-46ea-adbd-f89068d59785-impact.pdf Last visited March 27, 2013.

13. See Michael E. Porter and Mark R. Kramer, "Creating Shared Value" *Harvard Business Review* January 2011. Available at http://hbr.org/2011/01/the-big-idea-creating-shared-value Last visited April 5, 2013.

14. See the Morgan Stanley website at http://www.morganstanley.com/globalcitizen/investing-impact.html Last visited April 5, 2013.

15. Porter, op. cit.

and that their ESG reputations will not be helped unless those ESG issues most material to their success are addressed, they may identify the issues for their specific industry that pose the greatest sustainability challenges or offer the greatest opportunities—and then focus first and foremost on them. For example, pharmaceutical companies are likely to focus on such issues as product safety and long-term affordability, fossil fuel companies on climate change and alternative energy, and information technology companies on the digital divide and censorship. An increasing number of organizations such as the Sustainability Accounting Standards Board, the German Federal Environmental Ministry, and the European Federation of Financial Analysts Societies are currently developing such industry sets of key performance indicators.[16] Companies that focus on these KPIs are likely to be in the best position to respond to charges of "greenwashing" as they address in detail their most challenging and materially relevant issues. Nevertheless, this approach does not give priority to the concerns of all stakeholders nor does it assure that companies will be addressing all ESG issues.

Like approaches to responsible investment, these three approaches to implementing ESG programs need not be mutually exclusive, but they cannot all be given equal weight. An emphasis on stakeholders can spill over into core business models and vice versa, but in strategic management decision-making one or the other is likely to predominate. KPIs can encompass both certain stakeholder issues and certain business model challenges, but will not be all-encompassing. The clearer companies are about which model predominates, the easier it will be for them to communicate effectively with ESG investors and to identify those investors most likely to be aligned with their approach.

Four Types of Corporate ESG Investments:

Once management has decided which ESG approach to emphasize, it will then confront decisions on how best to incorporate it into daily practice. The challenges of systematic incorporation are virtually identical for whichever ESG model and investor type a company chooses to focus on. Incorporation basically requires four steps or stages, during each of which management must decide the extent of the investments it is willing to make. Needless to say, such commitments need to be carefully evaluated.

Investments in Strategic Planning: To be effective, ESG commitments need to be driven into corporate cultures and, in certain cases, into core business models. This implies incorporating ESG into strategic management planning and integrating what are often thought of as two separate considerations—finance and sustainability.

Unilever is an example of a company that has fully integrated environmental and social considerations into strategic planning through its Sustainable Living Plan. This ten-year plan, launched in 2010, seeks to "help more than a billion people to improve their health and well-being, halve the environmental footprint of our products, [and] allow us to source 100% of our agricultural raw materials sustainably," while continuing to grow the company's overall business.[17] Commitments to ESG integration need to come from top management and be integrated into strategic planning from the outset. If they end up as little more than add-ons or afterthoughts, systematic implementation will be difficult.

Investments in Policies and Goals. The first step in the implementation of an ESG program is the development of policies and goals. Policies serve as a necessary guide for the creation of coherent, consistent goal-setting and action, and they help drive ESG into the corporate culture.

Campbell Soup Company, for example, has integrated social and environmental considerations into the company's goals and policies through the concept of "nourishing." Its 2012 Corporate Social Responsibility Report spells out these policies in detail, and sets ambitious goals. One of its more ambitious goals is "to help improve the health of young people in our communities by reducing childhood obesity and hunger by 50% by 2020."[18] Without these clearly articulated policies and goals, investors have no yardsticks against which to measure companies' progress and future performance.

Investments in Practices: These ESG policies and goals, once integrated into the company's strategic plans, need to be implemented in practice; that is, the company needs to allocate the time and resources necessary to institute these programs thoroughly and effectively. Responsible investors, like any other investors, are interested in results. Unless a company is able to demonstrate concrete progress on material issues, it will not be perceived as having achieved more than "greenwashing."

In theory, the allocation of assets to ESG initiatives should flow naturally from strategic management decisions. In practice, however, management often faces difficult decisions about the short-term costs of these investments versus their long-term returns—financial and non-financial, tangible and intangible. Difficult-to-value factors such as reputational risk and rewards, and the challenges of how best to a change corporate culture, enter into the equation. Without successful implementation in

16. See the website of the Sustainability Accounting Standards Board at http://www.sasb.org/sasb/ for further details on its development of sustainability KPIs for various industries. See also Axel Hesse, *SD-KPI Standard 2010-2014: Sustainable Development Key Performance Indicators (SD-KPIs) Minimum Reporting Standards for Relevant Sustainability Information in Annual Reports/Management Commentaries of 68 Industries* (German Federal Environmental Ministry) 2010. European Federation of Financial Analysts Societies and the Society of Investment Professionals in Germany, *Key Performance Indicators for Environmental, Social and Governance Issues: A Guideline for the Integration of ESG into Financial Analysis and Corporate Valuation* (Frankfurt am Mein: DVFA) 2010.

17. See Unilever's website at http://www.unileverusa.com/sustainable-living/ourapproach/messageceo/ Last visited April 10, 2013.

18. See the Campbell Soup website at http://www.campbellsoupcompany.com/csr/pages/neighbors/childhood-obesity-and-hunger.asp#.UWVwo6Jg_7M Last visited April 10, 2013.

practice, however, the investments of resources in ESG planning and policies are of little value internally or externally.

The industrial gases company Praxair is an example of a company that has invested effectively in setting ESG goals and tracking progress toward those goals. Among other things, it has increased the percentage of its revenues that it derives from product applications with environmental advantages from 22% in 2009 to 26% in 2011.[19] Consistency in long-term commitments to practical implementation is essential for the realization of the value of these investments. Without this consistency, investment may be made randomly, changing management's focus from year to year and failing to succeed in any one area.

Investments in Communications: Once ESG initiatives have been integrated and implemented, management will confront the question of how much of which kinds of data to report in what form—and, more generally, what resources to devote to communications. The answer to these questions depends in part on which approach to ESG has been chosen.

Enriching Stakeholder Relations: If management has chosen to emphasize investments in stakeholder relations, it may want to report according to the Global Reporting Initiative (GRI) guidelines. Over the years, the GRI has engaged in a comprehensive multi-stakeholder consultation process to develop a widely accepted set of stakeholder-specific indicators. Reporting according to guidelines from the GRI, RobecoSAM, or similar organizations that stress a stakeholder-centered model can provide credible and easily accessible frameworks for reporting.

Developing Shared Value Business Models: If a company has chosen to emphasize shared value, management may want to look to models for reporting provided by the impact investment community, such as those developed by the Global Impact Investment Rating Service (GIIRS) and the Impact Reporting and Investment Standards (IRIS).[20] These models stress, among other things, the positive social and environmental impacts of the company's business model; the creation of high-quality jobs and services for underserved populations; and solutions to social and environmental challenges while at the same time earning competitive returns on capital.

Addressing Industry-Specific Materiality Key Performance Indicators: If the company has chosen to focus on addressing the most material social and environmental key performance indicators, management may want to focus its in-depth reporting on industry-specific KPIs, such as those currently being developed by the Sustainability Accounting Standards Board, the German Federal Ministry of Finance, and others.

In addition to questions of metrics and formats, management also typically confronts two related issues—how much time to devote to engagement with stakeholders on ESG issues, and whether or not to integrate ESG into financial reporting.

Engagement: As interest in the ESG aspects of corporate activities grows, responsible investors increasingly place demands on management's time to discuss and, in some cases, alter its ESG policies and practices. Investors may seek dialogue or propose stockowner resolutions. They may approach companies singly or in coalitions. Increasingly some of the largest institutional investors in the world—many acting through the Principles for Responsible Investment and its Clearinghouse for institutional investor engagement with corporations—are choosing to exercise their voice when it comes to social and environmental issues.[21]

Since the 1970s, the Interfaith Center on Corporate Responsibility has coordinated the filing of ESG shareholder resolutions by institutional investors in the United States.[22] Coalitions such as the Carbon Disclosure Project (CDP), which seeks enhanced corporate disclosure on greenhouse gas emissions, water usage, forestry practices, and other environmental issues, today represents institutional investors with some $87 trillion in assets under management.[23] Deciding which investors or other stakeholders to engage with, and to what extent, can be a challenge. Generally speaking, management may want to engage first and foremost with coalitions representing substantial numbers of investors and with those organizations that have proven trustworthy in similar engagements in the past.[24]

Integrated Reporting: One long unresolved question has been how to integrate ESG and financial data into corporate reporting. The U.K.-based International Integrated Reporting Council (IIRC) is currently studying how this integration might take place most productively. The IIRC plans to publish a proposed framework for integrated ESG and financial reporting in December 2013 and begin a pilot program in which some 100 companies will test the proposed framework through September 2014.[25] Given the additional interest by stock exchanges in creating responsible investment "indexes" and encouraging ESG disclosure through their listing standards for companies, the movement toward

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19. See the Praxair 2012 Sustainability Report, page 2. Available at http://www.praxair.com/~/media/Files/Reports%20Papers%20Case%20Studies%20and%20Presentations/Our%20Company/Sustainable%20Development/Sustainable_Development_Report_2012.ashx Last visited April 10, 2013.

20. For a model of such a reporting format see the GIIRS website at http://giirs.org/storage/documents/CompanyReports/sample_company_report.pdf. Last visited April 11, 2013.

21. For more details on the activities of institutional investors through the PRI's Clearinghouse, see http://www.unpri.org/areas-of-work/clearinghouse/ Last visited April 12, 2013.

22. For updates on shareholder resolutions that have been coordinated through ICCR see its website at http://www.iccr.org/shareholder/trucost/index.php Last visited April 12, 2013.

23. For more details on the involvement of institutional investors in the Carbon Disclosure Project see https://www.cdproject.net/en-US/WhatWeDo/Pages/investors.aspx Last visited, April 12, 2013.

24. For two studies on the nature of engagement on ESG issues in the U.S., see Marc Goldstein "The State of Engagement between U.S. Corporations and Shareholders," a study conducted by Institutional Shareholder Services for the Investor Responsibility Research Center Institute, 2011. Also see the Principles for Responsible Investment study, "Responsible Investment in Passive Management Strategies: Case Studies and Guidance," January 2010.

25. See the website of the IIRC for further details at http://www.theiirc.org/companies-and-investors/ Last visited April 11, 2013.

required integration of ESG and financial data appears well established.[26]

The Rewards of Corporate Investment in ESG

Having invested in the integration of ESG into their companies' policies and practices, managers will expect to be rewarded for these investments. When ESG programs demonstrably reduce operational costs, produce efficiency gains, or otherwise have financial paybacks over reasonable time periods, managers need look no farther than their bottom line to justify such investments.

The "business case" for corporate social responsibility and sustainability, however, is not always so simple or straightforward, and has been subjected to considerable academic study and debate.[27] This business case often depends on rewards that involve a complex mixture of tangible and intangible benefits—enhanced reputation for quality management, increased customer loyalty, lower employee turnover, avoidance of legal liabilities or regulatory lawsuits, decreased criticism in the media and from corporate watchdogs, or early warning about emerging social and environmental concerns. And such benefits, possibly as the cumulative effect of all of the above, may well result in a higher price/earnings multiple for the company's stock. Managers often have difficulty drawing a solid line between a given ESG investment and those market-based rewards that they are accustomed to measure and in relation to which they have been trained to manage. And as a consequence, they may decide that ESG investments are not "worth it." It may appear to them that investors who profess to seek companies with strong ESG records are not adequately rewarding them in the marketplace.

Nevertheless, responsible investors—whether they focus on norms and standards, ratings and rankings, stock valuation, or business-model impacts—share an underlying concern about the sustainability of our ecological and economic systems as the world approaches a population of nine billion, and where natural resources become increasingly scarce and social inequality increasingly visible. To address these broad concerns, responsible investors look for ESG initiatives that not only reward companies directly, but also create positive externalities that benefit all. A short-term, company-specific focus can fail to capture these positive externalities.

Such "positive externalities"—which can take the form of new technologies that increase efficiency in energy, materials use, and communications; improvements in infrastructure that facilitate commerce and economic development; highly trained workers who enhance overall productivity; or healthy populations who contribute to the general welfare—are among the rewards that responsible investors seek. The creation of such positive externalities is part of the reason responsible investors are willing to invest in the capital markets, not simply because of the performance of specific stocks. Without a perception that these less tangible benefits are being created by thoughtful long-term ESG initiatives, these investors are likely to view with suspicion the markets for publicly traded securities as a whole, as well as the securities of specific companies that fail to recognize their ability to create these public goods. Corporate managers will be well served by understanding the nature of these positive externalities and telling the story of these broad-based positives they create, along with their company's more tangible specifics.

Conclusion

Corporations seeking a receptive and loyal base within the responsible investment community can benefit from understanding the growing interest in environmental, social, and governance initiatives. The specific approaches of responsible investors may differ—with some emphasizing internationally recognized norms and standards, others sustainability ratings and rankings, others the integration of ESG data into stock picking, and still others the impact of their investments in the creation of socially and environmentally positive outputs and outcomes—but their underlying concerns and goals are the same.

To attract such investors most effectively, corporate managers should clearly focus their approach on ESG initiatives, stressing either stakeholder relations, the creation of shared value in business models, or the addressing of industry-specific sustainability key performance indicators. Having decided on a given approach, they can then integrate it into their strategic planning, policies and goals, specific practices, and communications.

In the hands of effective corporate leaders executing sound business strategies, these tools can enhance the attractiveness of corporations and their securities to a broad and growing world of responsible investors, while at the same time creating positive externalities that address the major social and environmental challenges of the world today.

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26. See the Sustainable Stock Exchanges Initiative website at http://www.sseinitiative.org/ for up-to-date information on initiatives in this area and its publication, "2012 Sustainable Stock Exchanges Report: A Report on Progress" for a comprehensive list of initiatives, available at http://www.sseinitiative.org/publications/. Last visited April 11, 2013.

27. See for example Iveta Chernea (ed.) *The Business Case for Sustainable Finance* (London: Routledge) 2012.

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