The State of Responsible Investment in South Africa
A study of the extent to which environmental, social and governance issues impact on the investment decisions made by institutional investors in South Africa

By Gloudi van der Ahee¹ & Jess Schulschenk²
January 2013


¹ Department of Accounting, University of Stellenbosch.
Email: gloudi@sun.ac.za
² Climate Change & Sustainability Services, Ernst & Young.
Email: jess.schulschenk@za.ey.com
This research report presents the latest insights and trends in responsible investment in South Africa. We are pleased to share these research findings, undertaken by Gloudi van der Ahee of the University of Stellenbosch in partnership with our research team.

With South African companies undertaking progressive commitments to transparent and accountable practices through integrated reporting, we believe that the investment community have a critical role to play in driving sustainable corporate performance.

The findings from this study suggest that there is growing interest and demand from the investment community to integrate environmental, social and governance issues in their decision making. With the practice of responsible investment gaining momentum, further research is required on developing industry wide standards and benchmarks to support investors in their investment decision making.

We hope that you find these research insights valuable and welcome the opportunity to discuss our ongoing research and practice further.

Jeremy Grist  
Director, Climate Change & Sustainability Services  
Ernst & Young Africa  
Email: jeremy.grist@za.ey.com
A diversity of global challenges, many of which have been unprecedented, have increased the focus on sustainability with environmental, social and governance (ESG) issues attracting significant attention.

A key question pertains to how ESG policies are understood to impact long-term company performance and corporate sustainability and/or are integrated into investment decisions by the financial market.

The interdependence between JSE-listed companies and institutional investors, and the effect of ESG issues on long-term sustainability, has given rise to the research presented in this report.

The King III principle of integrated reporting has impelled JSE-listed companies to report on ESG issues, yet there is no clarity on how much credence institutional investors give to the ESG policies of companies in which they have or are considering investing in.

This gives rise to the question: Do ESG issues influence the decision making of institutional investors in South Africa?

The research to answer this question was undertaken through a Web survey distributed to a sample of South African institutional investors (129 members of the Association for Savings and Investment South Africa (ASISA) and 430 members of the Principle Officers Association (POA)) with the aim of determining whether ESG issues influence the investment decision making of South African institutional investors.

The key objectives of the research were: (1) to understand the state of responsible investment in South Africa; (2) to investigate whether and to what extent institutional investors consider ESG issues in their decision making; and (3) to investigate the relative importance of the ESG components in terms of one another.

The findings suggest that the vast majority of respondents value ESG issues, with 84 percent of the South African institutional investors in this sample considering them.

Forty-six percent of the respondents’ eventual investment decisions are often (and 12 percent always) actually influenced by ESG issues. For an average of 60 percent, a company with sound ESG performance will encourage them to pay a premium when investing.

Important motivations for the consideration of responsible investment were identified, including being responsible corporate citizens, the Code of Responsible Investing in South Africa (CRISA) and the United Nations Principles of Responsible Investment (PRI) and financial returns.

The lack of ESG measurement tools remains the greatest barrier to considering ESG issues. Respondents consider short courses and benchmarks as enablers of responsible investment. All three ESG components are considered important, with governance ranked most important.
1. Introduction

The increasing number of corporate scandals, the recent financial crisis and the interlinked social and environmental crises have heightened the world’s awareness of sustainability challenges, and made them a real concern for businesses today. It is against this backdrop of change and uncertainty that interest in environmental, social and governance (ESG) issues gathered significant momentum at the turn of the 21st century. The major challenge is how ESG policies are understood to lead to long-term company performance and corporate sustainability and/or are integrated into investment decisions by the financial market. It is suspected that companies and investors are grappling similarly with the practical implications of ESG issues in terms of conventional investment and broader business decisions.

South Africa is no exception. The public media discourse articulates varied interpretations and responses to pressing sustainability issues. This is the case despite the country being ranked first in the world in the Global Competitiveness Report for the strength of its auditing and reporting standards, as well as for regulation of security exchanges. The successive King Codes of Governance Principles have set international standards of best practice and the launch of King III places South Africa among the first countries to require listed companies to provide integrated reporting (that includes ESG issues).

The Code of Responsible Investing in South Africa (CRISA) that was established in 2011 asserts that company value should not just be measured in financial terms in the short term, but also in terms of how it sustains the conditions that allow it to prosper over time. CRISA points out that modern governance thinking advocates that company boards and institutional investors should, in addition to economic considerations, consider all other factors (such as ESG) that impact long-term company value. This essential role of governance indicates that the prominent defense of the ‘efficient market’ has become less common, particularly in the wake of the financial crisis. Several guidelines and governance principles for corporate sustainability are therefore necessary to establish corporate sustainability, including public reporting on key sustainability issues.

Reporting guidelines concerning a company’s impact on corporate sustainability vary. Reporting is informed and influenced by global and national standards and benchmarks, such as the Global Reporting Initiative (GRI) and the Johannesburg Stock Exchange (JSE) Socially Responsible Investment (SRI) index. The GRI has emerged since 1999 as a leading global sustainability reporting standard, working towards the goal of a sustainable global economy by providing corporate sustainability reporting guidance through a Sustainability Reporting Framework. The framework enables organisations worldwide to measure, report and, hence be transparent, about their financial and ESG performance – the key areas of sustainability.

In order to be accurately assessed, corporate sustainability needs to address each country’s unique social and economic realities, and consider different ESG components accordingly. For example, South African companies need to factor in historical and current imbalances, caused specifically by institutionalised apartheid. Social challenges such as HIV/AIDS, employment equity, and community empowerment should be addressed because of their far reaching impact on business. Although only certain social and environmental reporting aspects are mandatory in South Africa, for example Black Economic Empowerment (BEE), many companies voluntarily adopt codes of conduct and corporate reporting in this regard. The JSE launched the SRI index in 2004 as a tool for investors to identify companies that have incorporated corporate sustainability practices such as these into their business.

A 2007 study investigating how South African investors view and understand responsible investment, indicated that while investors appear to have a grasp of ESG issues, there was sparse evidence of actual mainstream investment decisions with a long-term perspective. What was missing especially, was how they integrate ESG issues into investment decision making, thus the study results were mixed.

The impact of major corporate scandals, the financial crisis and growing awareness of key sustainability challenges have increased the focus on corporate sustainability with the emergence of the GRI, the SRI index and the King Reports. However, the question is whether these developments have influenced institutional investors enough to take material ESG issues into account in their investment decision making.
2. Background

Institutional investors are becoming increasingly prominent in the global financial markets, with influence exercised either directly through the ownership of shares or indirectly through the trading of stock. In 2012, institutional investors controlled roughly 95 percent of the South African investment market and as decision makers, assess the market value of a company in which they consider investing. Issues not accounted for are also considered, including factors such as future earnings, brand, reputation, the company’s risk management under scrutiny and the seriousness with which company considers corporate sustainability issues.

Professor King has pointed out that, for an investor to make an informed assessment, the old format of the annual report that mainly focused on financial information and the short-term horizon, is no longer adequate. King III therefore recommended integrated reporting to enable investors to make an informed assessment of the company’s long-term sustainability. This would work in tandem with the International Accounting Standards Board (IASB)’s objectives to provide financial information to inform investors’ decision making.

Concerns around advancing long-term sustainability as an investment practice have evolved during the last decades. The terms ‘sustainability’, ‘ethical’, ‘social’, ‘responsible’ and ‘socially responsible’ are used very commonly and often overlap in studies, although these words may refer to similar ideas. Over the years, the academic literature has referred to a broad genre of investment practice that integrates the consideration of ESG issues by a perplexing array of names. Some of the more common names include: Socially Responsible Investment, Ethical Investment, Sustainable Investment and, more recently, Responsible Investment. The extensive number of terms and acronyms for this practice, many of which are defined differently or used interchangeably have resulted in substantial potential for confusion regarding the exact meaning of this practice.

This is especially so for those investors who want to improve long-term sustainability by considering the integration of ESG issues into investment decision making. The emergence of the Principles for Responsible Investment (PRI) and the massive uptake of these principles in practitioner circles have brought this recent concept of Responsible Investment into prominence in the investment sphere. Responsible investment can be understood in at least two forms: a ‘business case form’ in which ESG issues are considered only to the extent they are financially material; and a ‘social form’ in which ESG issues are considered before the maximisation of financial investment return.

The United Nations-backed Principles for Responsible Investment (PRI) initiative shifted the focus from ethics to advancing risk-adjusted financial returns. Whereas earlier versions of this investment genre such as Socially Responsible Investment (SRI) and ethical investment were explicit about constraining investment practices on the basis of some notion of what was ethically correct or incorrect; more recent forms attached to the use of the term responsible investment have focused on the financial materiality of ESG issues.

The United Nations Environment Programme Financial Initiative (UNEP FI) defines responsible investment as:

Investment that incorporates an active consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership... where ESG issues are considered on the basis of their financial materiality.9

SRI is motivated by ethical imperatives to shape the market, responsible investment therefore needs to be clearly distinguished from SRI because its particular approaches strongly regard the financial materiality of ESG issues into mainstream investment decision making. The responsible investment approach is therefore not premised on moral principles, but rather on the principle that ESG risks can affect the financial performance of investments and therefore need to be considered. Therefore, for the purpose of this study, when referring to responsible investment in the discussions, it essentially refers to the consideration of ESG issues in investment decision making on the basis of the financial materiality of ESG issues. The aim of this research was to investigate the extent to which ESG issues influence the decision making of institutional investors in South Africa.
The PRI provides a voluntary framework by which all investors can integrate ESG issues into their decision making and ownership practices and so better align their objectives with those of society at large. The most remarkable growth in the number of signatories occurred since the start of the global financial crisis. The PRI initiative is of the opinion that this crisis continues to be a catalyst that influences institutional investors to value ESG issues in a way that will influence their decision making. In September 2012 there were 1 103 PRI signatories (of which 40 are South African) representing more than $30 trillion assets under management. The primary aim of the PRI is to help investors integrate ESG issues into their investment decisions.

CRISA is a voluntary code that sets out the governance duties of South African institutional investors in relation to the overall governance system. It also has the aim of integrating ESG issues into long-term investment decisions. Thus, the PRI, CRISA and King III provide a framework for all role players in the governance system, to consider ESG issues. This is expected to support sustainability development and ensure sound governance that will result in better performing companies that deliver sustainable value. The PRI initiative points out that the implementation of these principles will ultimately result in lower risk and increased returns, due to evidence that ESG issues can be particularly material to the investment’s long-term performance.

Dala, business analyst at Allan Gray, mentions that an increasing number of clients, especially long-term horizon clients such as pension funds, are asking for institutional investors’ official commitment to the PRI and CRISA, and therefore support responsible investment. Therefore it followed that the South African Minister of Finance issued Regulation 28 under section 36 of the Pension Funds Act (1956) which requires that investors consider ‘any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social and governance character’ in their decision making.

There is growing evidence of a correlation between a company’s performance on ESG issues and its financial performance, and that when ESG issues are integrated into investment decision making, it may offer investors long-term performance advantages, institutional investors who take ESG criteria seriously will therefore allocate a higher value to companies that consider ESG issues in their business practices in order to yield higher investment returns.

Although barriers to responsible investment and concerns regarding ESG issues exist, there are signs that progression of responsible investment in South Africa is underway. These include the JSE SRI index; compliance with BEE scores; increased focus on ESG performance with establishment of the PRI and CRISA initiatives; requirements of Regulation 28 to the Pension Funds Act and the commitment of the Government Employee Pension Fund, the largest South African pension fund, to the PRI. These are clear indications that ESG issues are no longer peripheral, but are becoming central investment considerations, especially at this time when the world is facing severe sustainability challenges. One can therefore conclude that ESG issues comprise a globally and nationally relevant topic for discussion. This has provided a setting for an interesting research opportunity.

The catastrophic crises of, for example Enron, WorldCom and the BP Oil saga, could have been prevented or at least mitigated according to Dr Thamotheram, Director of Responsible Management at AXA Investment Managers. He suggested that ‘more skilful decisions made by institutional investors’ could act as deterrents since the investment community has the biggest impact on corporate decision making. While JSE-listed companies are reporting on ESG issues according to the King III principle of integrated reporting and also voluntarily reporting on the GRI requirements, this may not be sufficient. According to Armstrong, head of Global Corporate Governance Forum in Washington DC, there is ultimately little to hold companies to account for nonperformance on key ESG issues and that interest in ESG issues from the institutional investors acts as a motivator. This is supported by surveys that suggested that companies respond more to investors than to regulators. The research problem that arises therefore results from the situation of there being little indication whether institutional investors value ESG issues in such a way that it influences their decision making.

Do ESG issues influence the decision making of institutional investors in South Africa?

10 Data, S. 2012. Interview: The view of institutional investors on the influence of ESG issues on their decision making, 29 February, Allan Gray, Cape Town.
15 See 11.
3. Method of Investigation

A survey-based research design using an extensive Web survey was used to collect both quantitative and qualitative data. Information regarding the influence that ESG issues have on the decision making of the targeted population of South African institutional investors, a sector where internet usage is high, was requested. The sample consisted of 129 ASISA members and 430 POA members, all of whom were contacted through their respective e-mail addresses. The survey based on this e-mail list sample was proposed to be sufficiently representative of the South African institutional investor population.

The survey was designed to be well structured, consistent and easy to answer in order to ensure a higher response rate and increase the data reliability and validity. The survey was also reviewed in detail by experts in the field of ESG and survey-based research designs before it was sent for a pilot test. Continuous, nominal and ordinal type questions were asked in the survey. The response rate from the ASISA members, POA members and the combined group was recorded at 12 percent, 5 percent and 7 percent respectively. A major downside to surveying these professional individuals with substantial work responsibilities was that there was insufficient time for many of them to complete the survey. The low response rate could also be attributed to the lack of interest in responsible investment among institutional investors. Since valid reasons exist for the low response rate, this is not deemed to be a problem in answering the research question. However, it is a limitation to this study because it influences the generalisation of the findings. A wide range of subject experts and established practitioners in the field were also interviewed throughout the research process to obtain their views on responsible investment. The insights obtained from these interviews contributed to a richer understanding of the data.

Noteworthy variations between factors were investigated with mixed-model repeated measures as the appropriate analysis of variance (ANOVA) method. The relation between nominal variables was investigated with contingency tables and appropriate chi-square tests. Where suitable, the Mann-Whitney test was used to test for equality of means between groups. A significance level of five percent is applicable for all inferences in this study, except for the qualitative data that was investigated to identify general comments.

4. Survey Findings

Forty one percent of the respondents were ASISA members and 59 percent were POA members. The respondents were grouped together, and the results and discussion are presented as from the combined respondent group. Figure 1 presents the different types of institutional investors primarily represented in the respondent group (of whom asset managers formed the largest category at 51 percent). Figure 2 highlights the primary positions of the respondents. The five percent of respondents in other positions included, for example, an employee benefit manager and an actuarial manager. The respondents had an average of 14 years of experience in the investment sector.
4.1 General view of responsible investment

**Awareness of PRI and CRISA**

The central aim of both the PRI and CRISA initiatives is to help institutional investors to integrate ESG issues in investment decision making. Ninety seven percent of the respondents indicated that they are aware of CRISA. Seventy percent indicated that they formally and officially endorse CRISA and/or subscribe to PRI. Almost all (94 percent) of the respondents indicated that they are familiar with the PRI. In 2007, a survey of responsible investment in South Africa showed that only a third of the respondents had heard of the PRI

Since most of the respondents are familiar with CRISA and PRI and support/are subscribed to these initiatives as well, these findings suggest that there is substantial awareness of responsible investment among South African institutional investors in this study.

**Motivations for considering ESG issues**

**Companies’ motivation for considering ESG issues**

The results presented in Figure 3 represent the answers of institutional investors who gave their reasons for what they believe motivates a company to report on the company’s impact on ESG issues. All of the respondents stated that companies’ main motivation for reporting on ESG issues is to improve their corporate reputation.

The McKinsey Global Survey of 2011 also pointed out that companies enjoy the good corporate reputation they gain from sustainability activities. Ninety six percent of the respondents stated that companies report on ESG issues to comply with King III and JSE listing requirements, whilst 80 percent regard reporting on ESG issues as a form of risk management.

Just over half (56 percent) of the respondents indicated return on capital or increased financial growth served as incentives; suggesting that almost half indicated that they do not see this as motivation to report on ESG issues. This potentially confirms the mixed evidence on whether corporate sustainability practices, such as reporting on ESG issues, impact company performance positively or negatively.

**Institutional investors’ motivations to consider ESG issues**

The 84 percent of institutional investors who stated that they consider ESG issues in their decision making were asked to elaborate on the specifics of what drove them towards this. These respondents had to indicate the level of importance of predetermined motivations that were provided with the question. Their motivations are indicated in figure 4.

---

**Figure 3: Motivations for companies to report on ESG issues**

**Figure 4: Motivations for institutional investors to consider ESG issues**
All, except for personal motivations, were considered critical motivations for institutional investors to consider ESG issues. Return on investment was considered the most critical, whilst corporate citizenship followed by CRISA were the greatest motivations in terms of overall importance. These tendencies towards viewing citizenship, CRISA and PRI as important motivations can be an indication that the aim of CRISA and PRI to align the objectives of institutional investors with the broader society is starting to influence investment decision making.

Client demand is an important factor of consideration for half of the respondents, while 27 percent pointed towards it as a critical motivation for including ESG issues in investment decision making. In the 2007 survey, the majority of institutional investors indicated that their clients make minimal demands for responsible investment, but that the attitude and level of demand for considering ESG issues in investment decision making was likely to increase within the next three years. Client demand tends to be an important driver towards considering ESG issues; it is therefore not surprising that the results from the current research show this. These results support Dala’s opinion that an increasing number of clients are asking institutional investors to commit to responsible investment. This implies that the institutional investors’ investment decisions can be influenced by the clients’ expectation of responsible investment.

Institutional investors’ motivations to not consider ESG issues

The 16 percent of institutional investors who stated that they do not consider ESG issues in their decision making were asked to point out which factors motivate them not to do so, depicted in Figure 5. The absence of adequate measurement tools was considered to be the greatest factor in disregarding ESG issues in investment decision making. A lack of awareness and understanding were not considered important motivations, while the lack of return and external assurance are considered to be important motivations for not considering ESG issues in investment decision making.

It is important to compare these findings with the view of the 84 percent of respondents who indicated that they consider ESG issues. According to their perspective, increased financial return is an important motivation or driver to include ESG issues in investment decision making (highlighted in Figure 4). The 16 percent of respondents, who stated that they do not consider ESG issues, believe that RI will not improve investment performance and hence view this as an important motivation not to consider ESG issues (highlighted in Figure 5).

4.2 Extent of considering ESG issues

The majority (84 percent) of the respondents stated that ESG issues influence their investment decision making. This finding challenges the view of the respondents in the 2007 survey, when the majority of the respondents stated that they were either not integrating ESG issues into decision making (39 percent), or, at most, had a restricted proportion of assets in responsible investment (42 percent). This implies that the majority of respondents in this survey pursue responsible investment with the integration of ESG issues into their decision making. Figures 6 and 7 which respectively show that 69 percent of the respondents implement PRI and 70 percent consider CRISA.
Stewart, a financial expert from an asset management company, suggested that although many South African institutional investors indicate that they consider ESG issues, only a few actively invest on the basis of these considerations\(^1\) and referred specifically to institutional investors who have more capital available to employ people who are skilled in ESG issues. The influence that the value of assets under management has on the option to integrate ESG issues into investment decision making is highlighted in Figure 8.

Figure 8 illustrates that those institutional investors who have more assets under management are more likely to integrate ESG issues into their decision making. However, the difference between them and those with less capital is not significant. This possibly suggests that these institutions wish to position themselves in the market by differentiating themselves as ESG-sensitive institutional investors. Further robustness tests were performed to investigate whether institutional investors with more assets under management are more willing to pay for access to ESG information. It was found that, although institutional investors who are financially stronger are more willing to pay for access to information regarding ESG issues, those with less capital are not significantly more willing to pay for access to ESG information.

\(^1\) Stewart, P. 2012. Interview: The view of institutional investors on the influence of ESG issues on their decision making, 6 March, Plexus Asset Management, Cape Town.
To what extent ESG issues are considered is also reflected by the time they spent on the consideration of ESG issues and how often ESG issues ultimately influence decision making. The majority (72 percent) of the respondents indicated that they consider ESG issues during the consideration of the risk, return and time frame of the investment (shown in Figure 9). These results suggest that it is imperative that investors consider ESG issues to influence the risk and return of investments.

Figure 9: Stage in investment process when ESG issues are considered

Figure 10 illustrates how often ESG issues influence the decision making of the sample of South African institutional investors. On average, the respondents spend 18 percent of their time actively considering ESG issues as part of their investment decision making process. The survey results that indicate that the majority of respondents consider ESG issues in their investment decision making are challenged when investigating the results from asking all respondents how often ESG issues ultimately influence their investment decision making. The respondents had to choose whether ESG issues actually always, often, less often or never influence their eventual decision making.

Even though the majority (84 percent) of respondents indicated that they do consider ESG issues, this indication does not ensure that the majority of institutional investors in the sample value or consider ESG issues in such a way that it will ultimately influence their decision making. Only 12 percent indicated that ESG issues always influence their decision making and 46 percent indicated that it often influences their decision making.
The growth in sustainability challenges motivated the investigation of the relative importance of the ESG components. The following discussion focuses on what is indicated as trends that influence the context of the companies in which the sample of South African institutional investors invest, followed by the respondents’ view about the level of importance of the three ESG components, as well as their willingness to pay a premium for the sound performance of these ESG issues.

### Trends influencing the landscape of companies

Whilst the other developments are important, corruption is deemed as the most critical sustainability challenge influencing the landscape in which the companies that investors invest in operate. This is also evident from perceptions regarding the increase in corruption in South Africa. The Union Bank of Switzerland (UBS) Governance Rank, which measures CG perceptions in 44 global developing markets, knocked South Africa from the top ranking with regard to auditing and reporting standards in 2012. This cautions that, if this perception is maintained, it could threaten South Africa’s safe haven status of being ranked first for the strength of its auditing and reporting standards as well as for regulation of security exchanges\(^\text{20}\).

---


---

### 4.3 Relative importance of ESG components

The growth in sustainability challenges motivated the investigation of the relative importance of the ESG components. The following discussion focuses on what is indicated as trends that influence the context of the companies in which the sample of South African institutional investors invest, followed by the respondents’ view about the level of importance of the three ESG components, as well as their willingness to pay a premium for the sound performance of these ESG issues.
Climate change is now thought of as one of the significant factors influencing the landscape of the companies in which the institutional investors invest, in contrast to the ranking of climate change as of low importance in the 2007 survey. This is indicated in Figure 11. This finding can likely be attributed to increasing attention that environmental issues, such as the impact of climate change, have received in recent years. In addition, since the companies involved in the study are in South Africa, social issues such as employment inequality and poverty were also considered important. With particular sustainability issues attracting more attention or being more related to the South African context, the relative importance of ESG issues was investigated.

![Figure 11: Trends influencing the landscape of companies](image)

### Relative importance of the three ESG components

Figure 12 shows that the level of significance assigned to the environmental and social components do not differ significantly, while the governance component differs significantly from the environmental and social components. It is therefore clear that the highest level of importance is given to the governance component with all respondents saying it is relevant or important. This is probably due to the increased perception of high corruption in South Africa. Corruption was indicated as the most important challenge facing the landscape in which those companies operate (Figure 9). Corporate governance has also been indicated as the most important ESG component in international research. Environmental issues, such as the company’s carbon footprint, are considered critical by 15 percent and as critically important by 67 percent, relative to the other issues. This level of importance also affirms the view that climate change is considered a sustainability challenge that influences the companies invested in (Figure 11). In other words, only 19 percent consider environmental issues as being irrelevant or not important. This is a reduction from the above 30 percent of respondents who believed that it was not important in the 2007 survey.

With the current study being conducted in the South African context it is not surprising that 26 percent of the respondents consider social issues, such as BEE scores or HIV/AIDS policies as a critical matter. These findings suggest that the trends influencing the context that companies operate in also relates to the level of importance institutional investors place on the different ESG components.

In further exploring the relative importance of the ESG components, respondents were asked whether where poor ESG performance was present, would they give up the possibility of a good financial return on an investment. Forty-eight percent, 38 percent and 59 percent of the respondents respectively indicated willingness to give up good financial return by turning down an investment in a company with higher perceived ESG risks in instances. These indications suggest that approximately half (between 38 and 59 percent) of the respondents are willing to give up good financial returns on an investment by turning down an investment in a company with higher perceived ESG risks. Since this conclusion is deduced from approximately half of the respondents only, it could, however, indicate institutional investors’ uncertainty regarding whether the consideration of ESG issues will increase investment return.

Additionally, these results also give an indication of the relative importance of the ESG components especially as they point to the importance of financial returns as criteria in investment decision making. The majority (59 percent) of the respondents are willing to give up good financial returns on an investment in instances where poor governance performance is present.

Willingness to pay a premium

On average 60 percent of the institutional investors in this study indicated that they are willing to pay a premium for sound ESG performance. Companies with lower perceived risks of ESG issues are clearly more attractive, with 74 percent of respondents indicating that they would pay a premium for sound governance performance. This was followed by 56 percent and 52 percent who respectively indicated that they were willing to pay a premium for sound environmental performance and sound social performance. This one again highlights that governance tends to be considered the most important ESG component.

To maximize the robustness of these results, the inquiry was directed towards whether institutional investors with more assets under management were more willing to pay a premium for a company with sound performance on the ESG components. It was found that the value of the assets under management does not have a significant influence on whether the respondents are willing to pay a premium for sound ESG performance.

Table 1 gives an indication of the percentage that the respondents are prepared to pay more to invest in a company with lower perceived risks in terms of ESG issues, rather than to invest in another company which is similar in all other respects.

Table 1 indicates a tendency among the respondents towards willingness to pay more for sound governance performance, relative to social and environmental issues. From these findings, it can be concluded that for the average of 60 percent respondents who indicated willingness to pay a premium, irrespective of the value of assets under management, they were willing to pay a premium of 14 percent when investing in a company with lower perceived risks in terms of ESG issues, ceteris paribus.

There is a tendency towards ranking governance issues as the most important component of ESG issues. However, it is clear that the majority of respondents consider all the components of ESG issues to be important. Financial return also very clearly plays a very important role. On average, the respondents tend to be willing to pay a premium for sound ESG performance. The conflicting results identified with regard to whether ESG issues are carefully considered and if they actually influence the investment decisions - in other words, whether they are achieving their intended goal - could be due to concerns about ESG issues or a lack of RI enablers.
4.4 Concerns and enablers

The qualitative nature of ESG

The lack of agreed measurement criteria has been identified (Figure 5) as the main motivation for not considering ESG issues. This absence of measurement criteria is believed to be due to the qualitative nature of ESG issues. This therefore makes it difficult to express the valuation of company performance in numerical terms\textsuperscript{22}. As a result, presenting the relevancy thereof to institutional investors is challenging. Table 2 illustrates whether the respondents believe that adequate measurement tools for the three components of ESG issues are available to serve as a basis for their investment decision making.

Table 2: Availability of measurement tools for the ESG components

<table>
<thead>
<tr>
<th>ESG component</th>
<th>Yes (%)</th>
<th>No (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental issues</td>
<td>22</td>
<td>78</td>
</tr>
<tr>
<td>Social issues</td>
<td>26</td>
<td>74</td>
</tr>
<tr>
<td>Governance issues</td>
<td>48</td>
<td>52</td>
</tr>
</tbody>
</table>

More than half of the respondents indicated that adequate measurement tools to base investment decisions on are not available for the components of ESG issues. The availability of corporate governance measurement tools can, in addition to the perceived importance of this ESG component, most likely justify why corporate governance has received the most research attention of the three components. The significant body of research that investigated the relationship between corporate governance and company performance also affirms this\textsuperscript{23}.

An additional analysis to investigate whether there is a relation between the availability of measurement tools for a specific ESG component and the willingness to pay a premium for sound performance of the specific ESG component was undertaken. Whether the availability of adequate measurement tools for the ESG issues influences the willingness of an institutional investor to pay a premium for such sound performance can consequently be derived from the results of this analysis. Table 3 illustrates the influence of the measurement tools available for the three components of ESG issues on the willingness to pay a premium for sound performance of each component. The areas shaded light grey show the proportion of respondents that have indicated that adequate measurement tools are available and that they are willing to pay a premium (thus both questions were answered ‘yes’). This table also represents those respondents who indicated that adequate measurement tools are not available, and that they are not willing to pay a premium (thus both questions were answered ‘no’).

Table 3: Influence of measurement tools on willingness to pay a premium

<table>
<thead>
<tr>
<th>ESG component</th>
<th>Willingness to pay a premium (Yes/No)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental issues</td>
<td>Availability of adequate measurement tools (Yes/No)</td>
</tr>
<tr>
<td></td>
<td>Respondents indicating Yes (%)</td>
</tr>
<tr>
<td></td>
<td>83%</td>
</tr>
<tr>
<td>Social issues</td>
<td>Availability of adequate measurement tools (Yes/No)</td>
</tr>
<tr>
<td></td>
<td>Respondents indicating Yes (%)</td>
</tr>
<tr>
<td></td>
<td>86%</td>
</tr>
<tr>
<td>Governance issues</td>
<td>Availability of adequate measurement tools (Yes/No)</td>
</tr>
<tr>
<td></td>
<td>Respondents indicating Yes (%)</td>
</tr>
<tr>
<td></td>
<td>92%</td>
</tr>
</tbody>
</table>

23 Chung, Wright & Kedia, 2003; Singh & Davidson, 2003; Hutchinson & Gul, 2004
The social and governance section shows that there is a significant relation between the willingness to pay a premium for sound social and governance performance and the availability of adequate measurement tools for these components. It can therefore be concluded that the availability of adequate social and governance measurement tools appreciably sways the willingness to pay a premium for sound social and governance performance.

The respondents were asked to indicate whether they considered the available benchmarks/indicators of ESG issues when evaluating which companies to invest in, since the availability of the ESG measurement tools influences the consideration of ESG issues. Given the lack of available benchmarks for South African institutional investors to evaluate which companies to invest in, it is not surprising that table 4 shows that all available ESG benchmarks are considered by the majority of institutional investors. Due to ESG issues being inherently unmeasureable and the lack of adequate measurement tools, it is understandable that King III points out that companies should obtain independent assurance regarding ESG disclosure in their integrated report.

### Table 4: Consideration of available benchmarks

<table>
<thead>
<tr>
<th>Available benchmarks</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>BEE scores</td>
<td>69%</td>
</tr>
<tr>
<td>Non-financial information in integrated report</td>
<td>68%</td>
</tr>
<tr>
<td>JSE SRI index</td>
<td>59%</td>
</tr>
</tbody>
</table>

**Assurance and compliance**

Independent assurance of the disclosure on ESG issues by an external party (such as a qualified consultant or external auditor) is something the majority (70 percent) of the respondents indicated that they value in their decision making. These outcomes suggest that institutional investors require assurance that they can reasonably rely on ESG disclosures and that it represents a true reflection of a company’s ESG impact.

In South Africa, only publicly listed companies are required to provide an integrated report (that includes disclosure on ESG issues) for listing on the JSE, however the institutional investors in this study were still asked to indicate which companies they would prefer integrated reporting to be mandatory for. Figure 13 shows that the vast majority (93 percent) would like to see integrated reporting (with financial and non-financial information) as mandatory for JSE-listed companies, followed by unlisted and private companies.

![Figure 13: Integrated reporting preferred to be mandatory for which companies](image)
Industries

The respondents were asked to indicate whether the nature of the industry or industries in which they invest influences the relative importance of ESG issues in their decision making process. The majority (74 percent) indicated that the nature of industries has an influence. In addition to this question, the respondents were asked to indicate, with reference to the three primary investment sectors in South Africa, which key ESG issues they evaluate in their decision making process. Table 5 illustrates which ESG component the respondents evaluate the most in which primary investment sector.

Table 5: Influence of industries on consideration of ESG issues

<table>
<thead>
<tr>
<th>ESG components</th>
<th>Financial</th>
<th>Industrial</th>
<th>Resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental issues</td>
<td>49%</td>
<td>91%</td>
<td>87%</td>
</tr>
<tr>
<td>Social issues</td>
<td>74%</td>
<td>95%</td>
<td>89%</td>
</tr>
<tr>
<td>Governance issues</td>
<td>100%</td>
<td>98%</td>
<td>84%</td>
</tr>
</tbody>
</table>

The results suggest that the industries in which institutional investors are investing can influence the relative importance of the ESG components in their investment decisions. The majority, between 70 and 100 percent of respondents, consider all the ESG components in the primary investment sectors, except for environmental issues that are considered by 49 percent of the respondents in the financial sector. From this table is it clear that ESG issues are considered the most in the industrial sector. This is also an indication that the industrial sector is the sector with the biggest value traded.

Access

Given that 84 percent of the respondents indicated that they consider ESG issues and since the ESG components are evaluated differently over the investment sectors, it is pertinent to examine how the information of the ESG issues is accessed. The majority (92 percent) of the respondents indicated that they access ESG information from the integrated reports of the companies they are interested in. This finding comes as no surprise since South Africa is among the first countries to require listed companies to provide integrated reporting that incorporates disclosure of information on ESG issues. Thirty one and 78 percent respectively make use of company websites or commissioned access from a third party and 87 percent stated that they do not access ESG information through developed mobile applications.

In addition, the respondents were asked to indicate whether they were willing to pay a premium to access comprehensive and accurate ESG information of the company they consider investing in. This premium refers to an extra amount they would be willing to pay relative to their payment for conventional investment information. The majority (64 percent) indicated that they were not willing to pay such a premium. On the one hand, one can reason that if institutional investors pursue responsible investment, one would believe that they would be prepared to pay a premium to access valid ESG information. On the other hand, this could probably be due to the view that it is the responsibility of listed companies to report on ESG issues, since it is a JSE-listed requirement.

Enablers

Concerns regarding ESG issues and barriers to the consideration of ESG issues exist, as evidenced from the outcomes of the discussion. The survey also investigated what the respondents believe will best enable South African institutional investors to accurately consider ESG issues in their decision making. Figure 14 indicates that 36 percent of the respondents regard responsible investment short courses to provide guidelines on how to integrate ESG issues into investment decisions as an enabler. Thirty-two percent regard benchmarks for mainstream responsible investment as an enabler, while 25 percent mentioned other enablers that would best enable the accurate consideration of ESG issues. The minority (seven percent) saw collaboration with civil society as a responsible investment enabler. The respondents from the 2007 survey saw mainstream responsible investment benchmarks as the most important enabler, followed by responsible investment short courses. As in the current study, the lowest proportion of the respondents considered collaboration with civil society as an enabler. The other enablers that 25 percent of the respondents pointed out were investigated. In general, useful ESG information and accurate disclosure of ESG performance were indicated as enablers.
Status and general view of responsible investment

In comparison with a previous survey in 2007, the focus of South African institutional investors on responsible investment has increased considerably. The majority of respondents are now aware of the PRI and CRISA initiatives. Since the majority are also PRI and/or CRISA signatories, it appears that the goal of PRI and CRISA to help institutional investors to integrate ESG issues into decision making is beginning to materialise.

Motives of companies to report on ESG issues were investigated given the King III principle encouraging companies to produce an integrated report. The majority of the respondents believe that companies report on ESG issues mainly to improve corporate reputation, while approximately half believe that they do it to increase company performance. The survey addressed what motivates institutional investors to consider or not consider ESG issues in their investment decision making, thus what are drivers and barriers to responsible investment. Therefore, the general view of responsible investment can also be explained with reference to the results that relate to the drivers and barriers to the consideration of ESG issues in investment decision making.

The majority considered corporate citizenship as an important and critical motivation among the factors to consider ESG issues. This motivation was followed by CRISA, financial return, PRI, client demand and industry regulation as other motivations to consider ESG issues. Most respondents tended to consider these other motivations as important. The value of financial return on investments had already been suggested in the 2007 survey as a driver for responsible investment. The expectation of the 2007 survey that there would be an increase in client demand for responsible investment. This was confirmed by the respondents' view that client demand is an important motivation for considering ESG issues. Personal motivations for considering ESG issues are significantly less important than the other motivations.

Also under scrutiny were the reasons institutional investors disregard ESG issues. The small sample size on which this investigation was based (17 percent of respondents) may have influenced the reliability of the inferences from this investigation. However, trends could be identified. Negative financial performance was considered an important barrier. However, the lack of adequate measurements of ESG issues was shown to be the most important barrier preventing them from considering ESG issues. Negative or low financial performance as a probable result of responsible investment was also recorded as the perception of respondents in the 2007 survey.

Consideration of ESG issues

The findings show a significant improvement from the findings of the 2007 survey where the majority of respondents stated that they either do not consider ESG issues in investment decisions or, at the most, have a limited proportion of assets in RI. Now, the majority of respondents indicated that ESG issues influence their decision making. The expectation of the 2007 survey that value of the assets under management does not have any influence on their consideration of ESG issues and their willingness to pay for access to obtain information about ESG issues.

The respondents from the current study indicated that they consider ESG issues in the investment process when they consider the related risk, return and time frame of an investment. They also point out that they spend 18 percent of their time considering ESG issues. However, when the respondents were asked to indicate whether ESG issues never, less often, often or always influence their decision making, just over half of the respondents indicated that they value ESG issues often to always in such a way that it actually influences their eventual decision making. In other words, this means that just above half are actively investing on the basis of ESG issues. This is despite the majority having indicated that ESG issues influence their decision making and also that they implement PRI and CRISA. These findings show that the proportion of respondents who state that they consider ESG issues is greater than the proportion who indicate that they actively make investments based on ESG issues. As these differing results were identified, this prompted questions on whether there are differences in the relative importance of the ESG components.

The relative importance of ESG components

It is suggested that South African institutional investors' investment decisions are most heavily influenced by corruption. Since this is the case, it comes as no surprise that governance is ranked as the most important ESG component. With the increasing attention on climate change and other
environmental issues, and South Africa being known for social issues such as HIV/AIDS and employment inequality, the other two components were both considered to be important. The levels of importance assigned to these two components, environmental and social, did not differ significantly.

The majority of respondents consider all the ESG issues in the primary investment sectors (financial, industrial and resources) in South Africa, while just less than half consider environmental issues in the financial sector. Thus, the findings provide evidence that the industries in which companies operate do influence the relative importance of the ESG issues in investment decision making. The findings also demonstrate that ESG issues are given the most consideration in the industrial sector.

Almost half of the respondents indicated that they are willing to give up good investment return by turning down an investment in a company with high ESG risks. While 74 percent of respondents indicated that they would pay a premium for sound governance performance, 56 percent of respondents are willing to pay a premium for sound environmental performance and 52 percent for sound social performance. Again, these findings are also robust regarding the value of assets under management. Further evidence showed that, of all the respondents who indicated that they were willing to pay a premium, the average of the premium they are willing to pay would be 14 percent more when investing in a company with lower perceived risks in terms of ESG issues, ceteris paribus.

Concerns and enablers

The first concern to be highlighted was related to the qualitative nature of ESG issues. Since the lack of measurement tools is perceived to be the main barrier to the serious consideration of ESG issues, the majority of respondents believe that no adequate measurement tools are available for measuring ESG performance to serve as a basis for their responsible investment decisions. The availability of measurement tools has a major influence on whether institutional investors would be willing to pay a premium for sound social and governance performance, which then is likely to influence the willingness to pay a premium for sound environmental performance.

Integrated reporting is also considered as the main approach in how the institutional investors gain access to information regarding a company’s ESG performance. Due to the concerns in regards to the qualitative nature of ESG issues, it is not surprising that the respondents value independent assurance on ESG reporting. They indicated that they would like to see integrated reporting that included reporting on ESG issues to be mandatory, mainly for the JSE-listed companies. Interestingly 64 percent are not willing to pay a premium to access comprehensive and accurate ESG information about a company.

Just over 30 percent of respondents regard short courses to provide responsible investment guidelines and mainstream responsible investment benchmarks as enablers for the integration of ESG issues into investment decisions. The majority indicated that they consider all available benchmarks of ESG issues.

In conclusion

The findings suggest that the majority of institutional investors in South Africa from this study are aware of responsible investment and are signatories to and/or supporters of initiatives that promote responsible investment. The lack of measurement tools of ESG issues is considered the main barrier to considering ESG issues. Whilst all of the components of ESG issues are considered important, the governance component is viewed as the most important. Important motivations for the consideration of responsible investment were identified, including being responsible corporate citizens, CRISA and PRI, and financial returns. The respondents also indicated that they are willing to pay a premium for sound ESG performance.

Even though most respondents indicated that they consider ESG issues in their investment decision making, just over half of them showed that they actively value ESG issues regularly, or all the time in such a way that it actually influences their eventual investment decision. This reveals that institutional investors may declare that they consider ESG issues in their decision making, but one cannot be sure that they actively make investments on the basis of such considerations. This could possibly be due to barriers to responsible investment, such as the lack of measurement tools and the perception of a few that the consideration of ESG issues may influence financial performance negatively. However, respondents consider short courses to provide responsible investment guidelines and mainstream responsible investment benchmarks as enablers of responsible investment, illustrating that they perceive ESG as potentially offering value.
About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 167,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

The Ernst & Young Africa Sub-Area consists of practices in 28 countries across the African continent. We pride ourselves in our integrated operating model which enables us to serve our clients on a seamless basis across the continent, as well as across the world.

Ernst & Young South Africa has a Level two, AAA B-BBEE rating. As a recognised value adding enterprise, our clients are able to claim B-BBEE recognition of 156.25%.

Ernst & Young refers to the global organisation of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. All Ernst & Young practices in the Africa Sub Area are members of Ernst & Young Africa Limited (NPC). Ernst & Young Africa Limited (NPC) in turn is a member firm of Ernst & Young Global Limited, a UK company limited by guarantee. Neither Ernst & Young Global Limited nor Ernst & Young Limited (NPC) provides services to clients.

For more information about our organisation, please visit www.ey.com

© 2013 EYGM Limited. All Rights Reserved

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organisation can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

Studio ref. 130405. Artwork by Sewpersadh.