



# **Socially Responsible Investment in Europe: the policy challenges**

**Delta Economics  
Working Paper  
09-14**

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## The role of socially responsible investment in a post-crisis world

In the last two years it has become clear that old models of financial Capitalism built on high risk credit markets is unsustainable in every sense of the word. In the words of Sir Martin Sorrell, Chief Executive of the Media and Communications group, WPP, "It must be said plainly that Capitalism messed up – or, to be more precise, Capitalists did. We – business, governments, consumers – submitted to excess; we got too greedy.... Yet just as the crash was inevitable, so will be the pendulum swinging the other way."<sup>1</sup> In other words, the old models that take a short term perspective on rewards and returns will become less important as a new, responsible, approach to investment takes hold. Some of the impetus will come from governments who will inevitably regulate for greater financial discipline, but much will come through the market mechanism itself. In the words of Joseph Stiglitz, the global regulatory and financial system needs more transparency but also more responsibility in order to be sustainable. Inevitably these must mean more dialogue between the social partners and investor communities.<sup>2</sup>

There are two further reasons why a strengthened role for sustainable investment is necessary. First, although the financial crisis has generated a new awareness of the need for responsible investing as the only way forward from here, the imperatives of climate change are placing equally pressing demands on society and politics. In order to avoid the consequences of what Jonathan Porritt terms the "ultimate recession"<sup>3</sup> (that is, of the simultaneous collapse of the world's financial and environmental systems) the time is right to take the opportunities that these stark challenges offer us to invest in a sustainable future.<sup>4</sup>

Second, and led by entrepreneurial philanthropists such as Bill Gates, Warren Beattie and Tom Hunter and a new movement towards social enterprise led by organisations like the Skoll Foundation, sustainable ways of addressing social and economic inequality are increasingly being addressed from the "Base of the Pyramid."<sup>5</sup> The key challenges of economic development rest on being able to move vulnerable groups of people from temporary and highly volatile employment to meaningful and long term employment and, as these groups see their livelihoods and jobs disappear as the recession takes hold in the developing world, the challenge of how to create sustainable enterprises through sustainable and long term investment becomes even more compelling.

The solutions to environmental and social problems for the public sector are too costly to bear alone. Already some €300bn has been invested in new environmental measures world wide as part of public sector economic rescue packages.<sup>6</sup> But in order to make a real difference to climate change and to the social problems of unequal economic development worldwide, long term and sustained investment is also necessary. Socially responsible investment (SRI) is a key mechanism for ensuring that the private sector is building in social and environmental criteria into investment decisions, but, equally as importantly, also providing investment funds for investments in specifically themed social or environmental projects and businesses.

These considerations have led to an increase in both volumes in SRI markets and the integration of "Environmental, Social and Governance" (ESG) issues into mainstream investment decisions and behaviours. For example, the total SRI market world wide grew by 18% between 2005 and 2007 and stood in 2007 at €1.917,3bn in the United States and €2.665,4bn in Europe. Investors, according to EUROSIF, the European network for SRI are increasingly attaching more rigorous ESG criteria to their investments<sup>7</sup> not least because SRI is seen as a "safe haven in these turbulent times."<sup>8</sup>

<sup>1</sup> Sorrell, Martin, (2009): "The pendulum will swing back: A new, more responsible Capitalism will emerge from the wreckage of the old." *Financial Times* The Future of Capitalism – The Big Debate May 12th 2009. p42.

<sup>2</sup> Stiglitz, J (2009) 'The global crisis, social protection and jobs', *International Labour Review*, 148, 1-2

<sup>3</sup> Porritt, J. (2009): "Living within our means: avoiding the ultimate recession." *Forum for the Future*, London 2009.

<sup>4</sup> UKSIF (2009): "A Green New Deal: Joined up policies to solve the triple crunch of the credit crisis, climate change and high oil prices." [www.uksif.org](http://www.uksif.org)

<sup>5</sup> Prahalad, C.K. (2006): *The Fortune at the Bottom of the Pyramid* Wharton School Publications.

<sup>6</sup> HSBC (2009): "A climate for recovery – the colour of stimulus goes green" [http://www.globaldashboard.org/wp-content/uploads/2009/HSBC\\_Green\\_New\\_Deal.pdf](http://www.globaldashboard.org/wp-content/uploads/2009/HSBC_Green_New_Deal.pdf)

<sup>7</sup> EUROSIF (2008): "Socially Responsible Investment Report, 2008"; *Financial Times*, March 10<sup>th</sup> 2009: "Investors want more disclosure of climate risk data from Companies".

<sup>8</sup> Novethic (2008): "Figures and analysis of the French SRI market".

Yet despite the undoubtedly important role that SRI has to play in Europe, public policy towards stimulating SRI is described as “following” rather than “leading”.<sup>9</sup>

Clearly there are differences between countries within Europe in terms of both the volumes of SRI and the forms that it takes. The UK and the Netherlands, for example, have substantially greater SRI profiles than do, say, Germany or France. Yet even so, argue Steuerer et al (2008), across Europe the structures are relatively under-developed in comparison to measures to support and promote Corporate Social Responsibility (CSR). Given the complexity SRI, not just in terms of its definition but also in terms of the types of policies to support it, this conclusion is understandable. For example, the concept itself is evolving continuously from a way of managing the ethical profile of investments ten years ago to include now the emerging areas of High Net Worth Individuals (HNWIs), dedicated Venture Capital (VC) funds, themed investment funds (around, say, key environmental issues like water supply or renewable energies) and microfinance to enable social and economic development from the “Bottom of the Pyramid”. This growing complexity moves the reach of policy beyond the provision of large company or investment fund reporting guidelines and regulations towards an enabling environment for creating growth oriented social enterprises.

The purpose of this paper, therefore, is to unravel some of these complexities by means of a selective overview of policies in Europe to support the whole range of SRI activities and developments. It argues that it is in the best interests of economic, social and environmental sustainability for policy proactively to engage with and to accelerate the emerging trend in SRI but that this rests on an understanding of the stages at which direct market interventions, guidelines and regulations are appropriate. For example, environmental regulations that govern emissions from buildings in the UK have spawned an industry focused on reducing the carbon emissions of new buildings as well as retro-fitting, say solar panels, to older buildings. The result is a potential market for private investment in these new companies and policy measures to facilitate investment in the technologies that enable lower carbon emissions and allow focusing on supporting the investment community accordingly through investment guarantees.<sup>10</sup>

The structure of the paper is as follows:

1. The paper begins with a description of the total European market for SRI in comparison to the rest of the world (particularly, Japan, North America and Australia). It demonstrates that the market has established itself over time and become a steady part of total investment portfolios. In other words, since such large sums of money are involved through the operations of the market, it should be regulated and governed with exactly the same requirements for transparency, ethical behaviours and reporting that apply to conventional financial markets.
2. Second, an overview of the challenges for policy across Europe makes clear that mechanisms for enabling and supporting SRI have to be seen from both a supply-side (in other words, the total available funds for SRI purposes across a spectrum of activities) and the demand side (in other words companies and investors who are looking to gain a “triple bottom line”<sup>11</sup> from their activities). It is argued that the role for policy is in enabling a “virtuous circle” that stimulates both the demand side and the supply side by supporting the establishment of social enterprises and community investments at the micro and small business end of the market and goes through to providing a supportive framework to mainstream ESG considerations in standard investment practices.
3. Third, the “virtuous circle” of SRI policy is examined in selected European countries. The review comes from a survey of the literature, original, online and documentary sources as well as interviews in the UK to build up a case study of how SRI is being built up in that country. Guidelines for socially responsible investment put forward by the Organisation for Economic Cooperation and Development (OECD)<sup>12</sup> and signatories to the United Nations Principles for

<sup>9</sup> Steuerer, R., Marquala, S., Marinuzzi, A. (April 2008): „Socially Responsible Investment in EU Member States: an overview of government initiatives and SRI experts.“ Final report to European Commission High Level Group on CSR.

<sup>10</sup> Department for Business, Innovation and Skills (BIS) (2009): “New Industry, New Jobs: Building Britain’s Future” HMSO, BERR/Pub 8863/2k/05/AR. URN 09/922; [http://www.dius.gov.uk/~media/publications/N/new\\_industry\\_new\\_jobs](http://www.dius.gov.uk/~media/publications/N/new_industry_new_jobs)

<sup>11</sup> The phrase “Triple Bottom Line” is taken to mean the economic, social and environmental returns from any business or investment activity. It is used to refer to the more sustainable view of returns that are attached either to SRI or to social enterprise activity.

<sup>12</sup> <http://www.germanwatch.org/corp/oece-fs1.pdf>

Responsible Investment (UN-PRI)<sup>13</sup> are outlined. It is suggested that international guidelines to support investment already exist and that by signing up to these agreements at a governmental level (including through public sector fund management according to SRI principles), a powerful signal is sent to the investor community to alter its behaviour accordingly.

4. The report concludes with recommendations from the analysis for policy in Germany. The analysis suggests that extending reporting guidelines to include companies as well as funds and providing tax incentives for investments SRI themed funds, community investments or business angel activity to support the social enterprise sector are powerful ways of influencing both the supply and the demand side of the SRI market. There are two key things in determining the viability of SRI as a long term investment practice: first, proof of the financial returns alongside the social and environmental returns and second, ensuring that there are mechanisms to change company behaviours from the bottom up enabling small companies to meet the ESG criteria of the larger firms they supply and, critically, to be established to provide social, environmental and economic returns from the outset. This latter point requires the development of an effectively functioning market to support social enterprise from start-up through growth to exit and is key to ensuring that the SRI process fully gains momentum. It is argued that Germany does have financial structures through the Kreditanstalt für Wiederaufbau, the Deutsche Entwicklungsgruppe and some regional banks and Sparkassen to enable this and that a private sector market is beginning to develop in microcredits as a way of enabling sustainable growth out of the financial crisis in key communities within Germany.<sup>14</sup> The next challenge is to harness the undoubted interest and momentum that is growing into a coordinated system that allows SRI to flourish.

### **Some definitions**

The terminology that is used in relation to SRI is changing continually and there are no universally accepted definitions of it. It is worthwhile, therefore, to provide a brief glossary so that the terms as they are used in this paper are clear. The definitions are largely drawn from EUROSIF's 2008 review of SRI in Europe:

1. *Responsible Investment (RI)*: A developing area within the institutional investment market amongst fund managers who take into consideration the influence of longer term non-financial (ESG) factors in their investment decision making. They integrate (or mainstream) ESG criteria with mainstream investment criteria and traditional financial analysis.
2. *Socially Responsible Investment (SRI)*: This is an important area for the retail financial sector and adds specific values (for example environmental or social impact) to standard ESG considerations. Groups of investments are excluded because of their (negative) impact on either the environment or the social economy.
3. *Sustainable Investment (SI)*: Investors align (or match) their investments with specific environmental or social themes (such as the provision of water, renewable energy research and development or community renewal). This is particularly important amongst an emerging group of private investors (HNWIs) and dedicated funds who expect economic returns alongside social and environmental impact or returns.
4. *SRI*: This is a generic term covering all ethical investments, responsible investments, sustainable investments and any other investment process that "combines investors' financial objectives with their concerns about environmental, social and governmental (ESG) issues."<sup>15</sup> It comprises of:
  - a. Core SRI: ethical exclusions (negative screening); Best-in-Class und thematic funds (positive screening); it combines positive and negative screening of potential investments.
  - b. Broad SRI: Simple screening (two negative criteria), Engagement, Integration/mainstreaming.
5. *Social Enterprise*: "A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being

<sup>13</sup> <http://www.unpri.org/>

<sup>14</sup> VisAvis Economy 07/09, pp 19-21: "Rendite mit Verantwortung"

<sup>15</sup> EUROSIF (2008) p6



driven by the need to maximise profit for shareholders and owners.”<sup>16</sup>

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<sup>16</sup> [http://www.cabinetoffice.gov.uk/media/cabinetoffice/third\\_sector/assets/se\\_action\\_plan\\_2006.pdf](http://www.cabinetoffice.gov.uk/media/cabinetoffice/third_sector/assets/se_action_plan_2006.pdf)

## SRI as a growing trend: market volumes, developments and emerging trends

### The global picture

Table 1 shows the SRI market volumes for 2007. The US accounts for 39% of the market, Europe for 53%.

		2007 (\$bn)	Total SRI (\$bn)	Total SRI (€bn)
US	Social Screening	US \$2098	US \$2710	€1917,13
	Shareholder activism	US \$739		
	Screening + activism	US \$(151)		
	Community investment	US \$26		
Canada (2006)	Core SRI	CN \$57,4	CN \$ 503,6	€333,6
	Broad SRI	CN \$446,4		
Australia N.Zealand	Core SRI	Au \$19,4	Au \$ 72,2	€41,4
	Broad SRI	Au \$52,8		
Japan		Y840	Y840	€5,5
Europe	Core SRI	€511,7	€2665,4	€2665,4
	Broad SRI	2153,7		

**Table 1**  
**SRI in selected global regions (2007)**

Source: EUROSIF, SRI Study 2008

The sheer quantity of money going into SRI world wide paints a picture of just how much the market has grown between 2005 and 2007. Overall during that period, the market grew by 102% in Europe and constituted an increasing proportion of total investments to 17.6% of total Assets under Management (AuM) in 2007. In Germany, France and Switzerland the fastest growth has been in core SRI while the total market growth has been greatest in the Netherlands and the UK. The breakdown of the figures across Europe is given in Table 2.

	Market size €bn	Total SRI as % AuM	SRI Themes €bn	Ethical exclusions/ core SRI €bn	Best in class €bn	Broad SRI €bn
AU	1,17	0,7%	0,1	1,1	1,1	1,0
BE	183,8	48%	4,2	11,4	9,7	-
DK	114,5	-	-	21,5	24,3	109,1
Fi	83,0	-	-	12,2	1,3	71,0
F	98,6	-	1,7	16,8	18,6	70,7
D	11,1	-	5,9	5,6	2,8	6,3
I	243,4	0,32%	1,5	1,6	0,8	240,3
No	208,8	-	-	170,6	-	182,4
NL	435,0	40,0%	2,9	61,2	9,1	366,0
Es	30,8	-	-	1,3	-	29,5
Sw	191,0	-	-	36,9	20,5	134,3
Ch	21,1	-	8,6	12,9	11,0	-
UK	959,0	-	2,4	36,7	2,1	909,4

**Table 2**  
**SRI in Europe 2008**

Source: EUROSIF 2008

## The development of SRI

SRI has evolved over the past ten years from a form of risk management for large firms and investors<sup>17</sup> to a more comprehensive and inclusive concept that captures the importance of two things:

1. Small, medium and large companies moves towards business models that are evaluated through the “Triple Bottom Line” (i.e. that include social and environmental impact and returns as well as economic and financial ones).
2. The emergence of a whole new business sector that has emerged from the cross over between the not-for-profit, voluntary and charitable sectors and the for profit sector that undertakes business activity to solve social or environmental problems, but that does not rely upon charitable or public sector donations in order to be able to do this. This “social enterprise” sector is increasingly vibrant and requires whole new investment and business models as well as governance structures in order to distribute profit to the objectives of the firm rather than to shareholders or owners. Such entities offer policy makers the opportunity for growing a whole entrepreneurial sector that can tackle both problems of poverty and under-development as well as environmental challenges, by building both resource-based public private partnerships and a socially responsible growth finance sector.

Alongside this, there is a strengthening trend within the financial community to integrate, or mainstream, ESG criteria into standard portfolio analysis in the first instance because governments and regulators have required this, especially of publicly owned pension funds, but equally, and perhaps more interestingly, because there is a growing commercial interest in evaluating and integrating CSR/ESG criteria into investment decisions as a proxy for strong and ethical management. This so-called “mainstreaming” process means that increasing numbers of large companies, especially if listed on international stock markets, are required to report on the ESG performance. As a consequence, there are accordingly better guidelines and more robust long term data which compares the financial performance of SRI funds with more conventional fund performance.

Effectively, then, the SRI sector as it is developing has clear supply-side and demand side requirements, as illustrated in Table 3.

<b>Supply side</b> Influences the quality and amount of money going into socially responsible investment	<b>Demand side</b> Influences the extent to which businesses, charities and community or environmental projects use commercial (SRI) investments to generate growth and social/environmental returns
<p><b>Key characteristics:</b> This has been seen mostly as working through the formal investment markets and is closely linked to the CSR strategies of large firms. Consists of screening (positive and negative) for ESG stance, shareholder activism, selection of “best in class” SRI profiles and community/environmental themed investments.</p>	<p><b>Key characteristics:</b> This works from the “bottom of the pyramid” to develop solutions to social or environmental problems. Often requires a social enterprise structure (for example, the UK’s Community Interest Companies) to attract investments; has historically been dominated by the not-for-profit, charity and community sector. Growth potential now being realised.</p>
<p><b>Market developments:</b> At the top end of the market there is increased “mainstreaming” of ESG principles into conventional investment practice; alongside this new investment</p>	<p><b>Market developments:</b> Emergence of a sector of entrepreneurs who want to generate surplus but reinvest it in the cause or issue they are trying to solve rather than distribute to shareholders.</p>

<sup>17</sup> Business for Social Responsibility (BSR) (2008): “Environmental, Social and Governance: moving to mainstream investing.” <http://www.bsr.org/research/reports.cfm>.

opportunities are arising in dedicated or, themed areas.

**Policy measures:** CSR and SRI regulations and guidelines, SRI regulations governing reporting and public sector funds; broader regulation as with conventional financial markets; tax incentives to encourage investment in dedicated community or public interest funds

Allows for economic as well as social and environmental returns (Triple Bottom Line)

**Policy measures:** business support to social enterprise sector; raising awareness of social and environmental businesses as alternative business models; tax incentives to individuals to invest directly into social enterprises as business angels or into funds; government guarantees or co-investments (Public-private partnerships)

**Table 3**  
**Developments in the SRI market from a supply and demand perspective**

Table 4, then, looks at the SRI market in three phases. Phase 1, was largely supply side and focused on providing an investor-focused set of guidelines, principles and regulations, Phase 2 shows the risk management fall-out from the profound failures of corporate governance represented by the Enron, Parmalat and Tyco affairs, while Phase 3 shows clearly the recent transition towards a more demand-oriented model that works to use CSR and SRI as a route out of the financial and environmental crisis that the world faces.

Date	EU level activity and member state regulatory changes
<b>Phase 1: 1988-2000 – investor-oriented measures aimed at increasing critical SRI mass</b>	
1999	<b>Norway:</b> ESG/SEE reporting requirements on public pensions
2000	<b>First Lisbon-EU Conference</b> , – Triple Bottom line investment practice.” <b>UK, Sweden, Denmark and Germany:</b> ESG/SEE <sup>18</sup> reporting requirements for public and private pensions
2001	<b>France:</b> Employee savings Law offers sustainable investments to savers; financial organisations required to offer a “solidarity fund” that invests in social projects; fund managers mandated to integrate SEE into investment decisions <b>Spain:</b> Private pension funds required to report on ESG and SEE stance and practice <b>Sweden:</b> The five largest pension funds required to integrate ESG and SEE criteria into investment decisions <b>Italy:</b> Pension fund reporting requirements <b>Switzerland:</b> 2,5% public assets dedicated to ESG/SRI investments <b>Norway:</b> all public assets, public pension funds and public oil funds mandated to include ESG/SEE criteria
<b>Phase 2: 2001-2004 – Enron, Parmalat, Tyco: Institutional backlash mainstreams environmental, social and governance risks</b>	
2002	<b>EU:</b> Trustees of investment funds demand ESG/SEE reporting; Agreement to recommend CSR monitoring; multi-stakeholder CSR Forum recommends that all pensions funds report on SRI criteria in funds and investment decisions
<b>Phase 3: after 2005: thematic investments gain traction</b>	

<sup>18</sup> Social, Environmental and Ethical

2006	<b>EU:</b> European Sustainable Development Strategy: EIB and Africa Partnership for Infrastructure Development required to develop sustainable reporting that correlates with the UN's Millennium Development Goals
2007	<b>EU:</b> further dialogue around CSR and SRI to focus on linking ESG criteria with financial incentives
2009	<b>EU:</b> Green investments, sustainability and responsibility at the heart of policy for Europe beyond the financial crisis

**Table 4**  
**Key developments in supply-side policy across Europe**

Source: EUROSIF, 2008; European Commission, 2008, BSR 2008

Major regulatory initiatives to introduce reporting requirements across Europe for ESG-SEE criteria were most obvious at the beginning of this decade. Since then, however, engendering a positive and sustainable mechanism for addressing climate change, social inequality and the financial crisis have become so pressing across the continent that policy has increasingly oriented itself towards encouraging direct investments in environmental or social projects, including integrating international micro-credits for developing nations into international development departments in Member States. In reality, then, policy is simply reflecting a broader pattern of development within the SRI sector itself. The key drivers of these trends are illustrated in Table 5.

Drivers	Demand or Supply side?
Growing interest in social enterprise as a solution to social, environmental and economic development problems (including social exclusion); professionalization of the "Third" (social and voluntary) sector	Demand side trend: organisations need appropriate structures to allow them to access investment finance and suitable investment vehicles need to be available.
Growing microfinance sector creating returns and development opportunities across the world (emerging economies and OECD)	Supply-side: Microfinance Investment Vehicles (MIVs) grew by 31% during 2007/8 fuelled by the International Finance Corporation (with KfW) at an international level, national development funds and private investors. This was slower than growth in 2006/7 but better than performance of mainstream funds.
Requirements to match public money with private money in addressing social issues because public budgets are squeezed <sup>19</sup>	Demand side and supply side: attracting investors into projects that use prevention rather than ameliorating to deal with social, health or community issues. Costs are higher for projects which are dealing with the consequences of a problem rather than the causes so savings are made which can be used to guarantee returns for investors.
Higher awareness, particularly amongst a younger generation of investors, in the issues of climate change and uneven development is prompting the development of	Demand side: higher demand for responsible and sustainable investments. The investments are often around specific themes (for example community projects or specific green technologies) so the fastest growing area of SRI funds is in the themed areas of core SRI. Private investment (for example business angel investments) grew by 8% between 2007 and 2008 <sup>20</sup> and

<sup>19</sup> Social Finance (2009): "Social Impact Bonds: Rethinking finance for social outcomes" London, [www.socialfinance.org](http://www.socialfinance.org).

“themed” investing. The UN-PRI (and the Global Reporting Initiative) have helped fuel this interest and raise awareness	there is evidence that the business angel market has survived the financial downturn well. <sup>21</sup> Growing feeling amongst fund managers that financial returns don’t offer sustainable value for communities regions, countries and the world.
Mainstreaming and Integration	Supply side: As the SRI sector develops, there is more data to suggest that SRI returns do not differ significantly to conventional investments. <sup>22</sup> As a result, the number of private sector signatories to the UN-PRI are increasing

**Table 5**  
**Drivers of SRI**

Source: Delta Economics, interviews

As can be seen from Table 5, international organisations play a central role in that they provide standards and guidelines for CSR generally and SRI in particular. The OECD has guidelines that cover the following: working practise, industrial relations, human rights, supply chain management, breaches of protocol, the environment, exploitation and corruption, consumer interests and science and technology. In meeting the OECD guidelines, a company is seen to meet the ESG conditions attached to SRI.

It is the guidelines that are provided by the United Nations for responsible investment, however, that have become a global standard for the sector. The private sector signatories to the UN-PRI guidelines are illustrated in Table 6.

Nation	Asset owner signatories	Investment manager signatories	Professional service partner signatories
United Kingdom	16	43	16
Denmark	16	3	1
France	4	25	5
Italy	1	3	2
Sweden	9	7	2
Netherlands	17	15	3
Spain	7	2	1
Switzerland	4	20	9
Belgium	1	3	0
Finland	7	0	0
Germany	2	1	4
Norway	5	0 <sup>23</sup>	0

**Table 6**  
**Signatories to the UN-PRI**

Source: UN-PRI: <http://www.unpri.org/signatories/>

Although Europe has a larger SRI market than the United States, the number of signatories to the UN-PRI is lower in Europe. This suggests that in Europe SRI funds are very focused in a small number of players rather than spread across a wide spectrum of investors. The only exceptions to this are the United Kingdom and Norway where larger numbers of investors dominate suggesting that mainstreaming is more prevalent. In the case of Norway, this may be because of the requirement of any fund managers associated with public sector and oil funds to integrate ESG and SRI criteria into their investment decisions suggesting that where the public sector leads through the management of its own funds, it will pull the

<sup>20</sup> EUROSIF (2009): *Public policy position paper in relation to SRI : response to the crisis.*

<sup>21</sup> Delta Economics interviews

<sup>22</sup> See Schröder, M. (2003): “SRI in Germany, Switzerland and the US: an analysis of investment funds and indices.” ZEW, Mannheim.

<sup>23</sup> There are two Nordic funds that cross the region that are also signatories; Similarly there are two funds with a Baltic focus that are also signatories

private sector along with it.

### **Summary – the challenges for policy**

The drivers listed above suggest an evolving picture of SRI across the world, not just in Europe. On the supply-side there are more funds and more private investors who are interested in achieving a “Triple Bottom Line” through their investment practice. In other words, they are not just interested in the financial returns of their investments, but also in having a social or environmental impact as well. The role of SRO has noticeably changed in the last 4-5 years: from ESG as ethical practice and risk management to a real opportunity to use the challenges of climate change and social inequality “to do well by doing good.”

The demand-side can be understood in two ways: first, there is a growing understanding that “bottom up” development is a sustainable solution to some of the world’s most intractable social problems and can actually be more effective than either grant funding or charitable donations to social causes. Much of this has been driven by Mohammad Yunus and the Grameen Bank<sup>24</sup> but the debate has been strengthened by a body of academic<sup>25</sup> and policy<sup>26</sup> research that suggests that the economic costs of inequality and climate change are too high to be sustainable and that entrepreneurship is the way out of this crisis. In this sector are the microfinance market and an emerging community investment market, where private investors are encouraged into community investments through State guarantees of their returns or through tax incentives. Second, and here there is substantial growth potential, the demand for start-up or growth finance for social entrepreneurs and third sector organisations is growing.<sup>27</sup> These are socially or environmentally motivated businesses that are innovative and, hence, require private money in order to bring a particular environmental technology or social innovation into the market. For example, it is estimated that around 3,4% of the population in the UK are “social entrepreneurs” over and above those who are more conventional entrepreneurs<sup>28</sup> and almost 50% of the growth-oriented entrepreneurial sector is motivated by social and environmental goals.<sup>29</sup>

This summary makes it clear that policy needs to be formulated across four areas, therefore:

1. **“Bottom-up“ Development:** social, community and environmental solutions provided through microfinance, community investments, social development banks and social enterprise.
2. **Growth phase:** social and environmental business and innovation funded through growth finance.
3. **Mainstreaming sustainability:** the sustainability of small and medium sized businesses (SMEs) as well as large firms is a pre-condition for a successful SRI market economy. There are difficulties, for example in the complexity of the issues, appropriate evaluation and measurement tools, and inadequate management skills in order to drive this forward. Similarly, the lack of adequate data that compares SRI with conventional funds prevents the full scale engagement of conventional fund managers in the SRI process.<sup>30</sup> “Social Return on Investment“ (SROI)- and adequate evaluation tools are necessary to ensure that awareness raising techniques are accompanied by effective guidelines and metrics for SRI.
4. **Sustainable Exits:** In order to embed SRI and the bottom up approach outlined above, it is necessary to have the structures for commercial exits and adequate tax and incentive systems to

<sup>24</sup> Yunus, M. with Weber, K. (2007): “Creating a World without Poverty: How Social Business can Transform our Lives.” Public Affairs Publishers, New York.

<sup>25</sup> Nicholls, A. (2006, ed): “Social Entrepreneurship: New models of sustainable social change” Oxford University Press, Oxford, Mulgan, G., with Tucker, S., Ali, R. and Sanders, B. (2006): “Social Innovation: What it is, why it matters and how it can be accelerated.” Skoll Centre for Social Entrepreneurship Working Paper: <http://www.youngfoundation.org.uk/files/images/SI-sp.pdf>. See also, Mulgan, G., Rashed, A., Halkett, R. and Sanders, B (2007): “In and out of synch: the challenge of growing social innovations.” Young Foundation/NESTA 2007; Harding, R. (2007): “Understanding social enterprise” Industry and Higher Education, London, March 2007, pp74-86. Boshee, J. and McClurg, D. (2003) “Toward a better understanding of social entrepreneurship: some important distinctions.” Minnesota, MN: Institute for Social Entrepreneurs. Harding, R. (2008): „Social Entrepreneurship in the UK“ <http://www.deltaeconomics.com/media/social2008fullreport.pdf>; Harding, R. (2008): “Growing up: the role of entrepreneurship in sustainable economic development.” [http://www.deltaeconomics.com/media/Growing\\_up\\_DeltaWES08.pdf](http://www.deltaeconomics.com/media/Growing_up_DeltaWES08.pdf)

<sup>26</sup> Included in this is the Stern Review in which Sir Nicholas Stern argued that the global economic costs of not addressing climate change are too high to bear. [http://www.hm-treasury.gov.uk/media/4/3/Executive\\_Summary.pdf](http://www.hm-treasury.gov.uk/media/4/3/Executive_Summary.pdf)

<sup>27</sup> Wohltätigkeitsorganisations, not-for-profit Organisationen und der ehrenamtlicher Sektor.

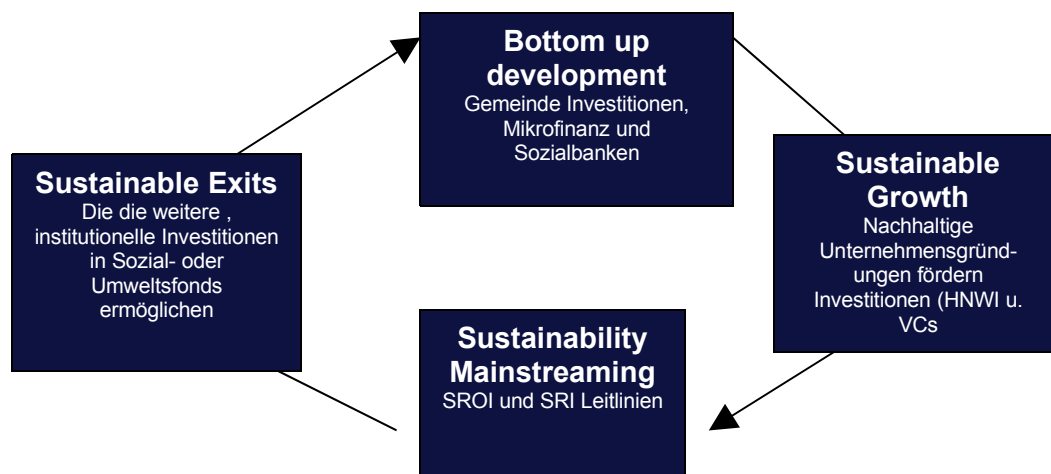
<sup>28</sup> Harding, R. (2008): “Social Enterprise in the UK: the results of a five year study” Delta Economics

<sup>29</sup> Harding, R. (2008): “Challenges and Opportunities for Growth and Sustainability, 2008 report” Delta Economics. 2009 version to be published in November 2009.

<sup>30</sup> <http://www.investorvalue.org/docs/TheChallengesOfMainstreamingEnvironmentalSocialAndFinancialPerformance.pdf>

ensure that money is reinvested. This has prompted discussion in the UK about social stock markets, for example. Although there are stock markets, such as the FTSE4Good<sup>31</sup>, the Dow Jones Sustainability Index<sup>32</sup> and the DAXGlobal Saracin Sustainability Index<sup>33</sup> that take a “Best in class” methodology in order to build their sustainability indices. According to the FTSE4Good around 40% of the largest firms in the world have the capacity to enter into these lists but, as they are lists of compliant funds rather than dedicated to managing exits, these do not substitute for a dedicated exit route for social investors.<sup>34</sup>

These four phases represent a policy “virtuous circle” and are illustrated in Table 7.



**Table 7**  
**The SRI policy virtuous circle**

## What’s happening in Europe?

As has already been emphasised, SRI as a market phenomenon is changing constantly and more rapidly in the past two years as the social, environmental and economic imperatives that the world faces have become more pressing. This has accelerated moves towards more bottom-up support measures, not all of which are obvious as they operate through community programmes at a very local level. The information presented in Table 8, therefore, should be seen as illustrative rather than comprehensive.

Nation	Bottom-up Development	Sustainable growth	Mainstreaming	Sustainable Exits
United Kingdom	Phoenix fund followed by UnLtd fund for micro-credits and grants to community projects; Community Investment Funds; Social Investment Business; Social Finance; New social enterprise research centre funded through the Economic and Social Research Council (currently focused on measuring scale of social enterprise activity)	Payroll giving tax relief (since 1986); Community investment tax relief, social venture capital trusts, emerging business angel and VC market; clean tech market growing; social enterprise coalition acts as a trade association to promote the interests of social enterprise employers	Carbon disclosure world centre; Pensions Act 2000: full disclosure of SRI stance and practices; Company Law Act 2006: all companies liable for reporting; SROI guidelines to SMEs; Operations and Financial Review (2005) requires non-financial reporting by listed companies	On-going discussion around social stock market  FTSE4Good
Denmark	Merkurbank provides	Merkurbank – ethical	Pensions Act;	

<sup>31</sup> [http://www.ftse.com/Indices/FTSE4Good\\_Index\\_Series/Downloads/F4G\\_5Year\\_Review.pdf](http://www.ftse.com/Indices/FTSE4Good_Index_Series/Downloads/F4G_5Year_Review.pdf)

<sup>32</sup> [http://www.sustainability-index.com/djsi\\_pdf/news/PressReleases/DJSI\\_PressRelease\\_090903\\_Review09.pdf](http://www.sustainability-index.com/djsi_pdf/news/PressReleases/DJSI_PressRelease_090903_Review09.pdf)

<sup>33</sup> [http://deutsche-boerse.com/dbag/dispatch/en/isg/gdb\\_navigation/market\\_data\\_analytics/20\\_indices/2710\\_international/475\\_sustainability?active=indexconcept&wpbpl=ETR&wp=DE000A0QY147&foldertype=\\_Index&wplist=null&module=M\\_IndexConcept](http://deutsche-boerse.com/dbag/dispatch/en/isg/gdb_navigation/market_data_analytics/20_indices/2710_international/475_sustainability?active=indexconcept&wpbpl=ETR&wp=DE000A0QY147&foldertype=_Index&wplist=null&module=M_IndexConcept)

<sup>34</sup> This is currently under discussion in the UK amongst the investor community according to interviews conducted for this research.

	micro-credits for sustainable development and investments; Anderskassen – micro-credits in developing countries	bank – biggest bank in sustainable banking – investment opportunities	Nation-wide CSR strategy 2007 to spur change in behaviours	
France	French microcredit agencies work with multinational CGAP	Payroll giving scheme;	Savings plans integrate SRI; SRI mandates for large company reporting	
Italy	Microcredits through Banca Ethica (leading players in European social investment)	Growth finance and public awareness – Banca Ethica only lends to co-ops and social institutions; invests private money for social purposes.	Pensions Act	
Sweden	Jord Arbete Kapital Bank – savings and loan cooperative; independent with SRI focus. Ekobanken – provides ethical and sustainable investments in communities and green technologies	2 hedge funds mandated for SRI investments; 10% of all investment funds used for social or environmental purposes	State pensions Act required disclosure; Swedish pension funds ethical council; theme funds under development	
Netherlands	Sustainable money guide; research being conducted; microcredit sector investing in emerging economies	Tax reductions for social or environmental businesses; dividends from returns on microcredit tax free; established “Green Funds” scheme	Pensions Act and State Pensions required to have SRI guidelines	
Spain	€60m microcredit fund	Institutional investment market growing which will have effect on Phases 1 and 2 of development	Public funds: 10% invested in SRI; Pension Act 2007 requiring reporting by commercial and public funds and inclusion of SRI in investment criteria	
Switzerland	Alternative Bank ABS – promotes social and community investments	Thematic funds developing – will stimulate social and environmental innovations – esp renewable energy	First to develop a „sustainability index“	
Belgium	Financité : promotes microenterprise and microfinance in Belgium	SOFICATRA – VC fund investing in double bottom line. Social and sustainability funds, 2003; Regional Flemish Pension Funds have community investment mandate	Law against financing of companies involved in weapons production or trading; Pension Disclosure Act 2003	
Germany	Microcredit and community investment through GLS, KfW and DEG	GLS – first social and ecological bank in Germany; DEG focused on growth investments in sustainable projects; BMBF climate change platform to inform finance providers on returns	Pensions Act governing reporting for company pensions; Some local and regional authorities (Neuss and Munich) provide support on SRI to their fund managers; Neuss: 1 <sup>st</sup> local authority to	DAXglobal Saracin Sustainability Index for German listed companies

		become member of ethical finance institute
Norway	Cultura Sparebank – uses investments in social and sustainable way through micro-credits	Second largest state fund in world is predominantly managed according to SRI principles, as is the state-run Oil fund; Accounting Act 1999 required all funds to report on SRI stance

**Table 8**  
**An overview of the phases of SRI policy in Europe**

Source: Delta Economics interviews

Table 8 shows that the structures in Europe are reasonably developed but equally, according to the research for this paper at least, are not especially coordinated through policy in order to achieve the virtuous policy circle as outlined above.

The UK represents one of the more developed SRI systems so it is worth dwelling on the case for a while. It is not perfect and the UK government’s latest action plan suggests that increasing momentum is still needed to embed social enterprise and socially responsible investment.<sup>35</sup> The system is coordinated through the Office of the Third Sector (OTS) and, to some extent by the Department for Business Innovation and Skills (BIS) but delivery is through public and private actors. For example:

- UnLtd (<http://www.unltd.org>) is a social investment fund that provides micro-credits, development loans and an introduction to risk capital for the social sector. Its €120m Fund was drawn from the government’s “Millennium Fund” but has to be managed and developed independently of the UK government.
- Community Investment Tax Relief (<http://www.berr.gov.uk/files/file43003.doc>): this is tax relief for private individuals who invest in their communities through the “Community Development Funds for Investment” (CDFIs). (<http://www.cdfa.org.uk/cmframe.php?prmid=1200>). These are funds that provide grants, loans and investments in community projects on a commercial basis. There are additional tax incentives for business angels who want to invest in specific community projects.
- BIS funds research and development and provides guarantees for small firms taking loans from banks and increasingly are focusing on the entrepreneurial opportunities of climate change. The “New Industry, New Jobs” White paper launched in April 2009 demonstrates the partnership role (finance and dialogue) that the UK government plays in facilitating sustainable development through entrepreneurship. BIS is also responsible for the SRI guidelines represented by the Operating and Finance Review (OFR) which, under the Companies Act of 2006 required all listed companies to report on their social and environmental performance.
- Social impact bonds and a new “Social Investment Wholesale Bank” are being discussed between private investors, an independent fund, Social Finance, and the government at present. Social impact Bonds are investment vehicles that incentivize private investors into making investments in preventative measures (such as health care or crime reduction) through returns that are paid when the savings from not having to treat the cure accrue to the public purse. Returns are guaranteed by the public sector in order to encourage investments into these funds amongst investors with social investment goals.

<sup>35</sup> [http://www.cabinetoffice.gov.uk/media/cabinetoffice/third\\_sector/assets/se\\_action\\_plan\\_2006.pdf](http://www.cabinetoffice.gov.uk/media/cabinetoffice/third_sector/assets/se_action_plan_2006.pdf)

## Conclusions

A virtuous circle of SRI policy stems from the effective coordination of the four stages of SRI development. These measures are arguably the responsibility of more than one department so the coordination has to be centralised in one place – for the UK this is the Office of the Third Sector. Keeping a broad stakeholder community on board is vital, not least because SRI is a complex concept which stems from CSR and represents the means by which long term social and environmental public policy goals can be met through private sector engagement.

From this overview, the following points should be stressed:

1. In order to raise awareness and interest in SRI, the way in which the virtuous circle could be implemented in Germany needs to be debated and researched. Data on the long term performance of SRI funds is still inadequate to encourage the bulk of mainstream investors into it and without such data it is impossible for policy either to identify where the “market failure” is and, similarly, to evaluate policy success.
2. There are two key ways of approaching SRI – either from a bottom-up perspective that emphasises social enterprise, community banks and investments in social and environmental businesses) or “top down” through regulations and guidelines that are focused on accelerating the integration of SRI criteria into conventional investment practice.
  - a. The latter, top-down approach can be assisted greatly by the government managing its own funds in a responsible way which then compels other investors in the private sector to do the same. This has been particularly effective in Norway.
  - b. Equally, however, there are opportunities to develop a market for growth-oriented social entrepreneurship that would require a growth finance structure ranging from micro-credits through to venture capital and eventual exit. Some of these structures exist in Germany through the KfW and DEG.
3. Alongside this, it is possible to incentivise investors into the market through the tax system – tax incentives for personal investors (like the UK’s Enterprise Investment Scheme or the Community Investment Tax Relief). The Netherlands and the UK are arguably the countries where this is most developed and these are also the countries with the largest SRI volumes.
4. Through co-investments and guarantees the government can create a risk capital market for social and environmental businesses that do not want the regulatory restrictions of charitable structures. This requires appropriate organizational formats (the UK’s Community Interest Companies<sup>36</sup> are good examples here)
5. The role of existing development banks such as the KfW and the DEG which are focused on economic, social and environmental development, should be strengthened as these provide an ideal vehicle for enabling the development of an independently functioning commercial market for social and environmental investment.

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<sup>36</sup> <http://www.cicregulator.gov.uk/>