The (mis)alignment of ESG perspectives in the investment chain.

A cross-country analysis of the obstacles facing companies, asset managers and asset owners

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To my sister.

‘’For there is no friend like a sister in calm or stormy weather; to cheer one on the tedious way. To fetch one if one goes astray. To lift one if one totters down. To strengthen whilst one stands’’

- Christina Rosseti

Abstract

As evidenced by the rapid increase of United Nations Principles for Responsible Investment (UNPRI) signatories, the integration of environmental, social and governance indicators (ESG) in investment decisions has become a popular topic. However, despite its popularity, there is no consensus among practitioners on what this actually means and how it should be tackled. The obvious lack of standardization is reflected by divergent ESG rating procedures, incomparable company sustainability reports and the widely differing strategies by asset managers and asset owners. This is a substantial hurdle as it can cause misalignment of perspectives within the investment chain, which keeps ESG from being pushed up the agenda. There appear to be substantial struggles on the road to ESG integration and several questions arise; are the perspectives on ESG integration aligned between companies, asset managers and asset owners? Where do possible obstacles on the road to responsible investment reside, what are they and how can they be overcome?

My main findings are four-fold. First, I find ESG reporting fatigue among companies due to the sheer number of ESG ratings and rankings. Companies should not let this overwhelm them and be clear that they only respond to a handful. Investors should only use it as a starting point and ensure that it does not become a substitute for a real conversation with their portfolio companies about ESG. This interest is necessary for top management to sign off on sustainability initiatives. Second, I find that asset owners are not as convinced of the business case of ESG as asset managers and companies are. This is often reflected in the way they select, monitor and review their asset managers. Third, the lack of in-depth ESG due diligence by asset owners likely lets asset managers get away with decoupling statements from actions. More specifically, it appears that ESG and finance are often still separated. Lastly, companies are more reactive than proactive when it comes to ESG efforts. The main driver for them to embark on their ESG journey is the consumer. We can therefore play a significant role in creating a more sustainable world, either as the beneficiary or the consumer.

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List of acronyms

AM - Asset Manager

ASN - Algemene Spaarbank voor Nederland

AO - Asset Owner

AOW - Algemene Ouderdomswet

AUM - Assets under Management

CSR - Corporate Social Responsibility

DB - Defined benefit

DC - Defined contribution

DJSI - Dow Jones Sustainability Index

ESG - Environmental, Social and Governance criteria

ICCR - Interfaith Center on Corporate Responsibility

ILCA - Industry Life Cycle Analysis

ILO - International Labor Organization

IMA - Investment Management Agreement

IR - Investor relations

IRRC - Investor Responsibility Research Center

LGPS - Local Government Pension Scheme

NGO - Non-governmental organization

PAYG - Pay-As-You-Go

RI - Responsible investment

ROI - Return on investment

SDGs - Sustainable Development Goals

SEC - Securities and Exchange Commission

SMA - Segregated managed account

SWF - Sovereign Wealth Funds

UNPRI - United Nations Principles for Responsible Investment

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1 Introduction

Many initiatives have tried to convince the market of the importance of extra-financials. The biggest promoter of this new era of investing emerged in 2006 as the United Nations Principles of Responsible Investing (UNPRI), an initiative of the United Nations. The initiative commits asset owners (from here on AOs) and asset managers (from here on AMs) to integrate environmental, social and governance aspects (from here on ESG) into their investment processes. Over 1,300 institutions with more than $45 trillion assets under management (AUM) have now signed this initiative, which comprises approximately a third of global AUM. This has grown nine fold since it started back in 2006 (PRI, 2014), which indicates that the UNPRI is succeeding in convincing the financial markets of the validity of ESG integration as an investment approach and its potential to become mainstream. After a long-standing debate, academics have also come to some agreement that there is a business case for ESG, but now it has to be further developed and understood (Arjaliès, 2010; Eccles et al., 2011; Majoch et al., 2014). Even though many are now convinced of the value-added, a truly integrated approach to ESG is still rare (Juravle and Lewis, 2009; Wagemans et al., 2013), which makes one wonder as to why this is the case.

Responsible investment (from here on RI) has been around for many years. However, it must be stressed that this certainly does not mean that we fully grasp it or know how to integrate it. At face value, everyone appears to be interested in RI and the majority seem to be ''experts'' in doing so. However, if that were the case, the true ''win-win'' or integrated approach, would not be such a rare find (Juravle and Lewis, 2008, 2009; Wagemans et al., 2013). This makes one wonder why it is not more common. On the other hand, given that the topic is still under-researched, it is understandable that it is not mainstream yet (Hoepner et al., 2015; Woods and Urwin, 2010). At the same time, the case for mainstreaming RI and for collective action is more pressing than ever. Humans are faced with an existential crisis and action is urgent. This became clear when the Sustainable Development Goals (SDGs) were endorsed by 193 countries in September 2015. This development agenda for 2030 makes the case for urgent action, with 17 global goals and 169 targets (UN, 2015). This does not just concern pension funds, who are required by their fiduciary duty to act in the best interest of their beneficiaries. Other organizations may face material consequences in the form of a damaged reputation by not taking action. Hence, if organizations want to be consistent with the 2030 development agenda, they should incorporate issues relating to E, S and G. If their efforts are then lost in translation in the investment chain, this will create major issues for the planet and its inhabitants. The case for alignment regarding RI in the investment chain is therefore more pressing than ever. The SDGs and the significance of RI will be further elaborated on in section 1.2.

Regardless of how believable the business case is and how urgent the matter has become, a thorough understanding of ESG integration is lacking. There are few qualitative papers that attempt to address it, which can be attributed to the excessive focus on the “why’’ (or financial sense) of ESG, which has finally largely been answered by the literature. Now it is time to address the ‘’how’’ to go about this in practice, as it is still outstanding (Capelle-Blancard and Couderc, 2009; Clark et al., 2015b; Fulton et al., 2012). That is why this research will zoom in on how the different players in the investment chain approach ESG integration. As the players within the investment chain are connected, either through ownership or mandates, it is crucial that their perspectives on ESG are aligned to move forward. Despite this, few scholars investigate the investment chain as a whole, or attempt to document misalignment issues. This thesis consists of different puzzle pieces which, together, shed light on the impediments to RI.

The first chapter will shed light on an important intermediary between AM and companies; the ESG rating and ranking industry. This industry has risen in popularity in the last decade to the point that there are now hundreds of different ESG rating, rankings, or other initiatives. However, they vary widely, conditional on the audience that they are looking to serve and the criteria that they take into account (Charles J Fombrun, 1998; Gladman, 2015; Scalet and Kelly, 2010; Sonnenfeld, 2004). Recent academic evidence finds a low correlation between different ESG ratings. This calls the reliability of ESG scores into question (Chatterji et al., 2015; Dorfleitner et al., 2015). This can, of course, cause some confusion. More importantly, since this type of intermediary tends to send questionnaires to the companies they assess, it is not unlikely that companies suffer from ESG reporting fatigue. The importance of this industry should not be overlooked, because many AMs rely on this industry to allocate billions of dollars in capital. AOs may also use this industry to evaluate their AMs. If these actors are not aware of the discrepancies between the different providers or if they blindly rely on scores, this capital is potentially misallocated. To my knowledge, no research addresses the way practitioners use the ESG rating and ranking industry in their investment-decisions or monitoring efforts. Furthermore, there is no research on the potential reporting fatigue this industry causes. Since the potential reporting fatigue and blind reliance on this intermediary could hinder the adoption of RI, the aim of this chapter is to investigate whether this industry is a vice or virtue in the adoption of RI.

Building on the findings of this chapter, I further explore the investment chain and turn to AOs. The pension sector is the largest investor class by far, with over $30 trillion under management (Ambachtsheer, 2016). They are especially significant owners in countries with a developed pension market, such as the UK and the Netherlands (OECD, 2011). Much is therefore expected of this prominent shareholder (Clark, 2008; Piggott et al., 2008; Wagemans et al., 2013; Wong, 2010). AOs should care about ESG for several reasons. First, it has been proven to add value (Clark et al., 2015a). Secondly, nothing is external to a global owner (Monks, 2001). Lastly, their long-term liabilities mean that the long-term (and therefore ESG) matters. Implementing it, however, is not always straightforward (especially in the case of outsourcing). Research has found that their beliefs and investment horizon do not always line up with those of the AMs they employ (Clark, 2013; Gifford, 2015; Søndergaard, 2014). However, AOs claim that it is the AMs who are not doing a good job (Nicholls et al., 2015; OECD, 2011). This could point to agency issues, whereby the agent (AM) does not act in the principal's (AOs) best interest. They may thus be better off creating the expertise in-house, a model often adopted by larger funds or Sovereign Wealth Funds (SWF). Another possibility is that they do not care about ESG or believe in it as much as they say they do. That could be the reason for the short-termism in mandates given to AMs (Barton and Wiseman, 2014; Clark, 2011; Desmartin, 2015; Søndergaard, 2014; UN Global Compact and PRI, 2014; Wong, 2010). This would not be in their beneficiaries or plan participants' best interest, pointing to another potential agency issue. Building on the knowledge gained from the first chapter on the way AOs use the ESG rating and ranking industry to evaluate their AMs, I further develop my understanding of the way they integrate ESG (into their selection, monitoring and review processes) and what drives them to do so.

Using the previous findings, I explore the AMs' ESG integration efforts. Although guided by their clients, they are at the heart of managing supply and demand. This makes them a vital link in financing the needs of the real economy, through shares, bonds or other products (Costanzo, 2011; Desmartin, 2015). The "transparency documents" on the UNPRI website illustrate that there is no consensus among AMs; they take widely different approaches to RI. This lack of consensus and standardization implies that many of them are not properly taking ESG into account (Eccles et al., 2012; Hayat, 2014; Kiernan, 2007, p. 200; van Duuren et al., 2015). Indeed, evidence suggests that few AMs are truly integrating ESG into their investment decision-making processes (Cappucci, 2017; Guyatt, 2006; Juravle and Lewis, 2008). This is interesting, given that it adds value when it is done well. Its effectiveness, however, depends on how well it is integrated (Busch et al., 2016; Clark et al., 2015a). On the AM level, some research has indicated that they may lack the expertise to interpret non-financial information (Juravle and Lewis, 2008; Munro, 2015; Searcy and Elkhawas, 2012). This could be the root of the frustration of AOs (Nicholls et al., 2015) and the reason AMs may turn to ESG ratings and rankings. However, very little is known on the way they make their investment-decisions (Delmas et al., 2014; Martin et al., 2007; van Duuren et al., 2015). For example, they could be plagued by short-termism from clients, making it hard to integrate ESG the way their clients would like them to. Some say that investor short-termism trickles all the way down the investment chain and causes companies to forego longer term opportunities (Graham et al., 2004; Graves and Waddock, 1990; Tonello, 2006). Yet others say that corporations are the problem and not institutional ownership (Aghion et al., 2009; Dent, 2010).

Lastly, I zoom in on their portfolio companies[1]. Nobody can refute that there are still many scandals. With the rising popularity of RI and increasing expectations of corporations, it is more difficult to get away with this than it used to be. Companies need to be profitable and responsible on both a social and environmental level (Mohrman et al., 2015). If this is ignored, they may not only face damage to their reputation, but litigation costs may hit their bottom line directly as well (Renneboog et al., 2008). Although several corporations have stepped up their game and seem to have rediscovered the purpose of the corporation, more work is needed. Why are there still so many scandals? One can argue that without the demand for harmful products or without the pressure to “make a quick buck” this would not be happening at all. It is likely that, also on the company level, many socially and environmentally colored issues are merely perceived to be peripheral and hence, easy to discard. This is also reflected by the way this type of information is presented in sustainability reports; lacking a connection to the strategy and business model of the organization (Eccles and Serafeim, 2015). Why does it seem like little seems to have materialized? What is the often-overlooked story of the corporation? I investigate what drives them to incorporate ESG and what is holding them back.

Overall, there appears to be a gap between what institutions say they are doing and what they are actually doing. To make matters worse, they seem to be pointing fingers at each other. The question then becomes; what kind of impediments obstruct RI and where do they reside? Potential impediments can reside at the different levels of the investment chain.

[1] To the extent possible, I look at the ownership structure of companies and try to identify their shareholders. This was not possible for all companies, but many are part of the investment chain I investigate

However, the problem could also arise from the way the different parties communicate with one another. The aim of this thesis is to examine this issue further and to explore why the integrated approach is such a rare find. This will be done by looking at a simplified version of the investment chain in the Netherlands, the UK and Germany. I will thus investigate the AOs, the AMs they employ (or outsource to) and the companies they invest in and the ways they influence each other. Each layer of the onion, so to speak, will be peeled back to get to the core of the problem.

The contribution of this thesis is the documentation of misalignment issues throughout the investment chain, from the company to the fund manager to the ultimate owner. Additionally, an important under-researched intermediary is investigated as it may be yet another part of the problem. Without a clear idea of what issues are holding back RI, not much advancement can be made towards true integration. We can keep pointing fingers at each other and hiding behind policies and legislation, without making any real progress. Knowing this, should also help policy-makers and regulators in drawing up more effective policies and legislation. The aim of this thesis is therefore to lift the veil and to get some clarity on the integration approach of the different actors and to figure out what impedes their progress.

The definition of RI as well as its significance will be outlined in the sections below. Thereafter, the research objectives and form of the thesis will be more specifically described. This includes an outline of the different chapters and the central questions that will be explored in each of them. This will then be followed by the methodology, sample and limitations. Afterwards, the literature review sets out the analytical building blocks of this thesis. At the end of the literature review, a conclusion is provided which will not only summarize the most important issues that will be explored, but also provide a roadmap to the rest of the thesis.

1.1 Responsible Investment

Due to the lack of consensus on what ESG means and how to integrate it, investors have constructed widely different strategies. This is also linked to whether the investors in question believe that ESG integration increases value or whether it is simply a must from a moral standpoint to exclude companies involved in i.e. tobacco, gambling, nuclear weapons etc. Thus, investors will indicate that they integrate ESG, but in reality, they might refer to their exclusion strategy or to their engagement strategy, which are two different approaches. The point is that, even when there is some degree of consensus about a definition, this does not mean that everyone agrees on its true meaning (Sethi, 2005). In fact, there are at least 37 different definitions of Corporate Social Responsibility (CSR) (Dahlsrud, 2008). Therefore, more information on the different types of RI strategies will be given in the section on AMs (3.5.2). Moreover, given the wide variety of interpretations of RI, the definition of the UNPRI will be used throughout this thesis.

"*Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole. It recognizes that the generation of long-term sustainable returns is dependent on stable, well- functioning and well governed social, environmental and economic systems*" (UNPRI, 2013, p. 7)

As can be seen above, "long-term" is mentioned explicitly as ESG risks and benefits may take a while to materialize. Unfortunately, the obsession with short-term quarterly returns is deeply embedded in the financial system (Clark, 2010; Hawley, 2015; Whittaker, 2011). Given that this is difficult to overcome, Barton and Wiseman (2014) have outlined some suggestions to shift to a longer-term approach. These suggestions are alignment with risk tolerance, active ownership and engagement, understanding long-term drivers as opposed to focusing on quarterly guidance and finally the alignment of internal processes (i.e. incentives and mandates). Although these suggestions are helpful, integrating it into decision-making and ownership practices remains a considerable obstacle for investors (Clark et al., 2015b; Sakuma-Keck and Hensmans, 2013).

1.2 Significance of Responsible Investment

Many investors or companies still believe that ESG should only be incorporated for ethical reasons. Therefore, ESG is often treated as a peripheral issue and will thus be the first thing to be thrown overboard when the ship is sinking. This is why it is often not integrated into the core business, even though it should be, to reap the benefits. The reasons to take ESG seriously are manifold and should be discussed before further exploring the topic.

First, as was mentioned before, there is a business case for integrating ESG. Over the years, it has become more “real” or “material” and can be linked directly to a company’s financial statements. Think about the recent drought in California and Brazil, which had real effects on companies’ growth (i.e. Unilever). Think about the enormous environmental lawsuits against British Petroleum or Exxon Valdez, which directly impacted profits. A report published by UNEP FI, finds that more than 50% of a company’s earnings can be at risk from environmental costs (PRI and UNEP Finance Initiative, 2011). Second, companies are increasingly held accountable for their actions through social media. This enables anyone to quickly spread bad news and damage a company’s reputation (i.e. twitter campaigns). Third, institutional owners own a substantial part of our economy and their portfolios are highly diversified. This means that for them ESG is by definition important, since one company’s mistake can be another one’s cost (i.e. insurance premium).

Last but not least, there is the obligation to society to preserve the planet for the next generations. This is also for economic reasons, given the interdependence of the eco- and economic system. If we continue to destroy our planet, this will lead to the inevitable collapse of the economy. The ecosystem contributes directly and indirectly to human welfare and natural resources are needed to produce goods. When society is healthy, this equals a productive workforce and when natural resources are used efficiently it makes productivity more sustainable. Quite simply stated, corporations cannot thrive without a healthy society or without natural resources. It is thus without question part of the total economic value of the planet (Costanza et al., 1997; Porter and Kramer, 2006). To help preserve the planet, the case for urgent action was underlined by the endorsement of the SDGs in September 2015. As discussed in the introduction, the 2030 development agenda was endorsed by 193 countries and it includes 17 goals and 169 targets (see table 1). Fortunately, investors appear to have started their efforts, as a survey by ShareAction among 64 investors finds that 75% of the respondents are taking steps to address three or more of the SDGs. Although these efforts are more likely to be framed around ESG than around the SDGs (ShareAction, 2016), both frameworks aim to address serious issues concerning people and our planet. With the formulation of the SDGs, ESG is given a sense of urgency and repackaged in a message that resonates with people everywhere. The survey indeed demonstrates that the message resonates; many investors deem the SDGs important and intend to address the goals in the next 15 years. To ensure that this effort is not, to some extent, lost in translation, the impediments I lay out in this thesis should be addressed.

Table 1. The Sustainable Development Goals

Goal 1	End poverty in all its forms everywhere
Goal 2	End hunger, achieve food security and improved nutrition and promote sustainable agriculture
Goal 3	Ensure healthy lives and promote well-being for all at all ages
Goal 4	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
Goal 5	Achieve gender equality and empower all women and girls
Goal 6	Ensure availability and sustainable management of water and sanitation for all
Goal 7	Ensure access to affordable, reliable, sustainable and modern energy for all
Goal 8	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
Goal 9	Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
Goal 10	Reduce inequality within and among countries
Goal 11	Make cities and human settlements inclusive, safe, resilient and sustainable
Goal 12	Ensure sustainable production and consumption patterns

Goal 13	Take urgent action to combat climate change and its impacts
Goal 14	Conserve and sustainably use the oceans, seas and marine resources for sustainable development
Goal 15	Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification and halt and reverse land degradation and halt biodiversity loss
Goal 16	Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
Goal 17	Strengthen the means of implementation and revitalize the global partnership for sustainable development

Source (UN, 2015)

1.3 Research objectives

The purpose of the research is to gain a thorough understanding of how different parties in the investment chain incorporate ESG in different countries. Moreover, the aim is to identify the bottlenecks. In-depth interviews will be conducted with companies, AMs and AOs. Furthermore, as the approaches and adoption rate differ across countries (Hawley, 2015; Renneboog et al., 2008), data will be collected from the Netherlands, the UK and Germany. The collected data will provide insights as to what the major obstacles in RI are from all three parties' perspective and across different institutional environments. Based on that, recommendations can be drawn up to overcome the identified challenges.

1.4 Overview of chapters

1.4.1 ESG ratings and rankings; vice or virtue in the adoption of responsible investment?

The ESG initiative industry has grown tremendously in the last decades and many of these organizations serve as an intermediary between companies and their investors. Billions of dollars of capital are allocated based on the judgment of these intermediaries and many academic papers rely on them as well. Regardless of its widespread use, little is known about how this industry came about and what its role is. The multitude of initiatives and lack of convergence raises questions on whether the industry's costs outweigh the benefits. This chapter therefore investigates 218 different ESG initiatives and uses the Industry Life Cycle Model, to illustrate that the industry is maturing. It also draws on interviews conducted with its users to strengthen this finding. The chapter concludes that reporting fatigue, a lack of convergence and the (sometimes) poor quality and transparency have made the industry more vice than virtue in the adoption of RI.

1.4.2 Asset owners and the diffusion of responsible investment. What explains the low rate of adoption?

AOs are significant, powerful investors and can play a leading role in RI and the move towards a longer-term horizon. It appears, however, that their ESG beliefs may differ from the AMs they employ. A recent survey also indicates that they may not be happy with the way their AMs incorporate ESG (Nicholls et al., 2015). It is unclear whether this is due to the way they guide their AMs, or whether this is indeed due to the AM. To find what influences the rate of adoption on the AO level, I conduct ten interviews with major players in the UK, the Netherlands and Germany. I find that they prefer to hire an AM who integrates ESG, but that they struggle to translate this into action. Looking at the perceived attributes of RI, I find that complexity, relative advantage and trialability impede the rate of adoption. I also find that there is too little dialogue for this complex innovation and that AOs are making too little effort. Overall, German AOs are lagging behind compared to the ones in the Netherlands and the UK. However, they are not as large and have significantly less exposure to equity. This means that they also do not have as much of a responsibility to drive RI forward.

1.4.3 Asset managers' ESG strategy; lifting the veil

It appears that AMs take widely different approaches when it comes to the incorporation of ESG. Given the limited body of qualitative research, too little is known on how RI is perceived, what triggers AMs to initiate change and how is it integrated in practice. It is possible that they receive conflicting short-term signals from clients, which hinder the RI efforts of AMs. I investigate whether this is true and whether there are other obstacles. I also look at how AMs make sense of RI and give sense to RI. To explore these questions, I interview 15 asset managers in the Netherlands, the UK and Germany. I find that, in some cases, it appears that they decouple what they say from they are actually doing. ESG teams are sometimes used as boundary spanning units to shield the rest of the organization from changes they do not want to make.

1.4.4 Companies' ESG efforts; catalysts and inhibitors

This chapter draws on 20 interviews with (mostly) sustainability managers in the UK, the Netherlands and Germany. Using the innovation literature, I investigate the catalysts of a company's ESG journey, as well as the inhibitors. Additionally, I look at the way ESG is perceived and whether this differs from the previous chapters. I find that companies strongly believe in the business case of ESG, but that they are generally more reactive than proactive. They often wait until normative pressure picks up, for example after a disaster, or after they are exposed by a non-governmental organization (NGO). I also find that customers are the main source of innovation. This may not be surprising, but this means that we, as the consumer, can play a much bigger role in the ESG journey of corporations. Lastly, I find many of the same obstacles that I found on the AO and AM level. Interesting, however, is that companies do not point fingers, but acknowledge that they should do a better job at communicating the business case of ESG. Investors will then likely follow their lead.

2 Methodology and Limitations

2.1 Methodology

2.1.1 Structure

The chosen structure is book form, given that there is considerable overlap of the chapters, to the extent that the field research feeds into all the chapters. The first chapter is mainly desk research, although some interview results will be used as well. The other chapters are purely based on the interviews, but not merely the ones corresponding to that specific actor in the investment chain. For example, the AO chapter uses insights from the AM and company interviews, in addition to the AO interviews. Moreover, they are combined and compared to establish the bottlenecks in RI. Thus, although they each add value by exploring the respective parts, they form a cohesive picture together and serve to illustrate the complexity and the obstacles in the investment chain when it comes to ESG integration.

2.1.2 Research Methods

Two kinds of methods were used to gather data. Firstly, desk-research was conducted to better understand the ESG initiative industry. Secondly, a qualitative study was undertaken as this research is not interested in finding out that RI is not mainstream, but it is interested in the reasons behind it. Moreover, there is currently a lack of theory to answer the previously outlined questions and the topic is relatively immature (Flick, 2007). Semi-structured elite interviews were conducted with the selected companies, AMs and AOs. This qualitative design enables comparison, allows for novel insights into this somewhat immature topic and caters to the desire of the elite to articulate their views (Harvey, 2011). Based on the arguments in the next section, the interviews follow the close dialogue approach as proposed by Clark (1998).

This is a form of a “bilateral engagement”, rather than a one-way street (Clark and Monk, 2017). Predefined questions guide the interview and the method is rather iterative, going back and forth between theory and empirical evidence. Although close dialogue may not be the most conventional method, it is necessary in this case to better understand organizational beliefs and behavior. Instead of taking the world that is made up of existing theories for granted, this method offers the opportunity to reconstruct and enhance our current understanding. Close dialogue is very valuable in helping us to think outside of the box and to promote conceptual and theoretical innovation (Clark, 1998a, 2007).

Access to “Business Elite” is rather restricted as they have critical information regarding the inner-workings of a firm. One advantage that I brought into the interviews was my industry experience which helped in securing interviews, most notably with AMs and AOs in the UK and the Netherlands. However, access was difficult especially in Germany where I do not speak the language fluently and do not have much of a network. It must also be noted, that not all the interviewees held substantial decision-making power in the companies they work for, although on the AO and AM level the majority can be categorized as “elite”. On the company level, many of them had been working for the company so long that I assume they also have quite some influence. In fact, on more than one occasion they were the ones who pioneered “CSR” in their respective companies. I handled each interview as a unique case. During some, I searched for a common understanding on a more personal level i.e. when interviewing someone my own age, gender or nationality. Yet on other occasions with participants that were more difficult to connect with, we talked about mutual connections or work experience to establish rapport.

Interviewing the elite comes with drawbacks besides gaining access. They are often trained in speaking to outsiders and many of them do this frequently and are thus rather rehearsed. This could affect the insights of the data gathered. Moreover, they often have a packed agenda and have little incentive to speak to researchers. It is thus especially helpful to them if you clearly indicate the length of the interview and if you can be flexible with your schedule. If the interviewee in question is especially highly ranked, you are more likely to score the interview if you indicate that it is under an hour. Other frequently mentioned difficulties with the elite are power relations or inequality. In some cases, they may challenge the interviewer or ramble on about their topic of choice and thus take control of the interview (Aberbach and Rockman, 2002; Goldstein, 2002; Harvey, 2011; Richards, 1996). These difficulties emphasize the need for continuous learning during the process. On top of that, the researcher is an instrument during the interview process, meaning that he or she should be aware of his or her input. It is thus advised to reflect on each and every interview right after it takes place. Reading notes thoroughly every time and listening to tape-recorded interviews can help in improving the quality of the next interview. This way, the researcher can be aware of his/her interview style, potentially misplaced comments or interruptions that might compromise the quality of the data (Galletta, 2013).

2.1.3 Positionality

When conducting scientific research, there is often a focus on facts and objectivity to derive theories from the data. Moreover, there is the assumption that the researcher is impersonal, impartial and detached from the process. However, I side with Clark (1998) and feminist literature (see McDowell, 1992 or England, 1994) that this can be quite unrealistic, especially when it comes to interviews. Firstly, it is not entirely plausible to assume objectivity. As a researcher, I am influenced by my background and my personal characteristics. For example, my industry experience may bias the research, but it may also enable me to build rapport faster with respondents or to grasp insights more quickly. The fact that I am young and female may mean that I am not taken seriously by my older, more experienced and predominantly male interview participants. However, the other option is that they may speak more freely, because I am non-threatening to them (Horn, 1997; Tarrant, 2014). These examples demonstrate that the researcher always brings baggage into the interview, which can influence the perception of the interviewee and the quality of the data.

Secondly, not reducing the complex world to theories could bring new insights. Of course, it is helpful to focus on a few drivers and to therefore reduce the complexity of the situation. However, in other cases it might also stifle our ability to comprehend the real world. For example, we can take the efficient market hypothesis for granted (which people often do), but real-life observations indicate that this might not always hold. Removing all the outliers and detail from a dataset can result in a false representation of the world. We have thus inherited many theories that may be quite removed from real-life situations and real-life processes. To develop our understanding or to innovate, we must break out of this cycle. The complexities and inconsistencies that are an inherent part of our world, should thus be embraced and not always stripped from the research process (Clark, 1998a, 2007; England, 1994).

Lastly, the researcher (much like the participant) may assume different roles during the course of the interview or situation (Clark, 1998a; Harvey, 2011; McDowell, 1998; Tarrant, 2014). This also means that the researcher cannot be completely detached from the research process, but is rather an instrument in the research itself (Clark, 1998a; England, 1994). The research should therefore be seen as a process rather than a product. During this process, the researcher needs to maximize the value of the insights gathered. If the participant is not as open as they could be, it may help to engage them or to gain their trust by shifting between an “insider” and “outsider” perspective. Moving positions during the course of the interview can help in not only challenging but also in validating their answers (McDowell, 1998). You might also have to briefly demonstrate your knowledge of the industry, in case you are sitting across the table from *the conversationalist* and you are being tested (see Clark, 1998). Of course, you must let them bring forward concepts on their own account and be careful not to “put words in their mouth” or even to lose your independence from the industry as mentioned by Clark (1998). Alternative to assuming the role of the “expert”, you may present yourself as the “ignoramus” as suggested by McDowell (1998). Obviously, this all depends on the role assumed by the interviewee and it is helpful to do some reading on their background, or even on previous interviews they may have done. However, it must be noted that building rapport can be complicated by the interviewee’s perception of the researcher. Although they are not necessarily different from other groups, differences between the interviewee and the researcher may be more pronounced in “elite” interviews. This is due to their status, experience and the likely age difference (Alvesson, 2010; Clark, 1998a; McDowell, 1998; Mullings, 1999; Roulston, 2010; Tarrant, 2014).

2.1.4 Desk Research

Sample Selection and Data Collection

As outlined above, desk research was undertaken in addition to semi-structured interviews. The collected information on the ESG initiative industry were compiled and sorted to provide a comprehensive overview. This overview is not meant to be exhaustive, as there are countless initiatives that may somehow be involved with ESG. Existing initiatives were gathered through extensive searches, reports of companies, existing overviews and some are mentioned by interview participants. The description, country of origin and launch date as well as target market and methodology were collected. The initiatives were then divided into six different categories; awards, rating, ranking, index, research, shareholder services. There were also initiatives that did not fit into either category and these have been listed under “other initiatives”.

The way the overview is categorized, is by main focus or initiative first launched, as there are several initiatives that provide many services, such as rating, ranking and indices. Take ISS for example, who were first founded for shareholder services, which is still their main focus. However, somewhere along the way (in 2002 to be specific) they launched the Corporate Governance Quotient (CGQ). This still means that they will be categorized under shareholder services. Only in a few cases, there are distinctly different services and the organizations have been included in the overview twice under the two suitable categories.

Initiatives that were more focused on rating countries were excluded. Some ESG initiatives have disappeared off the radar without much of a press release or anything else identifying what has happened. These have been excluded from the selection. However, in some cases it was still possible to piece together some information and to find books or papers from around the time the initiative was launched. Another item that was difficult to find in many cases, is the launch date of the specific initiative or product. In some cases, the organizations in question were emailed and in other cases, the launch dates are "almost sure". About 5% of the initiatives have a launch date that may be slightly off.

Data Analysis

The Industry Life Cycle Analysis (ILCA) was used as a tool to analyze the development of this new industry. This was helpful in analyzing the current state of the industry and to assess where it is going. This theory was introduced by Michael Porter in 1980 and it predicts that industries go through several phases as they evolve from birth to maturity. The early stage is characterized by ambiguity, as little is known about the product features desired by the buyer (Klepper and Graddy, 1990). The market should be convinced in the early stages and the duration of the total cycle depends on many factors, such as the barriers to entry and the ease with which it can be copied. If the product takes off, more players will enter the market to take advantage of its popularity. As the number of users grows and levels off after a while, companies have to adjust accordingly by improving quality at first and then shifting to enhancing the product and expanding capacity (Mirva Peltoniemi, 2011). At some point, there will be a decline in the number of players in the market as the industry starts to consolidate. The levelling off can be triggered by obsolescence of the product, or a fundamental change in technology which may be the start of a new product cycle (Audretsch and Feldman, 1996; Klepper and Graddy, 1990; Porter, 1980).

The ILCA lends itself well to analyze the ESG initiatives industry, but it has not been done before to the author's knowledge. By counting the number of initiatives each year and correcting for acquisitions, a graph is produced to establish the lifecycle of this insufficiently researched industry. For example, if the trend is levelling off, we can conclude that the industry is mature and that adjustments in quality of the ESG products or initiatives can be expected. However, if the number of players are declining, the industry is in the decline phase which could indicate obsolescence or a fundamental change.

2.1.5 Field Research

Qualitative Interview Design

As previously mentioned, the semi-structured interview is the chosen method for data collection as it provides sufficient focus to address the research questions, yet leaves some flexibility for participants to contribute novel insights (Galletta, 2013). Before selecting the respondents and constructing the survey instrument, I had informal chats with a company, a pension fund and someone who knows the asset management space very well. This was helpful in double-checking how relevant the topic is and to gather ideas for the construction of the survey instrument. The informal chats also helped in conducting and securing interviews at a later stage.

At the very beginning, the main issues or themes were drawn from the literature review; the role of ESG initiatives, short-termism, expertise of AMs, alignment of ESG perspectives, reporting fatigue and pressure on companies. These "themes" were then used to construct different open and closed-ended questions to ensure that the research questions were covered and to make sure there is sufficient opportunity for the participant to contribute their insight. For example, I ask both AMs and AOs if they use ESG ratings in their investment decision-making process or in the monitoring of their AMs. This provides me with additional insights, as many respondents do not mention the reliance on ESG ratings when explaining their investment decision-making process. I also ask them why and how they chose these providers, to understand what drives the choice of one provider over another.

Nearly all themes occur in all three survey instruments, as for example, short-termism can be detected at any stage in the investment chain. Another example is how ESG pressure is experienced at the different stages in the investment chain. Are AMs and companies feeling the pressure the AO is claiming to exert? By doing this, the intentions of the AO can be compared to the actual outcome all the way to the company-level (depending on how transparent the "ownership chain" is). This is done for several other themes, sometimes mainly for the two most relevant levels (i.e. ESG initiatives mainly concern AM and companies). Because the themes are broad and so are some of the questions, more than one theme can be covered by a specific question. The “alignment” theme is investigated by asking the same set of questions (~14) to all three parties. All of them are asked how they define RI, whether they believe it increases returns, why they incorporate ESG and so on. These are then compared in the end, to see if there is any consensus either between the same type of actor, or across the actors in the investment chain (the themes as well as the final survey instrument for the AOs, AMs and companies can be found in appendix 3).

Sample Selection

Company respondents were selected by means of a Bloomberg Screening. This was useful as a first list of potential candidates and in constructing a relatively comparable sample (i.e. size, sectors) across the UK, Germany and the Netherlands. Subsequently, I checked the shareholder structure of the selected companies and tried to identify the ownership chain. This was not straightforward as the ownership structure indicates either the AO or the AM, but not both. Google searches on who has won the mandates led me to some of the missing puzzle pieces and some respondents were open enough to fill in the remaining information. In some cases, I was offered an interview with the client or the AM right upon asking this question. Since I wanted to have all three parties in the investment chain, I selected AOs who outsourced their investment function and AMs who mainly invested in equity.

The sample selection for the AMs and AOs also included a requirement for a UNPRI transparency document. This was useful to prepare for the interviews, to fill in some missing information and to identify what AOs outsource their investments and invest in equity. This asset class is the focus of this thesis for three reasons; it is more developed, more criticized and it is one of the largest asset classes in pension portfolios (Hoepner et al., 2011).

The selected respondents were approached via LinkedIn or email, with a short description and purpose of the study. About 100 invitations were sent out altogether with a response rate of 45%. Out of the 45 interviews, 13 were held face-to-face, which was helpful in acquiring further potential interview participants. Most successful in recruiting participants was the use of existing contacts, or asking to be introduced to someone else after the interview. During the interview selection, I have also received help from Hermes Investment Management, the UNPRI and Uwe Fritsche (IINAS Institute). The help of the last two organizations was especially helpful and necessary for the German market, as many organizations there are more closed-off than those in the Netherlands or in the UK. Although not always feasible, conducting face-to-face interviews in Germany also helped in gaining access.

Out of the 45 interviews, 10 of them were with AOs, 15 with AMs and 20 with companies. This was spread almost evenly across the three countries. Participants on the AO level were mostly “Investment Managers” or “Head of RI”. In one case, the fiduciary manager did the interview. On the AM level, the participants’ role was often “Head of Equities” or “Head of RI”. In one case, I interviewed the “Head of Sustainability Research” at a bank, given that this particular person, although not directly involved with investing, is known in the space. The participants on the company level were mostly sustainability managers and sometimes they were joined by an IR person. In one case, a CFO did the interview (see appendix 6, 8 and 9 for more information about the respondents)

Data Collection

In all 45 cases, informed consent was obtained verbally (or written) before starting the interview. Additionally, I am subject to university regulations in the conduct of these interviews. All participants were also asked if they had any questions concerning the project or my background and whether they were aware of how the data would be used. Approximately 25 questions were asked and most interviews were conducted within an hour (see appendix 3 for the survey instrument). It must be noted that only few interviews were recorded as nearly all respondents indicated that they would speak more freely without recording. In one case I had to encouragingly turn off the recorder to keep the participant talking. Thus, instead, notes were taken during the interview and worked out immediately afterwards to ensure the data was “fresh”.

As expected, quite a few of the participants changed our appointment last minute, or indicated a preference for a phone call. Many of them also had to be approached several times, or be reminded to introduce me to their contacts. Although discouraging on some occasions, reading through the literature on “Elite Interviewing”, I was aware that some of the participants were simply not easily accessible, had little time and much more urgent matters to attend to. I thus followed the guidance of being flexible and especially time-conscious with the most “Elite” of the participants.

The fact that so many were sustainability people also meant that the IR department had to step in on the investor-related questions, at least in some cases. In most cases though, the sustainability managers had been with the company for many years and had a good idea of the amount of ESG-pressure from investors. Another issue, is that one might say that respondents who agree to the interview are more likely to be doing good job and the results are thus biased. However, because of a lack of standardization, there is still ample divergence when it comes to organizations who have started their ESG journey. The research is about this divergence, what people are doing and why they are doing it.

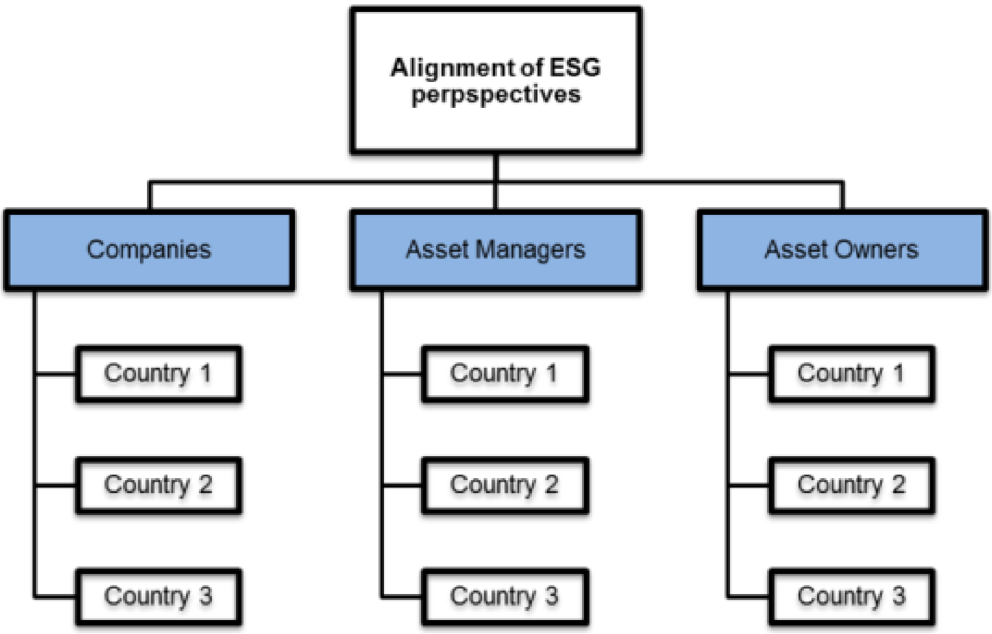
Data Analysis

Notes were worked out right after the interviews and all compiled into an excel database. This was then analyzed, coded and compared with the help of NVivo software. Although there are many advantages to computer-aided analysis, such as more explicit rules and higher coder reliability in applying said rules, there are also many drawbacks. One of these is that this data reduction method, by definition, omits the details from the collected data. The richness of the collected information is thus lost once the data is reduced. Other drawbacks are around the reliability and validity of the coding as there is much ambiguity to cope with. A computer can apply explicit rules in the same way, but the definitions or wording might be ambiguous and it might thus not measure the intended construct (Drisko, 2015; Weber, 1990). Because of the above-mentioned drawbacks, but mainly to prevent loss of rich data, NVivo is merely used as a tool to sort different themes and to look at the data from different angles.

The coding and the analysis itself is not purely deductive or inductive, but rather a combination. Some of the codes are established and inspired by the large body of ESG literature, industry experience or even the informal chats. One example is the expected terms “environmental”, “social” and “governance” in the definition of RI. However, many questions around the bottlenecks to RI are exploratory. This means that there are emergent codes as well and that there is thus an inductive element to the analysis (Eriksson and Kovalainen, 2008; Vogt et al., 2014). The analysis is therefore ongoing and iterative, requiring a continuous loop of organizing the data with NVivo, closely reading the interview notes, documenting emerging ideas and reading existing literature until the fundamental analytical threads surface (Galletta, 2013).

The interviews were also conducted in a specific order, namely one company, its AM and AO (if possible) and then I moved on to the next “set”. This was done to ensure access to all three parties involved, as this might not always be feasible. The level of comparison started from a case by case point of view i.e. the perspective on ESG is compared between interviewees. It was then compared between groups (companies, AMs and AOs) and subsequently between different countries. The chosen design is thus comparative as illustrated in figure 1.

Figure 1. Comparative design



2.2 Limitations

The biggest challenge of the research was to gain access to companies, AMs and AOs. Not all were willing or able to participate in the interviews. This was addressed by means of using existing contacts and making use of further networking opportunities at conferences. Although the interview process was time consuming, the upside of interviews is that the outlined problem can be analyzed in detail. Nonetheless, this also means that the sample is much smaller and that it is more difficult to generalize the findings to a larger set of companies (Flick, 2007). The selected sample may not be representative of other listed companies, in the same sector or in the same country. As previously emphasized, one might argue that those agreeing to interview are already doing a good job and that the results are thus biased. However, given the lack of consensus and the generally widely different approaches this is not considered a major obstacle. In fact, it is valuable when participants have already given some thought to ESG integration as this ensures that they have something to say about the topic.

One issue that needs to be addressed, is that research participants may not tell the truth (Clark, 1998; Roulston, 2010). This might especially be an issue for the company-level analysis, given how trained they are to speak to investors and how concerned they are with their reputation. However, given that most participants were sustainability managers, many were not used to speaking to investors. They were thus more likely to not have rehearsed a story, especially because in most cases the questionnaire was not sent ahead of time. In a few cases, this was a drawback as several participants could not answer investor-related questions. However, this was not a problem as the IR department supplied the necessary information and in most cases (17 out of 20 interviews) the sustainability manager had been with the company for so many years, that they could answer all the questions in detail. For the AM and AO interviews, one major issue could be that they are in general not very transparent. Much of the information relating to their strategy might be sensitive or confidential. This issue was addressed by offering anonymity to all respondents, building rapport and selecting UNPRI signatories who are generally more transparent. Once again, the fact that they are UNPRI signatories does not mean that they are advanced in RI and that the results are thus biased. The fact that they have started their ESG journey, lends itself well to a comparison of interpretations and approaches.

Another limitation was that due to the screening criteria, it may very well be that there are interesting parties which have been left out. However, as it is a time-consuming process, not everyone can possibly be interviewed. Furthermore, there might also be other relevant, yet subtle internal political issues at play that this type of research cannot pick up on. Lastly, as the content that needs to be analyzed is qualitative, it is difficult to maintain consistency. This is minimized, to some extent, by the aid of specialized software packages such as NVivo, but it remains a limitation.

3 Literature review

This literature review will start by giving some background on the topic of RI. A brief discussion is provided on how it all started and on how the ESG initiative industry emerged. The different ESG initiatives are discussed as well as the research that has been done. This will be the basis for the first chapter and its importance lies in the fact that AMs tend to rely upon this industry to analyze a company's ESG performance. They are an important intermediary between companies and AMs, although the accuracy of their analysis has been scrutinized in the literature. As such, it is an important building block to understand the incorporation of ESG in the AM and company chapter. Next, the literature review will draw on organizational- and institutional theory to explain organization-environment relations and to discuss why organizations incorporate ESG in the first place. After that, I lay the foundation for chapter 5,6 and 7, following the structure of the investment chain, starting at the top with the AO, followed by the AM and finishing with the company level Each of these actors are interconnected pieces of the puzzle and must first be understood separately, before they can be understood as a whole. Only then can conclusions be drawn on where the impediments of RI may reside. Furthermore, potential differences between the different countries may be subject to the debate on variegated capitalism, which is why this debate is briefly summarized, after the investment chain is explored. Lastly, a conclusion is drawn and the main building blocks and issues are reflected on. A roadmap to the rest of the thesis is provided in the conclusion of the literature review as well.

3.1 Responsible Investment; the very beginnings

There are very early proven cases of the possibility that businesses can win by incorporating ESG, such as the mill ran by Robert Owen in 1834 or the story of the Lever Bros (now Unilever) that started in 1885. However, these are sporadic examples of doing well whilst doing good. RI as we know it today, took a few decades to be accepted as a valid approach (Berry and Junkus, 2013; Bos, 2014). This is no surprise, as it disagrees with the profit maximization focus of economic theory. The world may not have been ready to break free from the widely accepted rules of economics at the time (O'Tool, 2015; Ransome and Sampford, 2013). A little later, around the 1920s, several labor unions in the US stepped up to defend workers' rights, with some success in securing health and welfare benefits and work-free weekends (Croft and Malhotra, 2016). Then, in 1932 the Gilbert brothers not only demonstrated that shareholders could, in fact, be active as owners but they also brought corporate governance to the agenda. They started attending shareholder meetings, but not only to listen; they started asking questions. This was new at the time and it slowly, but surely paved the way for the inclusion of shareholder proposals in company's proxy statements (Eisenhofer and Barry, 2005). The Gilbert Brothers became active owners of many companies and gave rise to a range of corporate governance topics, as well as several social issues (Goranova and Ryan, 2015; Monks and Minow, 2008; Paul and Aquila, 1988). This time was also marked by the start of an academic discussion on the pitfalls of separating firm ownership and control of a corporation (Berle and Means, 1932).

There were a few important divestment campaigns in the 1960s and 1970s that also helped in propagating shareholder activism. The first one started when several American universities were outraged by the involvement of corporations in the Vietnam war and encouraged divestment from companies that produced weapons. Another important divestment campaign started in 1971, when the presiding Bishop of the Episcopal Church asked General Motors to withdraw from South Africa. This Apartheid divestment campaign became successful; by 1985, the US corporations doing business in South Africa had been divested from a few portfolios (Domini et al., 1992). Two noteworthy parties were pivotal in booking this success. First, the Interfaith Center on Corporate Responsibility (ICCR), which was formed by several religious groups, played a vital role in this movement. Their concerns were mainly faith-based, but their protests and confrontations encouraged shareholder activism (MacLeod, 2014; Shapiro, 1992). Second, Reverend Leon Sullivan, an African-American minister on the board of General Motors is noteworthy on this topic. He is widely known for his fight against Apartheid and for the formulation of the Sullivan Principles in 1976 (Hawley, 2015; Lydenberg and Paul, 1992). These significant events can be found in the timeline of policies and other milestones regarding RI (see appendix 1).

Faith-based investors were clearly important in the initial development of RI. They brought shareholder activism into the picture, by aligning their investments with their faith. They also pioneered the exclusionary approach to investing, or the avoidance of "sin stocks" (i.e. tobacco, alcohol and gambling). Environmental concerns were more explicitly adopted at a later stage, as social- and corporate governance factors were at the forefront of the RI development (Ballestero et al., 2014). It must be noted that, although at the time there was not much written about the adoption of environmental criteria into investment decisions, the Pax World Fund already had "pollution control" in one of their criteria in 1971 (McKenzie, 1992). The adoption of environmental criteria became more widespread later on, as a result of scandals such as Exxon Valdez in 1989 and the subsequent development of the Valdez Principles by Ceres (MacLeod, 2014).

In the 1960s, 1970s and 1980s, various approaches in the form of proxy campaigns, governmental intervention and boycotts (i.e. Nestlé boycott in 1970s) were adopted to push corporations to become more responsible. Unfortunately these efforts did not cause significant change, but it did help challenge our ideas about corporate duty and social obligation (Murninghan, 1992). Then, in 1972, Yale professors addressed the ethical responsibilities of institutional investors and proposed guidelines for making investment decisions. Noteworthy, is that this effort was instigated by students who wanted their university to become more active shareholders. The authors concluded that shareholders have a unique position to change corporate practices and that they therefore bear responsibility for any intended or unintended harmful consequences. They further stated that the moral obligation wins if there is no clear evidence that the costs exceed the benefits. According to them, money managers could no longer ignore the public consequences (Simon et al., 1972)

Triggered by a shifting sentiment in the market, the first funds to take ESG into account did not take long to develop. Among the first movers were the exclusion based Pioneer Fund (1928), Ansvar Aktiefond Sverige in Sweden (1965), the previously mentioned Pax World Fund in the US (1971) which was established by a group of Methodist clergy and finally the Stewardship Fund in the UK (1984) (Ballestero et al., 2014; Schaefer, 2005; Shapiro, 1992; Sparkes and Cowton, 2004). Then, in the 1980s various scandals and the inflow of scholars from philosophy to management gave rise to the field of business ethics (Waddock, 2016). Around this time, there was also a proliferation of institutional share ownership (from 23% in 1955 to ~53% in 1990) and some of these institutional investors started asking questions (i.e. CalPERS) (Rubach, 1999). This was an important shift from the years before, when the "strong manager and weak owner" scenario prevailed (Roe, 1996). Around this time, some companies also responded to this shift in sentiment and added what we now know as the investor relations (IR) function, to engage more proactively with shareholders and to prevent criticism (Heard, 1992; Waddock, 2016).

By the 1990s there was an influx of CSR initiatives (discussed in the next section), reflecting increasing curiosity. By the end of the 1990s, another surge of governance scandals led to a wakeup call in the form of standards such as the UN Global Compact (Waddock, 2016). The phase from 1998 onwards is marked by the professionalization of "ethical investment". Pension funds gained importance as investors and the first discussions around regulation and materiality emerged between 2001-2004 (Dumas and Louche, 2016). What is more, by 2000 the first ESG research teams were formed at HSBC, who was the first to offer this in Europe (second in the world). A move like this encouraged mainstream investors and pushed ESG forward. Led by demand of institutional investors, several established brokerage houses were offering ESG research by 2005 (de Graaf and Haigh, 2011).

From 2005 onward, RI and governance are increasingly combined into what is now known as "ESG" (Dumas and Louche, 2016). In 2006, the previously mentioned UNPRI was launched to promote the integration of ESG into the investment processes of their signatories. There is growing demand for this type of investment and investors are held more accountable for their actions. With this growing demand, a complex web of ESG-related initiatives (e.g. ratings, rankings, awards), consultancies, networking groups and labels have surfaced. In addition, numerous scholarly papers have attempted to define what RI means and there are at least 2,200 papers that investigate the relationship between ESG and financial performance (Friede et al., 2015). However, methodological irregularities across studies makes most evidence incomparable and inconclusive (Bauer et al., 2006; Fulton et al., 2012). These inconsistencies are also reflected by the sheer fact that there is no universally accepted definition and that RI has even existed under various names. RI is one of the newer terms, originating from approximately 2006 when the UNPRI was launched. The frequent changing of names and various uses of the term has been a source of confusion and has hindered RI from becoming more mainstream (Hockerts and Moir, 2004; Hoepner et al., 2015; Ransome and Sampford, 2013; Searcy and Buslovich, 2014; van Duuren et al., 2015; Vandekerckhove et al., 2012; Woods and Urwin, 2010; Zarbafi, 2011). Many AOs and AMs have now signed the UNPRI (approximately a third of global AUM) and have therefore committed to the principles. However, despite this commitment and popularity, the concept itself has become “radically confused” and a truly integrated approach to ESG is still rare (Juravle and Lewis, 2009; Wagemans et al., 2013; Woods and Urwin, 2010).

In conclusion, RI has been around for a long time in one shape or another, triggered by a shifting sentiment in the market. Unfortunately, this does not necessarily mean that we indeed know how to do it right or that we understand it. RI has gone through different phases, different names and interpretations but it has still not gone mainstream. In fact, comparing the Social Investment Almanac published in 1992 (Domini et al., 1992) with the Handbook of Responsible Investment published in 2016 (Hebb et al., 2015), it appears that our knowledge has not advanced tremendously. We have, however, come up with many creative strategies.

3.2 The ESG initiatives industry

3.2.1 Intermediation

There is a significant amount of literature on the role of intermediaries in finance. Generally, scholars have come to the conclusion that they exist, because of the transaction cost advantage and because of the presence of asymmetric information (Admati and Pfleiderer, 1990; Allen, 1990; Gorton and Winton, 2002; Pyle and Leland, 1977). Admati and Pfleiderer (1990) argue that if an intermediary sells information to traders, they can make more informed investment decisions. This means that the price of the individual assets becomes more informative as market efficiency increases. One can also apply this logic to the large number of ESG rating agencies that have emerged in response to the rising popularity of RI. These intermediaries have an influential role in both the advancement as well as the dissemination of reporting on extra-financial information (Eccles et al., 2015). However, when looking at rating agencies as intermediaries, it is obvious that they actually do not produce any new information. After all, the assessments are mostly based on publicly available documents, if not exclusively. So instead of being the solution to asymmetric information, I follow the argument that Rhee (2015) makes about credit rating agencies. Rather than producing information, ESG agencies process a large volume of information to facilitate better investment selection. As outlined before, there are now many different players providing this information sorting function and they all claim to have a "unique" approach.

3.2.2 The birth of a new intermediary

Countless ESG products and initiatives exist today and this new industry has also encouraged a wave of initiatives in the shape of consultants who offer a helping hand in making sense of this chaos. On top of that, there are think thanks, institutions, and other associations with their own interpretation of how to best approach RI (Vandekerckhove et al., 2012). ESG rating agencies, indices or rankings assess corporations based on their social and environmental performance (Fowler and Hope, 2007; Scalet and Kelly, 2010;

SustainAbility, 2010). Some of the most well-known rating agencies and rankings today are Sustainalytics, MSCI ESG research and the Dow Jones Sustainability Index (DJSI). The very first ones were founded to meet the demands of religious institutional investors (i.e. church based or charity organizations) (Schaefer, 2005). For example, The Investor Responsibility Research Center (IRRC) was established in 1972 to study shareholder resolutions. After this, a myriad of other initiatives targeted at investors, companies and consumers were launched. In line with the history of RI, the majority of initiatives were founded in the USA and in the UK. Looking at a database with 218 ESG initiatives from 29 different countries[2], 33% and 14% originated in the USA and in the UK respectively. Germany and France follow with 6.9% and 6.4% respectively. Closely behind these countries are the Netherlands and Switzerland with 5.5% of each. Australia follows with 4.6% and the rest of the countries are home to a mere 1 or 2% of the initiatives in the database. Noteworthy also is that the USA was about a decade ahead of the rest of the world, given that they started around 1972. In comparison to the UK, the USA is also proportionately home to many more rankings than other types of initiatives. France, which is home to the first rating company, followed in 1983 and the UK followed in 1986. Then, in line with the development of credit ratings, the ESG research model changed as the reports were molded into an easier way for investors to incorporate information; ESG ratings, rankings and indices. This more quantitative approach enabled strategies, such as the popular “best-in-class” approach. The forms and shapes of ESG initiatives will be further discussed in chapter 4.

3.3 Organizational Theory

Organizations are products of human action and reaction, driven by personal interests as well as agendas for institutional change or preservation (Lawrence et al., 2009). Before I

[2] This is the database from chapter 4 on ESG ratings and rankings. It will be further elaborated on in chapter 4. Important is that these searches were done in English only, which may bias the results.

continue this section, it is important that I distinguish between an institution and an organization. AMs or AOs are often referred to as ''institutional investors'', meaning ''a set of financial institutions, located at the very heart of developed countries' financial systems'' (Clark and Monk, 2017, p. 23).The terms organization and institution are often used interchangeably in much of the academic literature and have also become blurred in practice. Typical financial institutions, such as banks, have taken over tasks typically associated with asset owners/managers and vice versa. Because they are tasked with such a significant financial function, I refer to AMs or AOs as organizations with the status of institutions.

Organization theory is a rich and diverse discipline, drawing inspiration from a wide variety of studies ranging from natural and social sciences to the arts and humanities (Hatch, 1997). A complete review of organization theory is therefore far beyond the scope of this thesis. Instead, I focus on the elements that underpin the later analysis of the interviews. Important then, is a description of why an organization would adopt ESG or why they would avoid the pressure to do so entirely. I will first describe the underlying theory of organization-environment relations, Next, I will apply institutional theory to shed light on the forces to adopt ESG. Lastly, I will briefly discuss how organizations can protect themselves from the environment.

3.3.1 Organization-environment relations

The closed system view of organizations and their internal relations dominated organization analysis until the1950s and early 1960s, when the idea of the environment was introduced. System theorists then recognized that organizations are, in fact, open to their environment. They depend on exchanges with other systems and are open to environmental stimuli as a ''condition of their survival'' (Scott, 1998, p. 182). Hatch (1997) summarized different perspectives of organization-environment relations; Contingency Theory, Population Ecology, Resource Dependence and Institutional Theory. Contingency theory was provided during the first period of environmental study in organization theory. It is concerned with mechanistic and organic styles of organization. The most influential theories, however, were developed during the second period, which began in the late 1970s.

Resource Dependency Theory was most comprehensively established by Jeffrey Pfeffer and Gerald Salançik (1978). This theory assumes that organizations are controlled by their environments. Because they transact with elements of the environment to obtain resources necessary for survival, they become dependent on those parties whose resources they require. This dependency has, of course, only further increased with the rise of specialization[3] (Pfeffer and Salancik, 1978). Organizations are driven by their own interests to reduce uncertainty, conflict and instability, but are less likely to do so when they are dependent on the sources of these external pressures (Oliver, 1991). An organization needs resources, such as knowledge or raw materials, which means that they are dependent or influenced by others. Managers can use this information and counter these influences with other dependencies, for example by establishing multiple sources of supply (Hatch, 1997). To assess resource dependence, several factors matter; the importance of the resource, the criticality for organizational survival, the discretion over the resource and the availability of substitutes (Hatch, 1997; Pfeffer and Salancik, 1978). Hence, this theory assumes that, although organizations are controlled by their environment, managers can mitigate this to some extent. Population Ecology on the other hand, takes an evolutionary standpoint. According to this theory, the potential for organizational adaptation is significantly smaller.

[3] With the rise of specialization, there has been a rise in outsourcing: Notable work on outsourcing has been done by Adam Smith, who outlined the basic theory of international trade and Ronald Coase (1937) who introduced the concept of transaction costs to explain the nature and limits of firms. This was later expanded by Williamson (1971), who is arguably one of the most influential economists when it comes to outsourcing. He introduced the concept of Transaction Costs Economics (TCE) and looks at the full costs of doing business, such as contracting, negotiating and governance processes. Clark & Monk (2017) also talk about the make or buy decision, but among asset owners. The way they represent it, is as a strategic decision by the board. This decision then has an impact on the boundaries of an organization. It determines what is inside and outside of an organization. There are certain elements which are subject to employment contracts and other elements which are subject to service contracts.

Instead, their behavior is largely determined by their environment (Hannan and Freeman, 1977).

Lastly, there is Institutional Theory, which introduces social legitimacy to the list of input resources. This is because institutions and organizations depend on the acceptance of the society in which they are operational (DiMaggio and Powell, 1983; Hatch, 1997). Institutions thus often adopt certain practices in search of legitimacy, which is the widespread perception in a given society, that the actions of an organization fit within a system of beliefs and norms (Suchman, 1995). Organizations need a license to operate, which is why it is important to conform, or at least appear to conform, to societal expectations (Boxenbaum and Jonsson, 2017). Institutional theory therefore represents the ''entry point for symbolic-interpretive studies into environmental research'' (Hatch, 1997, p. 76). It is based on the observation that organizations, in a given place, appear to become increasingly similar. It has been noted that isomorphic processes within a certain "area of institutional life" contribute to this process and that these can be divided into coercive, mimetic and normative mechanisms (DiMaggio and Powell, 1983; Meyer and Rowan, 1977). All three kinds of these mechanisms can play a role in the way ESG practices are adopted as well (Campbell, 2007; Garcia-Sanchez et al., 2015; Ioannou and Serafeim, 2012; Jennings and Zandbergen, 1995). Through the lens of institutional theory, ESG is a socially constructed term and it is the human actors in organizations, influenced by their discourse and politics who make and remake this construct. It is thus likely to vary between different institutional or social environments (Eduardo Ortas et al., 2015). They are explained briefly below as they are not only important in understanding why organizations adopt ESG practices, but also in explaining why it is more easily adopted in one versus another society.

3.3.2 Institutional forces to adopt ESG

Coercive Pressure

The organizations investigated during this research are all relatively large and multinational organizations. However, they are still anchored in different countries which may have a substantial impact on the extent to which they have integrated ESG (Bauer et al., 2007; Garcia-Sanchez et al., 2015). Coercive pressure relates to regulation or pressure from investors. This clearly has a hand in shaping organizational practices one way or another, as companies must conform to certain rules and regulations. In fact, political pressure (including laws and regulations), has been found to be the most important influence on corporate social performance (Ioannou and Serafeim, 2012). Others find that it does not lead to more sustainable investment behavior, as AMs who demonstrate conformance may merely be paying lip service to RI (Sakuma-Keck and Hensmans, 2013).

Regulation regarding ESG is not comprehensive and mostly voluntary, but there are several disclosure requirements that vary by country. Many do not consider it RI when companies are merely complying with regulations, as it is about going beyond what is required (EUROSIF, 2016). An overview of the ESG policies and regulation for the three countries investigated can be found in appendix 2. These may cover the company, AO or AM level. It must also be noted that the UK is a common law country, whereas the Netherlands and Germany are civil law countries. This may also have an impact on the extent to which ESG is adopted (Louche and Hebb, 2014). For example, companies belonging to the civil law category, with strong legal enforcement and ownership concentration have been found to show greater interest in disclosing ESG information (Garcia-Sanchez et al., 2015). Common law countries, on the other hand, are generally characterized by stronger outsider investor protection. This paved the way for deeper and more liquid capital markets and dispersed ownership (Dixon, 2014). The UK is deemed governed by the market, meaning that their ESG reports must also appeal to a wide audience. Bank-driven countries such as Germany have historically been more reliant on banks and do not have to appeal to such a wide audience (Bauer et al., 2007; Chen and Bouvain, 2009).

Although regulation is key, it is not the only type of coercion that can take place. Given their global holdings and significance, institutional investors can also have a vital impact (Clark and Wójcik, 2007; de Graaf and Haigh, 2011; Wong, 2010). In fact, as described earlier, they have already played a crucial role in the development of RI i.e. with the Apartheid divestment campaign and more recently with the wide-spread Fossil Fuel divestment. What is more, studies have found a degree of global convergence when it comes to standards of corporate and social behavior. Investors from elsewhere may have higher expectations concerning ESG and therefore push their portfolio companies to go beyond the applicable regulatory framework (Clark and Hebb, 2005; Hebb and Wójcik, 2005).

Mimetic Pressure

Mimetic pressure tends to arise when an organization encounters uncertainty and when they look at their peers for direction. This uncertainty may be due to confusion regarding technologies, vague goals or lack of clarity on how the puzzle pieces fit together. They may thus not understand the issue at hand completely, but due to legitimacy reasons and the need to survive, they may go ahead with it anyway (DiMaggio and Powell, 1983; Meyer and Rowan, 1977). Furthermore, some companies may resort to symbolic and rhetorical framing to keep up their public image (Meyer and Rowan, 1977). For example, AMs may appear to integrate ESG, but they may be using this in their marketing material to remain competitive in their asset-gathering efforts. For true sense-making and ESG integration to take place, these practitioners should interpret, discover and construct the concept for themselves (Weick, 1995), as opposed to only copying it without any real attempt (sense-making) to discover what it means to them (Sakuma-Keck, 2012). Another example is that many sustainability reports are being published, but they differ immensely both in the indicators they report on, as well as the title of the report (Brink and Woerd, 2004; Eduardo Ortas et al., 2015; Roca and Searcy, 2012). This implies that, although companies feel the need to report on non-financial information, many do not appear to know how to put this puzzle together. This then results in a range of different and incomparable sustainability reports.

Normative Pressure

Given that people are influenced by education, professional or social networks and the media, they develop certain values and norms. This causes a tendency in organizations to act according to societal expectations (DiMaggio and Powell, 1983). With regard to ESG, one can look at the extent to which it is taught in business schools (Kotler and Maon, 2016). For example, Goethe University and Mannheim University are lagging behind when it comes to teaching RI. Given that they are two of the most highly ranked universities in Germany, this is not a good sign. One can also look at whether the organization is part of business or professional associations that promote it (Campbell, 2007; Galaskiewicz and Burt, 1991). The UNPRI is an example of an organization that diffuses the idea that ESG should be integrated into investment decision-making (Gond and Piani, 2013). Signatories attend conferences or roundtables and are asked to report on their progress. Exposing them to continuous ESG discourse will encourage their signatories to eventually perceive it as the dominant paradigm. The same goes for the ESG initiatives described in the previous section, that also expose companies to continuous ESG discourse. Some studies have also found the media to have an influence. Campbell (2007) states that this is because the press can expose organizations and it therefore serves as a continuous threat to "do the right thing". Moreover, Létourneau (2015) finds that institutional investors are more likely to have RI policies in place in countries where citizens have a chance to participate in the public policy process, in combination with free press.

3.3.3 Avoidance strategies

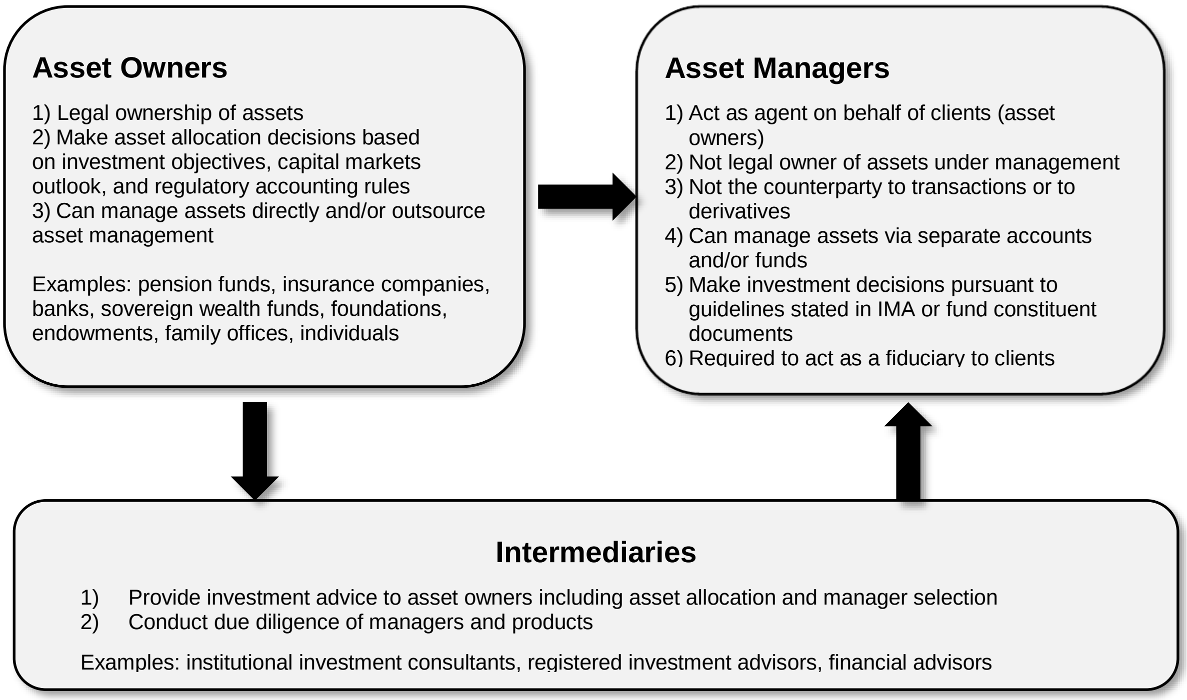
As mentioned in the previous sections, organizations would like to appear as though they conform to institutional forces, for the purpose of legitimacy. They may put up a façade of acquiescence to hide their non-compliance. They might thus seemingly or symbolically accept institutional norms, whilst they are actually not willing to implement them at all (Elsbach and Sutton, 1992; Oliver, 1991). Once an organization knows how to look good, they only need to talk the talk to survive. Social conformity is thus a ''victory of symbolic management'' (Hatch, 1997, p. 84). DiMaggio and Powell did note some of the limitations in later work and acknowledged that ideas and practices are not always diffused seamlessly and without contestation (DiMaggio, 1988; DiMaggio and Powell, 2012). Beckert (2010), argued that their depiction of organizational behavior is rather one-sided. He showed that the institutional forces can be used to support not only isomorphic, but divergent processes as well (Beckert, 2010). Although the framework has been subject to debate, it remains an important tool or even a starting point, to assess the forces for change in an organizations' environment.

3.4 Asset Owners

3.4.1 Asset Owner Industry

AOs are at the top of the investment chain and comprise institutional investors, such as pension funds, foundations, endowments and insurance companies (Gifford, 2015). These AOs typically stand in between savers and investors. Their governing boards are in place to represent the interest of these savers or beneficiaries based on trust. Unfortunately, they are often nominated based on connections as opposed to financial skills and expertise (Clark and Monk, 2017). Figure 2 provides an overview of the AO and basic differences with their AMs as well as a range of other providers the investment chain tends to rely upon. The reliance on intermediaries likely amplifies the potential agency issues, as there is more opportunity for misaligned incentives (Kay, 2012). The investigation of these intermediaries however, is outside of the scope of this thesis.

Figure 2. Differences between asset owners and asset managers



Source: Adopted from Blackrock (2014)

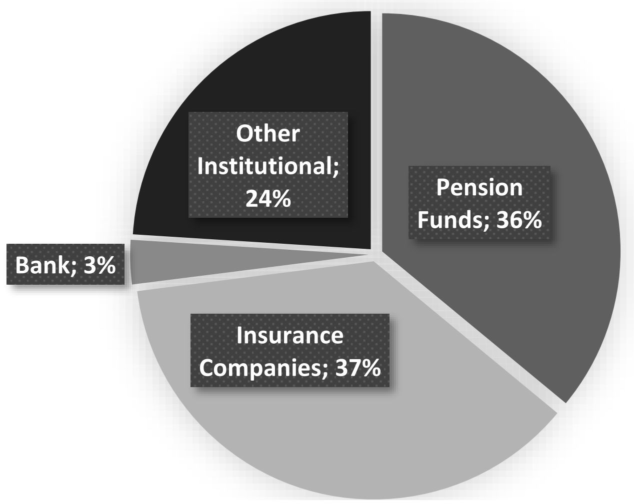
AOs have grown in numbers and in power over the last few decades, changing the ownership structures of European companies (Brossard et al., 2013). Europe is now the second largest pension market globally, after the US (PwC, 2016). As can be seen in table 2, the UK, Germany and the Netherlands rank among the top 4 countries by institutional assets in Europe. Among AOs, insurance companies and pension funds are considered the most significant ones in Europe (see fig. 3). Other research states that in addition to insurance companies and bank trusts, pension funds can be categorized as the most prominent shareholders of listed companies and thus much is expected of this investor (Clark, 2008; Piggott et al., 2008; Wagemans et al., 2013; Wong, 2010). Given that AOs are further away from undesirable corporate behavior (with the AM in between), they have not been targeted by the type of campaigns that corporations have had to cope with in the last few decades. They have also been receiving less attention than AMs. However, this is changing as not only corporations, but also AOs are increasingly held accountable for their impact on the world (Clark and Urwin, 2008; Gifford, 2015).

Table 2. Institutional assets under management per European country

Top 15 locations of institutional assets in Europe*	
Country	Assets (€ billion)
1) United Kingdom	3,405
2) Germany	2,434
3) France	2,380
4) Netherlands	1,631
5) Norway	1,065
6) Switzerland	988
7) Sweden	755
8) Italy	766
9) Denmark	695
10) Spain	357
11) Belgium	349
12) Finland	348
13) Luxembourg	190
14) Ireland	140
15) Austria	121

* Institutional assets including: assets of leading pension funds, insurers' portfolios and funds of funds
Source: PwC (2016)

Figure 3. Breakdown of European institutional investors by assets under management in 2015



Source: EFAMA (2017)

According to Clark (2008), pension funds perform several functions, such as administration, determination of benefit eligibility and value as well as asset management. Most of these functions may be outsourced to service providers. Asset management, which is most relevant to this thesis, can entail asset-liability matching and asset allocation in Defined Benefit Plans (DB – see next section). In the case of Defined Contribution Plans (DC – see next section), this entails evaluation of the investment product providers as well advising on investment opportunities and policies for plan participants. Pension funds can opt for internal or external management of their assets and their funds can be actively or passively managed, based on different investment strategies (Hebb and Wójcik, 2005). As previously mentioned, their wealth is also impacted by agency relationships with the asset management industry, as many pension funds have outsourced the investment management function (Clark, 1998b; Clark and Knight, 2008).

It is no wonder that institutional investors are the most important client for AMs, given that they account for 76% of total assets under management in Europe (EFAMA, 2015). AOs often select various AMs for different mandates, based on their skills and their track record. This can be within an asset class, sector or investment style (BlackRock, 2014). Once selected, the AM acts as the agent given their role as ''stewards" of their clients' interest (EFAMA,2015). Of course, this setup is likely to lead to agency problems (Berle and Means, 1932) and to minimize this, the "agents" are monitored frequently and they are guided by the Investment Management Agreement (IMA). This document stipulates the terms under which the agent is authorized to carry out the investment strategy. It can reach about 60-70 pages in the UK (BlackRock, 2014; Clark and Monk, 2017).

3.4.2 The right scale and the outsourcing decision

The misalignment between AOs and AMs are most pronounced when the investment decision-making process is outsourced (Lakonishok et al., 1992). This is a common occurrence as many funds are simply too small to develop the expertise in-house. They are therefore not set up to capture the benefits associated with internal management and face high administration fees and charges (Ambachtsheer, 2016; Clark, 2000). To further complicate this issue, Wysocka (2011) emphasizes that funds with less than $2 billion, may not only face higher costs, but also lack the capacity for effective monitoring of their AMs. Having the right scale can bring about many benefits, such as recruiting better staff, cost savings and better alignment. Resources can be used to shorten the investment chain and to develop expertise in house, so that the AO can make their own investment-decisions.

The Kay Review in 2012 already argued for a shorter investment chain, as it allows relationships to be based on trust, respect and the confident and open exchange of information (Kay, 2012). Positive scale economies along with better performance of internal management have been documented by several studies (Andonov et al., 2015; Bauer et al., 2010; Dyck and Pomorski, 2011; Lum, 2006; MacIntosch and Scheibelhut, 2012). One study shows that the cost of investment management more than halves, when fund size is increased from $1 billion to $5 billion (Lum, 2006). Other evidence shows that an internal active investment style is ~4.5 times cheaper than the external version (Lum, 2006).

Regardless of these appealing cost savings, internal management teams do not come without risks as failures can be disruptive to the overall fund (Wysocka, 2011). Wysocka (2011) highlights that internal investment management is more likely to be successful if there is little headline risk and low external pressure. Other obstacles are major political agendas and the inability to offer competitive remuneration practices. In comparison, a benefit of external management is that underperforming AMs can be changed more rapidly and easily (Koedijk et al., 2010). Other benefits of external management are specialized investment expertise in international equity or emerging markets (Wysocka, 2011). Koedijk et al. (2010) even argue that investment returns should improve as a result of the potentially superior skills of external managers.

Avoiding unnecessary costs on outsourcing can thus save hundreds of billions of dollars on an annual basis. This is not even counting societal benefits that come with a good governance structure (Ambachtsheer, 2016). As mentioned previously, it only makes sense to bypass asset management and the accompanying agency costs and fees, when a pension fund has sufficient AUM. According to Dixon and Monk (2014), sufficient scale is about $25 billion. Having in-house investment expertise is therefore relatively rare, although it is considered to be best-practice (Clark and Urwin, 2008). It is also not simple, because an AO must make a substantial amount of changes to make it happen. Clark and Monk

(2012) state that successful in-house asset management is underpinned by people, processes, systems and overall resources at the disposal of management.

3.4.3 Pension arrangements

It is more likely than not that employment comes with plan participation. Pension arrangements can vary immensely, ranging from public to private, to those sponsored by single or multiple employers as well as union or industry sponsored funds. The nature of the benefits varies as well. There are pensions where the working community pays the benefits based on a specific formula, such as the average or final salary (DB). There are also options to save for your pension individually, relying upon investment returns (DC). The difference between the two schemes is that the DC is dependent on the contributions paid, as well as investment returns and the investment risk/reward is assumed by the individual. The fixed contributions are paid into their individual member accounts. These types of plans tend to take higher risks and might be more short-term focused (pension product). The traditional DB on the other hand, is based on a formula, such as an individual's wages/salaries, age etc. A specific pension level is guaranteed in this case (pension promise). In some cases, the employer may top it up or tap it as the plan may be under- or overfunded given the contributions, benefit claims and investment performance (Walter, 2011). Other forms of DB plans are hybrid or mixed with DC elements within the DB plan. It is also not uncommon to have several types at the same time (Walter, 2011). Many DB plans have been closed in the last few years, as there is an increasing shift to DC plans. Among other reasons, the funding gaps after the financial crisis played a role in this, as well as the costs for employers and worker mobility (Croft and Malhotra, 2016). Although DB does encourage employees to remain with the firm longer, employers are exposed to investment risk and the costs are not as predictable as a DC (Munnell, 2006).

The type of funds do not only differ within a particular country, but the prevalent form also differs across countries (Clark, 1998b, 2008; Dutch Association of Industry-wide Pension Funds (VB) and Dutch Association of Company Pension Funds, 2010; OECD, 2012). The country a pension fund resides in, can have a significant influence and vice versa. For example, countries with larger pension funds tend to have better developed securities markets than those that do not (Davis, 1998). Differences may be attributable to history, the markets, social institutions and state regulations, which all have important consequences for the pension system. It is thus essential to continue with an overview of the situation in the UK, the Netherlands and Germany. As can be seen in table 3, their pension systems differ considerably.

Table 3. Overview of pension schemes in different countries

	Statutory pensions		*Supplementary private pensions*		
Country	**I State (SP)**		**II Occupational (OP)**		**III Personal**
	First Tier	**Second Tier**	**Collective**	**Firm**	**Individual**
Germany	Tested	<u>Earnings</u>	*Sector-Wide*	Larger firms	*Voluntary*
UK	<u>Basic</u>	Earnings*	-	<u>Opt-in</u>*	*Opt-in**
Netherlands	<u>Basic</u>	-	<u>Sector-wide</u>	Larger firms	-

Notes: *Opt-out of mandatory state second pensions possible
<u>Underlined</u> = Main income systems
Italics = Reformed since 1980s

Source: *(Ebbinghaus, 2011)*

UK

In the UK, about 68% of pension assets are in DB schemes (Willis Towers Watson, 2016). They have a multi-pillar mature pension scheme in the Beveridge tradition, a low public benefit and a heterogeneous (voluntary) occupational and personal pension sector (Bridgen and Meyer, 2011; Davis, 1998; Marcaillou, 2016). There was a short-lasting time of social-democratic reforms between '76 – '79, during which benefits were higher and coverage was broader. However, this was withdrawn again during a liberal phase between 1980 and 2007 (Bridgen and Meyer, 2011). Employees or unions have, until recently, not had much of an influence on scheme development and governance. This is due to the robust shareholder model of corporate governance followed by large British companies that offer schemes representative of the typical liberal market economy (Bridgen and Meyer, 2011; Davis, 1998).

As can be seen in table 4, the first pillar entails basic state pensions, to which everyone contributes. The state also provides the pensions in the second pillar, but these are more closely related to earnings and less redistributive than the first one. These two tiers are Pay-As-You-Go (PAYG) and thus unfunded, with the workforce paying contributions for the pensions of the retired. The pensions not directly funded by the state are included in the third pillar. Over time, these three pillars will eventually become a two tier system entailing a “state” tier and a “private” tier (Pension Policy Institute, 2016). Many private pensions have increasingly been converted from DB to DC schemes (Bridgen and Meyer, 2011; Marcaillou, 2016).

Pension fund governance in the UK is overseen by OPRA, as established in the 1995 Pension Act. This regulatory authority was deemed necessary to sharpen legislation following the Maxwell pension fund scandal. It took over nearly all the responsibilities of the Occupational Pension Board (OPB), which was established as part of the 1973 Social Security Act. Besides that, British private pension plans have to pass either reference scheme tests in case of DB, or protected rights tests in case of DC (Blake, 2003; Wiß and Ebbinghaus, 2011). As can be seen in appendix two, pension funds in the UK must disclose on social, environmental and ethical investment policies. In fact, they were the first country to make this mandatory (Renneboog et al., 2008; Sun et al., 2011). Another significant development is that the Law Commission proposed a legal interpretation of fiduciary duty which states that ESG issues, where financially relevant, should be taken into account by trustees. This definition was endorsed by the Pensions Regulator in the spring of 2016 (EUROSIF, 2016).

Table 4. Overview of the pension system in the UK

	First Pillar	**Second Pillar**	**Third Pillar**
Third Tier	State pensions (SP)	Occupational pensions (OP) Voluntary occupational pension plans	Personal pensions (PP) Voluntary personal pension plans
Second Tier	State Earnings-Related Pensions (SERPS) (1978-2002) State Second Pension (S2P) (since 2002)	National Employment Savings Trust (NEST): mandatory offer by employer with employer contributions of min. 3% from 2012. Employees can opt out of statutory scheme. No contracting out. Contracting-out to approved DB or DC occupation scheme instead of S2P	Contracting-out to approved personal scheme instead of S2P
First Tier	Basic State Pension Means-tested income Support for pensioners, plus housing and council tax benefits and winter fuel allowance; tax-financed		

Source*;* (Bridgen and Meyer, 2011)

Germany

In 1889, Germany's Chancellor Otto von Bismarck introduced the old-age social insurance program, making Germany the first nation in the world to do so. This meant that an earnings-related modest pension is paid out after 30 years of contributions. However, this changed in 1911 when white-collar employees pressed for their own pension scheme, which entailed (among others) higher contributions with status-maintaining pensions and an earlier retirement age. Railway employees and miners had their separate schemes as well, but this changed when a national insurance code caused the three social insurances to consolidate. However, several employers continued to offer occupational pensions in order to top up the relatively low earnings-related statutory pensions (Ebbinghaus, 2011; Wilke, 2009).

The conventional old-age pension is the ''Regelaltersrente'', with the pension age starting at 65 (Hansen, 2006). In 1957, the German Bundestag decided to convert the system to a PAYG, meaning that working members' contributions are transferred to current pension beneficiaries. They also introduced compulsory participation for all private, non-professional employees. This decreased the need for public supplementary pensions, but not completely as occupational pension schemes were still used to retain skilled workforce. The PAYG principle brings along certain risks, such as an aging society, whereby contributions become insufficient to cover current benefit payments (Clark, 1998b; Ebbinghaus, 2011; Hertrich, 2011; Wilke, 2009). The next reform happened in 1972, which introduced a window of retirement between 63 and 65, for those with at least 35 years in service (Wilke, 2009).

Pension funds in Germany are mostly unfunded and several types can be distinguished, as can be observed in table 5. Most of the pensions schemes were originally set up as *Direktzusagen,* or direct commitment schemes. In this case, the employer pays pensions straight out of its cash flow when they become payable and there is no obligation to fund the liabilities (Rößler and Zeppenfeld, 2015). Then there is the 'direct insurance' (Direktversicherung), which entails a contract concluded by an enterprise with a life insurer on behalf of its employees. This means that there is no employer liability, making this a popular choice among smaller firms. Besides that, they can also assign a legally independent 'super annuation fund' (Pensionskasse) to take care of its pension scheme, effectively functioning as a mutual insurance association. Then there are pension funds (Pensionsfonds), which only exist since 2002. This entails a more flexible, but more risky investment portfolio than superannuation funds, which may translate into higher returns. The *Versorgungsanstalt des Bundes und der Länder* (VBL) is an occupational pension fund for the public sector in the form of a PAYG scheme. In addition, two new fully funded DC personal pensions should be mentioned; The Riester (2002) and Rürup (2004) pension. The former is for low-income groups and families with children and the latter is for the self-employed, who are excluded from occupational schemes. As they both receive state subsidies and tax deductions, they come with regulation (Davis, 1998; Ebbinghaus, 2011). With the Riester reforms, it became legally allowed for employees to contribute to a DC scheme (Wagner, 2006). In the public sector, collective agreements led to a mandatory scheme for those who are not civil servants. Most occupational pensions entail voluntary commitment by employers in the private sector (Ebbinghaus, 2011).

BaFin is the authority in charge of monitoring solvency, transparency, consumer protection, and certification (Riester-pensions) of private pensions (Wiß and Ebbinghaus, 2011). In 2001/2002, BaFin followed the UK with pension fund regulation on ESG disclosure. They decided that pension funds must disclose a statement to their beneficiaries, regarding the extent to which ESG factors are incorporated into the decision-making process. What must also be noted, is that German legislation does not allow the typical DC plan according to Anglo-Saxon rules. In German pensions, employees do not carry the investment risk (Arteaga, 2015). Nevertheless, the nature of pension schemes has gradually changed more in line with Anglo-Saxon rules (i.e. funded pension liabilities). This is because the way pension reserves are treated internationally, can have an unfavorable impact on the debt to equity ratio of German companies and affect their rating or adherence to Basel II (Rößler and Zeppenfeld, 2015).

Table 5. Overview of the pension system in Germany

Supplementary pension	Coverage (million €)	Funding	Sponsor (contributions)	DB/ DC	Tax deductions / subsidies
Direct pension commitment (Direktzusage)	4.6	Internal/book reserves	Employer	DB	Yes/no
Support fund (Unterstützungskasse)		Internal	Employer	DB	Yes/no
Direct insurance (Direktversicherung)	4.4	External	Employer and/or employee	DC	Yes/possible
Superannuation fund (Pensionskasse)	4.5	External	Employer and/or employee	DC	Yes/possible
Pension fund (Pensionsfonds since 2002)	0.3	External	Employer and/or employee	DC	Yes/possible
Supplementary pension for public sector employees (VBL)	5.2	PAYGO/ funded	Employer and employee	DB, 2002: DC	Yes
Riester personal pension (Riester Rente since 2002)	12.9	External	Individual	DC	Yes/yes
Rürup personal pension (*Rürup-Rente* since 2004)	0.6	External	Individual	DC	Yes/no

Source: Ebbinghaus (2011)

The Netherlands

Although the Netherlands is a small country, they have a large amount of pension assets and a mature pension system. About 95% are in a DB scheme, down from 99% in 2005 (Willis Towers Watson, 2016). Pensions in the Netherlands are generally based on average salary (used to be final year, but was changed late 1980s). The multi-pillar pension system in the Netherlands is a combination between the Beveridge and Bismarck model (see table 6). The basic pension has similarities with Beveridge, whereas the other parts reflect Bismarck. The first pillar is The Algemene Ouderdomswet (AOW - General Old Age Pension), which is a PAYG system. The second pillar is the supplementary collective pension (i.e. from your employer) and lastly a private individual supplementary pension insurance forms the third pillar (i.e. life insurance) (Dutch Association of Industry-wide Pension Funds (VB) and Dutch Association of Company Pension Funds, 2010).

Three different types of pension funds can be found under the second pillar, namely (1) Industry-wide pension funds (2) Corporate pension funds and (3) Pension funds for independent professionals, such as medical specialists and dentists. On top of that, there is the Stichting Pensioensfonds ABP, which is a pension fund for public servants, such as teachers. This is one of the largest pension funds globally and one of the reasons that the Netherlands has such a high pension asset to GDP ratio (Davis, 1998; Dutch Association of Industry-wide Pension Funds (VB) and Dutch Association of Company Pension Funds, 2010)

Although there is no obligation by law to become a member of a pension fund, if the social partners choose to offer a pension scheme for their employees, the government can make it obligatory for an entire sector or profession. This compulsory membership is in line with the Dutch solidarity principle, but it does not only ensure that everyone is part of a good pension scheme. It also brings about economies of scale in terms of more cost-efficient management. Companies that do not fall under this kind of scheme can opt either for a corporate pension fund or for an insurance company to manage their pension scheme (Clark and Bennett, 2000; Dutch Association of Industry-wide Pension Funds (VB) and Dutch Association of Company Pension Funds, 2010).

The Netherlands is known for its widespread occupational coverage. The occupational schemes go further back than the public ones, with railroad workers being the first to receive coverage in the 19th century. By 1938, more than 750 schemes were established with more than 50 members each and the state intervened to regulate the schemes starting in 1908. In 1913, the Philips company pension fund was introduced and in 1917 the first sectoral pension fund emerged. In 1922, the Algemeen Burgerlijk Pensioensfonds (ABP) was established. As mentioned above, this is a pension fund for public employees and it is now known as Stichting Pensioenfonds ABP (National Civil Pension Fund). In 1942, occupational pension growth took off as contributions to occupational pension schemes were made tax deductible. Legislation was passed in 1949, which allowed the Minister of Social Affairs to declare a sectoral pension scheme compulsory for all employers in that sector. By the 1950s, occupational pension funds were fairly established and regulated by the PSW (Pensioen en Spaarfonds Wet), which provided an institutional framework for second-tier pensions only. In 1956, the AOW legislation addressed the issue of retirees covered by both occupational and public schemes, by establishing a pension-carrying income determined by a certain "AOW offset" (Bridgen and Meyer, 2011).

Today, the pension system is monitored by the Nederlandsche Bank (DNB) and the Dutch Authority for Financial Markets (AFM). The DNB monitors the financial situation of pension funds and whether they can fulfil their obligations going forward. If the coverage ratio drops below 105%, pension funds must write up a recovery plan for the DNB. The AFM keeps an eye on the behavior of pension funds, especially concerning the duty of care and transparency towards their beneficiaries. The former concerns investment support for members and the latter concerns adherence to the Pensions Act. Noteworthy on the legislation in the Netherlands is that, since 2014, the Federation of the Dutch Pension Funds and the Dutch Labor Foundation require pension funds to define a RI strategy and to disclose it publicly on a comply or explain basis.

What is important to note here, is that the shift towards DC schemes in the Netherlands has been more gradual. Many hybrid forms have emerged and companies in a mandatory industry-wide pension fund, are not permitted to shift to DC. In some pension funds, such as ABP, employers already enjoy DC like benefits (Munnell, 2006). There are collective DCs as well, which will remain important given the historical importance of DB. Moreover, the general pension fund (APF) is in the making, which will be run by financial providers as opposed to social partners as is currently the case. Pension funds can also merge in this kind of scheme, whilst still maintaining separate funding rates. It is thus expected that the Dutch pension fund market will consolidate (Moss, 2015; Preesman, 2016).

Table 6. Overview of the pension systems in the Netherlands

TIER	FIRST PILLAR	SECOND PILLAR	THIRD PILLAR
THIRD	None	Additional voluntary occupational pensions	Voluntary private pension
SECOND	None	Quasi-mandatory subsidized occupational pensions	Subsidized private pension
FIRST	Public flat-rate pensions based on 50 years of residency (AOW)	Sectoral pension schemes (bedrijfstakpensioenfonds) – 69 compulsory, 26 non-compulsory* and Company pension schemes (ondernemingspensioenfonds) – 543*	Mandatory private pension: none
	Social assistance		

**end of 2008*

Source: (Bridgen and Meyer, 2011; Immergut et al., 2007)

3.4.4 Asset Owners and Responsible Investment

As mentioned previously, AOs are the penultimate owners and influence RI indirectly via the mandates given to the AMs they employ (Søndergaard, 2014). The reasons for them to drive the demand for ESG are manifold. First, we, as the beneficiaries, entrust our assets to trustees, expecting them to make prudent investment-decisions for us. Collectively, these trustees allocate an immense amount of capital and thus have a tremendous impact on the world in which we live (Lydenberg, 2014). If this world is not liveable by the time you have earned your retirement, then what is your pension worth? As mentioned in section 1.2, the endorsement of the SDGs emphasizes the urgent case for action[4]. Significant investors such as AOs are expected to lead by example. Second, AOs are universal owners given

[4] As discussed in section 1.2, the SDGs repackaged the message of RI in a way that resonates with people everywhere. It provides investors with a common vision; clear goals to align their investment strategies with. Focusing on all SDGs at the same time is difficult as not all material issues are equally important for a given SDG (Betti et al., 2018), but they could pick 1 or 2.

their highly-diversified portfolios. This implies a ripple effect in their portfolio (i.e. in the form of an insurance premium), when any of their companies makes a ''mistake''. As mentioned before; nothing is external to a global owner (Monks, 2001). They are thus better off taking a comprehensive risk management approach, including those arising from ESG aspects. This should also benefit them, given that ESG has been proven to add value. Based on a meta-study of 200 different sources, Clark et al. (2015) find that 80% of studies agree that sensible sustainability practices have a positive effect on share value. Lastly, the long-term liabilities of the AO mean that the long-term (and therefore ESG) matters.

However, the investment horizon of AOs, belief and expectations on how ESG issues should be managed, may not be in line with those of their AMs (Clark, 2013; Gifford, 2015; Søndergaard, 2014). According to a recent survey, AOs are frustrated with the ESG performance of their AMs (Nicholls et al., 2015). However, they are also partly to blame for the problem, as they often fail to act on their promises (Hawley, 2015; Kiernan, 2007). Of course, uncertainty as to what the right approach is might also play a role. Even though there is consensus that there is a business case for ESG, it is not clear how to achieve a win-win situation. Another factor is that, since the 1970s, the reluctance to act was caused by the overly narrow interpretation of fiduciary duty. Now that this debate has essentially been resolved, it should no longer be an excuse not to take ESG into account (Clark, 2011; Freshfields Bruckhaus Deringer, 2005; Gary, 2011; Hoepner et al., 2011; Krosinsky, 2015; Sandberg, 2011; Sullivan et al., 2015).

With this obstacle out of the way, the discussion can then move on to the mandates that are given to AMs, as they are often still short-term oriented and thus likely a barrier to RI (Barton and Wiseman, 2014; Clark, 2011; Desmartin, 2015; Søndergaard, 2014; UN Global Compact and PRI, 2014; Wong, 2010). Monthly or quarterly reporting and monitoring may be in place to minimize agency problems, but it stimulates AMs to cling to a benchmark. This can save them from long phases of underperformance and discourages them from making more active choices (Kay, 2012). This excessive focus on the short-term may percolate all the way down to the portfolio company and give them the signal to inflate short-term cash flows at the expense of longer-term opportunities (Accenture and UN Global Compact, 2013; Desmartin, 2015; Gifford, 2015; Schroders, 2014; UN Global Compact and PRI, 2014; Whittaker, 2011; Wong, 2010). This short-termism is especially astounding for AOs given their long-term liabilities, which should spur them to invest for the long-term. Moreover, given that they are the ultimate owner of the assets, they are expected to lead by example (Barton and Wiseman 2014, Clark 2013, Gifford 2015).

3.4.5 Implications of the shift towards DC

Given that many of the DB pension plans have been closed down and that there is a shift towards DC plans, the possible effect of that for ESG should be discussed briefly. DC schemes have to be more transparent, given that the investment risk is borne by the plan participant. This makes good governance and transparency a must (European Commission, 2014). However, this is complicated, as beneficiaries often lack expertise and plan sponsors may lack interest (Clark and Urwin, 2011). There do not appear to be any significant differences in terms of asset classes, returns or fees (Broadbent et al., 2006; Farrell and Shoag, 2016). However, the DC scheme tends to be more short-term in outlook (*Capital Markets and Sustainability*, 2007), with the pressure of providing daily pricing and the difficulty to invest in illiquid assets (Kay, 2012; Wolf, 2016). This may thus not be in the long-term interest of plan participants (Kay, 2012).

At first glance, ESG can be incorporated in both types of pension plans. In DB plans, the trustees make these decisions. In the DC plan, the participants can choose from several options, including a default option. The question is, if the average person is more financially competent than the average trustee. It is estimated that by 2020, 90% of the members in the UK are invested in the default option. This happens, because beneficiaries are not interested, or competent enough to make their own investment-decisions. They often simply follow the “path of least resistance” and tick the default option (Choi et al., 2002; Pension Policy Institute, 2015; Rodriguez-Montemayor, 2014). Other research states that there will be more possibilities for RI, as participants finally have a say in where their money is invested (Fung et al., 2010; Landier and Nair, 2009). Regardless, it is not a far stretch to realize that this default option should not only be carefully designed, but also in a manner that includes ESG (Choi et al., 2002; Rodriguez-Montemayor, 2014; Sackers, 2016). Another important step for a smooth transition, is to educate participants as they have to make important decisions regarding their financial security.

In conclusion, AOs are at the top of the investment chain and are expected to lead by example. As discussed, it also makes sense for them to incorporate ESG based on their universal ownership, the value-add of ESG and their long-term liabilities. However, it appears that the mandates they give to their AMs still seem to be plagued by short termism. Some authors state that, besides the investment horizon of AOs, their beliefs concerning ESG may also not be in line with that of the AMs they employ (Clark, 2013; Gifford, 2015; Søndergaard, 2014). This can obviously complicate the incorporation of ESG for the AMs they employ. On the other hand, AOs have recently expressed their frustration about the way their AMs approach ESG (Nicholls et al., 2015). It is therefore important to explore the reasons behind this apparent misalignment, before ESG is discarded altogether.

3.5 Asset Managers

3.5.1 Asset Management Industry

As mentioned previously, AOs do not always manage their own money and tend to delegate this task to the AM. The AM acts as an agent or a steward of their clients' interest and their main goal is to enable them to reach their investment objectives (Desmartin, 2015; EFAMA, 2015; Søndergaard, 2014). Thus, they are guided by their clients, but they are at the heart of managing supply and demand. They are thus an important link in financing the needs of the real economy through shares, bonds or other products (Costanzo, 2011; Desmartin, 2015). In 2016, the assets managed in Europe reached a record high of €22.8 trillion. As can be seen in table 7, the asset management industry in the UK is of substantial size. The same can be said for the Netherlands, when viewed in the context of its GDP.

Table 7. Size of the asset management industry

Countries	AuM in billion €	% ∆ in 2015	AuM/GDP
UK	7,791	6%	320%
Germany	2,026	9%	67%
The Netherlands	1,244	1%	184%

Note Change is calculated from end AuM 2014 till end 2015
Source EFAMA (2017)

There are an incredibly diverse range of AMs, ranging from pure play boutiques to large diversified commercial banks, investment banks, insurance companies etc., who offer investment services in addition to many other products (Concannon, 2015; Walter, 2011). The large range of different AMs have naturally created a variety of different strategies. This can range from balanced strategies between equities and bonds, to fixed income to commodities and real estate. Given the large and diverse range of competitors, competition for client assets is intense (see table 8 below for the number of registered AM companies). However, if the AM has a good investment track record of at least three years, they have a chance to win new mandates (Concannon, 2015).

Table 8. Number of registered asset management companies

Country	2015
The UK*	1,000
Germany	309
The Netherlands	254

* Note The number for the UK is an estimate
Source EFAMA (2017)

An important distinction is that between the passive- and the active investor. The former is rather straightforward as it replicates an existing index as closely as possible (measured by tracking error). Passive investors operate on the assumption that markets are efficient and everything (including ESG) is already priced in. Given that they do not try to actively pick stocks to beat the market, it is less costly than active management (Hancock, 2005). Active investors, however, take on the challenge of trying to outperform (after fees) a specific benchmark (i.e. MSCI World) or meeting an absolute return goal (Concannon, 2015). As is evident, choosing between the various products can be a complicated endeavor for the AO, which is where investment consultants come in. They advise on investment policy structuring, manager selection and monitoring, asset allocation etc. Some well-known ones are Mercer and Towers Watson (Concannon, 2015). They are only one of the many intermediaries that might be part of the investment chain.

The endeavor does not end with the choice of product and manager. Investments can also be “pooled” or “segregated”. The former refers to combined capital from a number of investors whereas the latter is for a single large investor (Croft and Malhotra, 2016). When an investor chooses a segregated managed account (SMA), they must invest a minimum amount but can match their portfolio closely to their beliefs and preferences. This enables them to implement a certain exclusion policy, or to customize their tax exposure. This is because the assets are managed according to their investment guidelines, as laid down in the IMA. Examples of guidelines are; a sector limit of 25%, a cash limit of 5%, an investment limit in Europe of 25% etc. (Concannon, 2015). When the IMA is drawn up, management fees are often negotiated, as clients might be able to get certain discounts beyond a specified amount of assets. A management fee is a basis point fee, based on the amount of client assets managed and some AMs also receive performance fees in addition to that (i.e. 10-20% of profits). These could be calculated in terms of absolute investment returns, or relative to a benchmark (BlackRock, 2014; Concannon, 2015). As mentioned in the AO section, monitoring AMs frequently and relative to a benchmark, may discourage them from making more active choices and may drive them to cling to the chosen benchmark instead (Kay, 2012).

3.5.2 Responsible Investment Strategies

Looking at the total AUM of the UNPRI signatories, one can estimate the RI market at about $46 trillion today (Hebb et al., 2015). The rapid growth of the UNPRI signatories shows that the financial markets are more convinced of the validity of RI as an investment approach.

Indeed, also the academic community has reached agreement that the 'why' of RI has been answered. The debate should therefore move on to the ''how'' of RI (Capelle-Blancard and Couderc, 2009; Desmartin, 2015; Fulton et al., 2012; Scholtens, 2015; van Duuren et al., 2015). When reading the transparency documents published on the UNPRI website, it becomes clear that there is a wide variety of RI interpretations among investors. Zooming in on the universe of RI funds, there are sizable differences in how funds implement RI (Humphrey, 2015). The lack of standardization shows that AMs are not taking ESG into consideration the way that they probably should (Eccles et al., 2012; Kiernan, 2007; van Duuren et al., 2015). So, what are they doing exactly? As mentioned before, there are many different products offered by AMs. As can be seen in table 9, they too, have constructed many different RI strategies as there are no specific criteria as to what entails an ESG

Table 9. Overview RI strategies

RI Styles	
Norms based screening	*Screening against minimum standards of business practice based on international norms*
Exclusionary screening	*Positive or negative screens are used. This is the earlier mentioned example of excluding "sin industries" such as alcohol and tobacco*
Positive/Best-in-Class	*An often used approach whereby asset managers select the "most responsible" investments across different sectors.*
ESG Integration	*Systematic and explicit inclusion by investment managers of environmental, social and governance factors into traditional financial analysis*
Thematic Investment	*Takes a specific approach or theme such as water or agriculture*
Impact/community investing	*Takes on a focused investment approach such as low carbon. It is typically made in private markets aimed at solving social or environmental problems.*
Shareholder engagement	*Proxy voting and engagement strategies to give shareholders a say in the governance of companies. Shareholders use their power to influence corporate behavior.*

Source: Eurosif (2016)

product (EUROSIF, 2016). The strategies outlined below can be stand-alone or several can be combined.

As discussed, religious investors were the first to initiate some form of ESG incorporation into their investments (Sparkes and Cowton, 2004). Given that they wanted to invest in line with their faith, they excluded certain companies, based on whether they were considered a “sin stock”. Stocks such as tobacco, alcohol or gambling companies were therefore screened out of their investment portfolios (Dumas and Michotte, 2014). Exclusionary screening is thus one of the older strategies, although still a popular method, given that 48% of professionally managed assets is invested according to this strategy (ca €10 trillion). The most commonly used exclusion criteria is the production and trade of weapons (EUROSIF, 2016).

Norms-based screening (ca €5 trillion) screens out everything that does not adhere to some minimum criteria. What is often used for this strategy, is the UN Global Compact or the International Labor Organization (ILO) Conventions (EUROSIF, 2016). The best-in-class strategy emerged in the 1990s, when more active approaches were developed (Desmartin, 2015). ESG ratings lend themselves well to this “positive screening” method. A common approach is to invest in i.e. the top 25% ESG scores in each sector. This type of strategy reached about €493 billion in 2015. Other strategies only invest in certain “themes” (about €145 billion) and yet others are focused on solving specific problems (‘’impact investing” – about €98 billion).

Then there is Engagement (ca €4 trillion), which is gaining popularity, as it can be successful in influencing corporate behavior (Dimson et al., 2015). However, AOs, AMs and companies do not always reach agreement as to what constitutes a successful engagement (Goldstein, 2011). A noteworthy development, is the 2017 update of the EU Shareholder Rights

Directive[5], which aims to improve the uptake of long-term shareholder engagement. The updated directive identifies and addresses short-comings with regards to several issues, such as short-termism, shareholder identification and insufficient oversight on directors' pay (Say on Pay). It also addresses transparency of institutional investors, AMs and proxy advisors. For example, it mandates disclosure of the engagement policy, as well as a description of the investment strategy. The directive is therefore expected to both stimulate investors to engage and to improve their ability to do so.

Lastly, ESG integration (ca €2.6 trillion) takes a fundamental approach to analyzing companies. The additional information is used as a lens to help investors make better investment decisions. It is woven into a rigorous company analysis, which then offers a better understanding of the quality of the business and the management team (Desmartin, 2015; The Generation Foundation, 2015). This approach complements the financial with the non-financial to reduce information asymmetry, but is not very common yet (de Graaf and Haigh, 2011; Hawley, 2015). In fact, true integration, whereby RI experts are fully integrated into the financial team, is still rare among AMs (Johnsen, 2003; Juravle and Lewis, 2009; Wagemans et al., 2013).

Van Duuren et al. (2015) surveyed over 100 fund managers and find that ESG information in particular is often used to screen for red flags and for managing risk. This finding is further confirmed by a survey conducted by the CFA Institute (2015) among 1,325 portfolio managers and research analysts. Of the respondents, 75% take ESG into account and 63% do this to adequately manage risk. However, as discussed in chapter 4, much of this ESG information is provided by third-party research, which comes with problems of its own.

[5] Member states will have two years to adopt The Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement

3.5.3 Adoption rates across countries

The strategies discussed above are expected to differ in their uptake across countries. As discussed in the previous section, there are significant differences across countries (i.e. markets, history, pension arrangements), which can affect the adoption rates of RI. Moreover, organizations subsiding in different countries are subjected to different types of coercive, mimetic and normative pressure, which can have a profound impact on the way and the extent to which ESG is integrated. An overview of the coercive pressure AMs face in the UK, Germany and the Netherlands can be found in appendix 2. As can be seen in figure 4 below, there are indeed differences regarding the preferred RI strategy.

Looking at the UK, one can see that Engagement and Voting (~ €2.6 trillion) is the most prominent strategy. This is driven by institutional investors who have become increasingly active in the last two years. There are several notable initiatives on this topic; The Pension Fund Roundtable, the Aiming for A Coalition and the Association of Member Nominated Trustees. These initiatives either share best-practice voting instructions, brainstorm on what is expected from fund managers, or file shareholder resolutions. Engagement and Voting is closely followed by Exclusion, with approximately €1.9 trillion invested. In the UK's RI scene more generally, it must be noted that there are various NGOs and think thanks that drive the movement. Well-known organizations are the CDP and the UNPRI. The UK has a strong RI market and it is likely that it benefits from being close to London and Edinburgh, where many fund managers are clustered (EUROSIF, 2016).

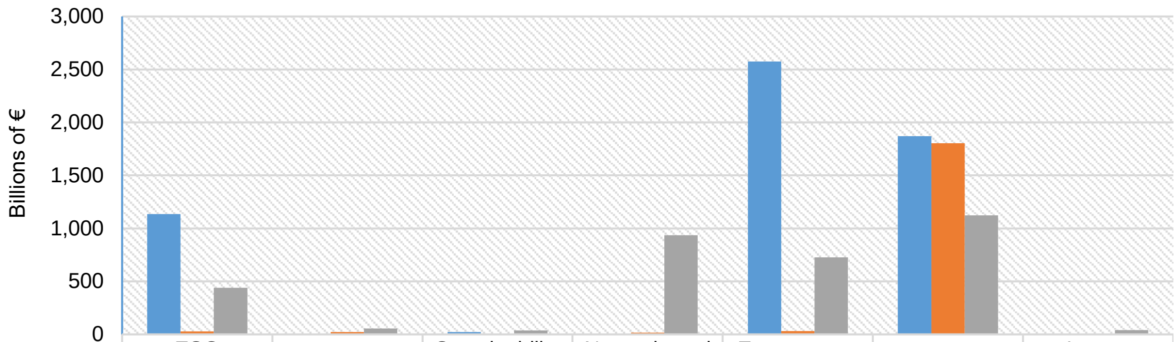
Precedents in the Netherlands go back to the 1960s, to banks such as the Algemene Spaarbank voor Nederland (ASN) in 1960 or the Triodos bank in 1980. The first RI fund was launched in 1990; Het Andere Beleggingsfonds (Ballestero et al., 2014). The Netherlands has attracted many AMs due to the favorable tax situation[6]. The RI landscape is strong, but rather fragmented. Pension funds and insurance companies are the biggest

[6] They do not levy taxes such as stamp duties or other taxes on capital contributions in an investment vehicle, annual subscription or net worth taxes in the Netherlands (EUROSIF, 2016).

players. Regulation-wise pressure has increased, which has also brought about an improvement in reporting, as pension funds are required to report on their RI strategies. Exclusion is the most popular RI strategy in the Netherlands, with about €1 trillion invested. More fundamental approaches such as ESG integration (€440 billion) and Engagement and Voting (€726 billion) have seen a positive uptake (EUROSIF, 2016).

In Germany, the roots of RI also go back to banks. Due to its size, the German banking industry plays a significant role in RI and quite a few specialist banks can be found on the topic of sustainability. In 1974, the first social and ecological bank was established; the Gemeinschaftsbank AG. Later, in 1980 BfG Okorent was created; a fund with a focus on ethics and ecology (Ballestero et al., 2014). The predominant RI strategy is by far the application of exclusion criteria, mainly around weapons and nuclear energy. A large majority of the RI assets come from institutional investors (85%), with 48% of these being pension funds. The Renewable Energy Act has also shaped the German ESG strategy uptake. In fact, 69% of the sustainability themes are around renewables, followed by energy efficiency. Noteworthy, is that nearly all financial industry organizations have launched a sustainability taskforce and many have published voluntary RI guides (EUROSIF, 2016).

Figure 4. % of RI assets per strategy end of 2015



	ESG Integration	Best-in-Class	Sustainability Themed	Norms based Screening	Engagement and Voting	Exclusion	Impact Investing
UK	1,136	8	21	8	2,574	1,871	5
Germany	28	21	8	15	32	1,803	5
NL	441	57	37	936	726	1,123	41

Source: Eurosif (2016)

3.5.4 Responsible Investment Struggles

Unfortunately, investors often lack the training on how to interpret and use ESG data to their advantage (Juravle and Lewis, 2008; Munro, 2015; Searcy and Elkhawas, 2012). Moreover, when companies disclose ESG data, it is often stand-alone and not in relation to the value creation process in an organization. To make matters worse, there is little engagement between AMs and sustainability managers on this topic and they often do not speak the same language (UNEP FI, 2010). This neither helps AMs to better understand the reports, nor does it help companies understand how they can improve. Combining the factors above, it is understandable that AMs struggle to use ESG in a way that it enhances their investment decision-making (Amaeshi et al., 2013; Eccles and Serafeim, 2015; Johnsen, 2003; Kiernan, 2007). Furthermore, many AMs separate their ESG team from their investment team, which encourages the idea that sustainability is secondary (Guyatt, 2005, 2006). Unfortunately the full integration of both of these teams is a rare find (Juravle and Lewis, 2008). Campbell and Slack (2011) also find that analysts are largely focused on quantifiable metrics over the short to medium term. They state that this focus is due to their incentive package. Guyatt (2005, 2006) and Juravle and Lewis (2008, 2009) also find that AMs gravitate towards short-termism.

Eccles et al. (2011) analyze how often the financial community clicks on ESG metrics on Bloomberg and find that there is a growing appetite for this type of data. They also realize that the most clicked on metric is a disclosure score, which does not reveal any information on the actual ESG performance of a company. Although interesting, the authors acknowledge that the limitation of this approach is that it remains unclear if this disclosure score is actually incorporated into the investment process in one way or another. The lack of knowledge on the type of data used by AMs and how it is incorporated in their decision making, is also recognized by other academics (Delmas et al., 2014; Martin et al., 2007; van Duuren et al., 2015). As previously emphasized, a substantial 68% of the 1,325 portfolio managers and research analysts surveyed by the CFA institute (2015), indicate that they obtain ESG data from third party research.

This third party research, or ESG ratings, was found to have low correlations between the scores given to the same companies, by different rating agencies (Chatterji et al., 2015; Dorfleitner et al., 2015). This could be an issue given that capital allocation decisions are therefore dependent on the chosen research provider. It is, however, too early to tell whether or not this is an alarming situation and whether or not these ratings are completely inadequate. There is simply too little information on how this is used exactly in the decision-making process. AMs might be more advanced than expected and they may use ratings for cross-checking, as opposed to blindly relying on them. The investment decision-making process and the type of information used, is simply not well understood (Delmas et al., 2014; Martin et al., 2007; van Duuren et al., 2015). Novel insights must be uncovered on the level of the AM, to find out whether RI is held back at this stage. If so, why is this and how can it be resolved?

To sum up, AMs are at the heart of supply and demand and they have constructed a widely diverse set of ESG strategies in response to the rising popularity of RI. Since it has now become clear that it indeed adds value, it is interesting that true integration is still rare. Due to a lack of information on the way investors make their investment-decisions, it is difficult to say why this is the case. It is thus of essence to assess whether they actually believe that it adds value and whether they rely on their own expertise or on that of others. It is also important to determine whether there is any short-termism on the AM level that may compromise RI, or whether they receive adverse signals from clients. These insights will fill gaps in the literature and make it possible to identify potential impediments.

3.6 Companies

3.6.1 Overview

A corporation can be defined as a ''firm that meets certain legal requirements to be recognized as having a legal existence, as an entity separate and distinct from its owners. Corporations are owned by their stockholders (shareholders) who share in profits and losses generated through the firm's operations'' (Businessdictionary.com, 2018). They are granted a license to operate by society and in return, they are expected to minimize harm to our planet (Girerd-Potin et al., 2014; Mayer, 2013; Tagesson et al., 2009). However, this expectation has become more serious after the many wake up calls we have had and corporations are held more accountable. ESG has now become too difficult for companies to ignore and globalization has played a vital role in this development. After a more liberal approach in the 1980s, a wave of criticism crashed down on corporations in the 1990s. Global value chains opened the possibility for companies in the North to use cheap labor in the South, to move their capital to the most tax-friendly area and to do environmental damage where it goes unnoticed. However, as mentioned in section 3.1, by the time the 1990s arrived, there was a change in sentiment and an influx of CSR initiatives. Corporate reputation had become more important and brands had become more vulnerable to negative press. Some CSR initiatives played the role of watchdog and news was disseminated more quickly with the development of global communication. Many companies thus developed supplier codes of conduct, in an attempt to control standards in their supply chain (Brennan, 2011; Jenkins, 2005). Their stance towards ESG thus evolved from defensive to more responsive as they tried to prevent scandals (Waddock, 2016)

After continuous waves of ESG scandals, it is no surprise that society's trust in corporations has deteriorated. In fact, according to the Edelman Trust Barometer, 50% of the ~30,000 global respondents stated that they lose trust when a company fails to contribute to the greater good. It is thus beneficial for corporate reputation to minimize their negative impact and to contribute positively where they can. Building trust can also help in retaining and attracting talent given that many employees, for example in the UK, do not trust the companies they work for (Edelman, 2016). It is then no surprise that only 27% of Millennials expect to still be with their current employer after five years (Deloitte, 2016). Sentiment is that CEOs should engage with the public to build trust and that he/she should focus on positive long-term impact and thus steer away from the short-term (Edelman, 2016).

Besides the reasons above, there is also evidence that focusing on ESG can open up new markets, lower costs and attract a more long-term shareholder base (and thus a more stable share price), or that it may even positively impact a company's value (Brochet et al., 2011; Clark et al., 2015a; Cox et al., 2004; Renneboog et al., 2008). Although an increasing number of companies are aware of all these benefits and of society's expectations, not much progress has been made. The UNEP FI Asset Management Working Group (2014) finds that many companies are still treating sustainability as a peripheral issue as opposed to truly integrating it into their business model. Interestingly, the CEO study conducted by Accenture & UN Global Compact (2013) highlighted that 76% of CEOs do want to embed sustainability into their business, but that investors pressure them for short-term results. This pressure leads companies to underinvest in the more long-term needs of the business and hence they forego valuable opportunities (Barton and Wiseman, 2015; Brochet et al., 2011; Shrivastave and Paquin, 2011; UN Global Compact and PRI, 2014). This is why the UN Global Compact (2014) recommends that companies publish evidence on how investor short termism has influenced business decisions.

Some companies try and reach out to their shareholder base for input (Garriga and Melé, 2004). In fact, the Global Investor Relations Survey (2015) found that about 75% of the 193 respondents approached the market for feedback on their long-term strategy over the past year. This does not mean, however, that corporations are not to blame. Also on the company level, there are obstacles that may slow down the process of embedding ESG. Some suggest there is a lack of training, organizational inertia and an excessive focus on the bottom line for promotion (Hanson, 2015; Shrivastave and Paquin, 2011). The question is, whether some of these issues are attributable to the above mentioned short-term pressure from investors.

3.6.2 Lack of Standardization

Comparable to the situation with AMs, the seemingly lack of company effort is not surprising given that the perception on what sustainability means differs widely among companies. Many executives lack knowledge on how sustainability and responsibility relate to the value of their firm (Hanson, 2015). This is probably why the majority of firms in the FTSE 100 make vague comments about behaving responsibly, without any evidence or elaboration to back up these claims (Aras and Crowther, 2016). As a result of the varying interpretations, the disclosure on ESG or the terms used to describe it, also differs widely (Hockerts and Moir, 2004; Ransome and Sampford, 2013; Searcy and Buslovich, 2014; Searcy and Elkhawas, 2012). The number and variety of approaches to CSR or ESG and related concepts can be overwhelming (Brink and Woerd, 2004).

Companies have reacted to the growing interest by publishing sustainability reports (Brink and Woerd, 2004; Eccles et al., 2011). According to Ioannou and Serafeim (2014) the number of companies reporting on ESG aspects 20 years ago hovered around 100, but by 2013 more than 6,000 issued sustainability reports. The rise in popularity, however, does not mean that a consensus has been reached as to what it is. In fact, Roca and Searcy (2012) analyze 94 Canadian sustainability reports from 2008 and find that even the titles of the reports differ widely. The interviews they conduct with 35 Canadian companies (on their sustainability report) indicate that reporting on sustainability is not clear to companies

(Searcy and Buslovich, 2014). Much like AMs, it is possible that companies copy their peers without fully understanding what is expected from them.

All this transparency is necessary to hold businesses to the implicit social contract they have with society. This contract is based on trust and in return for adhering to the implicit rules, they can continue their operations. They do, however, need to be monitored but, the quality of reported data on non-financial performance is often complained about (Amaeshi et al., 2013). There are some disclosure regulations in place to improve this, such as the narrative reporting requirement in the UK or the now officially implemented EU directive on ESG disclosure. The latter will apply to about 6,000 large companies on a comply or explain basis and guidelines have also been developed on the reporting methodology (Jeffries, 2016). This coercive pressure may improve the quality of the data and help investors in the incorporation of ESG.

3.6.3 ESG Inquiries

According to oekom (2013) 9 out of 10 companies view a good sustainability rating or the inclusion in sustainability indices as an important achievement. Many companies therefore respond to ratings and rankings questionnaires, or verification requests, from ESG ratings and rankings. This can be a substantial job, given that approximately 60% of the 100+ initiatives analyzed by SustainAbility, require some type of information from companies. This may be overwhelming or even lead to reporting fatigue (Hockerts and Moir, 2004; Searcy and Buslovich, 2014; UNEP FI, 2010). The DJSI questionnaire for example includes about 80-120 questions and requires expertise from different people in the organization. Other rating agencies even require interviews or on-site visits. About 71.8% of the 199 companies surveyed by oekom (2013) need half a full-time post to manage these inquiries. Nevertheless, about 39.1% of these respondents more or less agree that the cost-benefit ratio of responding is proportionate. The opinion, however, seems to be somewhat divided as 37.6% also more or less disagree with this statement. In addition to that, most respondents to the oekom survey receive about 10 enquiries annually, whereas 10%

receive up to 20 enquiries. In those more extreme cases, the costs might outweigh possible benefits.

3.6.4 The Role of Social Media

Widely used internet or social media means that news is spread globally within a few seconds. This continuous threat to be exposed serves as normative pressure to do the right thing. For example, human rights organization Amnesty International published a report stating that Wilmar, the biggest producer of palm oil, uses child labor (Amnesty International, 2016). Surprisingly, even CSR frontrunner Unilever is working with this particular palm oil supplier, although they claimed to not have any knowledge of these practices. Looking at Unilever's social media mentions on socialmention.com, the positive to negative ratio is normally 4:1 and the day after the report it decreased to 2:1, with keywords such as palm oil and child labor frequently mentioned. On twitter, the #palmoil and #childlabor have reached over 90,000 and 236.000 accounts respectively within 45 minutes. This is only an example of these specific hashtags, but of course different hashtags are used and news articles are shared on Facebook or LinkedIn, making the reach much, much greater than this example. The takeaway from this, is that a company might thus be better off by being one step ahead and by only being as transparent as possible, given that missteps are quickly diffused around the globe. If Hilary Clinton's emails can be leaked, surely someone can pull skeletons out of any corporation's closet and prominently display them on social media.

3.7 Variegated Capitalism

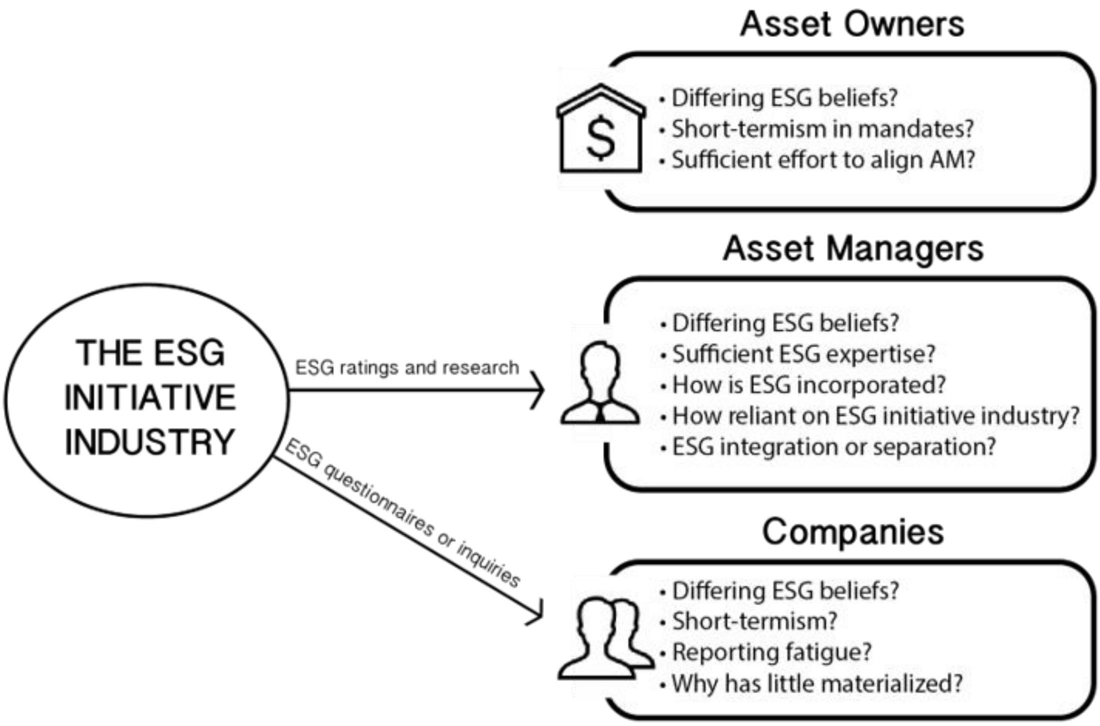
As discussed in section 3.3.2, companies must conform to certain rules and regulations and are thus influenced by their institutional environment. This also influences the adoption rate of RI, which is why differences may be not only be observed between companies, but also between countries (Bauer et al., 2007; Matten and Moon, 2008; Renneboog et al., 2008). This comparative approach of political economies has been researched extensively and given the developments, it is important to highlight one of the more recent streams of thought; the variegation of capitalism approach.

Earlier perspectives on comparative economies have been criticized for being static or path dependent (Dixon, 2014; Peck and Theodore, 2007). This is due to the fact that these approaches heavily emphasize the importance of the inherited institutional environment for a company’s form and function (i.e. coordinated/liberal market distinction by Hall & Soskice, 2001). However, the reality can be more nuanced than the exercise of comparing companies by the location of their headquarters. Shareholders might reside elsewhere and so might their suppliers or customers, which has important consequences. Some aspects may thus be conditioned by the inherited national institutional environment, yet other aspects might be converging to other political economies. Indeed, some case studies have shown that path dependence might not explain all and that in many cases, convergence to certain standards can be observed. This is why the variegation of capitalism takes into account that the development of capitalism may be uneven and variegated (Dixon, 2014, 2011; Peck and Theodore, 2007). This is a vital piece of information to consider when comparing different economies, as a static and path dependent view might overlook answers. Especially because this thesis looks at multinational companies and investors, it is important to take the role of globalization and possible convergence into account.

3.8 Literature review conclusion

A few important takeaways can be identified from the literature review above (see fig. 5). Firstly, RI has been around for a while in one way or another, although this certainly does not mean that we fully grasp it or know how to integrate it. As mentioned in the literature review, a comparison of the Social Investment Almanac published in 1992 (Domini et al., 1992) and the Handbook of Responsible Investment published in 2016 (Hebb et al., 2015), indicates that our knowledge has not advanced tremendously. Many ESG initiatives have sprung up since then, many new ''responsible'' funds have emerged and many ESG products have been launched. The truth is that the true ''win-win'' or integrated approach, still appears to be a rare find (Juravle and Lewis, 2008, 2009; Wagemans et al., 2013). This makes one wonder what is keeping it from becoming mainstream. Due to the different actors in the investment chain, it is difficult to pinpoint where it goes wrong.

Figure 5. Literature review conclusion



The ESG initiative industry is an important piece of the puzzle, as it functions as an intermediary between companies on the one hand and investors or the public on the other hand. Companies have increasingly been disclosing information on their ESG policies and practices, although this is often incomparable. These initiatives aim to sort out this information for practitioners. New evidence, however, calls ESG ratings into question (Chatterji and Levine, 2005; Dorfleitner et al., 2015). Moreover, the fact that Volkswagen was announced industry leader in the DJSI, minutes before the scandal came out, also casts doubt on the reliability of these ESG initiatives. It is thus necessary to examine them further and to understand the extent to which practitioners rely upon this tool to allocate billions of dollars in capital. It is also a costly endeavor for companies to respond to all the inquiries. The sheer number of requests they have to cope with, may possibly cause reporting fatigue.

Based on the universal ownership theory and their long-term liabilities, AOs should care about ESG and long-termism. They are at the top of the investment chain and have great leverage in influencing companies, which is why they are expected to lead by example. Unfortunately, it appears that their beliefs and investment horizon do not always line up with those of the AMs they employ (Clark, 2013; Gifford, 2015; Søndergaard, 2014). To make matters worse, some research has indicated that AMs may lack the expertise to interpret non-financial information (Juravle and Lewis, 2008; Munro, 2015; Searcy and Elkhawas, 2012). This could be the root of the frustration of AOs (Nicholls et al., 2015) and the reason they rely upon the above described ESG ratings and rankings. However, very little is known on the way they make their investment-decisions (Delmas et al., 2014; Martin et al., 2007; van Duuren et al., 2015). For example, they could also be plagued by short-termism in mandates (Barton and Wiseman, 2014; Clark, 2011; Desmartin, 2015; Søndergaard, 2014; UN Global Compact and PRI, 2014; Wong, 2010), making it hard to integrate ESG the way their clients would like them to. This short-termism may trickle down to the company-level and pressure them to forego long-term opportunities. It is therefore essential to answer some much-needed questions on the way AMs integrate ESG.

The literature review on the company level has revealed other questions as well. The above described weaknesses in the investment chain may affect the corporations these investors are shareholders of. Moreover, as discussed, companies receive many inquiries from the above described ESG rating and ranking industry. This is not the only pressure they face as society, investors and social media also play a part. Social media, for example, serves as a continuous watchdog, as it can spread news around the globe in a matter of seconds. There is thus substantial pressure to incorporate ESG, although little seems to have materialized. What type of pressure is most effective in forcing companies to incorporate ESG? The often incomparable and stand-alone sustainability reports seem to indicate that companies, perhaps are not sure how ESG relates to their business. There is either a weakness in reporting or a lack of know-how on the company-level. Do they not believe in it, do they not have the know-how or are they affected by their shareholders' short-term mindset? The truth is that we are not sure, as their story is often overlooked.

As can be derived from figure 5 and this conclusion more generally, this thesis investigates different layers of the investment chain. First, I begin by investigating the widely used ESG initiative industry, by drawing on industrial dynamics. This enables me to better understand the evolution and the status quo of this industry. This analysis is then supported by practitioner interviews, since they can provide insights as to how these initiatives are used and what the current situation is. I then proceed to the next layer; the AOs. This chapter draws on innovation diffusion, as this theory can concisely demonstrate the drivers and impediments to adopting RI, from an AO perspective. Next, I proceed to the AM. They are often hired by the AOs to invest on their behalf, but do not always appear to incorporate ESG the way that they should. To shed light on this issue, I investigate it in the context of organizational theory. Specifically, I use literature on institutional theory, sense-making, sense-giving, decoupling and boundary spanning. Next, I turn to the potential or current portfolio companies, of the investors mentioned above. I analyze the insights they offer in the interviews against the backdrop of innovation theory. I explore whether they are proactive or reactive regarding their ESG efforts. I also investigate what their main sources of “ESG innovation’’ are and what type of obstacles they encounter in their efforts. The conclusion, recommendations and limitations are then provided in chapter 8.

4 The ESG initiative industry; vice or virtue in the adoption of responsible investment?[7]

4.1 Introduction

Companies have come a long way in their ESG disclosure, but this topic is haunted by a lack of standards, training, and consensus. The information can therefore not be used for comparison, or is difficult for investors to interpret. (Hockerts and Moir, 2004; Juravle and Lewis, 2008; Munro, 2015; Ransome and Sampford, 2013; Searcy and Buslovich, 2014; Searcy and Elkhawas, 2012). ESG initiatives aim to sort this information for practitioner use. These groups assess corporations on their ESG performance (Fowler and Hope, 2007; Sadoswki et al., 2010; Scalet and Kelly, 2010). Unfortunately, they vary widely, conditional on the audience that they are looking to serve and the criteria that they take into account (Charles J Fombrun, 1998; Gladman, 2015; Scalet and Kelly, 2010; Sonnenfeld, 2004). Given that they are an important intermediary between companies and AMs, they are a crucial piece of the puzzle when researching RI impediments in the investment chain.

Some of these intermediaries simply send the companies they are assessing verification requests based on public information, but many rating agencies require more involvement from the companies they assess. They often send questionnaires, conduct interviews, or even visit them on-site (Schaefer, 2005). The Rate the Raters initiative by SustainAbility finds that, out of 108 organizations, about 60% rely completely or partially on information submitted by companies (SustainAbility, 2010). Amid this process, one concern is that there are too many, and often duplicative, questionnaires as much of the information asked for is already public (Searcy and Elkhawas, 2012). Many companies use half of a full-time post to simply respond to surveys, which is a significant investment (Oekom, 2013). This provides larger companies with an unfair advantage and helps them stand out for the wrong

[7] This chapter is the extended version of a paper, written parallel to the thesis and published in the Journal of Environmental Investing. Mooij, S., 2017. The ESG Rating and Ranking Industry: Vice or Virtue in the Adoption of Responsible Investment. JEI, State of ESG Data and Metrics 8, 331–367.

reason: ticking all the right boxes (Chatterji et al., 2009; Hanson, 2015; Searcy and Elkhawas, 2012). This is not surprising, as ESG rating organizations often state that the goal of their work is to support implementation of the UNPRI. In other words, many ratings are intended to tick boxes rather than increase shareholder value.

To make matters worse, recent academic evidence finds a low correlation between different ESG ratings. This finding casts doubt on the reliability of ESG scores (Chatterji et al., 2015; Dorfleitner et al., 2015). Even when Chatterji et al. (2015) adjust the ratings for what raters say they are trying to measure, convergence does not improve by much. According to the authors, this means that most rating agencies have substantial measurement error when trying to capture similar ESG concepts. Moreover, the fact that Volkswagen was announced industry leader in the DJSI, minutes before the emissions scandal surfaced does not help the case for ESG rating agencies. On the other hand, this is not surprising, given there are no rules guiding the development of these metrics, nor is there general agreement on how to measure ESG (Dillenburg et al., 2003; Dorfleitner et al., 2015).

As previously mentioned, these ESG agencies are an important intermediary between companies and investors. This means that they are a vital piece of the puzzle in investigating the adoption of RI. The large number of ESG initiatives, along with their questionable reliability raises questions about the role of the industry. It is thus important to take stock of this new industry – to investigate its status and to analyze its role as an intermediary. Two motivations drive this endeavor.

1. Scholars and practitioners (AMs) rely on ESG initiatives as a proxy for ESG performance, often not knowing that there is little agreement between different initiatives. This calls into question the validity of academic studies that have used these ratings (Igalens and Gond, 2005). The lack of agreement is difficult for AMs to observe (Chatterji et al., 2015), as they often use it to screen hundreds of stocks. These large investors tend to rely on these scores to help distinguish ''responsible'' from ''irresponsible'' companies. They use this tool to allocate billions of dollars in capital.

2. It requires time and is therefore costly for companies to respond to all (often similar) ESG-related inquiries. As established in the literature review, it is not unlikely that companies suffer from reporting fatigue. Moreover, if the conclusions of these ESG initiatives are not accurate, companies would be better off taking care of matters more urgent and relevant than reporting.

To address these concerns, we must understand the status of the industry and investigate the precise role it serves. More specifically; are these ESG ratings and rankings a vice or a virtue in the development of RI? This chapter explores these questions through research and interviews with companies, AOs, and AMs. Appendix 5 provides more information on the questions pertaining to this chapter.

I commence by defining what an ''ESG initiative'' is. I then proceed with a discussion of theories that can be used to analyze industry development. I then proceed with an overview of the analytical models, after which I apply the Industry Life Cycle Analysis (ILCA) to the ESG-initiative industry. I then provide an overview of the industry as well as some of its milestones. Although this overview only scratches the surface, it is the most comprehensive one in the literature (to my knowledge). Afterwards, I provide a comparison to the credit rating industry, as well as a brief overview on product innovation in the industry. The section thereafter provides the results of the interviews with companies, AMs, and AOs, along with a discussion of the findings. These results are used to answer the pressing question on whether the industry is a vice or a virtue in the development of RI.

4.1.1 Definition of an ESG initiative

Due to the many different types of ESG initiatives, it is important to describe what is meant by such an initiative. As described earlier, Scalet and Kelly (2010) define a rating agency as: *"Any organization that rates or assesses corporations according to a standard of social and environmental performance that is at least in part based on non-financial data"* (Scalet and Kelly, 2010, p. 70). Much like ratings, indices can also serve as a framework or basis for investment products and as benchmarks for assessing investment performance

(Grayson and Nelson, 2013; Lydenberg and White, 2015; Oh et al., 2013). These indices are often built based on ESG ratings and even awards and rankings are regularly based on these scores.

When using the term ESG initiative I refer to the above organizations, but also to others that focus on ESG or have launched an ESG related product. Examples are Corporate Social Responsibility (CSR) research agencies or shareholder services. These types of players influence the ESG discourse by, for example, publishing pieces such as Oxfam's "Behind the brands". An overview of all the 218 initiatives investigated can be found in appendix 4. This only scratches the surface as there are likely many more out there, but the database is a first attempt to shed light on the ESG initiative industry's status and role.

4.2 Industrial dynamics

The emergence, development and decline of industries are important topics when studying the growth of modern economies. This branch of study is called industrial dynamics and it is rooted in industrial economics. The latter was officially named in the 1950s, by Andrews (1952), although it had been around for a few years already under different names. Industrial economics investigates economic problems of firms and industries, as well as their connection to society. The theory of the firm is what underlies this branch of literature (Barthwal, 2007). Industrial dynamics, however, did not develop much until the 1980s. A reason for this may be that, before that time, a comprehensive theory to analyze the determinants of industry dynamics was lacking. Although there is early work by Marshall (1879, 1890) and Schumpeter (1939) on more dynamic models of industry growth, the analysis of industry structure was dominated by static models until well into the 1970s (Krafft, 2006; Malerba and Orsenigo, 1996).

As noted above, Marshall (1879,1890) is one of the pioneers when it comes to the way industries develop. He noticed differences in growth and decline across industries and acknowledged the role that knowledge and competencies play in driving this cycle. He also realized, that the importance of certain sectors to the overall economy may change over time. This may seem logical now, but back then static models of industries were the status quo. A few years later, Schumpeter (1939) stated that innovation, entrepreneurial activities and market power play a key role in economic change. He specifically underlined the vital role of technological innovation and how preceding technology becomes obsolete (''creative destruction''). Kuznets (1930) and Clark (1940) also contributed to these early observations of economic change. Kuznets (1930) finds that industries have life cycles in terms of sales and innovation, which influences the importance of the industry for the overall economy. Clark (1940) states that competition is a dynamic process, with less efficient ones disappearing over time. He finds that this also goes for certain industries, such as agriculture.

Rostow (1952,1960) then proceeds to notice regularities in the dynamics of industries. He pointed out the take-off and evolution towards technological maturity and the corresponding mass consumption phase. Granted, this lacks detail, but it sets the stage for further research into more dynamic models of industry growth. However, the years that follow are still dominated by static analyses. Especially the reason for concentration, firm size and profitability are popular research topics. Several leading economists made important contributions to the development of the field. One of these is Bain (1959). He was the doctoral student of Schumpeter and he introduced the structure, conduct and performance paradigm (SCP). He argued that market structure determines its conduct and thereby its performance. Given that behavior of market participants affects markets, it then becomes difficult to predict and establish fixed market structures. The Harvard Tradition in industrial organization picked up on this empirical approach. They then proceeded to make the connection between the concentration ratio and the harmful effects on social welfare. Another contributor to name is the Chicago school. They criticized the SCP paradigm, which pushed the discussion into a more theoretical direction. They suggested that market efficiency guarantees social welfare, which leads to firms seeking efficiency in production and distribution functions.

A shift then gradually occurred towards the internal structure of firms, to explain industrial organization. The emphasis here, is not on production, but on organization and the boundaries of the firm. Important literature is that on transaction costs, as an explanation for the existence of firms and vertical integration (Coase, 1937; Langlois, 1992; Williamson, 1979, 1973, 1975, 1981). This literature states that, in addition to production costs, there are transaction costs to using the market. Forming firms or vertical integration then becomes more beneficial, as it economizes on the cost of coordinating economic activity. Langlois (1983, 1989, 1992) later underlines the importance of firm capabilities as well as economies of scale in boundary decisions. He suggests that firms may need other capabilities under scenarios of rapid economic change. All else being equal, he proposes that vertical integration is higher in a fast-paced environment. In addition, he claims that path dependence is important and that organizational innovation drives economic change, as opposed to technological innovation.

All these different attempts are important advances for the development of industrial organization. However, static frameworks continue to dominate the literature (Krafft, 2006; Malerba and Orsenigo, 1996). Then, driven by two lines of inquiry, interest in industrial dynamics is revived in the 1980s. One of those is the assessment of contradictory stylized facts. Second, there is the motivation to further understand the life cycle of the industry. Then, in the 1990s, empirical research reveals gaps between stylized facts and theories, which triggers a third line of inquiry. Zooming in on the individual level, one observes ample diversity and turmoil. On a more aggregate level, regularities can be observed, which characterizes industrial dynamics. This line of thought has a particular focus on the understanding of industry evolution and builds on the foundations laid by Marshall and Schumpeter (Geroski, 1995; Krafft, 2006; Marshall, 1890; Schumpeter, 1939). More dynamic models finally emerge, that find technology, scale economies and demand to be key features of industry cycles. Building on Schumpeter's work, the important role of innovation is emphasized, industry differences are acknowledged as well as the effect of firm size on survival rates (Audretsch and Feldman, 1996; Audretsch, 1995; Jovanovic, 1982). This stream of work is termed industrial dynamics and is focused on industries made up of firms as well as the entry, survival and growth of these firms (Malerba, 2007).

Scholars have meanwhile come up with different models, to predict the changes that occur from birth to the decline of an industry (Abernathy and Utterback, 1978; Adner and Levinthal, 2001; Deans et al., 2002; Porter, 1980; Utterback and Abernathy, 1975). Although there are similarities, the names of the different stages vary, as well as the activities associated with it. One of the more widely known theories (as discussed earlier) was introduced by Michael Porter in 1980; the ILCA. His model predicts that industry growth generally follows an S-shaped curve, from introduction to growth, then maturity and finally decline. The phase of development an industry is in, has important implications for firm strategy, such as product innovation, cost reduction or scaling up. Product innovation, for example, can further increase the growth or stall the decline (Porter, 1998)**.** Thus, for organizations, understanding where they fall in the cycle should be the cornerstone of their long-term plan (Deans et al., 2002).

A stream of literature related to the ILCA is organizational ecology. The underlying principle of this thought stream is that organizations face inertial pressures once they are founded. These inertial pressures inhibit organizational capacities to change. The main reason organizational populations change, is believed to be demographic processes of birth and death. Organizational ecologists also look at legitimacy and its effect on firm survival rates. Legitimacy is the widespread perception in a given society, that the actions of an organization fit within a system of beliefs and norms (Suchman, 1995). Once a specific form becomes prevalent and population density increases, it gains legitimacy. Society perceives it as normal, which further boosts growth. Legitimacy also boosts survival chances as organizations can attract better staff, among other things. This also ties in with institutional theory, as companies adopt certain practices and policies in search of legitimacy and have better survival chances as a result. The main difference between organizational ecology and industrial dynamics, is the focus on organizational population. This ''big picture'' approach overlooks organizational level phenomena (Hannan and Freeman, 1977, 1984; Lomi et al., 2005; Singh and Lumsden, 1990).

The ILCA is helpful when attempting to explain changes by looking at technological developments, including decreasing product variety and emerging scale economies. Abernathy and Utterback (1978) are one of the pioneers of the ILCA. They recognized regularities in the way the automobile industry evolved in the USA. Gort and Klepper (1982) also contributed by investigating product innovation among 46 ''product histories''. They come up with an industry development theory and suggest that the historical order of events is a decisive factor for the ultimate product market. Further advances were made in the late 1980s and 1990s, either focused on mainstream (Klepper, 1997; Klepper and Graddy, 1990) or evolutionary analysis (Malerba and Orsenigo, 1996). The first investigates the drivers of the shakeout, that corresponds to a phase of firms' concentration and the way oligopolies emerge. Some claim that this shakeout is linked to the dominant design, whereas others postulate that survival during this phase is driven by exogenous technological change. Some argue that a dominant design does not always emerge, as buyers may appreciate diversity (Klepper and Graddy, 1990; McAfee, 2002). The evolutionary literature looks at learning and adaptation capabilities of firms, which is more in line with the early work by Marshall (1879, 1890). These are then used to investigate the process of competition and technological change is viewed as endogenous.

The early stage of the ILCA is characterized by ambiguity, as little is known about the product features desired by the buyer (Klepper and Graddy, 1990). The market must be convinced in the early stages and the duration of the total cycle depends on many factors. Examples are the barriers to entry and the ease with which it can be copied. If the product takes off, more players will enter the market to take advantage of its popularity. This reduction of uncertainty, may lead to new entrants or more established firms may decide to enter, after they have gleaned the industry's potential (Porter, 1998). As the number of users grows and levels off after a while, companies have to adjust accordingly, by improving quality at first and then shifting to enhancing the product and expanding capacity (Mirva Peltoniemi, 2011). At some point, there will be a decline in the number of players in the market, as the industry starts to consolidate. This levelling off can be triggered by obsolescence of the product or a fundamental change in technology, which may be the start of a new product cycle (Audretsch and Feldman, 1996; Klepper and Graddy, 1990; Porter, 1980).

An extension of this theory is *The Consolidation Curve* by Deans et al. (2002). They propose that, once an industry takes shape, it goes through several phases starting with opening, then scale, focus and finally balance and alliance. When companies are in the opening phase, market shares are highly concentrated and companies should aggressively defend their first-mover advantage by building scale, creating a global footprint and establishing barriers to entry. The scale phase is about building capacity whereby major players begin to surface, buying up competitors and forming empires and thus decreasing the number of players. After the heavy consolidation of stage 2, companies focus on expanding their core business and continue to aggressively outgrow the competition in phase 3. Stage 4 is where the market concentration reaches a plateau, with only a few players dominating. This is when large companies may form alliances with peers, as they must find new ways to grow their core business in an established industry.

Several factors influence the rate at which an industry goes through these phases. Firstly, there is the complexity of the product's technology, as simple products reach maturity faster. Simple products may be adopted more quickly and the ease of imitation is high, which reduces barriers to entry. Secondly, diversity in buyers' preferences hampers the emergence of a dominant design, which may lengthen the time it takes to reach maturity (Klepper and Graddy, 1990). However, some products do not have a dominant design as customers may value a wider range of choice (McAfee, 2002). These customers become more knowledgeable as the industry matures and tend to become more demanding as well. They may require complementary products, customization or improved performance (Porter, 1980, 1998). Customers may also express preference for bundling or unbundling of certain features. This tendency to offer packages is explained by economies of scale rather than transaction costs. Synergies can be accomplished in doing so, as a firm is likely bound together by several capabilities (Langlois and Robertson, 2002). Other drivers include the variation in the initial efficiencies of firms and technological innovations inside or outside the industry (McGahan et al., 2004).

The ILCA is a helpful method for the analysis of industries, as most progress through these cycles. It also lends itself well as a tool to better understand how a new industry, such as that of ESG initiatives, has developed. Moreover, if we know what stage of the cycle it is in, we can gain insight into firm strategy and get an idea of where the industry is going. The next section thus provides an ILCA of the ESG initiative industry, followed by a detailed description of the milestones in its development. This is, however, only the first step in developing our understanding of this industry. As mentioned above, both product innovation and customer preferences are important drivers of the ILCA. The former is discussed in section 4.3.4. The latter is discussed in section 4.4, where interviews with the users of these ESG initiatives further help to glean information on where the industry is going and what its role is.

4.3 The evolution of ESG initiatives

4.3.1 The life cycle of the ESG initiative industry

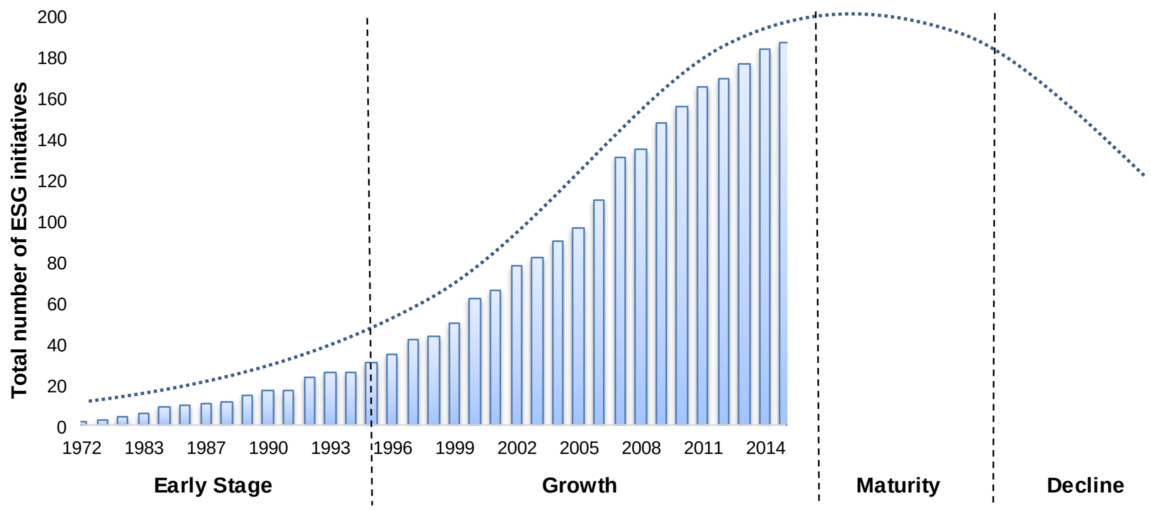
As described in the methodology, lining up the launch dates of the ESG initiatives and correcting for acquisitions, provides us with the opportunity to study the development of this relatively new industry with the earlier described ILCA. Although sales numbers are not available, the new entrants can be studied to gain some insight into growth as well. To be specific, the launch date refers to when the ESG-related product or service is launched. Where this is not available, it refers to the organization that launched it. The 218 initiatives in the database consist of different types, such as ratings, rankings or awards (see appendix 4 for the complete overview). Several sources were used to identify the initiatives, such as extensive Google searches, company websites and interviews. This is by no means a complete overview, although it is the most comprehensive one to my knowledge. The last major attempt to list these initiatives was made by Waddock (2008), although she did not consider the launch dates, the country of origin or the acquisitions that have taken place. The database I use here does not list all products separately. KLD, for example, launched the Domino 400 Social index in 1990. This is the first social investment benchmark, but they launched their rating product shortly thereafter in 1991. The launch of their rating is thus more of a product expansion than a separate initiative, which is why they are listed together and only counted once; as an index starting in 1990.

As described in the literature review (section 3.2.2), the ESG initiatives in the database are located in 29 different countries. The majority of the initiatives were founded in the USA (33%) and in the UK (14%). Germany and France follow with 6.9% and 6.4% respectively. Closely behind these countries are the Netherlands and Switzerland with 5.5% of each. Australia follows with 4.6% and the rest of the countries are home to a mere 1 or 2% of the initiatives in the database. As to the type of initiative, most are ratings (~27%) or indices (26%). There are also a substantial number of rankings (~17%) and ESG research (~14%) initiatives. The number of shareholder services, awards and other initiatives are not that pronounced in the database; with approximately 6%, 4% and 7% respectively.

As can be seen in figure 6, the ESG initiative industry is just transitioning from the *growth* phase to *maturity*. The increase is slowing down and the number of new entrants is now closer to the number of exiting companies. This is normally when organizations shift their efforts from trying to improve the product and introducing new variants, to tweaking the process and growing their capacity (McAfee, 2002; Mirva Peltoniemi, 2011). Many players in this industry already built up scale during the growth phase, as coverage is one of the most important criteria for buyers. In fact, about 15 acquisitions took place from 1999 to 2002 and many partnerships were formed between the organizations in the ESG database. This was done to either boost coverage or to expand the number of products on offer. At this point, only a few players dominate the market and large companies may continue to form alliances with peers, as they must find new ways to grow their core business in an established industry (Deans et al., 2002). Difficulty to maintain market share and profit levels characterizes the *maturity* phase, as competition is high. At this stage, most potential customers have already bought the product (Porter, 1980, 1998).

Although the products launched by the ESG initiative industry are not very complex in nature, diversity in buyers' preference has probably hindered a dominant design from surfacing. As previously described, there is simply a lack of standardization and consensus around the ESG topic. This has given rise to a multitude of RI strategies and this has created room for a variety of ESG products. This, besides different opinions on how to best use these products, is likely one of the reasons that the industry has not matured faster. Moreover, as can be seen in section 4.3.4, product innovations have taken place. These innovations were used to reach a wider variety of buyers and this has thus further increased the adoption of ESG initiatives. As described in the previous section, this can be an effective tool to stall the decline phase and to increase growth.

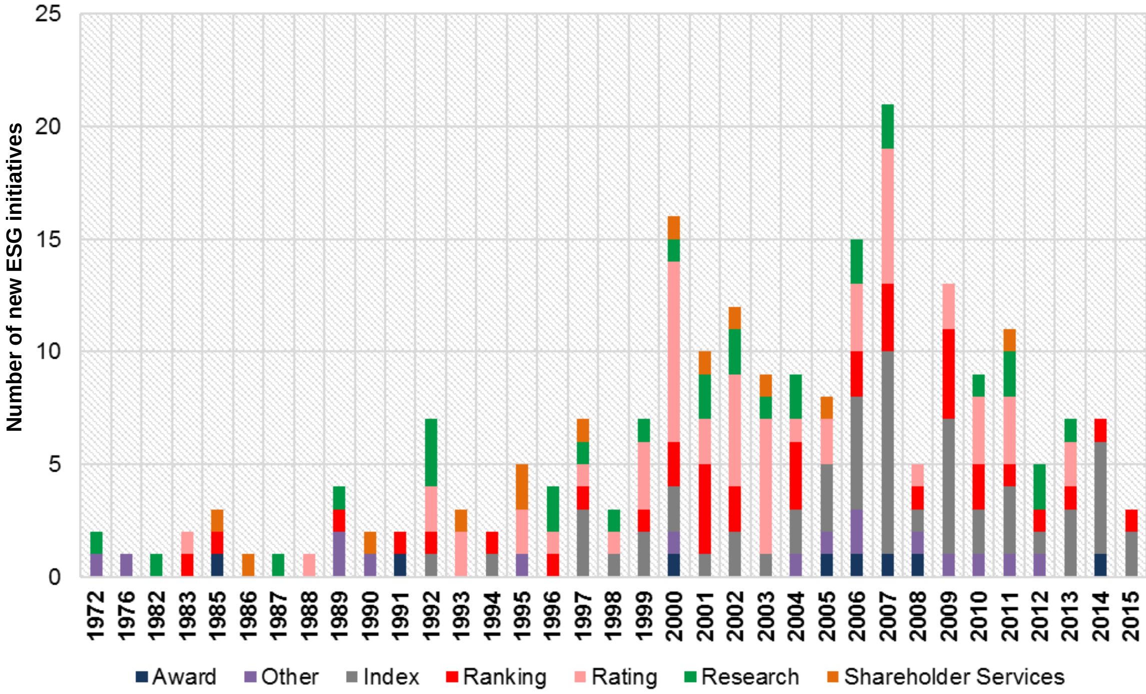
Figure 6. The lifecycle of the ESG initiative industry



4.3.2 Milestones in the development of ESG initiatives

Further analyzing the 218 initiatives in the database provides insight into how the industry has developed. As discussed in the literature review, most ESG initiatives in the database originated in Europe or North-America, which is in line with Schaefer (2005), who states that the market there is most advanced for these types of services. The USA and the UK, followed by Germany, France and Switzerland are home to most of the ESG initiatives in the database. Figure 7 shows the first type of products that were launched and how this evolved. For example, most rating products were launched in the year 2000. In 2007, we can observe another influx of ESG ratings. The milestones during the development of these initiatives are listed below and the innovation of ESG products is discussed in the next section. Although discussed briefly in this part, the database does not include sell-side research on ESG. While this does reflect an increase in demand on the investors side, the ESG offering as part of their overall product portfolio is negligible. The organizations investigated here, are more focused on ESG and this comprises a large part of their activities.

Figure 7. ESG Initiatives launched per year and by type



1960s and 1970s

There were smaller waves of interest in the social conduct of corporations, such as that in the 1900s, when it became clear how dangerous certain working conditions were and how children were exploited (Lydenberg et al., 1986). However, the interest in measuring it started in the 1960s when a need emerged to add social measures to the traditional economic ones. The Census department, supported by the National Science Foundation, carried out a national survey to capture measures such as crime statistics, health- or education indicators. However, this effort was discontinued in the early 1970s and the social mindset was replaced by a more economic one in the 1980s. Meanwhile, the corporate world also tried to market social information to businesses. This was led by Abt Associates of Boston and their rating system entailed objective and subjective CSR metrics, such as minority data, contribution to philanthropic activity and others. Companies were measured on these aspects and on what would be the most desirable behavior (Domini et al., 1992).

The Council on Economic Priorities was also launched in 1969 to track corporate and government behavior. They launched a series of publications with profiles of US corporations and their environmental- and hiring practices and published a book on this in

1986. This is co-authored by Steve Lydenberg who later led the launch of the Domini 400 Social, together with Amy Domini and Peter Kinder. The company profiles let readers interpret the information without labelling corporations with a specific rating. The Council did want to start rating companies, but were not sure how to attempt this, as many companies engage in some good and some bad behavior. Due to the inherent subjectivity, they therefore decided not to go through with it. That might also be the reason why, although cited in the New York Times and aired at congressional hearings, they never gained that much traction (Lydenberg et al., 1986).

Other milestones in the 1970s, were the launch of the previously mentioned IRRC and the Interfaith Center on Corporate Responsibility (ICCR), both established in 1972. The IRRC is more of a research and consultancy agency, whereas the ICCR is a coalition of different organizations with over $100 billion in invested capital collectively. The ICCR members were also the first religious investors to file proxy resolutions with social and environmental themes. Of course, proxy voting and corporate governance inclusion goes back much further (i.e. Gilbert brothers in 1932), but these initiatives were formed specifically to help institutional investors, as the demand for RI products and consultancy had started to grow. They helped investors with research pieces and advice, so that these investors could invest in line with their morals. This later slowly evolved into products that were easier to use for investors in their decision-making processes. Furthermore, the Sullivan Principles introduced in 1976 also gained substantial traction. These Principles were launched to help fight the Apartheid regime. Companies voluntarily subscribing to the Sullivan Principles were monitored and compliance was rated. This approach gained significant momentum in the 1980s and prompted debate (Lydenberg and Paul, 1992; Lydenberg et al., 1986). It also laid the foundation for the commercial rating models that exist today.

After the Nixon administration ended in the 1970s, there were cutbacks on efforts to improve social conditions. This obviously stifled progress in the adoption of RI. The recession in the 1990s also played a part in putting this development on hold, as nobody wanted to have their failures exposed. To make matters worse, under the Reagan administration, companies were no longer obliged to report accident frequencies. Many business executives also thought that reporting these figures would make them vulnerable, as it invites critique (Lydenberg and Paul, 1992).

1980s and 1990s

The first ranking, “America’s Most Admired Companies’’, was launched by Fortune in 1983. This marked the start of the ranking industry. The rating industry started at the same time, with the introduction of the now well-known rating company ‘’EIRIS’’. They started out as a foundation, helping churches and charities incorporate their ethical principles into their investment allocation decisions. Demand for ESG focus from institutional investors drove them to launch a rating service, but this only covered exclusion criteria at first. This evolved over time, as other forms were established to make it easier for the financial market and the consumer to distinguish between ‘’good’’ and ‘’bad’’ companies. They thus broadened their ratings in 2000. However, as can be seen in the previous figures (fig. 6 and fig. 7), this was rather late as many other players had entered the scene by then.

As mentioned earlier, KLD was a pioneer with the launch of the Domini 400 Social index in 1990 (now MSCI KLD 400 Social). However, they gained more popularity when they launched their rating product in 1991. At the time, there was no benchmark in place for investors who screened their portfolios based on ESG indicators. This was exactly the motivation for constructing this index as Kinder, Lydenberg and Domini applied different sets of screens to the S&P 500 (Domini et al., 1992). The rating product behind the index construction was launched a year later and became very well-known. Because they are the only ratings provider going back to 1991, this database is widely used by academics. The rating assesses a company's strengths and weaknesses in several social areas, the environment, military contracting, employee relations, community involvement, product safety, quality programs, excessive compensation of executives, diversity and nuclear power. These indicators are binary and they have expanded over time, as KLD added or changed some of them. They became part of RiskMetrics in 2009 and MSCI acquired RiskMetrics in 2010.

2000 till present

A more robust demand for ESG developed and various scandals, such as Enron in 2001, gave this development another push. This also gave rise to questions regarding corporate governance as well as the role of investors, as shareholders of these corporations. The year 2000 saw many newcomers on the scene, with notable ones being UN Global Compact 100 and Governance Metrics International. The former later became an input for many ESG screening tools and the latter was the predecessor to GMI Ratings, a well-known rating agency that has been part of MSCI ESG since 2014. The ESG initiatives had to professionalize their products to stay afloat and expand their coverage to compete for customers. As stated above, most acquisitions in the database took place from 1999 to 2002. Since customers tend to choose rating agencies based on coverage, it is important for the rating agency to either establish partnerships or to make acquisitions to scale up. Once they can sell the existing database to many different customers, their margin expands significantly.

As previously mentioned, the first ESG research teams were formed at HSBC in 2000. As the demand of institutional investors increased, several established brokerage houses were offering ESG research by 2005 (de Graaf and Haigh, 2011). Part of the push behind this came from the launch of ''The Enhanced Analytics Initiative'' (EAI) in 2004. This initiative encouraged the incorporation of extra-financial issues in sell-side research. European (mostly French) AOs and AMs with assets of €330 billion (which grew to over a trillion at the end), came together as they did not believe that traditional equity research was long-term enough, nor that it fully reflected the risks and opportunities of their investments. They joined efforts and provided incentives for research providers in the form of increased commission. This kind of support was essential during the early-days (Hagart and Knoepfel, 2008). EAI evaluated and praised research to spread the word and to convince other major sell-side institutions to incorporate extra-financial issues. Unfortunately, many analysts paid attention to extra-financial aspects because of personal affinity, but were not completely supported by their institutions. Overall, the initiative helped in stimulating more comprehensive sell-side research. They became part of the UNPRI in 2008 to roll this out on an international basis.

Different and more technologically savvy products emerged, aimed at carbon screening and other portfolio analytics for institutional investors. As previously mentioned, innovations such as these can boost adoption among users and stall the decline in the ILCA. RepRisk, for example, launched a web-based tool in 2006, which enables investors to screen the media for ESG risks. Although products have changed over the years, the issues on the agenda of rating systems today do not differ widely from those raised in the 1960s and 1970s. What does differ, is how they are put on the agenda. For example, instead of calling for increased regulation companies are now expected to make voluntary changes to stay ahead of the competition.

In 2007, Dutch documentary Zembla aired and exposed the, sometimes controversial, holdings of pension funds. This served as a wake-up call for many pension funds to re-examine their investment decisions (see chapter 5) and to start including ESG criteria. This year also sees a general influx of ESG initiatives, which is possibly related to the economy doing well; there is budget to invest in ‘’extras’’. However, soon after the financial crisis ESG is pushed to the sideline and the focus shifts to saving costs. As can be seen in fig. 7, not many new ESG related initiatives were launched in 2008. Corporations were in survival mode and prioritized finance over ESG. Soon after, it becomes clear that society has lost trust in corporations and that ESG can help in building back that trust. In 2009, more initiatives are launched again and even Bloomberg starts including ESG data. Louche et al. (2014) describe the post-financial crisis phase as a phase in which RI gains renewed legitimacy.

4.3.3 Comparison to the credit rating industry

As mentioned earlier, ESG ratings have some similarities to credit rating agencies as they both mold an assessment into an easy-to-use form; scores or letters. Both often use public input information, which means that the intermediary does not solve information asymmetries. I follow the argument that Rhee (2015) makes about credit rating agencies having a sorting function: instead of producing new information, ESG agencies process a large volume of information. This facilitates more efficient ESG screening.

Another similarity between ESG and credit rating agencies is the initial research stage, after which ratings are attached to company profiles. The credit rating industry has its roots in 1841, when a merchant started gathering and selling information on the creditworthiness of companies in the US. He had been collecting this information on his own clients and spotted a gap in the market. The first commercial rating book was published in 1857 and Moody's Investors Service joined in 1909 with their bond ratings. About ten years later, U.S state and local government bonds were rated. ESG ratings differ in that most are unsolicited, although a few companies offer ratings to companies for a fee. This kind of service is then more of an assessment and consultancy for companies to improve their rating. Most though, are paid for by the users (i.e. AMs) and thus unsolicited (Sylla, 2002).

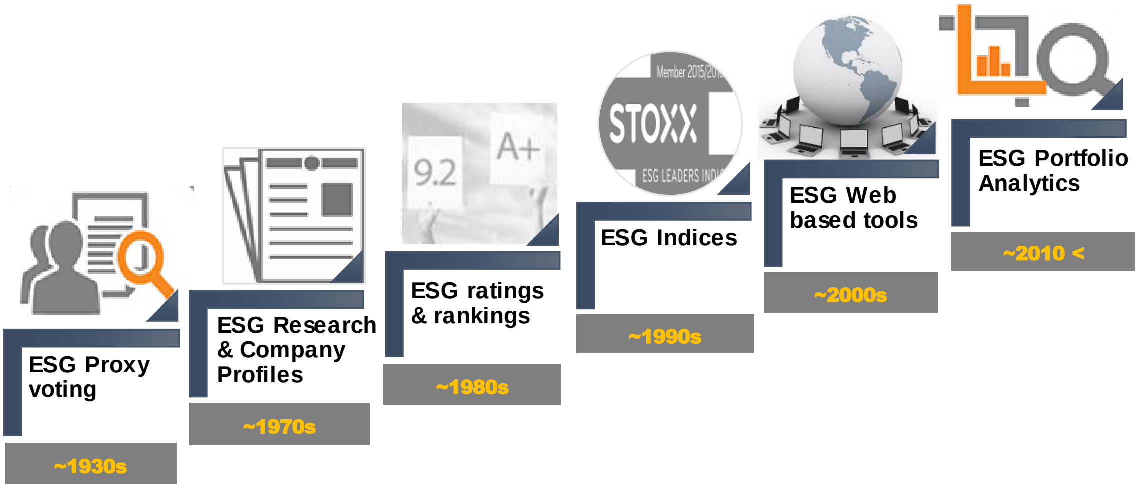
Credit ratings do not only inform investors about the quality of securities, but they also help to reduce regulatory costs (Jeon and Lovo, 2013). All the way back in 1936, the Comptroller of the Currency prohibited national banks from investing in bonds that were not investment grade. In case of any doubt about the rating, it had to be guaranteed by at least two credit rating agencies. Later, in 1975, the Securities and Exchange Commission (SEC) introduced the Nationally Recognized Statistical Ratings Organizations. This way, SEC regulations were only applicable to long-recognized ratings, which meant that the smaller as well as the new ones were left out (Coffee, 2006; Sylla, 2002). Although ESG ratings differ from the regulated credit rating industry, some of the AMs have adopted ESG ratings in a similar approach. They opt for the established rating agencies and subscribe to more than one provider. In case of extreme discrepancy between the ratings, they further examine. This is especially helpful for larger holdings, as a small error on behalf of one rating agency may result in capital reallocation.

4.3.4 Product development and complementarity

If we line up the milestones in the previous sections and the timelines, it becomes clear that the ESG product has progressed through several phases. Although most organizations started out with one product, they gradually expanded to a one-stop-shop for an investors' ESG needs. For example, Sustainalytics offers a range of solutions nowadays, from ESG research & ratings and index services to (controversy) screening services and portfolio analytics. This was achieved by acquiring smaller, specialist shops such as ESG Analytics in 2015 or forming partnerships with bigger players, such as Glass Lewis and Bloomberg. Figure 8 provides an overview of when the different types of products approximately entered the scene. It must be noted that proxy voting has been around for a long time, but the service for institutional investors started with IRRC in 1972.

As discussed, the lack of consensus and wide range of different ESG strategies brings about diversity in buyer preferences. This is likely one of the reasons that the industry has not matured faster (Klepper and Graddy, 1990). Most of the ESG initiatives thus have a large assortment of products, which cater to the wide range of ESG strategies employed by investors. As can be seen in figure 8, in-depth ESG- and proxy research have been around for a while. These products are still used by some fundamental investors. Other investors need tools to work through many companies and to screen out the ''irresponsible'' companies, based on a set of exclusion criteria. Yet others must comply with a clients' request for a low-carbon portfolio and need an index or screening tool for that. AOs are more under pressure than ever to know what they own and Portfolio Analytics can be a helpful tool. This provides a starting point for a discussion with their AMs, or it may serve as a monitoring tool.

Figure 8. The ESG initiative industry: product development



4.4 Interview Results

The results of interviews, by subject, are detailed below. It is important to note that the interviews were focused primarily on those ESG initiatives that need information from companies, such as rating agencies, awards, rankings, and indices. The interviews were conducted with 20 companies, 15 AMs, and 10 AOs in the UK, the Netherlands, and Germany. The response rate was 45%. More details on the interviews and the respondents can be found in appendix 5, 6, 8 and 9.

4.4.1 Companies

Companies on average receive approximately 30 requests a year from ESG agencies. This is likely an underestimate, since invitations to participate are sent to disparate departments. The range of requests varies widely and companies without an ESG reporting function may split these requests between different roles. The number of annual requests is three-times greater than what oekom (2013) found. This may be attributable to the fact that the companies in my sample are larger. It may also be due to growth of the industry and the methodological inclusion of rankings and other initiatives.

More than half of the companies doubt the value of responding to all the requests, as it often takes up at least half of a full-time job. This includes a few respondents who stated that the industry does have value, but that it has become too unwieldy. Moreover, the respondents who do think the industry has value all seem to have a more advanced filtering system in place, minimizing reporting fatigue.

Nevertheless, many respondents still try to fill out as many requests as they can. They want to be helpful and transparent. Some even respond to requests, despite describing the scores as “nonsense.” Reputation is another important driver for respondents. Not filling out a questionnaire may give the impression that they have something to hide. Concern among the respondents that there are too many different agencies makes responding difficult to prioritize, although nearly all respondents agreed that CSR awards are not a priority. While useful for marketing, these are not as important or credible as ratings or rankings. Respondents say that many awards have lost credibility by asking for sponsoring money.

Some companies prioritize based on credibility. I find that MSCI, Sustainalytics, and oekom are perceived to be the most credible organizations. The Carbon Disclosure Project (CDP) and DJSI are also frequently mentioned, as is the Dutch Transparency Benchmark for Dutch companies. However, the last two are also sources of frustration. In general, established raters are preferred over newcomers, indicating that there is not much room for new entrants. Few companies maintain a materiality approach, by which they select those ratings and rankings that are most relevant to them. Some companies simply respond to those agencies requested by shareholders, or to those with a large audience. Some players, such as CDP, Sustainalytics, and DJSI reach a considerably wide audience, as they distribute their data via the Bloomberg terminal.

For some companies, ratings and rankings have become a benchmark. It also triggers a sense of competition with peers, as everyone wants to be the highest rated or the industry leader in the DJSI. Many companies use these ratings to measure their progress and to work on their journey as they gradually try to increase scores. These effects are especially helpful for internal ''sustainability people'', who are trying to gain support for certain ESG projects. To them, these questionnaires have become a proxy for investor demand. More than one respondent claimed that it helps to get their superiors to sign off on certain projects. It also helps companies to understand the areas in which they need to be more transparent and it provides them with insight into trending topics and potential points of improvement.

More than half of respondents complain about the time required to fill out non-comparable yet overlapping or irrelevant questions – time that could be used to make actual progress with their ESG journey. The methodologies are complex and there is a lack of harmony. This is reason for concern, since there are so many of them. Some respondents state that ratings and rankings have become an obsession for companies and that one can score high by simply ticking the right boxes: Practice makes perfect and this also goes for filling out questionnaires. The DJSI, especially, was mentioned as a frustrating process, both lengthy and demanding of expertise from different departments. This can take more than 30 employees and 1,000 hours to respond to. On top of that, payment is often required to get feedback. However, the opinion is divided, as some also find it helpful to see what questions are on the agenda and to get an impression of how they measure up. Few use the DJSI as a management tool or link it to compensation, but most respond to it because it reaches a wide audience. CDP was also frequently mentioned, but in a more positive light, as the initiative is more transparent.

Companies believe that ratings and rankings should focus on material and relevant issues. They must be transparent both with the methodology and the assessment. The matter in which companies are assessed is often not very straightforward. Some respondents described receiving inconsistent assessments between years. They also said that it would be helpful if these initiatives shared data, as this would minimize reporting fatigue and inconsistencies. Another suggestion was that they improve their follow-up – sometimes a six-month wait for an outcome – and be more considerate toward companies in general.

Thus, to sum up, a benefit of ESG initiatives is that they can help in understanding what is expected of them. They are also used as a proxy for external demand, which helps sustainability-focused employees in getting projects approved. Finally, they are useful for benchmarking and tracking progress. The downsides include irrelevance or immateriality as well as the sheer number of ESG initiatives. Many ESG initiatives are also not transparent enough in how they conduct assessments. Overall, they take up too much time and questions are overlapping, but different. Companies that excel at filling out the questionnaire can improve their score without changing practices. The exercise then becomes more about ticking the right boxes, as opposed to making the right improvement.

4.4.2 Asset Managers

Due to the sheer number of companies that must be screened, AMs often use external parties with extensive ESG coverage. As stated above, this is the reason why many rating agencies built up scale through acquisitions or partnerships. Investors face a lack of time, expertise, or analysts, making it infeasible to do ESG research. It is more efficient to simply subscribe to an ESG rating agency. This is in line with other research, which finds that investors are resource-constrained (van Duuren et al., 2015). They often have many stocks to cover and use ratings and rankings as a screening tool, to identify their investable universe. This means that stocks may automatically be cut off from the portfolio when the ESG score is downgraded.

Although not everyone is aware of the recent evidence on the lack of correlation between ESG ratings, AMs are not surprised either. Some have already discovered errors in ratings and try to be mindful when choosing a provider. Some state that, although far from perfect, ESG ratings currently offer the best approach, given the sheer number of stocks to cover. Others subscribe to several different rating agencies to resolve discrepancies. Although costly, this provides them with different viewpoints and diversifies risk. Large discrepancies between the scores can be investigated, which is more efficient than analyzing every single company rating in the portfolio. Some combine several providers including RepRisk, Trucost, Sustainalytics, and MSCI.

MSCI and Sustainalytics are the preferred providers and many respondents described these rating agencies as complementary. A few respondents said MSCI is known for governance (due to the GMI acquisition), while Sustainalytics is stronger in environmental and social analysis. Both players have extensive coverage, which is favorable to the screening process. The choice of provider may also be due to a fund's history. For example, the MSCI benchmark is often already in place. As discussed earlier, this ''one-stop-shop'' model is practical for the users of ESG data. In addition to these kind of rating providers, respondents often use a RepRisk "overlay" to track reputational aspects.

Overall, the reliance on rating agencies is more pronounced than that found by van Duuren et al. (2015) in their survey among 100 fund managers. These investors indicate that they mainly used ESG rating agencies for red-flagging and managing risks. According to the interviews I conducted, many investors rely on rating agencies for ESG expertise and efficiency. Although not always clearly indicated, many AMs use the scores to identify the ''most responsible'' companies – a screening method that assumes these ratings are a good proxy for ESG performance. AMs allocate capital based on these ratings, though many know that it is not a perfect solution. Respondents questioned the quality of the data and had difficulty quantifying certain information. However, they also stated that this is the best approach available and that rating quality has been improving over the last few years. Other (very few) AMs do not find the scores useful and use the narrative included in the company profiles to feed investment decision-making. They state that they find it helpful to have different viewpoints and to outsource the collection of ESG information.

4.4.3 Asset Owners

Approximately seven AOs have no preference when it comes to AMs doing their own ESG research or outsourcing it. Most do not think it is their job to tell AMs how to make investment-decisions. The respondents did agree that blindly relying on ratings is not a good idea and that ratings are useful for gathering different viewpoints and supporting thought and discussion throughout the investment decision-making process. AOs also acknowledge that portfolios are quite large, on average, making subscriptions to ESG rating agencies efficient and likely the best approach right now. They were generally not aware of the low correlation between ESG scores, but nor were many surprised.

Except for one respondent, AOs do not tend to use ESG scores to evaluate or compensate their AMs. Some do use the scores to get input for review talks: it makes it easier to have some input for discussion with their AMs as ESG is a broad concept. Thus, they use the narrative to read up on their portfolio and to develop an understanding of what they own. This helps them to challenge their AMs. Respondents state that they do not take specific action based on these reports, but that they merely use them for review purposes. Sometimes trustees want to see how the portfolio compares to the benchmark on ESG criteria. One of the AOs started using ESG ratings in a similar way to credit ratings: they defined an investable universe for their AMs, according to a pre-determined threshold.

4.5 Discussion

The initiatives described in this paper have experienced tremendous growth. Companies use ESG ratings to benchmark their efforts, customers use them to identify ''good'' employers or buy ''better'' products, investors use them to identify more ''responsible'' investments, and academics use them to investigate the financial value of ESG. However, some recent evidence has cast doubt on the reliability of ESG initiatives – in some ways unsurprising since we have not agreed on what indicators matter and since materiality is different for every company. It is also not surprising though, that once so many indicators are aggregated, the final score becomes a noisy proxy for ESG. The lack of consensus and understanding of what ESG entails is precisely what has made many of these initiatives popular.

There is no doubt that some of these initiatives have supported the development of RI, evidenced by the role of the ICCR in the fight against Apartheid (MacLeod, 2014; Shapiro, 1992). To this date, ESG-related initiatives can play an important role as watchdogs, as illustrated by Amnesty International's recent investigation into the supply chain of multinationals such as Unilever (Amnesty International, 2016). According to Waddock (2008), some of these initiatives serve as a voluntary responsibility assurance system. They provide an ''independent'' perspective on how a given company upholds their social contract, and thereby serve as a monitor. This exerts some degree of normative pressure on companies and can help change dominant conventions (Sun et al., 2011).

Some company respondents also suggested that ESG ratings help to get certain topics on the agenda and create a sense of urgency. For example, management will be more likely to sign off on a renewables project when external parties ask for it. Sustainability managers are not often in a room with investors, which creates a certain disconnect. They tend to use these initiatives as a proxy for investor demand, which helps to convince their superiors. The finding that companies barely talk to their investors about ESG is interesting, as this further underlines the role of the ESG-initiative industry as an intermediary and emphasizes the need to better understand this industry.

Given resource constraints and a lack of understanding, investors will likely continue to use this intermediary. A handful have transitioned from scores to the narrative, using their investment skills to infer investment implications. For AOs, this can be helpful preparation for a review meeting with their AMs, as they often do not have the skills or time to do ESG research in-house. (Nearly all AOs indicate that they do not expect AMs to do this in-house.) Given that portfolios often comprise hundreds of stocks (or more), ESG scores remain the most efficient way to screen them. It is therefore important that AMs thoroughly understand the rating methods they choose (Chatterji et al., 2015; Delmas et al., 2013). Some interview respondents subscribe to more than one rating agency to avoid major errors. This solution, though, can be quite costly and still may not provide an accurate proxy for ESG. At some point, it may be more cost-efficient to train financial analysts in ESG analysis and have more all-round analysts on the investment team. As to academic use, it may be better to breakdown scores into smaller parts for a less noisy proxy; this could help reveal financial relevance of individual indicators.

Even though the industry serves a purpose, the accuracy of this proxy for ESG performance is questionable; there is simply no consensus on what it means. Several other concerns are equally problematic. First, there is the time that companies must put into questionnaires and other requests. Based on interviews, it appears that reporting fatigue is close to a peak; respondents are frustrated. Some made it clear that they will soon start to implement a strict filter. One idea from Schaefer (2005) is that rating agencies should lower transaction costs of processing ESG data for companies. Respondents that do have a filter or priority system have a clear preference for the more established players. This means that smaller rating agencies, once excluded, will have to exclusively base their assessment on public information. They will thus become even more likely to be shaken out or acquired. This supports findings in the ILCA and shows that the industry is reaching maturity.

Another problem is that most of the reported ESG data are not audited and reliability is debatable, at best (Eccles et al., 2015). The same is true for the input information. This lack of reliability and convergence adds to the ambiguity surrounding this topic. Additionally, due to the proprietary nature of methodologies it is difficult for ESG initiatives to be fully transparent. From my interviews, it seems that this is especially problematic with rankings like the Transparency Benchmark or Corporate Knights – and even the DJSI to some extent. This only adds to frustration as companies put in an effort and are then left in the dark as to how they scored fewer points than last year. In some cases, as with the DJSI, companies can find out how to improve their performance for a fee of roughly €50,000. Although a clever way to make money, this does not help the credibility of the DJSI and causes companies to question the value-added of responding.

There are a few rating agencies that appear to offer high-quality data. According to company respondents, the most credible ratings/rankings are MSCI ESG, Sustainalytics, and the DJSI. Other players mentioned favorably were oekom and the CDP. Although companies mentioned the DJSI frequently, it was also a source of frustration for them. What is more, they are not mentioned by investors at all. For investors, the leading providers were MSCI and Sustainalytics. Sometimes they also mentioned Trucost, CDP, and RepRisk. This is not fully in line with other research, which also mentions ASSET4 and EIRIS (now VIGEOEIRIS) as leading ESG providers (Dorfleitner et al., 2015; Sustainable Insight Capital Management, 2016). Neither the company respondents nor any of the investors mentioned these players.

4.6 Conclusion

The ESG-initiative industry has become an important intermediary between companies and their investors. Recent evidence along with the sheer number of initiatives, have cast doubt on the value of this industry. Yet billions of dollars in capital are allocated based on these tools and companies spend at least half of a full-time job responding to requests from ESG ratings agencies. Given the implications for the adoption of RI, it is crucial to develop an understanding of this industry. Is the ESG-initiative industry a vice or a virtue in the development of RI? To answer this question, I investigated 218 ESG initiatives and analyzed the industry with the ILCA. I also explore the role of ESG initiatives by conducting 45 interviews. The respondents were AOs, AMs, and companies located in the Netherlands, the UK, and Germany.

In weighing the pros and cons, my findings indicate that the ESG-initiative industry is an impediment to the adoption of RI. The industry has helped boost the adoption by exerting normative pressure on companies, exposing them to ESG-related discourse and serving as a monitor. There is also, currently, not a more efficient way to screen on ESG criteria. The problem is that there are simply too many rating agencies and their judgement is questionable. Looking at the 218 initiatives in the database, the obstacles named by interview respondents, the academic evidence that casts doubts on the accuracy of ESG ratings, and the fact that Volkswagen was announced an industry leader just prior to the emissions scandal makes it clear that this market is not functioning.

The ESG-initiatives industry is now at a crossroads: the sheer number of ratings, rankings, and indices fuel ambiguity and reporting fatigue more so than they spread benefits. For some companies in my sample, the time has come to be more selective, as much of the rating industry is little more than a nuisance. Those who have a filtering approach in place, could reinforce their focus on the established and credible agencies. This is bad news for newcomers, as this implies an increase in entry barriers. As evidenced by the ILCA, the growth in new entrants is already stabilizing and the industry is likely to transition to maturity in the next few years. More partnerships and acquisitions are expected, which is good news for those companies suffering from reporting fatigue. It would also help if more users became aware of the flaws inherent in ratings/rankings and if companies published evidence on how much time this industry requires from them. If this happened it would exert more pressure on ESG initiatives to be transparent, build credibility, and even collaborate by producing a standardized question list. Initiatives such as the Global Initiative for Sustainable Ratings (GISR) help to set some minimum standards and encourage best practices (Makower, 2013). They have also previously organized training on ESG ratings for companies; it might be helpful if they continue to offer this type of education.

At the end of the day, investors will rely on the ESG expertise of this industry. Even if they have the skills to do ESG analysis, portfolios are simply too large. This know-how will take another few years to become mainstream, given that ESG has not yet been integrated into the curricula of most business schools and industry certification bodies (Krosinsky, 2015). Companies may be better off talking to their investors about what information matters to them; they can more effectively focus their efforts if they are on the same page. I am stressing this point, because many people are under the impression that investors use ESG scores without knowing which ones or how. As an alternative to spreading thin, companies could respond only to those initiatives that align with their goals and industry type: heavy water users can, for example, participate in CDP's water program. A few respondents already use this approach. They said that this focus frees time and helps them to work toward their goals more effectively.

The findings in this chapter have important implications for scholars and practitioners alike. The overview in appendix 4 and in-depth discussion have demonstrated that the ESG initiative industry has turned into a web of ambiguity. First, it is important that users are aware of the pitfalls of this proxy and that they proceed with caution. Besides acknowledging its limitations, scholars may also be better off researching individual indicators as opposed to aggregated scores. This can reduce the noise and subjective weights in their search for financial significance. Second, it is important for companies to establish a strategy to manage their workload. As described above, being on the same page as their investors is one way of doing this. Third, AMs should be careful in the extent to which they rely on this industry. Cross-checking with another provider may be helpful, if there is absolutely no way around the scores. Fourth, AOs should also make sure they are on the same page with their AMs. It may not be helpful to identify an investable universe based on these scores, or to evaluate their AMs with these scores. What is helpful, is to clearly communicate objectives and goals regarding their portfolios' ESG performance and to have regular and challenging discussions with AMs on this topic.

The ''noise'' or disconnect between investors and companies may only be the tip of the iceberg. Especially the finding that companies do not tend to talk to their investors about ESG (and vice versa), hints at a larger misalignment problem in the investment chain. This has strong implications for the sixth and seventh chapters on the issues faced by AMs and companies respectively. It is evident that, due to the disconnect, companies are not clear on what investors are expecting from them. It is then no surprise, that they respond to as many requests as they can and consequently suffer from reporting fatigue. This chapter also has implications for other parts of this thesis, as it sheds light on the extent to which

AMs and AOs rely on this information. On the AO level, this industry is not an impediment as they do not tend to use raw scores for evaluation purposes. In fact, the ESG research reports merely serve to help them in challenging their AMs. The search for friction points on this level thus continues in the next chapter, by considering other potential sources of misalignment. On the AM level, the chapter illustrates to what extent they rely on rating agencies and screening methods. This strengthens the idea that they may indeed not be adopting ESG the way that they should. The next chapters build on this evidence and continue to search for impediments, by investigating the way AOs, AMs and companies approach ESG integration and the kind of obstacles they encounter.

There are several limitations to this research. First, given that several parties in the investment chain are investigated, the sample of respondents is rather small. Future endeavors could therefore focus on a larger sample. What would also be interesting, is if one could obtain data on the response rate of ESG initiatives. If this has declined over time, it would support the findings of this chapter. Getting an ESG raters' opinion on this, would also provide an interesting angle. Other endeavors could look at the influence on a company's share price once they stop responding to a major rating agency, or once they are de-listed from the DJSI. There is some research on this already (i.e. see (Cellier and Chollet, 2015), but our understanding of this industry's impact is not satisfactory. This is especially true, given the size of the industry and its role as an intermediary between companies and investors. After all, they are our point of reference in allocating capital to ''responsible'' companies. On top of that, sustainability managers spend too much time filling out slightly different questionnaires. This time could instead be invested into actual progress.

5 Asset owners and the diffusion of responsible investment. What explains the low rate of adoption?

5.1 Introduction

The pension sector is the largest investor class by far, with over $30 trillion AUM (Ambachtsheer, 2016). They are especially significant owners in countries with a developed pension market, such as the UK and the Netherlands (OECD, 2011). Given that they are the most prominent shareholders of listed companies, much is expected of this AO (Clark, 2008; Piggott et al., 2008; Wagemans et al., 2013; Wong, 2010). They can help us shift to longer-term investments and free the market from short-termism (Wong, 2010). They can also play an important role in mainstreaming RI (EUROSIF, 2016; Hoepner and Majoch, 2016). They face growing pressure to take on this leading role, as they are increasingly held accountable for their impact on the world (Clark and Urwin, 2008; Gifford, 2015). Some of them indeed have taken on this role and have thoroughly integrated ESG into their business model. However, the majority seem to be clinging to business as usual for reasons that are not entirely clear. Many do seem interested, as reflected by the approximately 350 AOs, with about $17 trillion AUM, who have signed up to the UNPRI so far. This shows that these signatories, at least to some extent, believe in RI. Integrating ESG is also in their best interest, for the reasons discussed earlier in the literature review. To recall, ESG has been proven to add value (Clark et al., 2015a). Moreover, their universal ownership makes it impossible to run from externalities. Lastly, we, as the beneficiaries, entrust our assets to them, expecting them to make prudent investment-decisions for us. The efficacy of the financial system as a whole relies on entities, such as pension funds, to take responsibility for their actions (Davis, 2009). This has become even more pressing with the endorsement of the SDGs. Theoretically speaking, if they do a good job leading this movement towards long-termism and ESG integration, intermediaries and the economy at large will follow (Hoepner and Majoch, 2016).

In practice, it is not as easy as it sounds on paper and the rate of adoption of RI is not as high as it could or should be. In fact, although it appears as if investors have become more socially and environmentally responsible, organizational reality begs to differ. Looking at business practices on the whole, too little seems to have materialized (Busch et al., 2016; Davis et al., 2009; Hoepner and Majoch, 2016). Given that the investment chain is quite long on average, with many different parties involved, it is no surprise that this slows down the adoption rate. There may be substantial barriers along the way that hamper them from pursuing true ESG integration. For example, there may be governance related issues or inertia in the boardroom (Ambachtsheer et al., 1995; Ambachtsheer, 2016; Ambachtsheer and McLaughlin, 2015). As discussed in the literature review, agency issues may arise as investment-decisions are often outsourced (Berle and Means, 1932). To minimize these conflicts, the “agents” are monitored frequently and they are guided by the IMA. To make sure that this influence is put to good use, they have to clearly stipulate their objectives in this agreement (Costanzo, 2011). Unfortunately, this is often not the case and form is confused with substance (Kiernan, 2007). Therefore, the investment horizon of AOs, belief and expectations on how ESG issues should be managed, may not always be in line with those of their AMs (Clark, 2013; Gifford, 2015; Søndergaard, 2014). The mandates that are given to AMs are often still short-term oriented and thus likely a barrier to ESG integration (Barton and Wiseman, 2014; Clark, 2011; Desmartin, 2015; Søndergaard, 2014; UN Global Compact and PRI, 2014; Wong, 2010). This excessive focus on the short-term may percolate all the way down to portfolio companies and give them the signal to inflate short-term cash flows at the expense of longer-term opportunities (Desmartin, 2015; Gifford, 2015; Whittaker, 2011; Wong, 2010). This short-termism is especially astounding for AOs given their long-term liabilities, which should spur them to invest for the long-term. At the same time, the problem could also very well be the intermediary used. According to a recent survey, AOs are not very happy with the way their AMs integrate ESG. They express frustration with ESG reporting and with the way their objectives are managed by their AMs (Nicholls et al., 2015).

Because of the significance of these powerful institutional investors, it is important to understand what is holding some of them back. As discussed above, due to their size and influence, they are expected to lead by example (Barton and Wiseman 2014, Clark 2013, Gifford 2015). Of course, ambiguity and a lack of consensus may be the reason for this reluctance to reinvent themselves, but this cannot be said with certainty given the lack of qualitative research. It is thus important to investigate where the bottlenecks reside, before ESG is discarded altogether. Given that the research is mainly exploratory, in-depth interviews are well suited to investigate what slows down the rate of adoption. The findings are analyzed in the context of Innovation Diffusion Theory, given that this sheds light on the way AOs perceive ESG and how they translate this into their strategy and their IMAs. More specifically, the framework by Rogers (1962) provides an interesting way to analyze the rate of adoption of RI among AOs. Using this angle, one can better grasp the drivers as well as the impediments. Additionally, the framework sheds light on the way the different countries in the sample facilitate, or slow down, the adoption of RI.

This chapter starts by defining the concepts of innovation and diffusion, as well as the theory on innovation diffusion. After briefly highlighting the way the theory developed and elaborating on the framework that will be used, I apply it to the findings of the ten in-depth interviews (see appendix 3 and 6 for interview participants and survey instrument) with AOs in the Netherlands, The UK and Germany. Hence, I first discuss the perceived attributes of RI and investigate aspects such as *relative advantage* and *complexity.* I then discuss other important attributes, including those relating to the different social systems in which RI is to be diffused. For example, some countries may be home to less developed pension systems, which has consequences for the adoption of RI. I also analyze attributes such as the *extent of effort by AOs*, specifically their monitoring and review process. The findings are illustrated in figure 11, at the beginning of the results section. Lastly, I conclude with a summary of the findings, I discuss the implications and suggest future research endeavors.

5.2 Innovation Diffusion Framework

Although innovation diffusion is a relatively new field, much can be written about its development over time and its contributors. The brief overview provided here therefore merely scratches the surface of Innovation Diffusion (for a more in-depth overview see (Godin, 2017). In what follows, I will define innovation and diffusion, briefly discuss its development and highlight some contributors. Finally, I will provide a more detailed description of the model that will be used for the analysis of the findings.

5.2.1 What is diffusion

Before discussing the theory, it is important to define the concepts of innovation and diffusion:

''An innovation is an idea, practice, or object that is perceived as new by an individual or other unit of adoption'' (Rogers, 2010, page 11).

'*'Diffusion is the process by which an innovation is communicated through certain channels over time among the members of a social system. It is a special type of communication, in that the messages are concerned with new ideas*'' (Rogers, 2010, page 5).

According to the *Oxford Handbook of Innovation* (2006), the difference with an invention, is that an innovation is the first attempt to carry it out in practice. It is also not unusual for there to be a substantial lag between the invention and innovation phase. Noteworthy is that innovation is a continuous process, as we continue to tweak it over time. When these new ideas are diffused and adopted or rejected by its members, it alters the structure and function of a social system. (Fagerberg et al., 2006).

5.2.2 The theory on innovation diffusion

Gabriel Tarde, a French sociologist played an important role in the development of an Innovation Diffusion Theory for social science. In his role as a lawyer, he observed several trends based on the legal cases he encountered. This sparked his curiosity and led him to investigate why some innovations are spread and others are forgotten. He stated that inventions diffuse by the process of imitation. This gave rise to his influential book on “The Laws of Imitation’’ in 1890 (French ed.) (Tarde, 1903). Another notable contribution to the field is made in 1922, by the American sociologist William F. Ogburn. He became one of the pioneers to explain social change from social-cultural premises. He suggests that technology is the main driver of progress, but that it is influenced by the social response to it. The four stages of technical progress that he suggests are; invention, accumulation, diffusion and adjustment (Ogburn, 1922; Ritzer and Ryan, 2010). Innovation theorist Schumpeter (1939) further emphasizes the vital role of technological innovation and talks about creative destruction, whereby preceding technology becomes obsolete. His focus is on economic change as well as the role of innovation, entrepreneurial activities and market power (Schumpeter, 1939). Important to note is that Tarde (1903) views the invention or innovation as the driver of social change, whereas Schumpeter (1939), attaches more meaning to the ‘’entrepreneurial function’’.

Several rural sociologists in the U.S then conduct diffusion studies on independent farmers. The most notable one is a study published in 1957, which summarizes the work that has been done on the diffusion of new ideas and farm practices in the preceding 20 years. They divide the adoption process into five stages: awareness, interest, evaluation, trial and adoption. Moreover, they look at the order of influence over time, which is now known as the typology of adopters (Beal and Bohlen, 1957). They proceed to validate the stage sequence together with Everett M. Rogers (Beal et al., 1957), who later generalizes the idea in his influential and comprehensive book *Diffusion of Innovations* in 1962. He describes the typology of adopters and proposes a framework to explain the rate of adoption (Rogers and Shoemaker, 1971). He does this by looking at the perceived attributes of an innovation and the social system in which it is to be diffused. This will be explained in more detail in the next section. The generalizations he makes are based on many preceding studies and he has updated his *Diffusion of Innovations* book several times, with the latest edition published in 2010.

Another important development occurs in the 1960s; the establishment of the Science Policy Research Unit at the University of Sussex in 1965. Led by Christopher Freeman, a team of interdisciplinary researchers focus on the role of innovation in both economic and social change. The increased emphasis on innovation and the research that followed, led to the launch of the journal ''Research Policy'' a few years later. Freeman is named editor of the journal and he publishes his book on *The Economics of Industrial Innovation* in 1974 (Fagerberg et al., 2006; Godin, 2017; Rogers, 2010; Valente and Rogers, 1995). Since then, many other types of adoption theories or technology acceptance models have sprung up in different organizational fields. Most do have, to a certain extent, some similarities with the Innovation Diffusion Theory. However, many are explicitly focused on the individual level and/or on human behavior, such as the Theory of Reasoned Action (Ajzen and Fishbein, 1980). Others are more mathematical and lend themselves well to forecasting (Bass, 1969) or to the identification of spatial patterns (Hägerstrand, 1953). Yet others are cross-disciplinary such as that by Rogers, but not as comprehensive (Valente, 1996). An example of another widely accepted model is the Technology Acceptance Model (Davis, 1989), which is the first one to include psychological factors as impacting technology acceptance. A similarity, is that both models look at the perceived usefulness and the perceived ease of use. It was later updated to also incorporate the social influence and cognitive instrumental processes and the effect of increasing user experience (Venkatesh and Davis, 2000). A more unified framework for the use of technology was proposed a few years later, which looks at performance expectancy, effort expectance, social influence and facilitating conditions, as well as several individual moderator variables such as gender and experience (Venkatesh et al., 2003).

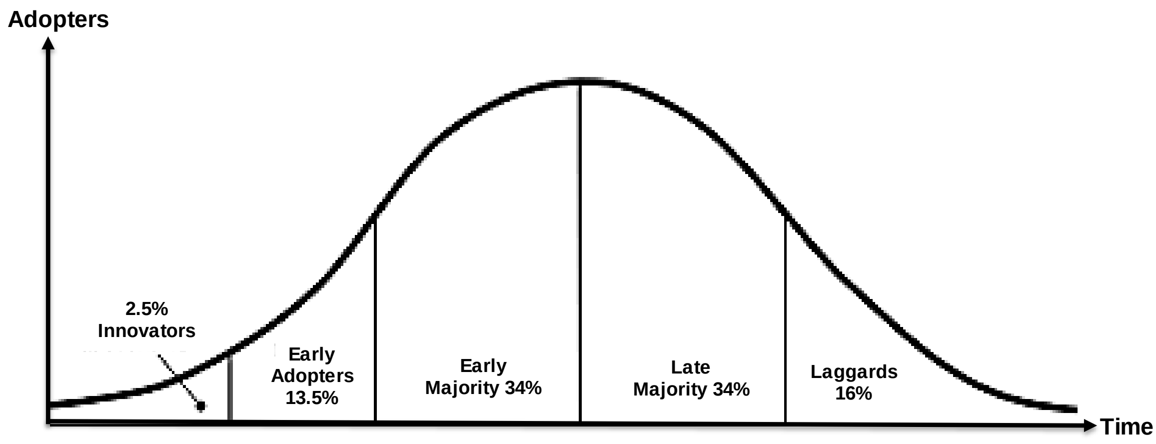
Compared to the framework by Rogers, it can be concluded that the other frameworks described are not that suitable for the investigation of ESG integration. This is due to their explicit focus on technology or on the individual level, whereas Rogers' framework is suitable for innovations as well as ideas and can be implemented at an individual and organizational level. Moreover, this framework consolidates at least 1,840 studies by many scholars from different disciplines. The elements he includes are those that are significant and most frequently researched (Midgley, 1987). The generalized elements described in the next section provide an interesting angle to investigate the rate of adoption to RI among AOs. They provide insight into the drivers of RI, the influence of the social/legal system as well as the impediments to adoption. However, it does not come without limitations. For example, the perceived attributes would have more explanatory power if collected prior to the decision to adopt, or reject an innovation. Moreover, the model does not consider the resources available to adopt a new approach. This is especially relevant for pension funds, as it is well documented that they benefit from economies of scale (Lum, 2006). Size is often a proxy for resources and hence innovative capacity (Baldridge and Burnham, 1975; Clark and Urwin, 2008). Many pension funds, however, are still too small and lack the resources and expertise to keep up with the larger ones.

5.2.3 Rogers' Innovation Diffusion Theory

Drawing on Rogers (1969, 1983, 1995, 2010) and Rogers and Shoemaker (1971), I elaborate on the innovation diffusion model. As can be seen in figure 9, time is an important element, given that it is used to indicate how long an individual/organization takes to make the decision to adopt or reject a new idea. It is also used in measuring how early or late someone is in the adoption process compared to others. For example, innovators have a shorter decision-making process than laggards do, as they are less resistant to change. It is also used to indicate an innovations' rate of adoption in a system. In his framework Rogers does not distinguish between a planned or a spontaneous idea diffusion, as his aim is to discover the most important drivers for both. (Rogers, 1962)

Based on the earlier described study by Beal and Bohlen (1957), Rogers describes the typology of adopters, ranging from the innovators, to the early adopters, the early majority, late majority and the laggards. The adopter categories follow a bell-shaped curve (see fig.9). The first group, the innovators (2.5%), are normally small compared to the others and little is required to persuade them. The second group, the early adopters (13.5%), represent opinion leaders who are open to change and need relatively little information to be convinced. Implementation instructions and ''how to'' documents often suffice. The early majority (34%) need slightly more, such as success stories and evidence, to be convinced. The more difficult work starts with the late majority (34%), as they are skeptical to change. What often helps, is to inform them of the number of people or organizations that have benefited from adopting the innovation. Both the early and late majority are the largest groups in his model. Lastly, the laggards (16%) present the most difficult case as they are very conservative. Other adopters can attempt to persuade them and statistics may be necessary to help convince them.

Figure 9. The Rate of Adoption of Innovations

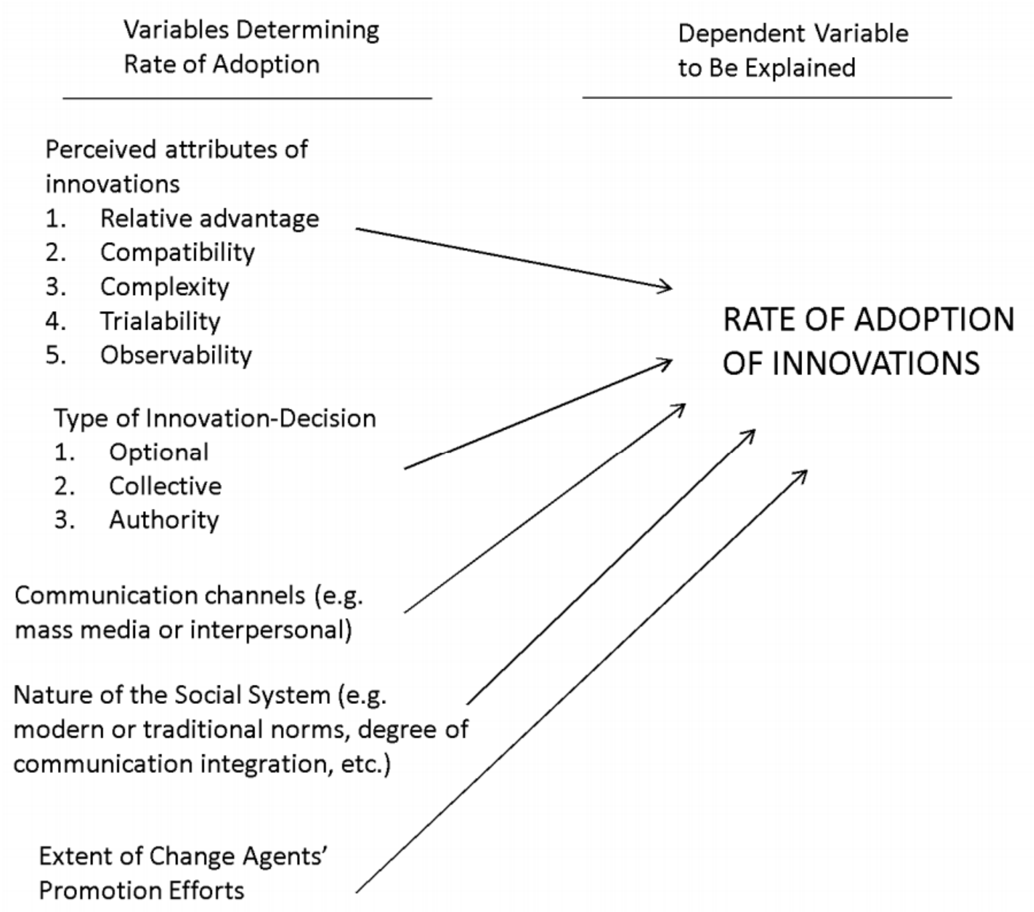


Source: Rogers (1962, 1995, 2010)

Rogers identifies several important attributes that explain the rate of adoption of innovations (see fig.10). The first set is related to the perceived attributes of an innovation and the second set is related to other attributes; the type of decision, communication channel, effort and the nature of the social system. The selection of the perceived attributes has been found to be the most important in explaining the rate of adoption, more so than individual attributes (Holloway, 1975; Ostlund, 1974). The first of these perceived attributes is *relative* *advantage*, which looks at whether the innovation is perceived to be better than the existing situation. Secondly, *compatibility* is important as the innovation is not likely to be adopted as quickly if it is not compatible with the dominant beliefs in a social system. Sometimes, this type of innovation requires the adoption of a new social value system. Third, *complexity* matters, given that more complex innovations take longer to be understood and accepted. If new skills and understandings are required, the rate of adoption will be slower. Fourth, *trialability* influences the rate of adoption as well. If a new idea can be experimented with, uncertainty decreases. An example of this, is the trial period for new software programs. Lastly, *observability* is an important factor, given that it is easier to adopt something if you can see that it works. Visibility also encourages discussion and this further helps to diffuse the idea or innovation.

The *type of innovation-decision*, *communication channel*, *nature of the social system* and *the degree of effort* put in by the change agent, also have a significant impact on the rate of adoption. First, the *type of innovation-decision* may be optional and is influenced by the norms or expectations of the social system. A decision could also be collective and based on consensus by members in a social system. Authority innovation-decisions are made by those members with power or status. Other members have no influence on this decision and simply need to implement it, which leads to quicker adoption rates. However, given the lack of consensus, members often find a way to depart from the rules. Another example is when two decisions are required, which is referred to as a *contingent innovation-decision.* The system may decide to implement a certain innovation, after which it becomes optional for members to adopt it. The nature of the innovation-decision may also change over time. Second, for the idea to spread, people need to talk about it. This brings us to the *communication channel.* After all, contact is when alterations and enhancements of ideas occur (Dixon, 1928). Mass media channels, such as the internet can be used to spread innovations quickly. However, a more effective channel, especially for complex ideas or innovations, is the interpersonal channel which entails a more in-depth face-to-face exchange.

Figure 10. Attributes that explain the rate of adoption of an innovation



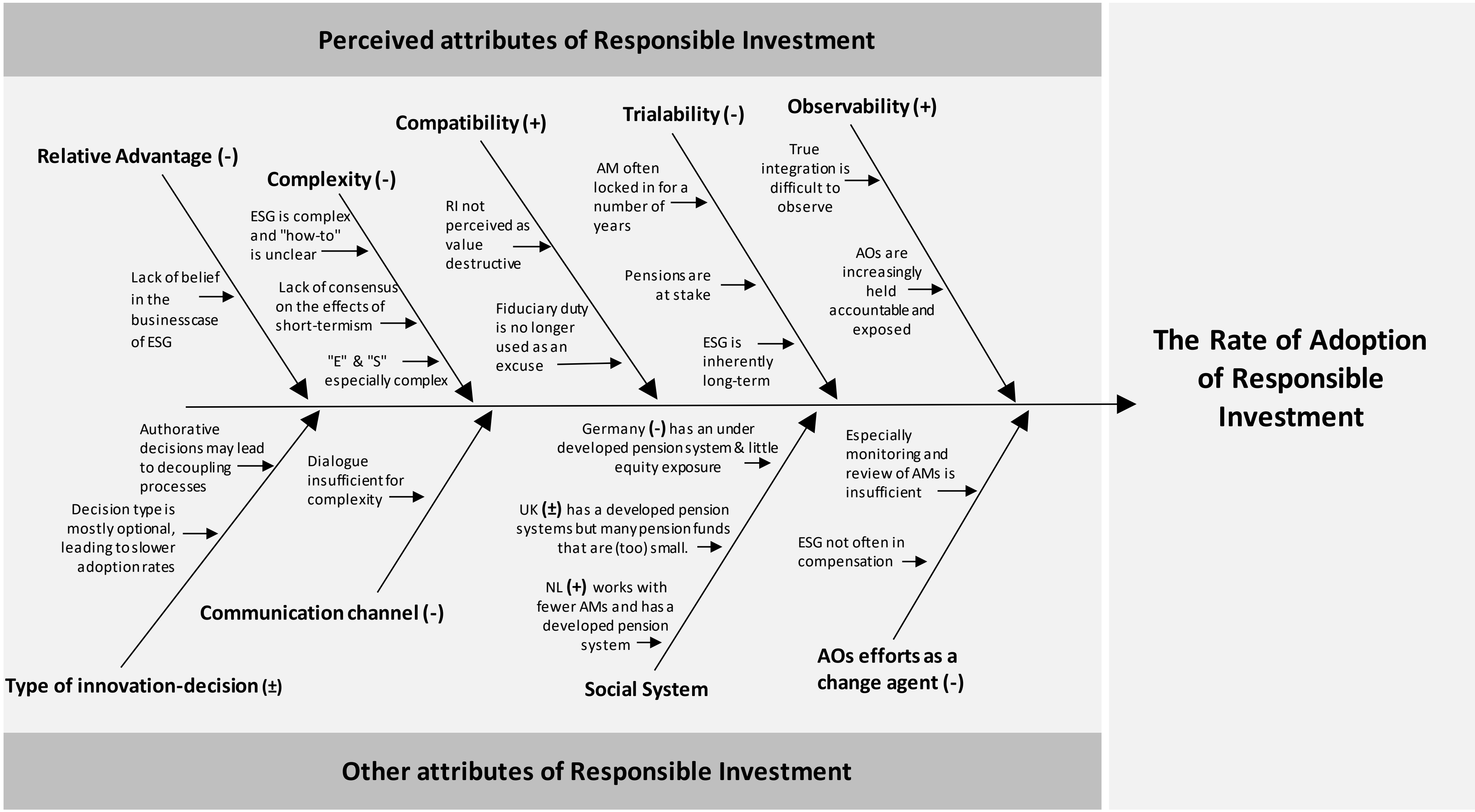
Source: Rogers (1962, 1995, 2010)

The *nature of the social system* matters given that larger, more complex and diverse systems slow down the adoption rate. Closely linked communication networks in a social system, on the other hand, boost the diffusion process. In the case of this chapter, it is important to touch upon the complexity and fragmentation of pension funds in the UK, the Netherlands and Germany. This may complicate or enable the adoption of RI. For example, Baldridge and Burnham (1975) argue that, in an organizational setting, size and complexity increase the ability of an organization to innovate. Lastly, the change agents' *degree of effort* can boost or stifle the adoption rate. In this chapter, this is interpreted to be the extent to which AOs lead by example and encourage their AMs to adopt RI. They can do this by means of a thorough selection, monitoring and review process.

5.3 The Rate of RI Adoption among AOs

In-depth interviews were conducted with 3 Dutch, 3 German and 4 UK AOs. The majority (seven) have more than €40 billion AUM. As expected, the larger pension funds are based in the Netherlands and the UK, as they have a long history of prefunded occupational pensions (Dixon and Monk, 2014). They all outsource more of their equity investments than they manage in-house, with one exception (see appendix 3 and 6 for details on the interview participants and survey instrument). This section will apply the above described framework to the interview findings, by first looking at the perceived attributes of RI; *relative advantage*, *compatibility*, *complexity*, *trialability* and *observability* I then continue with the other attributes; the *type of innovation decision*, the *nature of the communication channel*, the *nature of the social system* and the *degree of effort* made by the AO. The resulting RI diffusion model can be found in fig. 11 below. This figure serves as a summary of what is described in the sections that follow. Some findings were explicitly mentioned by respondents and others became clear as the interviews unfolded. If the attribute impedes the adoption rate of RI, this is indicated with (-) and if it facilitates adoption, this is indicated with (+).

Figure 11. The Rate of Adoption of Responsible Investment



5.3.1 Perceived attributes of Responsible Investment

Relative advantage (-)

When asked about the definition of RI, AOs do not mention “financial returns” or “business” as much as AMs or companies do. They do mention that, to them, it means risk management and impact on society, without compromising returns. Another survey among 475 global institutional investors also illustrates that the majority use ESG to manage volatility (State Street Global Advisors, 2017). However, this survey also finds that 68% of AOs indicate that integration of ESG had significantly improved returns. This is contrary to my findings, as less than half of the AOs interviewed believe that RI generates alpha. This encumbers the rate of adoption of RI, as AOs are not convinced of its *relative advantage.* The finding that there is uncertainty when it comes to the business case of ESG, is in line with other research (Juravle and Lewis, 2008).

Based on the literature review and the interviews with AOs, it is estimated that the innovators and early adopters have incorporated ESG successfully or are in the progress of doing so (Ambachtsheer, 2016; Clark and Monk, 2013). As described earlier, that means that the early majority now has to be convinced (Rogers, 1962, 1976, 2010). A solution is to win them over with more success stories and evidence. This could be provided by other AOs, but also by AMs, according to some of the respondents. Interviewees mention that it would help if AMs demonstrated the value-add of their ESG strategies more clearly. It is sometimes difficult to understand their competitive edge and to distinguish their marketing story from true integration. Along the same line, they would like to see better metrics to capture the materiality of environmental and social aspects and improved data credibility in general. These are all elements that would improve their understanding of what AMs are undertaking and how this adds value. Besides evidence on the business case for ESG, some interviewees also mention the need for evidence on the added value of long-termism.

Compatibility (+)

As described above, an innovation is not likely to be adopted as quickly if it is not compatible with the dominant beliefs in a social system. This type of innovation may require the adoption of a new social value system. An example of this, is the fiduciary duty debate. Since the 1970s, RI was believed not to be compatible with fiduciary duty. Many pension funds were therefore reluctant to adopt RI. To remove this barrier, the legal interpretation of fiduciary duty was changed in the spring of 2016 (EUROSIF, 2016). Previous papers have found that AOs still perceive RI not to be compatible with their fiduciary duty (Juravle and Lewis, 2008; Sethi, 2005; Sievänen, 2014). However, none of the respondents in the sample mention fiduciary duty as an obstacle. Although it is possible that the interviewees are more advanced than the average AO, it is encouraging that fiduciary duty is no longer used as an excuse *not* to take ESG into account. This is, of course, connected to the belief that the majority do not think that it decreases performance. It therefore does not clash with their fiduciary duty to begin with. Nevertheless, *compatibility* is not found to impede the adoption of RI.

Complexity (-)

More complex innovations take longer to be understood and accepted. When it comes to RI, it can be said that there is a lack of consensus and that new skills and understandings are required. As mentioned in the literature review, there are at least 37 different definitions of CSR (Dahlsrud, 2008). Not surprisingly, nearly all interviewees emphasize the need for education on ESG. Some interviewees highlight the difficulty of capturing environmental and social performance and that it would help if we had better metrics. The overall lack of consensus on what ESG means is a real obstacle, as this uncertainty weighs down on the adoption rate. The need for education is in line with other research, which identified this as an obstacle as well (Guyatt, 2006; Juravle and Lewis, 2008; Wagemans et al., 2013).

Half of the interviewees indicate that there is also a need for education on the benefits of long-termism. The detrimental effect of short-termism on companies has been subject to much debate (Brossard et al., 2013; Dent, 2010; Graves and Waddock, 1990). The AO interview participants are not in complete agreement when it comes to this discussion. Eight believe that the holding period of an investor affects the degree to which companies can focus on the long-term. This may be problematic for companies, as many investors are still focused on the short-term. These investors expect or require them to report to the market on a quarterly basis and thereby focus on short-term results. More than half of the respondents emphasize that they do not deem quarterly reporting to be necessary, as it is a self-fulfilling prophecy. They thus support that the regulation regarding quarterly reporting was lifted in recent years, although few companies have abandoned it so far (European Commission, 2013). Other AOs feel that companies attract those investors that suit them best. Thus, if companies become more long-term themselves, they will eventually attract long-term investors.

Overall, respondents emphasize the need for education and evidence on RI and long-termism. This was most frequently emphasized in the sample as an impediment to the adoption of RI. The uncertainty around RI weighs down on the adoption rate and has consequences for the way they select, monitor and review their AMs. This will be discussed in more detail in the section on the *degree of efforts* by AOs as change agents.

Trialability (-)

We have already established that RI is perceived to be complex. This increases the uncertainty that comes with an innovation even further. If an innovation can be experimented with, however, this reduces uncertainty and helps to convince adopters. Although it is easier to ''experiment'' with external managers than it is with internal managers (Wysocka, 2011), some respondents mention that their AMs have been with them for many years and that it is costly and time-consuming to switch managers. In fact, it is estimated to cost as much as 1-2% of the assets involved (Focusing Capital on the Long Term, 2015). This only further strengthens the case for a thorough AM selection process. RI is thus not an innovation one can easily experiment with. This is based on several reasons. First, pension funds of beneficiaries are at stake. Second, it is difficult to choose the right AM.

Lastly, it takes several years to see results. After all, RI is inherently long-term. This only further reinforces the case for education and success stories. Once more evidence is published, the need for *trialability* will not be as great. Uncertainty will be lowered as the *relative advantage* becomes clearer. Additionally, once AOs become more knowledgeable, they can better select those AMs that add value by incorporating ESG.

Observability (+)

Some evidence shows that especially larger and public funds tend to be under pressure to incorporate RI (Sievänen et al., 2013). Indeed, six of the respondents I interviewed said that they started incorporating ESG because of external pressure, such as the media, NGO's or beneficiaries. Some AOs mention an impactful television documentary on cluster bombs as a trigger point. This documentary by the (Dutch) investigative journalism program Zembla in 2007 not only exposed their investments to the public, but also made them more aware of their own holdings. Other documentaries on the role of pension funds and the controversial aspects of institutional asset management followed in 2011 and 2013. This served as a wakeup call for AOs to become more aware of their holdings. This outcome is in line with other research, which finds that public judgement and approval are drivers of organizational behavior (Baron, 2009; Meyer and Rowan, 1977). This is no surprise, as organizations tend to act according to societal expectations (DiMaggio and Powell, 1983). Especially when pension funds are large, it is difficult to escape from society's pressure (Sievänen et al., 2013).

To manage this external pressure, organizations may turn to policy-setting and box-ticking. AOs may display impressive investment beliefs and ESG policies on their website. Although this is a good start, it does not mean that ESG is integrated. In fact, theory suggests that external pressure for social performance encourages decoupling processes. A policy is an example of an action that is easily decoupled (Guyatt, 2006; Weaver et al., 1999). This type of decoupling is expected to occur when institutional legitimacy clashes with other organizational goals (Meyer and Rowan, 1977). Although this is a quick solution to mitigate external pressure, much more is needed besides a policy. When it is truly integrated, it affects every day decisions and all employees are held accountable to it. This is more likely to be the case when top management is committed to the cause (Weaver et al., 1999). Without a devoted leader, commitment and follow-through is unlikely. Respondents also mention the role of internal champions in starting the ESG journey, in combination with external drivers. The role of ''champions'' in ESG is in line with other literature (i.e. Hoepner and Majoch, 2016). The presence of external pressure can help a champion to give their issue a sense of urgency (Andersson and Bateman, 2000; Kotter and Cohen, 2002).

Overall, it can be said that *observability* is growing as AOs are increasingly held accountable for their impact on the world. The generational shift towards a more educated and connected generation also plays a role, as institutions are increasingly pressured to change (Weber, 2015) or under threat to be exposed. Visibility is thus increasingly important in driving ESG forward and has already pushed several AOs to integrate ESG. As discussed, true integration remains difficult to observe. Internal champions or devoted leaders may be necessary to mitigate the chance of decoupling. However, if AOs are exposed to have holdings that are not in line with their stated investment beliefs, this may indicate that their integration process is not as thorough as it seems. This, of course, tremendously helps *observability* and serves as a monitoring tool to mitigate agency issues between beneficiaries and pension funds.

5.3.2 Other attributes of Responsible Investment

Type of innovation decision

As described in section 5.1, the *type of innovation-decision* matters as well. The voluntary nature of current legislation (see appendix 2) has already been emphasized in the literature. In some cases, there is mandatory disclosure, demanding specific policies or an explanation as to what extent a pension fund takes ESG into account. There are several comply and explain rules in every country, especially in Germany, which can be categorized as the earlier described contingent innovation-decision. This forces pension funds to make the decision to consider ESG in their investments, or to explain why they do not. This will change around 2018, as the new EU Directive on pension fund regulation will come into force in member states. This makes it obligatory for pension funds of a certain size to consider ESG and to disclose how this is done in the Investment Policy Statement. This could accelerate the rate of RI adoption, but given that it is not based on consensus it could also lead to decoupling policies from action. Noteworthy is that the establishment of the EU has had a significant impact on convergence. This type of EU-wide regulation on ESG disclosure, makes the regulatory differences between the UK, the Netherlands and Germany increasingly less profound.

Nature of communication channels diffusing RI

As previously described, communication is a central element in the diffusion of an innovation. Exposing members of a social system to continuous ESG discourse, helps in making ESG the dominant paradigm. Especially given the c*omplexity* of RI, dialogue is important as this is a more effective communication channel (Nielsen, 2015). However, the findings show that there is currently insufficient dialogue between AOs and their AMs when it comes to ESG. It is not only the complexity of ESG that makes dialogue more difficult, but also the outsourcing of the investment function and the cooperation with, in some cases, many AMs. The Dutch AOs cooperate with only one or a small number of AMs. Interesting, is that they give more positive responses, when asked if they are happy with the way their AMs integrate ESG. They also have more intense dialogue with their AMs, which helps in diffusing RI. These appear to be the fewer and deeper relationships mentioned by the Kay review in 2012.

Besides *complexity*, differences in expertise also complicate personal dialogue. This is called heterophily (Rogers, 2010) and it is attributable to the lack of consensus and education on ESG integration. Given that the ‘‘how-to’’ of RI is unclear, many different approaches are taken. Moreover, some employees have completed formal training, others have worked in the field for a few decades and yet others have no background in ESG.

Some respondents indicate that there is an expertise gap between smaller and larger pension funds. Smaller pension funds often lack the expertise and resources to be at the forefront of the RI movement. This also makes it difficult for AMs to reconcile different client needs when working with various AOs. One respondent also highlights that investment consultants often lack expertise when it comes to ESG integration. Some research states that investment consultants in general tend to lack professional qualifications (Baxter, 2014). Having a dialogue then becomes more difficult as participants may be too different in their background, ESG expertise and beliefs.

Nature of the system in which responsible investment is to be diffused

The AO respondents are anchored in different countries, which may have a substantial impact on the extent to which they have incorporated ESG (Bauer et al., 2007; Garcia-Sanchez et al., 2015). As discussed in the literature review, differences may not only be observed between institutions, but also between countries (Bauer et al., 2007; Matten and Moon, 2008; Renneboog et al., 2008). ESG is a socially constructed term and it is the human actors in organizations, influenced by their discourse and politics who make and remake this construct. This is thus more than likely to vary between different institutional or social environments (E. Ortas et al., 2015). Although ESG regulation will briefly be discussed, the findings illustrate that especially the different pension landscapes seem to matter in explaining the rate of adoption of RI. These differences will therefore be the focus of this section.

Companies must conform to certain rules and regulations, which influences the adoption of RI. As has been described in the literature review, the Netherlands, Germany and the UK have different ESG regulations in place. This has already briefly been discussed in the *type of innovation-decision.* As can be seen from the policy/regulation overview in appendix 2, not only is most ESG regulation minimal, it is also often voluntary. Additionally, EU-wide regulation minimizes the differences between its members. As previously stated, regulation does not mean guaranteed success either, as institutions may try to find a way around it and decouple policies from action (Weaver et al., 1999). This may be less likely in countries such as the Netherlands, where management tends to be more participatory (Singh et al., 2005). Judging from appendix 2, they also have the least regulation regarding ESG, although the difference is minimal.

What appears to matter most, is that the pension systems in the Netherlands, the UK and Germany are inherently different (see appendix 7, fig. 15 - 18). The first two countries have a more developed pension system than the latter and hence tend to be home to larger funds. It is well-documented that larger funds benefit from economies of scales (Lum, 2006; MacIntosch and Scheibelhut, 2012). They may also be better equipped for innovation given that, to some extent, size is a proxy for resources (Baldridge and Burnham, 1975; Clark and Urwin, 2008). Larger pension funds may thus be more likely to adopt RI (Létourneau, 2015). The fact that the countries in the sample do not have equally developed pension systems therefore matters. For example, although the UK has many large funds, they also have many small ones. Given that respondents mention that there is often a gap in knowledge on RI between the smaller and bigger players, this could be an issue especially pronounced in the UK. Their pension landscape is changing though, as they have already halved the overall number of pension funds (see appendix 7, fig. 16) and will continue to consolidate. A promising development in the UK, is that 89 Local Government Pension Schemes (LGPS) in England and Wales will be pooling about £200 billion into 8 asset pools. This will be operational by April 2018 and is estimated to generate millions of pounds in savings for each of the asset pools (Baxter, 2016; Todd, 2016). The pooling of assets will also encourage *communication* among AOs and help bridge the gap between larger and smaller funds.

The Netherlands has reduced the number of pension funds from 800 to 365 between 2005 and 2015. The reasons are likely to be the search for economies of scale as well as cost reductions (OECD, 2016; Preesman, 2015). As mentioned before, it is interesting that none of the Dutch AOs in the sample work with more than a handful of AMs. This simplicity enables better interpersonal communication and seems to help when it comes to alignment regarding RI as well. Germany is a completely different picture from the UK and the Netherlands. Their pension system is still relatively underdeveloped (Kalus et al., 2016), with smaller and fewer pension funds. The number has also been relatively stable between 2005 and 2015. However, Germany has made some progress by allowing companies to bundle the pension assets of their foreign subsidiaries. Before July 2013, they were required to launch a pension fund for every country they operate in (Gold, 2014). If, as a result of all the consolidation, fees are lowered along with an increase in net returns, this will clearly be beneficial for beneficiaries and plan participants. This is likely to be the case, as the Pension Markets in Focus (2016) report finds that countries with 30-149 pension funds are more likely to achieve higher real net returns, as compared to countries with more funds.

Important to note, is that besides having a less developed pension system, German AOs also do not invest as much in equity as compared to AOs in the UK and the Netherlands (see appendix 7, fig. 17). ESG incorporation in equity is thus not likely to be as developed either. This is partially attributable to regulations in place on asset allocation, which is more likely in countries with a less liquid capital market and thus less investment experience. Common law countries, such as the UK, have deeper capital markets and provide pension fund managers with more flexibility with the ''prudent person'' rule (The World Bank, 2000). Although the equity cap in Germany is about 35%[8] (Gnaedinger, 2010), they merely have ~5% invested in equity. This compares to ~20% for the UK and ~40% for the Netherlands (OECD, 2016). Given the 35% ceiling, a buffer of 30% seems generous[9]. Regulatory restrictions alone can thus not explain their low exposure. Germany may not have what is called an ''equity culture'' (The World Bank, 2000). Germany, being a classic civil law country has less liquid capital markets and they have historically been more reliant on banks (Bauer et al., 2007; Chen and Bouvain, 2009; Dixon, 2014). One can argue that, due to the

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[8] Equity cap applies to the ''Pensionskasse'' and insurance companies
[9] A buffer is not unusual, given that equity can be volatile

low exposure to equity, AOs in Germany have less of a significant role to play than those countries with more equity investments.

The extent of the Asset Owners' promotion efforts in the diffusion of responsible investment

All interviewees prefer an AM who incorporates ESG in their investment strategies (all else equal) and about half of them do the selection process themselves. This can be complicated, given that there is no consensus as to what ESG entails. Indeed, the meaning of this varies. There were two German AOs who, during the selection, ask whether the AM is a signatory to the UNPRI and/or if they have an ESG strategy. This is not as thorough as the selection process of the other respondents. Signing the UNPRI does not necessarily signal meaningful change. In many cases, this is merely a box-ticking exercise to win mandates (Louche and Hebb, 2014). However, in other cases this signal for intent sets the accountability clock ticking (Kiernan, 2007). Other respondents have a comprehensive check list of how ESG is tackled by the AMs and how they define concepts such as materiality. Moreover, although the majority (6) appear to have a thorough selection in place, none have a specific preference for the way ESG is incorporated. Whether their AMs purchase ESG research or conduct it themselves does not matter to them, as long as they have some type of ESG strategy. This is no surprise, given the substantial size of some portfolios and the lack of a standardized ESG approach. This does, however, leave AMs with ample freedom. A potential solution is for AOs to clearly formulate sensible investment beliefs and select intermediaries in line with these beliefs. They should then not only check if the AM has an RI policy, but also find out what it entails and how it is integrated into investment decisions (Croft and Malhotra, 2016). If they can then better select AMs who are committed to RI, it would have a significantly positive impact (Louche and Hebb, 2014).

As discussed in the literature review, agency issues are reduced by clearly specifying agreements in the IMA and by monitoring AMs. This document stipulates the terms under which the agent is authorized to carry out the investment strategy (BlackRock, 2014; Clark and Monk, 2017). As previously described, these contracts come with problems of their own, such as short-termism. This is deeply entrenched in our financial system, through a fixation on short-term results and short-term bonuses (Gifford, 2015). Many active AMs point to short-term signals from clients as one of the reasons they make short-term decisions (IIRC Institute and Mercer, 2010). For example, monthly or quarterly reporting may be in place to minimize agency problems, but it stimulates AMs to cling to a benchmark. This can save them from long phases of underperformance and discourages them from making more active choices (Kay, 2012). When AOs rely on short-term AMs, the portfolio they claim they want and the one they have can be quite different from each other. This is referred to as the ''broken agency of institutional investing'' (Clark and Monk, 2013; Sheffer and Levitt, 2010). Most of the interviewees understand the adverse effects of asking AMs to report quarterly or monthly, although it is also part of their fiduciary duty to pay close attention.

If they want to lead by example, AOs should give the right signals and incentivize AMs to incorporate ESG (Louche and Hebb, 2014). Unfortunately, this appears to be in the very beginning stages, as very few interviewees have requirements or targets on ESG in their mandates. All Dutch AOs do it to some extent, 2 UK respondents do it and 1 German respondent. It must be noted, that the other two UK respondents are planning to make changes to their IMAs. It thus seems that the Germans are least developed in terms of ESG enforcement. The same goes when it comes to compensation, where none of the German respondents link it to ESG. However, ESG in compensation is not common, given that only 2 Dutch and 2 UK respondents have this integrated to some extent. For the most part, this entails some type of qualitative review. Some have KPIs or ESG targets that help them to rate performance. One respondent also links it to ESG ratings of the portfolio. Most also emphasize that the actual performance evaluation is done over a period of three years. Although the time horizon for compensation is ideally done over a longer timeframe, in practice it is difficult to go beyond 3-4 years. Ambachtsheer (2016) suggests removing artificial pay ceilings and developing a clear view as to how investments should be benchmarked. He also recommends developing and integrating a more explicit risk-adjustment protocol regarding the calculation of investment-related pay for performance. Costanzo (2011) emphasizes that the fee schemes should be more linked to the achievement of objectives, as opposed to the managing of assets. This would produce a remuneration model in the interest of both AOs and AMs.

A solution to these agency issues, which is also considered best-practice, is to develop the expertise in-house and to skip intermediaries all together. As noted in the beginning, this is not feasible for smaller funds. However, according to the estimated $25 billion threshold by Dixon and Monk (2014), at least seven of the respondents in the sample should be able to manage their investments in-house. Larger funds with internal management also benefit from other cost savings (Andonov et al., 2015; Bauer et al., 2010; Dyck and Pomorski, 2011; Lum, 2006; MacIntosch and Scheibelhut, 2012). In addition, it brings the AO closer to portfolio companies, reducing the likelihood of agency issues (Ambachtsheer, 2016; Tilba and Wilson, 2014). This model is therefore likely to be more conducive to RI and long-termism as well, as there are fewer bottlenecks in the investment chain. Several frontrunners (i.e. Ontario Teachers' Pension Plan) have already adopted this model, but the change is not easy and comes with its own challenges (Clark and Monk, 2013). If AOs still opt for outsourcing, as illustrated in this section, alignment with AMs is key as there are many potential agency issues. Enforcement is lacking and there is a gap between what is desired by AOs and what is delivered by AMs. AOs claim that they do exert pressure on their AMs to incorporate ESG in their investment strategies, but when asked the same question, AMs claim that AOs do not challenge them enough. This may change in the coming years, however, as most AO interviewees are exploring more systematic ways of incorporating of ESG criteria into the selection, monitoring and review process. This will help diffuse RI, as AMs will experience more pressure from their clients.

5.4 Discussion and Conclusion

Although there are theoretical ideals and expectations of AOs, their ownership behavior is based on assumptions: reality paints a different picture (Tilba and McNulty, 2013). They are the cornerstone of our capitalist system and could , if they want to be consistent with the SDGs, put a stop to many of our environmentally and financially destructive practices (Barton and Wiseman, 2014). Some frontrunners have illustrated how to go about this, with innovative approaches and better returns as a result (i.e. Ontario Teachers' Pension Plan[10]). Others are lagging behind. Some research indeed states that AOs have, overall, been slower to adapt as compared to AMs (Hoepner and Majoch, 2016; Louche and Hebb, 2014). Other evidence points towards AMs as an impediment in mainstreaming RI (Nicholls et al., 2015; OECD, 2011). The problem is thus, that it is not clear why some AOs are more ahead than others. To investigate this, this chapter draws on ten interviews with AOs in the Netherlands, the UK and Germany and analyses them in the context of the Innovation Diffusion Theory (Rogers, 1962).

The findings indicate that many of them have made great strides and that AOs prefer an AM who incorporate ESG (all else equal). As can be seen in figure 11, looking at the perceived attributes*, relative advantage*, *complexity* and *trialability* are found to impede the adoption of RI. Given the few AOs that have truly incorporated ESG (either in the outsourced or insourced model), it is estimated that the innovators and early adopter group are there (MacIntosch and Scheibelhut, 2012), but the early majority has to be convinced. As mentioned previously, this can be done with evidence and success stories. Education and dialogue are also necessary to help manage the complexity of RI. An interesting finding is that *compatibility* is not an issue. Fiduciary duty is not mentioned once as an obstacle, which is connected to the finding that none of the respondents believe that RI destroys value.

[10] For example, the Ontario Teachers' Pension Plan (OTPP) has outperformed its policy benchmark portfolio by 2% annually over its history of more than 20 years (Ambachtsheer, 2016)

However, they also do not all believe that it generates alpha. This may very well be the reason that not everyone translates their claimed preference for ESG integration into action.

I also find that the *degree of effort* made by AOs as change agents is insufficient. Although the selection effort is there in six of the cases, they generally do not have a thorough approach for their monitoring and review process. There is too much uncertainty around how to capture ESG and many thus struggle to incorporate this into an IMA. This is in line with Louche and Hebb (2014), who state that AOs should be more assertive and incentivize AMs to incorporate ESG. Overall, findings indicate that AOs, in some cases, do not believe enough in ESG to pressure their AMs to incorporate it. In line with other research, I argue that AOs must believe that RI enhances returns, for it to become mainstream (Guyatt, 2006; Juravle and Lewis, 2008; Sakuma-Keck and Hensmans, 2013). If it does not truly become part of the mindset, the incorporation of ESG is unlikely to be thoroughly carried out. Given that there is a lack of belief in its potential, more evidence and education is necessary. If companies and AMs report the added value of ESG, this would help convince AOs that this is the right way to go. Moreover, AOs can do the same by learning from each other and by opening the dialogue. The asset pooling by LGPS can also prove to be a good stride for RI, given that some smaller pension schemes will be working with larger and more advanced players.

Looking at the different countries, Dutch AOs are more advanced than the UK and Germany. They cooperate with fewer AMs and thus have closer relationships. Their monitoring process is thus less complex and can be more intensive. These deeper but fewer relationships have been recommended before (Kay, 2012) and they appear to be more conducive to RI as well. UK respondents are also working on translating their words into action, although they still tend to work with many different AMs. Pooling assets and making the space more competitive for AMs may help improve their situation considerably. It has become clear that Germany is a laggard in this sample. However, as previously argued, their pension system is less developed and equity exposure is much lower (OECD, 2016).

It can therefore be said that they do not have as much weight to pull as those AOs in the UK and the Netherlands. Noteworthy, but not highlighted in the findings, is that good governance is a prerequisite in successfully adopting RI. Without effective monitoring and review processes in place and managing everyone involved, it is unlikely for a pension fund to lead the way forward (Ambachtsheer, 2016; Ambachtsheer and McLaughlin, 2015)

The findings in this chapter have significant implications for everyone involved in RI and for those interested in being consistent with the SDGs more generally. We need to continue educating and publishing evidence to learn from each other and to convince major actors, such as AOs, that there is a business case for ESG. Encouraging progress has been made, although it takes time before real changes occur. Beneficiaries or plan participants should make their voices heard, as external pressure is an important driver. Practitioners should think about the *complexity* in their investment-making process and whether this obstructs their efforts to incorporate ESG. If they are still convinced that external management is a better option for them, they should think about how to make the right AM selection. Finding an AM that is most aligned with their beliefs takes up resources, but it is better to do this right once, as opposed to having to repeat this. Truly understanding the AM's ESG strategy and beliefs is crucial to identifying whether they are the right choice. Finally, AOs should ensure that there are clear IMAs in place to enforce their intentions and to further increase alignment.

Given that, in many cases, the right enforcement is lacking, the next chapter is likely to show that AMs do not make as much effort as they could be making. We already know that there is a disconnect between companies and their investors, which is currently ineffectively bridged by the ESG rating/ranking industry. Similar misalignment appears to be present between AMs and their clients. As previously noted, although AOs believe that they exert pressure on their AMs regarding RI, AMs do not think that they are sufficiently challenged. If RI is already obstructed at this level, it is reason for concern given that there are many more parties involved. If RI is plagued by impediments at every level, this deserves prompt attention as mainstreaming will otherwise not become a reality. The extent of the misalignment issues will further be explored in the next chapter on AMs. I will thus continue to build on this evidence and explore the way AMs cope with the lack of pressure and direction from AOs.

Although most of the AO respondents are significant players with a corresponding significant opinion, the sample was rather small. It would be interesting to research, on a larger scale, why so many large AOs still outsource investment-decisions. Several papers have now been published on the cost-savings of internal management, but few AOs are actually doing it (Ambachtsheer, 2016). Although significant changes will have to be made to make this shift, good governance can support this (Clark and Monk, 2013). Another interesting avenue is to take a case study approach and to investigate the role of champions and external pressure regarding RI. The interviews illustrated that external pressures were important, but it is difficult to establish a link with internal drivers. Literature on decoupling processes suggests that both drivers are needed to achieve real change (Weaver et al., 1999). It would thus be interesting to investigate this process in one or several large AOs.

6 Asset managers' ESG strategy; lifting the veil

6.1 Introduction

As set out in the literature review, the AM acts as an agent or a steward of their clients' interest. Their main goal is to enable them to reach their investment objectives (Desmartin, 2015; EFAMA, 2015; Søndergaard, 2014). Although guided by their clients, they are at the heart of managing supply and demand. This makes them a vital link in financing the needs of the real economy, through shares, bonds or other products (Costanzo, 2011; Desmartin, 2015). However, we do not know much about the way they incorporate ESG, why they do it and what hinders them. As previously pointed out, the lack of qualitative research can be attributed to the excessive focus on the "why'' (or financial sense) of ESG, which has now largely been answered by the literature. We, however, do not know much about the ''how'' to go about this in practice (Capelle-Blancard and Couderc, 2009; Clark et al., 2015b; Fulton et al., 2012). The transparency documents on the UNPRI website illustrate that there is no consensus among AMs; they take widely different approaches to RI. This lack of consensus and standardization implies that many of them are not properly taking ESG into account (Eccles et al., 2012; Hayat, 2014; Kiernan, 2007; van Duuren et al., 2015). Indeed, evidence suggests that few AMs are truly incorporating ESG into their investment decision-making processes (Cappucci, 2017; Guyatt, 2006; Juravle and Lewis, 2008).

The reasons for the lack of integration have not been thoroughly explored in the literature. This is unfortunate, since AMs are a crucial link in the investment chain (Desmartin, 2015; Sandberg, 2011). The adoption of RI may be stymied by this significant intermediary. To determine this, we must explore this layer of the investment chain. It is possible that a true ownership mentality is lacking (Aras and Crowther, 2016), or that there is ambiguity and a lack of knowledge on RI (Busch et al., 2016; Sørensen and Pfeifer, 2011). Unfortunately, investors often lack the training on how to interpret and use ESG data to their advantage (Juravle and Lewis, 2008; Munro, 2015; Searcy and Elkhawas, 2012). Moreover, as described in the preceding chapter, agency issues likely arise between the AM and their clients (Costanzo, 2011; Desmartin, 2015). As demonstrated, AOs are not always convinced of the business case of ESG. This likely results in a lack of pressure on their AMs to incorporate ESG. Additionally, as established in the fourth chapter, the extensive reliance on the ESG rating and ranking industry comes with drawbacks. One is that companies and AMs do not tend to have comprehensive conversations when it comes to ESG. This was already pointed out by UNEP FI in 2010, but it is, unfortunately, still the case. The lack of dialogue between companies and AMs, as well as between AMs and clients, raises questions on what AMs are doing and why they are doing it. Has it become more about demonstration than integration? (Guyatt, 2006; Kemna and van de Loo, 2009; Louche and Hebb, 2014; Sakuma-Keck and Hensmans, 2013).

This chapter will investigate how AMs approach ESG and whether they are the weak link in the investment chain. I conduct 15 in-depth interviews with AMs in the Netherlands, the UK and Germany (see appendix 8). The interviews examine the motivations of AMs and how they perceive RI. They also shed light on how AMs incorporate ESG and what some of the barriers are. Is it possible that, as indicated in a recent survey, AMs do a poor job at incorporating ESG in their investment strategies (Nicholls et al., 2015)? To explore these issues, I start out by describing the framework. I build on the institutional forces (as described in the literature review), to better understand the type of pressure AMs encounter. To explain the way AMs make sense of RI, I draw on sense-giving and sense-making literature. The way they perceive it, is likely linked to how it is implemented. Additionally, given that organizations do not necessarily conform to these normative, coercive and mimetic isomorphic forces, I also describe avoidance strategies such as decoupling. As established in the preceding chapter, some AOs have trouble identifying those who match words with action and those who do not. Obviously, from an asset-gathering perspective AMs are interested in signaling competence regarding ESG. This pressure to demonstrate expertise, is likely to lead to decoupling, intended or not. Lastly, I list the barriers that surfaced during the interviews. Adding these elements to the findings from previous chapters, enhances our understanding of whether the AM stymies the adoption of RI in the investment chain.

6.2 Organization theory

As discussed in the literature review, organization theory is a very rich and diverse discipline, drawing inspiration from a wide range of studies ranging from natural and social sciences to the arts and humanities (Hatch, 1997). A complete review of organization theory is therefore far beyond the scope of this thesis. Instead, I build on the analytical building blocks outlined in the literature review and only focus on the elements that underpin the later analysis of the interviews. In the sub-sections below, I outline the theory I use to explore why AMs may not match words with action. Many polished reports have been published in recent years on what everyone is doing, but reality paints another picture.

I start by discussing organizational identity to highlight the complexity of incorporating new values. I then discuss the way organizations make sense of their environment. This later helps to provide insight into the way interview respondents make sense of RI and implement it. The beliefs around RI are likely linked to how it is implemented. To recall, the general institutional forces to adopt ESG are described in the literature review. I also apply these forces to the environment of the AM specifically, but this is provided at the beginning of the results chapter: section 6.3.1. One of the critiques of Dimaggio and Powell's infamous framework, however, is that organizations are not always passive and conforming. They may, in fact, protect themselves from their environment. I therefore end the theoretical framework with a section on how organizations may evade the normative, coercive and mimetic institutional forces proposed by these authors.

6.2.1 Organizational Identity

Edgar Schein argued that one of the problems in defining organizational culture ''derives from the fact that the concept of organization is itself ambiguous'' (Schein, 1990, p. 111). Nevertheless, he made a valuable contribution to the literature by creating a model of organizational culture in 1985. The three levels he identified were; basic underlying assumptions, values and then the outer layer of observable artefacts. The former is at the core of the organization and often starts out as organizational values. These values then gradually become taken for granted as they defy the test of time. At this point, they are no longer questioned or up for discussion. Given that it is so deeply embedded, it is difficult to change. Assumptions influence people, i.e. in the way they perceive things and how they think and feel, but exist outside of ordinary awareness. Values are less taken for granted and people are thus generally more aware of them. They can occur in the form of principles, goals, standards, ideologies, philosophies etc. They can be best identified by means of open-ended interviews. Schein described artefacts, the outside layer of organizational culture, as something you feel and observe when you enter, such as the dress code, statements of philosophy, annual reports etc. These artefacts, however may not tell the whole story, especially when the underlying assumptions of the organization are not known (Hatch, 1997; Schein, 1985, 1988, 1990). This three-level model has held up well since its inception (Schein, 2016) and it sheds light on how difficult it is for an organizational culture to change its values.

6.2.2 Sense-making and sense-giving

Strategic change can be defined as ‘’an attempt to change current modes of cognition and action to enable the organization to take advantage of important opportunities, or to cope with consequential environmental threats’’ (Gioia and Chittipeddi, 1991, p. 443). A manager’s main role in initiating the strategic change process is probably best understood in terms of ‘’sense-making and ‘’sense-giving’’(Gioia and Chittipeddi, 1991).

The interdisciplinary field of sense-making is rooted in cognitive science and sociology. Sense-making is defined as the process of social construction, which happens when a person’s ongoing activity is disturbed by conflicting signals. It also encompasses the retrospective process of probable meanings that rationalizes what people are doing (Maitlis and Sonenshein, 2010; Weick, 1995; Weick et al., 2005). Managers must make sense of what is happening around their organizations and act upon the information they gather. As described above, this is most likely triggered when there are changes in the environment. Sense-making and sense-giving thus involve processes, whereby top management tries to determine what certain strategy relevant events, threats or opportunities mean for their organization. They then create and circulate their interpretation, or vision, which likely inspires employees or other stakeholders to incorporate and understand it. According to Gioia and Chittipeddi (1991), top-management can be pictured as architects, assimilators, and facilitators of strategic change. Their perceptions are powerful, given that they set enactments in motion, which subsequently confirm those perceptions. For example, if they do not think a given unit is important, it is unlikely that this unit will thrive (Weick, 1988). The acts of making sense of new information and translating this into a new vision for the organization, are key processes involved in initiating and managing change.

Daft and Weick (1984) used two key dimensions to explain organizational interpretation differences. The first is a manager's beliefs about the extent to which the external environment can be analyzed. The second is the extent to which the organization actively searches for answers. Examples of actively searching for answers are hiring consultants or attending a training course. Actively searching for answers can be described as enactment theory, in which sense-making is a mutual exchange between actors (enactment) and their environments (ecological change). They will keep occurring only, if the preserved content is believed or questioned in future exchanges. This reciprocal relationship includes sense-making actions such as sensing irregularities, enacting order into flux and being shaped by the environment. The organizing elements include ''noticing'' and ''bracketing'' as an organization starts to order- and make sense of ambiguity. During the ''selection'' stage, possible meanings get reduced by way of retrospective attention, mental models as well as articulation. The outcome is a locally plausible, but a tentative and provisional story. This story then gains solidity during the ''retention stage'' as it is linked to past experiences, significant identities and as it is used as a basis for subsequent action and interpretation

(Weick et al., 2005, 2009). It must be emphasized that this ‘’cycle’’ is triggered or updated, only with uncertain use of previous knowledge (Daft and Weick, 1984; Weick, 1988, 1995; Weick et al., 2005). Gioia and Chittipeddi (1991) argue that this cycle of sense-making and sense-giving occurs at every organizational level, as the meaning of strategic change is unlocked.

Managers may adopt institutional logics for no other reason than to gain legitimacy. This may, however, obstruct longer-term adaptation, which happens when organizational members are unable to make sense of their leaders’ proposed vision. This is not an unlikely scenario, given that scholars believe that all sense-giving is a response to an ambiguous, troubling or confusing situation (Maitlis and Lawrence, 2007). Managers may engage in labelling and categorizing in order to make sense of this chaos (Weick et al., 2005). They may be motivated by a desire to demonstrate conformance with expectations and engage in sense-giving by way of labelling. Unfortunately, this type of behavior may, in fact, impede organizational sense-making and sense-giving. New visions should be built into the core strategy and core value of the organization. Otherwise, their genuine efforts are likely to be rejected or resisted (Sakuma-Keck and Hensmans, 2013). To state it differently, if top management only cosmetically adopts certain beliefs, these mixed signals will impede the adoption of institutional logics. Engaging in significant sense-giving then becomes even more difficult. This may occur when management has a limited affinity or understanding of the ‘’threat’’ in question and when it concerns an already ailing part of the organization (Sakuma-Keck and Hensmans, 2013).

Gioia et al. (2012), on the other hand, proposed that ambiguity in managerial talk is not a bad thing, as it can facilitate successful change. The authors therefore argued that it is best to be deliberately vague when making substantial changes in an organization. They explained this by drawing on the complexity of modern organizations. They pointed out that various people with different agendas, preferences, power bases and expertise are involved (Daft and Weick, 1984; Gioia et al., 2012). These differences can thus interfere significantly in substantive change efforts. When top management is deliberately vague, this shakes up the status quo, making it easier for members to adapt to. The authors therefore claim that ''substantive change will only occur, if there is a change in ways of conceiving the organization and its purposes and directions'' (Gioia et al., 2012, p. 370). This alone is not sufficient though, as the induced state of flux needs to be ceased and existing knowledge needs to be revised. At the cognitive level, members can modify their frameworks for understanding, by limiting their sense-making to suit their own job description (Etzion et al., 2015; Gioia et al., 2000, 2012). ''Ambiguity, then, is not the enemy of order, but a means by which orderly transitions can occur'' (Gioia et al., 2012, p. 371).

6.2.3 Coping with institutional forces

As described above and in the literature review, change might be challenging considering how deep certain assumptions reside in the organizational core. Even organizational values can be difficult to change, as an organization is used to a certain way of doing things. They may therefore resist the institutional forces for change that are described in the literature review (and further elaborated on in section 6.3.1) Avoidance is, in fact, an important response to institutional pressure (Meyer and Rowan, 1977; Oliver, 1991; Pfeffer and Salancik, 1978). It can be defined as ''the organizational attempt to preclude the necessity of conformity'' (Oliver, 1991, p. 154). This can be achieved through several mechanisms; buffering, boundary spanning and decoupling.

Buffering and boundary spanning

Although buffering and boundary spanning roles can overlap, the former concerns material requirements and the latter entails information needs. They concern two different lines of arguments. Firstly, buffering is focused on central work processes and how they can continue, uninterrupted by its environment. Closing the system artificially is an example of buffering. This can help in protecting the technical core from issues such as capital- or material shortages. For example, a purchasing person is assigned so that production employees' activities are not interrupted. Buffering thus amplifies the protective boundaries of the organization. Boundary-spanning, on the other hand, is more about modifying the boundaries of the organization. It is about making an organization more fluid and adaptable to its environment. It therefore entails bridging strategies between organizations and their environment (Scott, 1998). Boundary-spanning concerns ''activities of members or agents of an organization that serve to functionally relate the organization to its environment'' (Adams, 1980, p. 328). This mainly concerns the transfer of information across the organization's boundary and thus the representation of the organization and its interests to the outside world. This has also been described in the literature as ''flak-catching''. For example, special offices are established specifically to display concern for issues important to society. They symbolize commitment, but in reality, shield the core of the corporation from external pressures (Feldman and March, 1981). Thompson (1967) argued that those units that are not part of the technical core are boundary-spanning units. An example of this is the IR department. They are the link to the environment and must cope with- and adjust to the limitations and demands from the environment. As opposed to having the entire organization manage all units of the environment, structural units are assigned to cope with homogenous segments of that environment. They may become powerful within the organization, but organizational dependence raises questions on their commitment to- and integration into the organization. Moreover, they are considered to be ''more distant, psychologically, organizationally and often physically, from other members of his organization than they are from each other'' (Adams, 1976, p. 1176).

Adams (1980) argued that boundary roles have five different functions; acquire organizational inputs and dispose of outputs, filtering of inputs and outputs, the search for- and collection of information, representation of the organization to the external environment and lastly, the protection of the organization. The latter can be achieved by buffering it from potential external threats or pressures. As can be derived from these roles, impression management is a big part of boundary-spanning. In fact, the inability to present an advantageous picture of the organization, may lead to a loss of social support or legitimacy

(Adams, 1980). Boundary spanning roles may be used to ceremonially conform to certain expectations, whilst sticking to ''business as usual''. Stated differently, these roles may help an organization to engage in decoupling processes[11]. This type of resistance is likely to be higher when the perceived economic gain from conformity to institutional pressures is low (Oliver, 1991).

Avoiding institutional forces: decoupling

The institutional environment may be fragmented and generate conflicting signals. This tends to amplify uncertainty (Oliver, 1991; Pfeffer and Salancik, 1978). This uncertainty is very much part of today's society, as the number of incompatible external pressures is ever-increasing. This creates heterogeneity and complex organizational structures (Bromley and Powell, 2012, p. 35). Formal policies may thus be more of an idealistic representation of organizational action (Weick, 1976). These elements are merely a reflection of the environment. However, this reflection is crucial as organizations seek legitimacy and attempt to avoid sanctions or scrutiny. The environment may also create pressures that are at odds with internal efficiency (Meyer and Rowan, 1977). A solution to both is thus to cosmetically adopt rationalized myths, but to continue 'business as usual'' (Boxenbaum and Jonsson, 2017; Meyer and Rowan, 1977). This is also called ''decoupling'', which can be defined as ''a process by which organizations respond to institutional pressures, for which they may or may not have the capacity, willingness or affinity'' (Bromley et al., 2013, p. 488). This contrasts Weber's assumption that formal organizational elements are closely related to day-to-day activities. In their search for legitimacy, organizations may pretend to adopt certain widely-held beliefs or ''rationalized myths''. This is done ''to maintain technical efficiency in a competitive quest for survival'' (Boxenbaum and Jonsson, 2017, p. 93).

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[11] I am aware of the large body of research on transaction and coordination costs that arise from decoupling. Coase (1937) helped lay the foundation for outsourcing with the Coase Theorem and Williamson (1979) expanded on this with the concept of Transaction Cost Economics (TCE). He looks at the full costs of doing business and zooms in on the cost of contracting, negotiating and governance processes. Similar costs can be observed when decoupling processes within the organization, such as coordination costs, which did not exist before the decoupling.

6.3 Results and Discussion

The above described theory is used as a lens for the findings. Before I apply the theory to the findings, I elaborate on the ESG environment faced by AMs. I then proceed with the interview results, starting with what drives AMs to adopt ESG, after which I will talk about the way they perceive ESG and how it is implemented. Finally, I will list the barriers that were explicitly mentioned by interview participants (see appendix 8 for information on the participants).

6.3.1 The institutional forces to adopt or discount ESG

As described in the literature review, organizations face normative, coercive and mimetic forces. These forces can also be helpful in assessing the environment of the AM when it comes to ESG. Starting with normative forces, the extent to which it is taught in business schools tells you how wide-spread this concept is (Kotler and Maon, 2016). Another sign is to look at business or professional associations that promote it (Campbell, 2007; Galaskiewicz and Burt, 1991). Although this is slowly starting to change, most business schools and industry certification bodies have not yet integrated it (Krosinsky, 2015). Of course, the UNPRI must be noted, given that they diffuse the idea that ESG should be integrated into investment decision-making (Gond and Piani, 2013). As can be seen in figure 12 below, there has been a steady increase of AM UNPRI signatories in the Netherlands, Germany and in the UK[12]. Regardless of whether they actually implement the RI principles, they are still subjected to ESG discourse. This can, over time, become the ‘’new normal’’ for them. It is also likely that those AMs who collaborate with many other organizations who are interested in ESG, are more prone to start their own journey. Moreover, as described in the ESG rating and ranking chapter, there are a myriad of other initiatives that also exert pressure on organizations and diffuse the idea that ESG should be part of the dominant

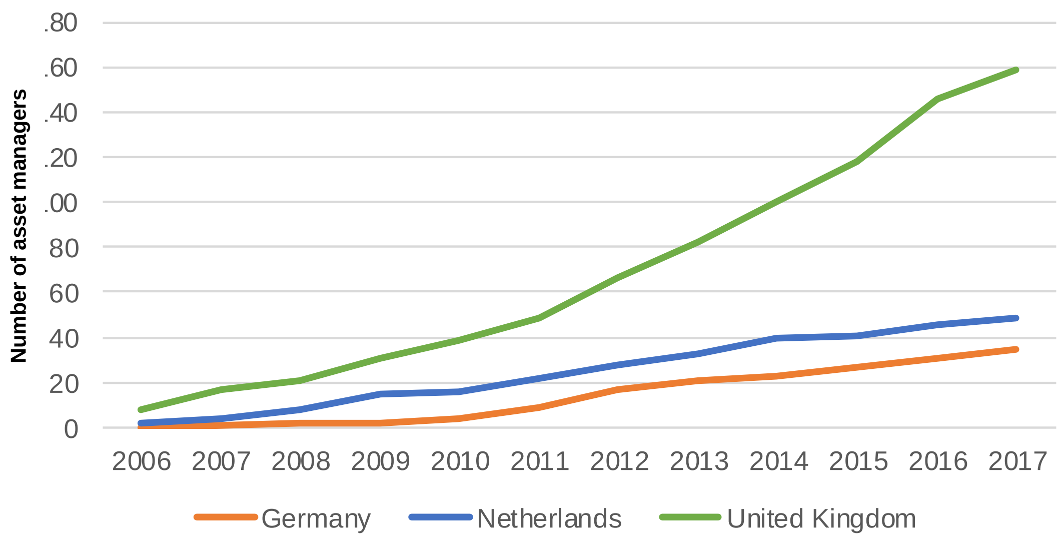
[12] Obtained from www.unpri.org/directory. Taken together with EFAMA (2017), percentages can be derived. As a percentage of total AM companies in the respective countries, more Dutch AMs have signed up than UK AMs have.

paradigm. Lastly, in the three developed countries I investigate, citizens have a chance to participate in the public policy process in combination with free press. Létourneau (2015) finds that institutional investors are more likely to have RI policies in place in these countries, as they are more subjected to pressure. Hence, although AMs may not have the expertise, the expectation to incorporate ESG (and to be consistent with the SDGs) is increasing. Given that the language around ESG is changing, sense-making is triggered because ''sense-making is an issue of language, talk and communication'' (Weick et al., 2005, p. 409).

As to coercive pressure, this may not be the main driving force because, besides some disclosure requirements, most regulations concerning ESG are voluntary (see appendix 2). Additionally, most of this ESG or disclosure regulation is either directed at the AM's clients (AOs) or at their portfolio companies. This is expected to change going forward, with coercive pressure in the form of regulation becoming stronger, given the urgent case for action. For example, one recent regulatory development is the previously mentioned EU Shareholder Rights Directive. As discussed in section 3.5.2, the 2017 update of the EU Shareholder Rights Directive aims to improve the uptake of long-term shareholder engagement. As discussed, it does this by addressing short-comings with regards to several issues, such as short-termism, shareholder identification and insufficient oversight on directors' pay (Say on Pay). Moreover, it mandates disclosure of the engagement policy, as well as a description of the investment strategy. The directive is expected to both stimulate investors to engage and to improve their ability to do so. It will also encourage them to think about their investment strategy and increased transparency will decrease the likelihood of decoupling words from action. Moreover, the directive will likely have an impact on the ESG uptake among companies targeted by investors. At the time of writing, however, this directive has not yet been implemented and at the moment, coercive pressure in the environment of the AM is more likely to come from clients. Given their significance, AOs can form an important coercive force and drive AMs and portfolio companies to go beyond minimum regulatory guidelines. However, as established in the preceding chapter, there is still considerable room for improvement when it comes to the extent to which AOs influence their AMs on ESG.

Lastly, mimetic pressure appears to be a significant force in ESG adoption. Due to the variety of interpretations surrounding the topic and the likely lack of expertise, it is possible that many organizations attempt to copy their peers without fully understanding what ESG is. Hence, some might resort to symbolic and rhetorical framing to keep up their public image (Meyer and Rowan, 1977). They are tempted do so from an asset-gathering perspective as well. Thus, in their quest for mandates, they may fold to mimetic pressure and follow their peers in designing a strategy, according to one of the previously described third-party ratings.

*Figure 12. AM signatories to the UNPRI since inception**



Source: UNPRI

**Note that with the numbers given by EFAMA (2017), this means ~16% of UK's AMs have signed up, ~20% of Dutch AMs and ~12.5% of Germany AMs*

6.3.2 What (or who) shook up the status quo?

Before we continue with sense- making and giving, it is important to determine what or who drove them to re-assess the situation. Academics have not paid much attention to what drives practitioners to embark on a RI journey (Sakuma-Keck and Hensmans, 2013). This is surprising, given that the right push from the right player can come a long way in helping to mainstream RI. Moreover, the motivation for RI also shapes the way it is used or implemented (Bromley et al., 2013). As described above, ‘’substantive change will only occur if there is a change in ways of conceiving the organization and its purposes and directions’’ (Gioia et al., 2012, p. 370). Stated differently, ‘’sense-making starts with chaos’’ (Weick et al., 2005, p. 411). Earlier, I talk about deliberately vague statements by top management, which shake up the status quo. The interview participants talk about the events that shook up their status quo and drove them to start their RI journey.

Zooming in on their motivations (see table 10 below), four respondents started incorporating ESG because of change agents in the company or because of top leaders who believe in the value-add of RI. An equal number of respondents were triggered by external events, such as the BP oil spill, the financial crisis or the documentary on cluster bombs that raised awareness (Zembla – see chapter 5). Three respondents mention a combination of external drivers and internal drivers. This was expected, since external drivers provide change agents with a sense of urgency. This often helps in making themselves heard (Andersson and Bateman, 2000; Kotter and Cohen, 2002). Clients were also mentioned as a driver in three cases. However, when specifically asked about it, more than half of the respondents claim that they do not feel pressured or influenced by their clients (AOs) regarding the incorporation of ESG. At the same time, most AOs *do* claim to pressure their AMs on this topic. Out of the 14 who answered, 8 do not feel sufficiently challenged, 4 do feel pressured and 2 of them mention that influence goes both ways, hinting at cooperation.

Table 10. Drivers of ESG integration

Drivers/Combinations	**Number of mentions**
External drivers	4
Internal drivers	4
UNPRI/Regulation + Champions	3
Clients	3
UNPRI, then gradual integration	2
Always been doing it, gradual integration	2

Regardless of whether they are being pressured to incorporate ESG, they do feel like they are, on average, on the same page with their clients. A little over half state that they are happy with the cooperation, although this statement mostly applies to their largest clients. This is further corroborated by the five respondents who say that it varies, given that there is a difference between both institutional and retail clients and between smaller and larger clients. Especially smaller clients are more difficult to work with, given that they often lack ESG expertise. In general, it is difficult to reconcile the needs of different clients. Two other respondents highlight that clients may not always understand ESG, which makes it difficult for them to choose the right AM. Looking at the previous chapter's findings, AOs stated that AMs need to get better at communicating or translating the ESG message, so that they can more easily distinguish between them. Adding that to these findings, it appears that both parties should help each other to fix the disconnect; AOs should enhance their understanding of ESG, but AMs need to do a better job at communicating how they are integrating it.

6.3.3 How do asset managers ''make sense'' of and ''give sense'' to responsible investment?

Top management of AM firms must interpret external pressures and then signal their understanding of those pressures to other members of the organization. This also applies to RI and thus means they could make or break ESG integration. If they introduce it selectively, by only complying with minimum stakeholder requirements and shielding themselves from the angry public, it is unlikely to work. Stated differently, if top management merely adopts ESG superficially, other members of the organization might not be able to make sense of RI (Sakuma-Keck and Hensmans, 2013). However, they can also introduce it as a core part of the company strategy. They could see it as way to generate better returns and to gain a competitive advantage. By giving sense to it in this way, it is more likely to succeed (Basu and Palazzo, 2008). The question is, how is it done in practice?

6.3.4 How is responsible investment perceived?

Given that ''situations, organizations and environments are talked into existence'' (Weick et al., 2005, p. 409), it is important to consider how people perceive RI and how they educate themselves. Theoretically, education would help improve the way they can make sense of their environment. According to Daft and Weick (1984), attending training courses is a way to actively search for answers. However, in most cases, respondents do not follow any structural training regarding ESG. Most of the training they attend, is in the form of a short training course or one-day workshop. Courses that were mentioned are: EFFAS, ICGN and the UNPRI Academy (online)[13]. Many respondents mention that ''on-the-job learning'' is how they have acquired their expertise. A few participants state that there are too little courses available and that there is a general lack of depth. It thus seems that the willingness to actively search for answers is there, although there are not many tools available.

Perceptions are powerful, given that they set enactments in motion, which subsequently confirm those perceptions. As expected, there is a lack of consensus on what RI means to investors. Even if the wording is similar, it means different things to different people (Berry and Junkus, 2013; Sethi, 2005). Asking respondents to define RI is thus not only a technical exercise, but a normative and ideological one as well (Crane et al., 2008; Gjølberg, 2010). If ESG integration is not perceived to be important, it is unlikely that it will thrive within the organization (Weick, 1988). When asked to define RI, some respondents mention that this is a difficult question as the definition is rather broad. As can be seen in figure 13, they often mention the long-term as well as integration and responsibility. They also mention economic value or better returns more than their clients do. This is important, because believing in it lowers the likelihood of resistance to institutional pressure to conform (Oliver, 1991).

[13] EFFAS: The European Federation of Financial Analysts Societies. EFFAS also offers a certified environmental, social and governance course. The course offered by the International Corporate Governance Network (ICGN) is the ESG integration course.

Figure 13. Most frequently used terms when respondents define responsible investment

Fortunately, 12 AMs believe that RI increases returns. This contrasts with earlier findings of their more skeptical clients. The three AMs who are skeptical are either German or Dutch, meaning that the UK respondents are all believers of the business case of ESG. This finding is encouraging, given that this is the first step in integrating it into their core strategy (Guyatt, 2006; Juravle and Lewis, 2009; Sakuma-Keck and Hensmans, 2013). It still makes one wonder why so few investors truly integrate it (Cappucci, 2017; Eccles and Kastrapeli, 2017). They even give themselves imperfect scores for their efforts (van Duuren et al., 2015) and admit that they are not completely certain how to approach the ESG analysis (CFA Institute, 2015). This raises questions as to what the implementation looks like.

6.3.5 How is responsible investment implemented?

Resource dependency

Nearly all AMs use ESG rating reports, at least as a starting point to do their ESG research. This number is higher than the 68% found by the CFA institute survey (CFA Institute, 2015). It also contradicts with the finding that investors most value information that comes directly from issuers (Institutional Investor Research and Ernst & Young, 2015). Contrary to ESG ratings, ESG indices are not often used because many respondents have an active approach. Information sources most commonly named are Sustainalytics and MSCI. The reasons mentioned by respondents for the use of ESG providers are manifold: efficiency, lack of capacity, it stimulates thinking due to the divergent viewpoints and it can be used for triangulation (also with other rating agencies). One AM explains that it is not their goal to gather the information, but rather to interpret the information for investment decision-making. This AM, however, uses the narrative as opposed to the raw scores. As evidenced by the fourth chapter, the jungle of ESG scores can cause ambiguity and AMs should be careful when they blindly rely on scores. AMs with many stocks to cover, do often end up relying on the purchased ESG scores. However, many of them double check information, at least for larger holdings.

Some research suggests that AMs, to gain legitimacy, become dependent on these providers (Sakuma-Keck and Hensmans, 2013). The dependence on ESG scores is to be expected, given that the average financial analyst does not have a background in ESG. In fact, it is estimated that only about 10% of professionals globally receive training on ESG (CFA Institute 2015). Moreover, the qualitative nature of the issue may further complicate it for quantitatively focused analysts (Guyatt, 2006; Juravle and Lewis, 2008). Thus, to bridge this knowledge gap and because it is more efficient, AMs have become dependent on this resource as an input in their investment-decision making process.

As mentioned previously, to assess resource dependence, several aspects should be looked at; 1) the importance of the resource, 2) the criticality for organizational survival, 3) the extent to which the organization in question has discretion over the resource and 4) availability of substitutes (Hatch, 1997; Pfeffer and Salancik, 1978). On the first point, the resource is important given that, in many cases, there would not be an ESG strategy to offer without ESG scores. Secondly, AMs are increasingly held accountable and asked for ESG by their clients. This makes this resource increasingly critical for organizational survival, although AMs still tend to have a large part of their assets in mainstream portfolios. Third, it is unlikely that this dependency results in a sustainable competitive advantage, since competitors have access to this data as well (Sakuma-Keck and Hensmans, 2013). Thus, in theory, all AMs can offer a ''best-in-class'' portfolio based on Sustainalytics scores. From an ESG perspective, this does not make them better or worse than their competitors. On the last point, as established in chapter 4, there are an overwhelming number of substitutes available. However, the use of a certain provider does become somewhat embedded in organizational processes. Thus, given that some of these aspects balance each other out, the resource dependency is therefore classified as ''medium''. ESG rating agencies have a relative amount of power over AMs, but the high number of providers makes this resource less critical.

Boundary spanning and decoupling

When asking about their ESG approach, about half have separated ESG from the financial function. However, several of those are either in the process of increasing integration or the roles are already slightly overlapping. Many have a top-down screening method and use ESG rating scores to get to an investable universe. They may conduct additional research for larger holdings, but have a separate ESG team for this. It is interesting that many of these large AMs still do not have ESG integrated into the core business. Juravle and Lewis (2009) pointed out, that it is rare to find cases whereby RI staff is fully integrated. Nine years later, this does not seem to have advanced tremendously. Buying information from other firms with several in-house "ESG experts" is a more frequent occurrence than an integrated strategy. Another option, also found among the respondents, is the presence of a fully staffed in-house ''ESG team''. Regardless of how well staffed the ESG team is, the practice of separating finance from ESG impedes true integration. This is because it may lessen the amount of ESG data that is used in final investment decisions and it makes the integration of the different data more difficult (Guyatt, 2005).

Drawing on the earlier described literature, several potential explanations arise. First, looking at it from a resource dependency perspective, Pfeffer and Salançik (1978) state that the power of a certain department in an organization depends on the number of vital resources they contribute. It is therefore not inconceivable to argue that financial teams are likely more powerful than these "ESG Teams''. This is partially because, as described, the information is often bought from third-parties, but also because financial teams are often much larger. Weick (1988) states that when units are not perceived to be important, it is unlikely that they will thrive in the organization. As previously described, these expert teams may have been established as a bridge between organizations and their environment. Perhaps these are merely boundary-spanning units that protect the core (financial team) from shocks to the system. Whilst the core sticks to business as usual, boundary-spanning roles represent a different image to the environment. They thus symbolize commitment but, in reality, shield the core strategy from the external pressure to incorporate ESG (Feldman and March, 1981; Thompson, 1967). Hence, these roles may help an organization to engage in decoupling processes.

Secondly, as described earlier, managers may engage in labelling and categorizing to make sense of chaos (Weick et al., 2005). It may be that they struggle, because of a lack of affinity with the topic or perhaps it may be due to a limited understanding. This labelling is then their way of demonstrating conformance with expectations. However, this type of behavior may hinder organizational sense-making and sense-giving. This is because the updated vision should be built into the core strategy and core values of the organization. If not, their genuine efforts are likely to be rejected or resisted by organizational members (Sakuma-Keck and Hensmans, 2013). Interesting, is that those AMs who try hardest to demonstrate conformance, are least likely to have truly incorporate ESG. Thus, coercing them to conform might therefore result in a strategy of disguise as they seek to regain legitimacy as a responsible investor (Meyer and Rowan, 1977; Sakuma-Keck and Hensmans, 2013). As mentioned in the AO chapter, other research suggests that external pressure for social performance encourages decoupling processes (Guyatt, 2006; Weaver et al., 1999). This type of decoupling is expected to occur, when institutional legitimacy clashes with other organizational goals (Meyer and Rowan, 1977). Looking at those respondents with a separate team, I find that those that engage in labelling feel most pressured by their clients. In fact, slightly more than half of the respondents (who separate) feel pressured. Another two respondents mention that the pressure to incorporate ESG goes both ways. Only one respondent (who separates) does not feel that their clients influence them regarding ESG incorporation. Looking at the other group (the one that does not engage in labelling), a strong majority does not feel pressured by their clients and only one respondent does. Although the sample is too small to draw conclusions, it is possible that AMs indeed try to demonstrate conformance to their clients, by engaging in labelling. If top management indeed only cosmetically adopts certain beliefs, these mixed signals will impede the organizations from truly integrating ESG.

Engagement

Engagement can be defined as ''involving stakeholders in decision-making processes, making them participants in the business management, sharing information, dialoguing and creating a model of mutual responsibility'' (Manetti, 2011, p. 11). Goals can vary from advancing certain shareholder interests, to achieving broad social objectives. The ways engagement can occur ranges from informal discussion to more formal methods, such as shareholder resolutions (Martin et al., 2007). Effective engagement can benefit all stakeholders involved. It has its roots in the 1940s, when the SEC disseminated the first version of the shareholder resolution rule. However, engagement has especially become a popular topic in the last several years (Ferraro and Beunza, 2014; Gifford, 2010; Søndergaard, 2014; Useem et al., 1993).

All AM respondents claim to engage with their portfolio companies and to influence them with respect to ESG. They engage around once or twice a year. In three cases, this is triggered by engagement themes that are set every year. In two cases, the engagement and monitoring processes appear to be comprehensive. One makes use of scores to track improvements and another one discusses in-depth cases with company management. Although the investor activities sound promising, portfolio company respondents (as discussed in the next chapter) barely feel pressure from investors on ESG. Some companies state that most investors are far behind. It could be that investors' messages are lost in translation, or rather lost in the complex organizational environment. If companies do not feel challenged, it could be because there are too few investors engaging with them.

However, it could also be because investors are not doing a good job. Other research finds that there is too little contact between investors and company boards (Beale, 2005; Citigate Dewe Rogerson, 2015) and that most engagement is still short-term (UN Global Compact and PRI, 2014). Of course, it must also be noted that not all companies can be influenced (Ferraro and Beunza, 2014). As noted in the literature review, the amendment to the Shareholder Rights Directive is expected to further improve the uptake of long-term engagement. Although this does not guarantee engagement success, it is likely that companies will, as a result, feel more challenged by their investors.

6.3.6 Barriers to organizational change

Short-termism

It is estimated that AMs turn over their portfolio approximately every 1.45 years and this may lead to missed opportunities as fundamentals do not change as much as share prices do (Roberge et al., 2015). Scholars also estimate that ~65% of portfolios have a higher turnover than expected. Managers indicate that volatile markets, hedge fund activity, signals from clients and short-term incentives are some of the drivers behind excessive turnover (Guyatt and Lukomnik, 2010; IIRC Institute and Mercer, 2010). The AM industry is a considerably competitive space and short-term underperformance comes with risks, such as being abandoned by clients (Koedijk and Slager, 2010). To minimize short-term returns chasing, it is recommended that AOs include an expected turnover rate in their mandates and request that their AMs explain when it is exceeded (Guyatt and Lukomnik, 2010). When asking the respondents about their investment horizon, it appears that Dutch and UK respondents are more long-term and not the expected bank-driven Germany. Not everyone can provide an answer to this question, but five respondents claim that their investment horizon is between 2-5 years (3 Dutch and 2 UK AMs). There are also 1 Dutch and 2 UK respondents, who claim that it is between 5-10 years. Lastly, 3 interviewees claim that they have an investment horizon between 0-2 years (2 German, 1 Dutch).

When it comes to the quarterly reporting of portfolio companies, there is a lack of consensus among respondents. For example, several say that quarterly reporting is a distraction and that one should engage with companies directly if information is needed. Others, however, insist that transparency is needed to reduce uncertainty in the market. Interestingly, none of the UK AMs believe quarterly reporting is necessary. The skeptical respondents are, again, either Dutch or German. Some of the sceptics do say that bi-annual reporting would be acceptable, as long as they know whether the ''ship is sailing in the right direction''. Others say that quarterly reporting would perhaps work better, if short-term guidance is left out.

Looking at whether companies are affected by the holding period of investors, ten respondents agree that the holding period matters. Again, the UK AMs all agree, or even strongly agree, that the holding period of investors affects the potential of companies to create long-term value. They elaborate by adding that this is especially the case when all investors are short-term. The other five interviewees believe that the holding period should not be an excuse for companies to be short-term as well. They argue that it is up to the company to be long-term and that they will then attract investors with similar beliefs.

According to Guyatt (2006), short-termism is encouraged by short-term (i.e. annual) review periods and incentive packages. Short-termism in AM evaluation may also be a barrier to ESG integration (Desmartin, 2015). However, only five of the respondents emphasize that AOs should change this. These respondents would like to see changes in the way returns and incentives are measured. Measuring against inflation, instead of the benchmark is one idea. They state that the most important thing is the courage to leave the benchmark. Exploring the short-termism of review periods, it can be said that only two of the respondents have annual reviews. I also find that 1/3rd of the cases in my sample have a long-term bonus, which is based on a review period of more than three years. The most frequent (six respondents) scenario among respondents is an annual review period, plus a three-year review or vesting period. Juravle and Lewis (2009) point out that organizations with a three-year rolling performance may follow different market beliefs and norms. Short-term return chasing is discouraged in these organizations. Encouragingly, I find that some incentive schemes are even longer term; in 4 of the cases a 1, 3 and 5-year review period can be observed in 2 Dutch and 2 UK AOs. Another (German) case is approximately four years. Both the longest and shortest review periods are by the Dutch and UK AOs and it can therefore be said that there is much diversity, when it comes to performance reviews.

Although ideally the review period of all respondents is longer than three years, it appears that AMs have already made, or are undergoing, changes to align themselves with a more long-term approach. Although my findings appear to be relatively positive, when comparing this with what investors think it should be, it becomes clear that there is room for improvement. According to the State Street survey by Eccles and Kastrapeli, 47% of AOs and 43% of AMs expect ESG benefits to unfold in five years and beyond. The respondents in my sample therefore do not align their incentive schemes with the time-horizon in which ESG outperformance is expected. Thus, although not as short-term as expected, I side with Cappucci (2017) in concluding that there is still room for improvement in the alignment of incentive schemes.

Other points of improvement relate to the integration of ESG into compensation. Slightly more than half of the respondents link it to performance evaluation, although mostly indirect or in individual cases. This is approximately equally divided among countries, meaning that about half of the Dutch, UK and German AMs do not link ESG to compensation According to the respondents, this is because ESG is difficult to quantify.

Overall, short-termism is not explicitly mentioned by AMs as an obstacle to ESG integration. I do find that, compared to the timeframe in which ESG is expected to unfold, incentive packages are not long-term enough. On average, ESG is not yet integrated into compensation. Explicit barriers to long-termism as mentioned by half of the respondents, are a lack of client understanding and inconsistent demand. Clients need to challenge them to explain their approach and especially smaller clients have a lot of work to do. When I ask what would encourage them to shift to more long-term thinking, many believe that it starts with the AO and that long-termism will percolate down the investment chain. Nevertheless, the effects of deep-rooted myopia should not be underestimated, especially because ESG requires patience.

Lack of understanding

Respondents mention several obstacles that stand in the way of mainstreaming RI. A general lack of understanding of ESG is most frequently mentioned (seven respondents). It is a broad topic, with many facets to it. This lack of understanding sometimes causes clients to be dissatisfied when results turn out differently than expected. Likely because of the lack of understanding, there is ample diversity in opinion. Respondents point out that some people are also still under the impression that ''doing good'' costs money. The finding that investors have a low level of understanding of ESG has also been found by other scholars (Sørensen and Pfeifer, 2011; Wagemans et al., 2013). Sometimes, it is not only misunderstood but also hyped. This hype can make it difficult for clients to select an AM who truly incorporates ESG.

In addition, six respondents mention that many different organizations with different opinions want to weigh in on their journey, which can make it difficult. On this point, Christensen et al. (2013) argue that constant exploration, experimentation and learning are needed and that it is therefore crucial that many different voices partake in this journey. Although this might cause ambiguity, the inconsistencies in talk and action allows for the exploration of possibilities. Moreover, this ambiguity makes room for different shareholders or stakeholders to agree on the same (broad) idea (Christensen et al., 2013).

Silos

Five respondents mention silos or a lack of integrated thinking as an obstacle to mainstreaming RI. The silos mentioned by respondents refer to the separation of ESG and finance, but some also refer to silos between different goals. On the first point, other research has also noted the lack of integration (Guyatt, 2006; Juravle and Lewis, 2009). Traditional, narrow valuation models are still common place, whereby financial criteria are over emphasized (Hager Jemel-Fornetty et al., 2011). Some respondents mention that certain approaches to ESG may be superficial or merely data-driven (i.e. screening). As previously discussed, these silos have also been found among the organizations in the sample. It is encouraging that many respondents are aware that this is likely an obstacle. This type of separation only spreads the idea that sustainability is secondary (Guyatt, 2005, 2006). As mentioned earlier, if AMs want to truly incorporate ESG, it is important to attribute equal importance to ESG and to make it a core part of the strategy. It is not only the physical separation that strips ESG of its importance, but it is also continuously referred to as a separate issue. If both the language and assumptions are widely shared and regularly used, it will have an impact on what people do and how they think about and design the social and organizational world. If this is true, then social science theory and the language and assumptions of such a theory are significant. Unfortunately, theories can become self-fulfilling and resistant to change. As they generate self-fulfilling beliefs, societies, organizations, and leaders can get stuck in repetitively destructive behavior (Ferraro et al., 2005; Shrivastava, 1995).

Inertia and impatience

Four respondents emphasize that change takes time. This is especially the case when it comes to ESG, as it takes time to unfold. In addition, mandate restrictions mean that it takes even longer before anything can be changed. Moreover, people and organizations can also be resistant to change. Herding behavior is not uncommon, as everyone is waiting for somebody to go first. Unlike Eccles and Kastrapeli (2017), I do not find that the reason for inertia is a concern about costs or underperformance. However, as discussed, some respondents comment on being measured differently and needing the courage to leave the benchmark. These types of remarks are most likely related to concerns for underperformance in the short-term. AOs should therefore send long-term signals and encourage AMs to leave the benchmark.

Bad data?

Four of the respondents emphasize that there is still ample room for improvement when it comes to data. Especially the data availability for the ''E" and the ''S" of ESG is limited. This type of data is also often merely backward looking. Moreover, eight respondents in my sample claim that companies do not sufficiently report on ESG performance. A lack of transparency is part of this problem (Sørensen and Pfeifer, 2011). Similar findings emerge from a global survey conducted by Eccles and Kastrapeli (2017). They find that 60% of AOs and AMs, as well as retail investors, mention that the lack of standards for measuring ESG performance impedes their ESG incorporation efforts. Hence, investors should make it clear to companies that they need more ESG information and explain why. More effective dialogue is thus a necessity if AMs want to be consistent with the SDGs and advance in their ESG efforts. Without dialogue, ESG incorporation will be difficult.

6.4 Conclusion and limitations

Even though we have now largely been convinced of the business case for ESG, evidence suggests that not many AMs are truly integrating ESG into their investment decision-making processes (Cappucci, 2017; Guyatt, 2006; Juravle and Lewis, 2008). Looking through the UNPRI transparency documents, they appear to be taking considerably different approaches. Unfortunately, we do not know much about their motivations to integrate ESG, what hinders them or how they tackle this challenge in general. This leads me to conduct 15 interviews with large AMs in the Netherlands, the UK and Germany. The isomorphic forces by Dimaggio and Powell (1983) are used as a starting point to assess the pressures AMs face to adopt ESG. I also draw on several other elements of Organization Theory to explain my findings, since, despite the expectations for AMs to fold to these normative, coercive and mimetic forces, reality begs to differ. To understand potentially ‘’deviant’’ behavior of AMs, I draw on organizational identity, sense-making and sense-giving research. I also draw on avoidance strategies, such as boundary-spanning and decoupling, to explain why they may not translate their words into action.

First, I must note that there are no considerable country-related differences in the findings. Some AMs are more integrated than others, but (in my limited sample) this does not appear to be related to country of origin. As noted in the literature review, this may be subject to the debate on variegated capitalism. I do, however, find differences in the sense that AOs and AMs look at ESG differently. More specifically, AMs believe in the business case more than AOs do, although only about half of them truly integrate it into their core business. Hence, much like research by Guyatt (2005), I find that there is yet another disconnect between investor beliefs and actions. I also find that several AMs are dependent on the ESG rating and ranking industry. This is interesting, since constructing the same best-in-class portfolio as your competitor does not yield a sustainable competitive advantage. From a resource dependence angle, it can be concluded that this resource is not critical, given the tremendous number of suppliers (see chapter 4). Nevertheless, AMs should be careful with blindly relying on raw ESG scores. This is not only because the industry comes with its drawbacks, but also because blind reliance does not provide them with a competitive edge on ESG. After all, the power of a certain department in an organization depends on the number of vital resources they contribute (Pfeffer and Salancik, 1978). If the analysis is bought from third-party providers, ESG teams have little power and are unlikely to thrive.

Related to ESG being treated as a peripheral issue, are the silos I find in about half of the cases; ESG and finance are often separated. This is further amplified by the lack of ESG incorporation into incentive packages. As previously stated, new visions should be built into the core strategy and core value of the organization. Otherwise their genuine efforts are likely to be rejected or resisted (Sakuma-Keck and Hensmans, 2013). Drawing on sense-making and sense-giving literature, it seems as if this separation is, at least in some cases, a labelling exercise to demonstrate conformance. Especially in those cases whereby AMs feel pressured by clients, they label and separate ESG teams. Having an ''ESG Expert Team'' sounds impressive, but if it is not part of the organizational core, it is not likely to be truly incorporated. As described earlier, having these boundary-spanning roles in place protects the core (financial) from external pressure. Hence, in some cases, it appears that AMs engage in a decoupling exercise, whereby they only cosmetically adopt ESG beliefs. As mentioned in the literature review, AMs should instead interpret, discover and construct the concept of RI (Weick, 1995), as opposed to copying it without any real attempt (sense-making) to discover what it means to them (Sakuma-Keck, 2012). It is, however no surprise that some AMs adopt ESG in a superficial way. As demonstrated in the previous chapter, AOs do not sufficiently challenge their AMs. Given their lack of understanding and probing, they (sometimes) let their AMs get away with-superficial statements of ESG integration.

I also find that incentive packages are not often aligned with the horizon in which ESG benefits are expected to unfold; five years and beyond. If an AM wants to make ESG part of the core of the organization, it is important that incentive packages are aligned. The respondents also claim that client demand should be more long-term and consistent, as it is currently a barrier for them in their ESG efforts. They also indicate that there is a general lack of understanding, which means that much work is to be done when it comes to education. As discussed, the interest in actively searching for answers is there, but the courses are not sufficient. Moreover, respondents also recognize that the separation of ESG and finance is a barrier to ESG integration. Thinking processes are not as integrated as they could or should be. Lastly, effective dialogue is necessary. If AMs are not satisfied with the ESG reporting of their portfolio companies, they should inform them of this issue. This way, companies can better understand the needs of their shareholders. Then, instead of responding to the all the ESG rating and ranking requests that come their way, they can focus their efforts on meeting shareholder expectations.

In conclusion, society has become more demanding of AMs and besides this normative pressure, coercive and mimetic forces are also increasing. However, as I demonstrate, this pressure to conform does not necessarily mean that they indeed do so. Much like the critique on the early framework by Dimaggio and Powell (1983)[14], I find that conformance is not the only option. By drawing on sense-making and sense-giving literature, I find that some of the AMs make sense of RI through labelling. I also note that, if leaders are ambiguous in their vision this might help individual members limit their sense-making to suit their own job description (Etzion et al., 2015; Gioia et al., 2000, 2012). Moreover, after reviewing research on boundary-spanning and decoupling practices, I find that this can be applied to AMs' ESG approaches as well. From these perspectives, I argue that, for many, ESG remains a peripheral issue. Important is that, as already pointed out in the preceding chapter, AOs should challenge their AMs more. The finding that some AMs engage in decoupling only further strengthens the case for AOs to do so. Adding the insight from the previous chapter, I argue that both parties have a role in resolving this disconnect; AOs should enhance their understanding of ESG and challenge AMs. Additionally, AMs need to do a better job at communicating how they are incorporating ESG. This will reduce the

[14] Dimaggio and Powell do acknowledge this critique in later work and Powell writes about decoupling many years later (Bromley and Powell, 2012)

likelihood of decoupling on the AM level and it will help their clients to make better selection choices. It must be noted, once again, that this type of resistance (decoupling) is likely to be higher when the perceived economic gain from conformity to institutional pressures is low (Oliver, 1991). Given that most AMs do believe in the value-add of RI (more so than their clients), greater integration will likely occur going forward as the above-mentioned issues are resolved.

It must be noted, however, that the sample is too small to generalize. The 15 in-depth interviews provide interesting insights, but this makes it difficult to draw conclusions about the general AM population in the countries investigated. Moreover, these AMs are UNPRI signatories who may already be more advanced in their ESG journey in comparison to others. As mentioned previously, this is not considered to be a major obstacle, since there is not a standardized way to implement ESG. In fact, they need to have started their journey one way or another to have something to talk about. Those that have started, take considerably different approaches and hence provide an interesting sample. One might also argue that there are size differences between AMs (much like AOs), not captured in the sample. Two points are worth mentioning regarding this limitation. First, resources are, to some extent, a proxy for capabilities. Given that the AMs must have started their journey to have something to talk about, I use ''being a UNPRI signatory'' as a proxy for this, meaning that firms are naturally larger. After all, UNPRI signatories must pay a fee and ESG requires resources (i.e. new staff, training). Second, the AMs interviewed in this sample, work with the AOs that have also been interviewed and are invested in the companies that are analyzed in the next chapter. With this research, I attempt (to the extent that it is possible) to identify the investment chain. Given the interesting insights, further research endeavors could take the time to focus on a larger sample. Interviews would be preferred over surveys, given that probing is required to truly understand their ESG approach and to explore in detail their reliance on ESG ratings.

7 Company's ESG efforts; catalysts and inhibitors

7.1 Introduction

Companies are at the bottom of the investment chain, but this is ultimately where everything happens. This is where oil spills transpire. This is where food products may be recalled because of toxic ingredients and this is where child labor might take place behind the scene. Today's increasingly global and interconnected world has increased its expectations of corporations. Their license to operate is simply not handed out as freely as it used to be anymore. They need to be profitable and responsible on both a social and environmental level (Mohrman et al., 2015). If this is ignored, they may not only face damage to their reputation, but in addition, litigation costs may affect their bottom line directly (Renneboog et al., 2008). Several corporations have made great strides and seem to have rediscovered the purpose of the corporation. However, if they want to be consistent with the SDGs, much work still has to be done. Why are there still so many scandals? One can argue that without the demand for harmful products or without the pressure to "make a quick buck" this would not be happening at all. It is likely that, also on the company level, many socially and environmentally colored issues are merely perceived to be peripheral and hence, easy to discard. This is also reflected by the way this type of information is presented in sustainability reports; it often lacks a connection to the strategy and business model of the organization (Eccles and Serafeim, 2015). Nevertheless, the pressure to take these issues into account is stronger than ever. Globalization has made multinational corporations powerful and susceptible to criticism about their roles and impacts on this world.

Besides the ethical motivation to ''do good'', a recent survey shows that 76% of CEOs also believe that embedding sustainability into their business is financially advantageous. However, they emphasize that they are frustrated with short-term pressure from investors (Accenture and UN Global Compact, 2013). The UN Global Compact and UNPRI (2014) have therefore urged companies to publish evidence on how investor short-termism influences business decisions, but this request has not seriously been picked up to my knowledge. Additionally, the sheer number of different definitions and interpretations of ESG can be overwhelming for companies (Brink and Woerd, 2004; Delmas et al., 2014; Hockerts and Moir, 2004; Searcy and Buslovich, 2014). They may not be aware of what it is that investors are expecting from them. This is especially likely given the finding that companies and investors do not tend to sufficiently discuss ESG matters. Thus, on the one hand they are scrutinized for not looking beyond numbers and on the other hand, they are pressured for (ESG) results. Although corporations have endlessly been criticized in the uproar of ESG, their side of the story is often overlooked in the literature. This chapter will therefore aim to fill this gap and shed light on their perspective.

As argued in chapter 5, RI or ESG is a way of improving or innovating. I therefore analyze my findings against the backdrop of innovation theory. I will start by outlining the dimensions of innovation, which serve as the analytical building blocks for the analysis. Specifically, I use the distinctions between radical- versus incremental innovation and reactive- versus proactive innovation. Next, I draw on the literature on innovation clusters, since the interview participants are located in different sectors. Using these innovation concepts, I then analyze 20 interviews with (mostly) sustainability managers of corporations in the UK, the Netherlands and in Germany (see appendix 9). Whilst the size of the sample is relatively small, the size and significance of the multinational interview participants is substantial, both in terms of market capitalization and ESG effort. Their insights can help inform the methods used to improve ESG incorporation in the investment chain. After uncovering the corporate perspective on ESG, particularly the drivers and bottlenecks, I finalize this chapter by discussing the conclusion and implications of my findings. Lastly, the limitations are provided, particularly those concerned with the relatively small sample size.

7.2 Innovation theory

The focus in this section is innovation, given that this is a powerful tool to explain differences in the adoption rate of ESG effort between firms. Some authors find that more innovative firms also tend to engage in more CSR activities (Martinez-Conesa et al., 2017; Shen et al., 2016). As defined in chapter 5; *‘‘An innovation is an idea, practice, or object that is perceived as new by an individual or other unit of adoption*’’ (Rogers, 2010, p. 11). To lay the foundation for the analysis of the findings, I will highlight several innovation dimensions, which serve as the analytical building blocks for the subsequent analysis. I will end this section by discussing innovation clusters and by highlighting ESG innovation in the three countries involved; the UK, Netherlands and Germany.

7.2.1 Dimensions of innovation

Radical vs incremental

An important distinction is that between incremental or gradual change[15] and radical or disruptive change. The more evolutionary and incremental form is also referred to as continuous improvement or *kaizen* in Japan (Imai, 1986). It can be defined as a ‘’culture of sustained improvement targeting the elimination of waste in all systems and processes of an organization’’ (Bhuiyan and Baghel, 2005, p. 761). Hence, it is the ‘’do what we do better’’ approach. These types of incremental changes often merely affect a certain segment of the organization, are less risky and generally increases the change capacity of organizations. Major improvements can be achieved as, over time, the numerous incremental improvements add up and become significant.

The disruptive innovation theory, on the other hand, posits that organizations tend to be more likely to create new growth when they introduce disruptive innovations into the market. This is the ‘’do what we do different’’ angle. These innovations may create new markets or re-define the existing market place with a highly desired value proposition. They tend to

[15] I use innovation and change interchangeably because all innovation is change. However, not all change is innovation.

require immediate attention of all organizational members. However, companies innovate more quickly than any one customer can change their life. Hence, organizations need to find a balance as they do not want to be too far ahead of customer' demand (Anthony and Christensen, 2005; Christensen, 1997).

Reactive vs. pro-active

Where do innovations come from? There are many different push and pull forces that may trigger the innovation process. A company may be proactive or anticipatory in their innovation strategy, or more reactive to what is happening around them[16]. It is commonly known that a corporation does not innovate in a vacuum, but relies on exchanges with its environment. The more open the corporation is to the external environment, the smaller the chance is that they will be missing out on opportunities that emerge outside of their reach (Fagerberg, 2006). For example, to stay competitive, they must pay close attention to their customers, suppliers (van Hippel, 1988) or competitors. Corporations may also be ''shocked'' or triggered by market and technology turbulence. In the public policy literature, these events are referred to as ''focusing events''. These types of events help in the agenda-setting process, as they may be pushed up or down the agenda (Birkland, 1998). They help in bringing together the different streams of problems, policies and politics. It opens the window, albeit briefly, for a problem to be equipped with the attention that is needed for a change in policy and politics (Kingdon, 1995). Although corporations may initially react to ''shocks'' by creating buffers (see chapter 6), this may later lead to true changes (King, 2000). Some scholars argue that, due to organizational resistance to change, wake up calls in the form of regulation could help shock them into fundamental change (Porter and van der Linde, 1995).

Nevertheless, not every organization can ''absorb'' external information effectively and adapt their strategy accordingly. Reacting and being responsive is not necessarily the easy way out, because the ''absorptive capacity'' of a corporation matters. This can be defined

[16] In some work also referred to as knowledge-push or need-pull.

as the ''ability of a firm to recognize the value of new, external information, assimilate it, and apply it to commercial ends'' (Cohen and Levinthal, 1990, p. 128). Especially in today's world, this can be a complicated endeavor. Corporations face even more stimuli than before, with often global operations and complex supply chains. Innovation therefore needs brilliant individuals who have the capability to combine their energy with both enthusiasm and creative insight. This enables them to invent and roll out new concepts. As important (if not more) is the commitment of top management. ''Top management commitment is a common prescription associated with successful innovation...there needs to be long-term commitment to major projects, as opposed to seeking short-term returns'' (Tidd et al., 2005, p. 102). An example of such a visionary and capable leader is Unilever's CEO Paul Polman. His passion for sustainability is well known and he has made great strides steering his business onto a more sustainable path[17]. This type of visionary leader may decide to be more pro-active and anticipate changes in their environment. Management may decide to implement change pre-emptively, as they believe that this leads to a competitive advantage. These firms are more likely to have a competitive edge over others, as they engage in proactive innovation (i.e. R&D). This must be continuously renewed, to maintain advantage in a competitive world. However, a good idea does not necessarily translate into a good implementation, nor does it guarantee that the market is ready for this innovation. It can therefore be a risky endeavor.

7.2.2 Innovation clusters

Porter (1990, 2000) suggests that the local business environment influences the sophistication with which companies compete in a particular location. The way he framed the cluster concept became very popular and many still view Porter (1990, 2000) as the pioneer. However, his idea is by no means new as it stems from the idea of agglomeration

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[17] Unilever is still learning how to manage a tremendously complex supply chain. As discussed in the literature review, Amnesty International recently exposed one of their suppliers. See https://www.amnesty.org/en/latest/news/2016/11/palm-oil-global-brands-profiting-from-child-and-forced-labour/

economies (Marshall, 1890; Pavitt, 1984; Schumpeter, 1939). The further development of this concept was led by economic geographers. For example, some economic geographers suggest that access to knowledge, information, collaboration and a favorable institutional environment drive the likelihood of a firm to engage in innovation (Abreu et al., 2008; Doloreux and Shearmur, 2012). These factors can, of course, differ per country. Doloreux and Shearmur (2012) find that the proximity to large and/or medium sized cities matters. They do not, however, find any evidence to support the notion that the location influences collaboration efforts, markets, access to information sources etc. D'Este et al (2013) find that, in cases where firms are not part of a dense cluster and hence do not collaborate with other firms, companies will instead rely more on geographical proximity to their university research partners. This then gives rise to some type of regional innovation system. Yet other economic geographers suggest that innovation comes from a blend of ''buzz'' at the local scene (i.e. Silicon Valley) (Bathelt et al., 2004; Ibrahim et al., 2009) as well as from global channels (Bathelt et al., 2004).

All this research by economic geographers has, in some way, given Porter (1990, 2000) an audience when he essentially repackaged the cluster concept for business use. The reasons he gained more traction than economic geographers did are twofold. First, he conveyed his take on clusters in terms of the economics of business strategy, which made it easy to translate into business practice and policy strategy. Second, he was more focused on key issues that resonated with policy makers at the time. Examples are competitiveness of firms and productivity. The idea of economic geographers on the other hand, was more diverse and difficult to grasp and use in practice (Martin and Sunley, 2003, p. 200).

The diverse manner in which the cluster concept is applied nowadays, is not appreciated by all scholars (Huber, 2012; Martin and Sunley, 2003; Suire and Vicente, 2009). ''The cluster literature is a patchy constellation of ideas, some of which are clearly important to contemporary economic development and some of which are either banal or misleading'' (Martin and Sunley, 2003, p. 28). Martin and Sunley (2003) specifically emphasize two limitations. First, the concept is used for such diverse purposes, that it leads to the erosion of the power of causality and determination. The other limitation is that particular associations do not always translate to general causality and applicability. More specifically, clustering does not necessarily mean that this drives economic growth or the relative success of a particular industry. Martin and Sunley (2003) therefore strongly suggest a more thoughtful and sensible use of the cluster concept, particularly when it comes to policy.

7.2.3 ESG innovation in the Netherlands, UK and Germany

Looking at the level of ESG development across countries, some are more advanced or innovative than others (Hebb et al., 2015). Chapter 5 already pointed out that those countries with a developed pension landscape may have an edge in RI. Especially the Netherlands seems to be well positioned. To recall, I also find that the Dutch AOs in my sample tend to have a more efficient monitoring system, as they work with fewer AMs. The pressure to incorporate ESG may then more effectively percolate down the investment chain. Other factors, such as availability of talent, collaboration and regulation may also cause ESG innovation to differ across countries. Zooming in on the countries I investigate in this thesis, the Netherlands excels at collaboration and knowledge diffusion, according to the global innovation index[18]. Collaborating or knowledge-sharing on ESG may be even more important when there is a lack of expertise in the organization. This thus gives the Netherlands another possible edge. Secondly, looking at the availability of courses on the topic of ESG or sustainability, one quickly finds that important universities in Germany, such as Goethe- and Mannheim University, are lagging behind. Nearly every major university in the Netherlands offers some type of sustainability course[19]. The same goes for the UK, with universities such as Oxford and Cambridge taking the lead in incorporating sustainability in their courses. The fact that Germany's major universities are lagging behind in teaching

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[18] See www.globalinnovationindex.org

[19] For example, Erasmus University, Leiden University, University of Groningen, Wageningen University, Vrije Universiteit Amsterdam, Universiteit van Amsterdam and Maastricht University all offer sustainability related master programs.

students the importance of sustainability, is likely not beneficial for the ESG efforts of German corporations. Of course, sustainability graduates from elsewhere might also decide to move to Germany, which would offset this deficit. Lastly, as discussed in previous chapters, the creation of the EU has largely evened out differences in company ESG regulation. This is therefore not expected to play a major role. Based on these arguments, it seems that there is a likelihood that the companies that reside in the Netherlands are more advanced with respect to ESG. However, based on the global nature of the companies in the sample and the debate on the variegation of capitalism (as discussed in the literature review), the argument of ''global channels'' of innovation also likely plays a role.

7.3 How is ESG perceived and integrated?

7.3.1 How is ESG perceived?

For companies, RI is more about the combination of ESG and business or economic returns (see fig.14). In fact, half of the respondents strongly agree and seven agree that it increases economic returns. This is line with other research, which finds that 76% of CEOs believe that integrating ESG into the core business brings benefits, such as revenue growth and new opportunities (Accenture and UN Global Compact, 2013). Among the respondents, 2 Dutch and 1 German company state their perspective as neutral, but nobody believes it destroys value. There is thus less variety and they are more positive about the value add of ESG compared to AMs and AOs. To recall, AOs are skeptical and the majority (12 out of 15) of AMs are believers. It appears that their portfolio companies are stronger believers of the business case of ESG. Nevertheless, looking at the average sustainability report, one finds that ESG and financial or strategy information are often separated. This makes it complicated for investors to learn how it is linked to financial performance (Eccles and Serafeim, 2015).

As with AMs, many of the participants have been trained by means of ''on-the-job-learning''. Few have an environmental background. Most (14) of the respondents organize some type of ESG training regularly. Most of this is in the form of internal discussions. Sometimes, however, all that is in place in terms of training is a code of conduct. A small number of companies invite external speakers, work with other companies or attend workshops elsewhere. Attending conferences is sometimes also mentioned as a form of training. Others mention that they collaborate with competitors on specific issues, such as reducing supply chain questionnaires. Overall, the majority do not appear to actively search for information and most appear to be internally focused. According to some respondents, this is because there is not much ESG related training available to corporations. This is in line with what was found in chapter 6 among AMs.

Figure 14. How responsible investment is perceived by corporations

7.3.2 How is ESG integrated?

As became clear in the preceding chapter, investors do not always translate words into action. Indeed, many perceive ESG to be a peripheral issue (Mohrman and Worley, 2015). When investigating this issue at the portfolio company level, the results are more encouraging. Twelve companies do not separate sustainability from the rest of the business. Respondents mention that it is ''pretty much'' part of everyone's job. Hence, the silos that were found among AM respondents do not seem as pronounced among portfolio companies. This might be connected to the fact that they are stronger believers of the business case for ESG. It must also be noted that they are subjected to many external influences, such as customers, suppliers, regulators, society, the press etc. They are thus more interconnected and face more criticism from their external environment than AMs or AOs do.

However, on the supervisory board level, there are opportunities for further improvement as genuine interest from top-management seems to be present in about half of the cases, but this cannot be stated with certainty. Several respondents separate sustainability from the supervisory board. For example, by creating a separate board for sustainability and one of its members then reports to the supervisory board, or is on the supervisory board as well. This may be adequate and efficient if this person is genuinely interested and believes in the value-add. This person could also neglect to emphasize the importance of sustainability at board meetings. Another potential issue is that this person may not have the expertise. A study by Ceres finds that not many board members have sustainability knowledge. In fact, they find that only a mere 19% of directors who are part of board sustainability committees of large US corporations, actually have sustainability expertise (Ramani, 2015).

Looking at ESG incentives, many of them (17) tie ESG to senior level compensation. This is more encouraging than other research, which finds that only 25% of large U.S. corporations tie sustainability issues to executive compensation (Ramani, 2015). I find that, in 3 cases (1 in each country), the percentage of compensation that depends on non-financial targets is relatively high (25% or more). As to the time horizon, most bonus schemes are annual. The time horizon for the bonus depends, but the average employee bonus is annual. Senior managers tend to have a vesting period of 3 years (8 respondents). In 4 of the cases this is longer; 1 case where it is 1,3 and 5 years and 3 cases have a 4-year vesting period.

7.4 The ESG innovation catalysts

The internal and external ESG innovation catalysts as displayed in table 11 below, will be elaborated on in this section.

Table 11. ESG innovation catalysts

External	Times mentioned	Internal	Times
Stakeholders, especially customers	12	CEO	7
Investor interest [20]	4	It is in our corporation's DNA	6

7.4.1 External sources of innovation

Stakeholders (including NGOs, suppliers, customers (B2B or B2C), the local community or regulation) is, with twelve mentions, the most frequently cited reason to embark on the ESG journey. Sometimes they are mentioned under the umbrella term "stakeholders'', either in combination with this overarching term or individually. The consideration of the broader environment was not taken very seriously by companies in the 1960s and early 1970s (Slatter, 1980). As stakeholder claims increased with intensity, stakeholder-oriented planning processes became more common (Carroll, 1983; Charan and Freeman, 1980). According to some scholars some value must be created for this interest group if a business is to be successful. It benefits to be a good citizen, because a business needs a license to operate (Freeman and Ellen R. Auster, 2015). There are also stakeholders who do not have normatively legitimate claims on the corporation. However, these stakeholders may still have influential power. Examples of these groups are competitors or the media. Management still needs to consider them, given the potentially beneficial or adverse effect they may have (Jones et al., 2007; Phillips, 2003). The literature review elaborated on the role of social media and how quickly NGOs, such as Amnesty International, can harm a

[20] Investors can also be seen as internal to the firm since they are the owners. However, given the separation of ownership and control I consider every source that does not come from within the firm (i.e. employees, leadership), to be external.

company’s reputation. The importance of normative pressure also emerged in chapter 5, where the Zembla documentary on cluster bombs was mentioned by pension funds as a wakeup call. The media and NGOs act as ‘’watchdogs’’ who expose corporations’ unethical behavior. Equipped with social media attention, normative pressure is thus an important driver. Frequently, however, this type of urgent attention arises out of a disaster, or ‘’focusing event’’. This form of, sometimes fatal, wakeup call is costly. However, they do equip the problem with the necessary attention that is needed for a change in policy and politics (Kingdon, 1995).

Customers are considered to be key stakeholders (Ferrell, 2004). Indeed, ‘’customers’’ or ‘’customer demand’’ was the most frequently mentioned (seven respondents) stakeholder, to trigger the ESG journey. This was either in combination with other stakeholders or individually. We should therefore not forget that a corporation, whether environmentally and socially irresponsible or not, exists because there is a market for their products. For example, the 2013 Rana Plaza collapse in Bangladesh killed more than 1,000 factory workers. The price Primark paid for sourcing cheap clothes from this factory? A meagre $12 million in costs and their sales went up[21]. Another example, is the overwhelming evidence of the positive impact on both our health and our planet, of going vegan, vegetarian or at least by avoiding red meat (Erb et al., 2016; Eshel et al., 2014; Ranganathan et al., 2016). Knowing this, do we want to change our traditions, habits and indulgence? The short answer is no. At least not many of us. We know where cheap clothing comes from. We know the truth about oil companies and we know the truth about the meat industry. We do, however, have to cope with a substantial amount of personal inertia. If we truly wanted corporations to change and do our part in reaching the targets in the SDGs, we should perhaps start at home. Why don’t we, as consumers, give corporations more of an incentive to change? There is no market for socially and environmentally damaging products if we do not buy, or

[21] This is clearly not as easy as it sounds. Some brands may pull out of a market like Bangladesh as a result of a boycott, which would leave many locals jobless.

ask for them[22]. Note that this is in line with SDG 12: ensure sustainable production and consumption patterns (see section 1.2).

''Investor interest'' only has four mentions and is never mentioned as the sole trigger for starting the ESG journey. In fact, 16 of the interviewees do not feel pressured by investors at all. The interest from investors, however, is important, because it is used by several sustainability directors to create a sense of urgency internally. The majority of the group that feels pressured, state that it is not much or not enough. Four of them believe that this is a silent confirmation that investors are satisfied. because they are ahead of the game and that investors therefore do not ask many questions. According to them, investors are always one step behind. It is also said that some investors are box tickers and that they look for confirmation, not confrontation. For example, respondents mention that they do not receive comments (positive or negative) from investors about their ESG scores. Corporations do try to open the dialogue. As mentioned in the literature review, according to a 2015 survey conducted among 193 IR officers, 75% have asked investors for feedback in the 12 months preceding the survey (Citigate Dewe Rogerson, 2015). According to Fuller and Jensen (2002), a dysfunctional conversation between Wall Street and Main Street can do much harm. ''Clearly, it is time to restart the conversation on a new, stable, and enduring footing'' (Fuller and Jensen, 2002, p. 46). Improved communication will also lift the ''ESG disconnect'' between companies and their investors found in chapter 4.

7.4.2 Internal sources of innovation

The right CEO is as important as the consumer, with also seven mentions. One well-known example is Paul Polman, who drives change and promotes sustainability at Unilever. This is positive, because top management commitment is important to the innovation process

[22] I am aware that we have made great strides and that ethical consumerism is on the rise, especially among millennials and out of health concerns (Bucic et al., 2012). It would be beneficial, however, if more people were aware of how their purchases are made and the impact that has on our planet, our animals and fellow human beings. Large segments still perceive issues of, for example animal welfare, to be something that should be resolved by the food industry. These people do, however, feel upset when scandals surface (Ingenbleek et al., 2013).

(Tidd et al., 2005). As mentioned in chapter 6, decoupling is less likely to happen with the commitment of top management. CEOs therefore have a prominent role to play in leading their company down a more responsible path. The incentives of a CEO to do so, have been found to be both monetary and non-monetary. For example, a new incoming executive may not only have a longer time horizon, but might also want to gain legitimacy among various stakeholders. Powerful and entrenched CEOs or one with low career concerns, have also been found to engage in CSR (Fabrizi et al., 2014). Fortunately, an increasing number of CEOs realize that ESG is important. According to a 2016 PwC survey among 1,409 CEOs globally, 64% claim that it is central to their business. This is because they need to build trust with their stakeholders in the currently low-trust environment (PwC, 2016). Although it does not always mean that the CEO is truly driving change (Rangan et al., 2015), seven participants in my sample did recognize the role of their CEO in driving ESG.

The third most mentioned source, with six mentions is; ''it is in the corporation's DNA''. This is interesting because at least two of the companies who mention this, have had their share of disasters. In one case, about 200 people died, which makes one wonder whether this, perhaps, served as a wake-up call. Was this disaster the reason that they started taking ESG seriously? Unfortunately, that is difficult to state with certainty. What is clear, however, is that many of these corporations started paying attention to ESG issues early on and have gradually innovated or tweaked their strategy. These tweaks often add up to be significant over time. This falls into the previously mentioned continuous improvement (incremental changes) category, whereby the changes often merely affect a certain segment of the organization. They are therefore less risky. More importantly, this ensures that organizations do not fall victim to resistance as much, because their change capacity increases as a result of the continuous tweaks. They thus become more flexible over time as they adapt continuously.

7.4.3 ESG Innovation clusters?

The sample varies as there are progressive companies in all three countries. The findings do seem to cluster, to some extent, by sector. For example, certain sectors (i.e. oil and gas, chemical) have been heavily criticized in the past, as many accidents have occurred. These companies are, because of many disasters or ''shocks'', prone to more regulation and have had to improve their health & safety efforts significantly. Indeed, two interviewees mention that it is in the ''nature of the industry''. Another one stresses that the chemical industry was heavily criticized in the 1970s, which led to considerable changes. With such substantial normative pressure, it is difficult to suggest reasons why corporations should not change. Other sectors, such as the retail sector, have not historically been criticized as much and are therefore slower to change. Indeed, one respondent underlined that the retail sector is slow to change. This is also shifting, with organizations such as PETA increasingly criticizing animal welfare practices in the supply chain of clothing manufacturers, for example. Many companies then either continue business as usual or react and improve their ESG efforts. Few, however, anticipate these issues and take a pro-active stance[23]. As mentioned earlier, it is less risky to take a reactive stance as the market clearly signals when it is ready for change.

7.5 The ESG innovation inhibitors

7.5.1 Investor myopia and quarterly reporting

There has been ample discussion regarding the impact of investors on executives' myopia. Some research finds that institutional investors are not the reason for myopic behavior among companies (Dent, 2010; Wahal and McConnell, 2000), others argue that they are (Brossard et al., 2013; UN Global Compact and PRI, 2014). For example, one survey found that C-level executives or board members felt most short-term pressure from their own

[23] Patagonia is an example of a pro-active clothing retailer, at least on the environmental front (Kreitner, 2009). They are, however, privately owned by an environmentalist. On the animal welfare front, they are still regularly criticised by PETA, although they do take this criticism into account.

management teams or boards and not from the market (Bailey et al., 2014). I ask respondents if the holding period of investors affects the way they can create long-term value. Fourteen participants agree or strongly agree with this statement. However, several respondents emphasize that it also works vice-versa. If a company focuses on creating long-term value, they will attract more long-term investors. As discussed in chapter 5 and 6, several AOs and AMs also brought this up. Other scholars also emphasize that companies can make this happen by, for example, emphasizing long-termism in their communications. By doing this, they will attract investors with similar horizons and achieve a more stable stock price and investor base as a result (Brochet et al., 2011).

When asked about quarterly reporting, some state that it depends on whether the corporation in question feels like it is a distraction. The majority (11) of the respondents do not perceive quarterly reporting to be an obstacle per se. According to them, it is essential to keep the market updated and they do not see a problem as long as investors do not act on short-term numbers. Some have already moved away from short-term earnings guidance and towards including more non-financial information. Research indicates that those companies issuing earnings guidance, also tend to have a shorter-term investor base (Karageorgiou and Serafeim, 2014). Hence, there are elements of the quarterly report that could be excluded, such as earnings guidance, to encourage long-termism. Instead, the focus could be on value-relevant financial and non-financial disclosure, which could help to resolve information asymmetry without encouraging short-termism. Of course, such a change must be implemented and communicated carefully, preferably by the CEO, to ensure that it is not interpreted as a negative signal (Kotsantonis et al., 2015).

Six respondents emphasize that long-term legislation or better guidance would be helpful in moving towards a longer-term approach. Some say that general myopia and greed is a problem of the system at large. For example, sustainability projects may be rejected because the return on investment (ROI) does not fit the traditional threshold. These opportunities may thus be rejected, because ''the system'' does not allow for it. If ESG is ever going to be truly embedded, this type of short-sightedness needs to be changed. The ''system'' suffers from fixation on short-term numbers, short-term targets and equally short-term incentive packages. Instead, if organizations want to be consistent with the SDGs, long-termism and ESG criteria should be part of the ''system''. Not only on the company level, but also on the AM and AO level, because becoming more long-term and responsible is a collective effort. This is especially true for the interconnected investment chain.

7.5.2 Lack of understanding

The need to further develop our understanding of ESG was mentioned by eight different respondents. This could be in the form of education and raising awareness among consumers, investors as well as employees. If these groups of individuals are not equipped with the necessary knowledge, it becomes difficult for corporations to drive change. Two respondents mention that ESG is complicated, because there are so many different facets to it. This is echoed by many of the AO and AM respondents who also expressed the need for education (chapter 5 and 6). One example of what is complicated for corporations, is that indirect ESG impact is difficult to claim. For example, if corporations roll out an innovation which saves water (i.e. dry shampoo, low-flush toilet), can they claim credit for their customers' reduced footprint? Should consumers then pay a premium for more responsible products? Along the same line, two respondents claim that there are data issues when trying to internalize externalities. Do costs and prices tell the truth?

7.5.3 Communication

When asked, seven respondents mention that they themselves must do a better job at showing investors the business case of ESG. They could help drive change by improving their communication. Interesting is that, instead of blaming others, company respondents acknowledge that they can do better. If they manage to communicate the business case, this will also help lift one of the main obstacles on the AM level that was found in chapter 6; companies do not sufficiently report on ESG performance. Demonstrating the value-add should also lift the main obstacle among AOs that was found in chapter 5; a lack of belief in the business case of ESG. If companies report in a clearer way by moving towards integrated reporting, for example, this may even reduce the number of ESG ratings and rankings described in chapter 4. After all, if the focus shifts to what the company sees as value-add or material, we do not need so many different scoring methods anymore. Other research also mentions that, if companies did a better job of selling the business case for ESG, perhaps more investors would be interested (Rytkönen and Louhiala-Salminen, 2014).

Another four respondents emphasize that there is a need for more communication regarding ESG, between the investor and the company. More specifically: mainstream analysts need to start asking questions. Currently, it appears to be more of a hygiene factor for them. Dialogue is, however, necessary for companies to feel the pressure. It would also help sustainability staff to use this external demand to convince top management to sign off on the sustainability projects. At the moment, as described in chapter 4, the ESG rating and ranking industry is often used as a substitute for a comprehensive dialogue or assessment.

7.5.4 Finding a balance

Customers may be the reason for a corporation to embark on their ESG journey, but they can also be a reason for them not to do so. Indeed, the notion of maintaining a proper balance, or ''finding the sweet spot'', is named by six respondents. Being too focused on sustainability makes you an environmental company, according to one respondent. A few others describe it as not producing anything the market is not ready for, as you cannot get too far ahead of customer demand. This also naturally makes it more difficult to be proactive in terms of product offering. Even further complicating this issue is, of course, that there are different customer segments that must be catered to. Customers with a below average income cannot afford to pay a premium for more sustainable food or products. Even if it pays off in the long-term, many customers will not invest in that ''low-flush toilet'' or those "LED energy saving light bulbs''. Hence, it makes sense to wait until customers are asking for it, or to make slow and incremental changes. Radically changing the business may leave a corporation with less customers than they hoped for. Gradually introducing more sustainable products is thus often the preferred way.

Balance is also mentioned by three other respondents in the context of growth and ESG efforts. The constant requirement to deliver growth takes away from sorting out ESG related tasks. Reducing carbon emissions, for example, whilst delivering growth can be a difficult task. However, delivering growth is often a pre-requisite for job security. It is therefore no surprise that three other participants say that they need (more) top management commitment. As mentioned before, this is crucial in the innovation process. It will help employees feel more supported in their endeavors and ensure that the corporation is truly changing for the better. Additionally, this will free up resources for those involved in ESG related tasks. These three participants, on the other hand, may never get the resources they need as their top management is not sufficiently committed. Because the executives do not truly believe in ESG, they may engage in decoupling and claim that they incorporate ESG whilst not supporting their employees in the implementation. One of the companies was a clear example of that, as the respondent disclosed that their CEO was not interested in ESG in the least. The other two did not disclose this level of detail.

7.5.5 The ESG rating and ranking industry

As chapter 4 pointed out, the ESG rating and ranking industry can be a nuisance to companies. Four respondents mention that harmonization, or increased transparency of these initiatives would help. They want to spend less time filling out duplicate surveys and are frustrated with time-consuming questionnaires, such as the DJSI. As mentioned in chapter 4, it can be helpful for companies to implement a filtering system that is aligned with their strategy. For example, they may want to participate in the CDP water program if they are a heavy water user. They can also decide to only participate in those ratings with the widest coverage and therefore most likely used by investors. Of course, communicating choices is essential to prevent potential misalignment.

7.6 Conclusion and limitations

Many scandals have surfaced in the last few decades. From governance scandals to environmental- and social disasters. Corporations have, to nobody's surprise, been under a substantial amount of pressure. This can take many different forms; media attention, NGOs, the rating and ranking industry, shareholder engagement, divestment etc. This chapter investigated to what type of pressure companies are most responsive. The triggers for companies to embark on their ESG journey have not been researched extensively. Uncovering these drivers, however, can inform our methods to help mainstream RI. Moreover, the AM participants in chapter 6 claimed that they pressure their portfolio companies regarding ESG. Do companies truly feel challenged by their investors? To answer these questions, this chapter draws on company interviews in the UK, the Netherlands and Germany.

The findings are threefold. First, I find that companies are more reactive than proactive when it comes to ESG integration. Even though companies are stronger believers of the business case than AOs and AMs, most started their ESG journey because they reacted to their external environment. Especially ESG disasters and the subsequent normative pressure seem to have served as a wake-up call to incorporate ESG. This ability to respond means that they have the ''absorptive capacity'' to learn and to change. Nevertheless, this reactive stance means that something must go wrong first. As discussed earlier, these type of wake up calls can shock companies into fundamental change (Porter and van der Linde, 1995). Indeed, fatal mistakes or ''focusing events'' in the early days may shape a better health and safety program (or overall ESG program), as it creates a sense of urgency (Birkland, 1998). Looking at the sectors that have been under scrutiny historically, such as oil and gas and chemical companies, it seems that their ESG program is more developed (in this sample) than that of retail companies, for example. This reactive stance of corporations towards ESG was also found in a global, quantitative sample. Cheong et al. (2017) find that negative market and investor sentiment in the prior year encourages companies to enhance their CSR performance in the year that follows. It is thus likely that only a small number of companies are pro-active about ESG. Several reasons may be the cause of this. First, with the customer being a key stakeholder, they are hesitant to introduce a product the market is not ready for. Several companies mention indeed that the trick is to ''find the sweet spot''. Second, multinational corporations may suffer from immensely complicated supply chains. If a corporation wants to make claims about the sustainability of their ingredients, they should be certain about the practices of their suppliers. With thousands of suppliers, is this feasible? Point being; the incremental changes and reactive stance of the corporations on ESG in my sample, is likely common among multinational corporations.

The second finding is that stakeholders, particularly the customer, is the most frequently mentioned source of innovation. This means that we, as the customer, have a significant role to play in driving ESG adoption. To ensure that we carry out this duty, a case can be made for better consumer education. However, it is not only the education deficiency that needs to be resolved. Often times, we simply buy what is cheapest or aesthetically most pleasing (Brown, 2013). If there is more transparency as to where our products come from, perhaps we would shift to the most traceable products. Perhaps, if the social and environmental benefits were more clearly communicated on responsible products, we would be more inclined to buy them. This could be communicated as ''contribution to the SDGs'', or alternatively ''harm to the SDGs''. Of course, to implement this type of labelling we need more transparency and we need to introduce some of the tracing tools of the clothing industry in other sectors as well. Alternatively, some scholars suggest a more emotional message on the packaging. This will make consumers feel guilty (Brown, 2013; Trijp, 2013). Because of complex supply chains, we are so far removed from reality, that it is simply hard for us to empathize with the underpaid workers who manufacture our clothes. As well, it is difficult for us to feel responsible for oil spills, because we were not there to witness the environmental impact.

Third, I find that companies appear to be struggling with similar obstacles as those found in the earlier chapters on AOs and AMs. Encouraging is that companies do not blame others. In fact, they state that they should do a better job at communicating the business case of ESG. The idea that corporations should better communicate the value-creation of ESG, is in line with the efforts of the International Integrated Reporting Council (IIRC). This practice is still in its infancy and many companies are unsure how to set it up (Burke and Clark, 2016). Nevertheless, it is encouraging to find that companies acknowledge that they can do better. If they do indeed clearly communicate it in the future, it will lift several other obstacles that were found in the other chapters. For example, the obstacle on the AO level that there is a lack of belief in the business case. Or, on the AM level, the difficulty of comparing companies to each other. Lastly, the ESG rating and ranking industry may become less crowded, if a companies' ESG efforts are easier to understand.

Overall, companies are tentatively beginning their journey and exploring the balance of consumer demand and ESG. I do not find any significant country related differences, which may be due to the multinational nature of the companies involved and the likelihood of convergence (see variegation of capitalism debate in section 3.7). What I do find is that, without the demand or necessity, companies are likely not going to change. Hence, if we want to be consistent with the SDGs, we should be aware of the changes we can make at home. We also have a role to play in achieving the SDGs, either in the role of the beneficiary or the role of the consumer. Our purchasing behavior should thus be aligned with our values. Equally, the government should play a more preventative role to ensure achievement of SDG 12; sustainable production and consumption patterns. They could introduce a scheme, whereby products with a high social and environmental footprint are more heavily taxed. Once again, we should obviously first make sure that we have a transparent and straightforward way of calculating it. Additionally, they could introduce education tools aimed at customers, such as informative advertisements or campaigns. This will underscore government commitment and ensure that consumers have an independent source of information. Lastly, the local government and individual municipalities should also align their procurement policies with these values. Some efforts have already been launched, such as the EU Energy Efficiency Directive, the Government Buying Standards (UK) and Greening Government Commitments/Grondstoffenakkoord (UK/NL). These policies should be monitored, communicated and reviewed thoroughly, as it is crucial that the government leads by example.

There are several limitations to this chapter. The first one is clearly the sample size, as only 20 companies were interviewed. This limitation is even more pronounced, because of the spread over the three different countries. It would be interesting to construct a survey based on the findings in this chapter and then roll it out among a broader group of multinational companies, in different countries. Secondly, there were some insights that surfaced in the analysis, that could not be sufficiently explored. For example, board interest in ESG did not seem to be satisfactory in all companies interviewed. This was difficult to explore, given that some respondents were either far removed from top management or did not want to disclose further details. Some of the respondents were also far removed from the reach of investors and therefore had difficulty answering investor-related questions. This was, however, resolved by following up with the investor relations department. Another limitation concerns the pinpointing of an ‘’ESG innovation cluster’’ in a small sample. To more accurately investigate this, one could repeat this effort in a larger sample, evenly spread across different sectors. The knowledge sharing networks these companies are part of should also be considered, to account for other sources of innovation.

8 Conclusion

8.1 Summary

This thesis' aim is to find out if there are misalignment issues in the investment chain when it comes to RI. The investment chain I investigate is a simplified one, but comprises the most significant parties; the AOs, the AMs and their portfolio companies. Additionally, I include an important intermediary between AMs and companies; the ESG rating and ranking industry. RI and the academic studies that investigate it have steeply risen over the last few years. This popularity, however, is not indicative of how well we understand this holistic way of investing. The reasons for a qualitative investigation into how RI is implemented by the parties mentioned above, are four-fold. First, although AMs often use the ESG rating and ranking industry to allocate billions of dollars in capital, our knowledge of this industry is lacking. Second, recent evidence suggests that AOs and AMs may not be aligned when it comes to ESG (Nicholls et al., 2015). Although this may be true, there is no research that explores the underlying reasons. Third, very little is known about the way AMs incorporate ESG into the way they make investment decisions. Fourth, although everyone appears to believe that ESG is important, little seems to have materialized. This hints at a larger problem, whereby some actors may not be translating words into action. Another possibility is that there are other bottlenecks in the investment chain, such as short-termism, a narrow interpretation of fiduciary duty or a lack of education. Given the urgency of the SDGs, these concerns should be explored and resolved.

I approach this investigation by first drawing some boundaries. First, I narrow the research to three different countries; the UK, the Netherlands and Germany. These are countries that are relatively advanced when it comes to RI, although they are at different stages of development. They are also countries that all fall under EU regulation, meaning that ESG policies are not widely different to the extent that it causes all the variation in the sample. Second, I narrow the research by only focusing on equities, as ESG incorporation is more advanced here than it is in other asset classes. I also focus on the model whereby investment-decisions are outsourced to AMs, to better understand potential agency issues. Lastly, I make use of the UNPRI signatory list to identify my interview respondents, since these signatories have started their ESG journey and therefore have a story to tell. The additional information they must disclose as a signatory, also provides helpful preparation or cross-check material. With these boundaries in place, I conduct in-depth interviews with 45 respondents in the UK, the Netherlands and Germany, I conclude that there are disconnects at every level in the investment chain.

First, the ESG rating and ranking industry has become an intermediary between investors and companies. Over the years this has caused a major issue; investors and companies do not have in-depth discussions about ESG. The demand from investors is important though, because it incentivizes company's top management to sign off on sustainability projects. In the last chapter, I do find that investors are not the main reason for companies to embark on their ESG journey, which makes the disconnect between companies and their investors less profound. Nevertheless, investors could make more of a difference by talking to their portfolio companies about ESG. Secondly, I find a significant obstacle on the AO level; they are not that convinced about the value of ESG. This is, of course, a major impediment since it may cause a superficial adoption among AOs. Additionally, I find that there are few in-depth conversations between AOs and their AMs regarding ESG. Because of insufficient pressure from AOs, AMs often get away with superficial ESG integration. I also find silos between ESG and finance; about half of the AMs I interview have a separate finance and ESG team. Overall, very few financial analysts are all-round specialists. Lastly, the company chapter established that the consumer plays a significant role in driving ESG at the company level. If we deem the planet to be important and if we want to be consistent with the SDGs, we should behave and purchase accordingly. This will then drive companies to bring more responsible products to the market.

8.2 CONTRIBUTION OF THE CHAPTERS

The chapters each shed light on a different actor, or component, in the investment chain. These layers are connected either through mandates or ownership. By both looking at the broader picture of how the different components fit together and then exploring these components separately, I investigate the way RI moves through the chain and where it is obstructed. I investigate the actors or components both separately and together, as impediments may reside at the different levels or even between them. Hence, I examine a specific player, but also ask them about the actors they are connected to. This enables me to gain insights into the different links that feed into or flow from the actors in the investment chain; it shows how the puzzle pieces fit together.

8.2.1 Chapter 4

The first puzzle piece investigates the role of the ESG rating and ranking industry. I find that the sheer number of ratings, rankings and indices causes more ambiguity and reporting fatigue than it brings benefits. Although little is known about this industry, I find that they have become an important intermediary between AMs and companies when it comes to ESG. This likely happened for several reasons. First, the incomparability of sustainability reports was and still is often a frustration for AMs. To make matters worse, these reports often fail to point out the value-add of ESG. Second, AMs with often large portfolios do not have another way to screen such a large number of companies on ESG. Although AMs likely did not have ESG expertise when they first started incorporating it (as it was and still is in some countries, not widely taught in universities), I find that this lack of knowledge is not very pronounced in my sample. Those AMs who do not have the expertise can also rely on the third-party opinion of the ESG ratings and ranking industry.

I continue to explore the industry, to develop our understanding of this important intermediary. I research what the industry entails, how it came about and how it developed over the years. I also investigate the way practitioners make use of this industry. What becomes clear during this analysis, is that the industry has peaked and that, going forward entry barriers will go up. This is based on several findings. First, to stay afloat in this competitive industry, many have acquired others or formed partnerships over the last few years. The ILCA supports this finding; the industry is transitioning into the maturity stage and we can thus expect consolidation to continue. Second, corporations claim that reporting fatigue is at a peak and many have or will have to start ignoring the requests of non-established players. Third, AMs have already chosen their preferred providers and in many cases these ratings become somewhat embedded in the investment process (and are hence difficult to change).

I conclude the chapter by suggesting that companies can mitigate reporting fatigue by implementing a process to filter out requests. For example, given that investors with large portfolios tend to rely on mainly those ESG ratings with wide coverage, companies could do the same. The choice to only continue with a handful should then be clearly communicated to shareholders to avoid misalignment. The same goes for the other actors in the investment chain as they all need to be aware of the pitfalls of the ESG rating and ranking industry. Companies can also look at what is material to their business and then respond to corresponding initiatives. For example, CDP water for heavy water users. The point is that, if companies want to alleviate reporting fatigue, they need to be selective and communicate their choices. These decisions do not only help in coping with the ESG questionnaire ambush, but such a sensible approach also displays competence. Once this clear stance has been established, they can free up reporting time and invest it in more urgent matters.

This chapter enriches the literature by further developing our understanding of the ESG ratings and ranking industry. It shows how the industry has developed over the years and it provides the most comprehensive overview of the landscape in the literature (to my knowledge). This type of overview is helpful in raising awareness concerning the number of ESG initiatives. These insights provided in this chapter should make AOs, AMs and academics more aware of the pitfalls of ESG ratings and rankings. Moreover, it adds novel insights as to how it is used by practitioners. Additionally, corporations can use it to enhance their understanding of how the industry works and how they can mitigate ESG reporting fatigue. Lastly, based on these findings, regulators and policy makers may decide to intervene and regulate this industry (further elaborated in section 8.3.1).

8.2.2 Chapter 5

The second piece of the puzzle examines the diffusion of RI among AOs. I find that, although several AOs have made great strides in setting an example, others still have much work ahead of them if they want to be consistent with the SDGs. I estimate that the innovators and early adopter group are there (MacIntosch and Scheibelhut, 2012), but the early majority still needs to be persuaded. A further investigation reveals that there are several reasons for this reluctance to adopt ESG. First and foremost, there is a lack of belief in the value-add of ESG, which is likely the source of the problem. After all, if the belief or the will is there they should be able to find a way. There are other reasons that further complicate matters for AOs. There is the issue of complexity, which refers to both the many facets of ESG as well as the outsourcing decision. Although the latter is a frequent occurrence among AOs, it comes with agency issues. The right monitoring and review processes need to be in place to make sure that AMs incorporate ESG the way that is expected of them. If one outsources to many different AMs, however, there is the issue of spreading too thin.

This brings us to the communication problem. If AOs spread themselves too thin, they can clearly not have the same in-depth conversations (i.e. about ESG) as they could with a handful of AMs. Of course, smaller AOs spread themselves too thin rather quickly and do not have the same resources as compared to the larger ones. Nevertheless, in this sample of rather large AOs, a lack of dialogue was found between these two actors in the investment chain. If ESG is perceived to be so complex, why make it more complicated by involving so many parties? Would it not be more helpful to invest the additional effort into thoroughly understanding the ESG strategy of only a handful of AMs? To have extensive review meetings and to get a better idea of what you own and why? These extensive efforts of the

AOs to drive ESG forward would also send a clear message; ESG is important. Currently, this signal does not clearly come across to AMs, if at all.

What also surfaces during the analysis, is that certain pension systems are more conducive to RI than others. We should be careful to place the same expectations on AOs in different countries of different sizes and with different asset allocations. Countries like the Netherlands and the UK have a well-developed pension system, which results in larger pension funds (with more resources). There are also many small pension funds in the UK, as the pension landscape is very fragmented. Can we then place the same expectations on these small players? Arguably not. As mentioned above, they likely spread themselves too thin and likely do not have sufficient knowledge of RI to begin with. That is why the consolidation initiative by the LGPS is likely going to help enhance RI efforts, as the smaller ones learn from the larger ones. Another issue relating to the pension system is whether these AOs are significant equity holders to begin with. German AOs, for example, are not as much invested in equity as the Dutch and the UK AOs are. They can therefore not be expected to pull the same weight.

This chapter contributes to the literature by concisely outlining the drivers and barriers to RI for AOs. Little research has been done on what motivates these powerful investors to incorporate ESG, although it provides valuable insights. It also raises important points on the consequences of the way RI is set up internally and how it is likely influenced by the pension system at large. More specifically, not every set-up is equally conducive to RI and we therefore need to be mindful in treating AOs (or pension funds in particular) as a homogenous group. Size differences and the (often related) choice of outsourcing over insourcing can have a real impact on the way these actors can encourage RI. Lastly, the chapter uncovers an important insight as to the extent to which AOs are convinced of the business case of ESG. If we do not resolve this weakness first, we cannot reasonably expect for them to strengthen their efforts and to take the lead in implementing the SDGs.

8.2.3 Chapter 6

The third piece of the puzzle investigates whether AMs translate their words into action. I conclude that some AMs tend to engage in decoupling the saying from the doing. This was, to some degree, expected based on the preceding chapter. When AOs do not have the right selection, monitoring and review methods in place, AMs can get away with superficial adoption of RI. What I mean by decoupling, is that the financial and ESG analysis are often separated. When traditional investment analysts are not trained in ESG issues and vice versa, it can impede the comprehensive consideration of ESG. The silos that I find between ESG and finance are both implicitly and explicitly mentioned by respondents. Although they do believe in the value-add (more so than most of their clients), not all of them have taken the step towards integrated thinking. What is encouraging, is that it seems that the majority know (at least approximately) where to go from here. However, it is a time-consuming process that is further complicated by several obstacles. In addition to a lack of probing from their clients, there may be other reasons behind these silos as well. It could be due to a lack of trained ESG people, but it is also likely that top-management commitment is not yet sufficiently committed to the cause.

A problem related to the silos is that the ESG department is, to some degree, outsourced to the earlier analyzed ESG rating and ranking industry. Then, if the ESG department does not contribute any unique resources, how can it become equally as important as the financial department? Of course, some AMs add their own contribution to the raw ESG scores. Yet others only use the narrative as an input for their own type of analysis. However, there are also still many strategies that do blindly rely on the raw scores. If the AM does not offer any other investment products with a more thorough or unique way of integrating ESG, it then becomes clear that they do not truly have any competitive advantage in ESG. With the ever-growing importance of RI, these AMs should be cautious about blindly relying on a third-party.

The disconnect that surfaced during this analysis is not only on the discrepancy between words and action. It also became clear that there is a lack of interest from clients, although many clients do think that they stimulate ESG incorporation. However, box-ticking such as ''are you a UNPRI signatory'' does not signal to the AM that their clients are interested. Neither does the occasional question about ESG or simply handing them an exclusion list. Instead, AOs should try asking the tough questions and challenge AMs to defend their strategy and choices. Of course, as demonstrated, this not possible for all AOs as their set-up may limit the extent to which they can drive this movement forward. When AMs do move to a more integrated way of thinking, they may be better able to explain their ESG strategy to their clients as well. They may also be able to send a stronger message to their portfolio companies, who fail to detect a real interest from their shareholders.

This chapter contributes to the literature by exploring the way AMs incorporate ESG. As previously emphasized, there is a lack of knowledge on the type of data used by AMs and how it is incorporated in their decision making (Delmas et al., 2014; Martin et al., 2007; van Duuren et al., 2015). Again, the qualitative nature of the analysis furthers our understanding of the way RI moves through the investment chain. It also shows that, adding in the AM intermediary (between the AO and the portfolio company), does not come without its share of problems. This chapter examines the AM and shows exactly how this intermediary may stifle ESG. It calls for AOs to be more cautious in assessing the ESG expertise AMs claim to possess. Moreover, it contributes to the earlier discussion on the insourcing/outsourcing issue of RI.

8.2.4 Chapter 7

The last puzzle piece is that of the portfolio companies. I find that companies are more reactive than proactive when it comes to ESG. They tend to change when their stakeholders pressure them for change, or when a disaster shocks them into change. The most important reason for them to embark on their ESG journey is the customer (B2B or B2C). Although this is not surprising, this does put things into perspective. If they want to be consistent with the SDGs, customers can play a significant role by purchasing more responsible products. However, this sounds easier than it is, as there are several problems with this proposition. First, consumers may not understand the impact they can have. There is insufficient straightforward and independent information for consumers to educate themselves. Second, they may not care enough to alter their purchasing behavior. They have been buying what they want for many years, so why change now? Moreover, we are often so far removed from the production phase, that it becomes difficult to empathize. There are so many intermediaries that it becomes easier to lose sight of who is accountable and to engage in moral decoupling. Lastly, it might not be clear to them how to live more responsibly. For example, product labels do not inform consumers how much water or carbon emissions were used for that specific product. It is difficult to make the right decisions without clear information. Nevertheless, consumers are increasingly starting to ask where products come from. This movement makes corporations more accountable to society, as their practices are scrutinized. These questions and concerns provide them with clear signals as to where they should be headed. Historically, it appears that the sectors that have been pressured for a longer time have a better idea of how to incorporate ESG. Equipped with social media, normative pressure can be a powerful tool.

Interest from consumers is especially important as corporations do not detect a real interest from their shareholders. According to them, investors are often one step behind and simply fail to send them a strong message regarding ESG. The interest is either not there, especially not from mainstream analysts, or it is merely to confirm and never to challenge. They are nevertheless the fourth most important driver for corporations to embark on their ESG journey. If investors were to more successfully signal their interest in ESG, they could make more of a difference. Additionally, important to mention is that corporations realize it is not only the consumer or the investor who are responsible for advancing ESG. They acknowledge that they have a responsibility to communicate the value-add of ESG and that their efforts fall short of what is needed.

The findings in this chapter reveal the untold story of the way corporations cope with the rising popularity of RI. This final puzzle piece ties the rest of the findings together, by demonstrating how ESG interest is received at the bottom of the investment chain. The catalysts and inhibitors of ESG incorporation can inform the methods used to advance RI and the SDGs more generally (further elaborated in section 8.3.5). It also establishes that companies can play a more significant role in driving RI, if they want to be consistent with the SDGs, by more clearly communicating how ESG enhances their business (further elaborated in section 8.3.4). This insight can help policy makers and regulators, or even reporting initiatives, to strengthen the case for better reporting.

8.3 Impediments and proposed solutions

As described. several impediments related to ESG, have surfaced in the investment chain. Putting all the pieces of the puzzle together enables us to find the bigger threads that run through the different chapters. This does not only further enhance our understanding and fill gaps in the literature, but more importantly, it provides us with a starting point to resolve the problems that have been identified. This section provides an overview of recommendations to overcome the impediments that were found in this thesis.

8.3.1 Endorse a handful of ESG rating agencies

The first apparent impediment is that of reporting fatigue. Fortunately, the overwhelming number of ESG ratings and rankings can be managed, for example, by learning from the credit rating industry. As previously discussed, the SEC intervened around 1975 to introduce the Nationally Recognized Statistical Ratings Organizations. This meant that only long-recognized ratings were relevant for SEC regulations and both the smaller and new ones were omitted (Coffee, 2006; Sylla, 2002). Hence, a handful of the largest ESG rating agencies could be endorsed, which will stop the other ones from overwhelming companies with questionnaires. Clearly there are downsides to consider, such as a potential decline in quality, as the competition decreases. What also complicates this, is that the largest rating agencies are not necessarily of the highest quality. Their large coverage does not change the issue that their proxy is likely a noisy indicator for ESG performance. Due to the qualitative nature of RI, ESG ratings are not as straightforward as credit ratings. Nevertheless, that does not mean we need 100 noisy proxies for ESG. In the interest of reducing reporting fatigue and the currently too many opinions, policy makers and regulators could consider endorsing a handful of these agencies. This could be done based on criteria such as the transparency of their assessment, the consistency in the scoring, their feedback mechanisms and their use of information that is already public.

8.3.2 A call for dialogue

Another interesting thread that can be observed throughout the investment chain (when it comes to ESG), is the lack of dialogue between the different actors. In one case, it is the ESG rating and ranking industry that has, to some extent, become a substitute for a conversation between the AM and their portfolio company. As we shift away from dialogue by adding layers of intermediaries and thus complexity, misalignment likely results. As discussed above, companies fail to detect any real interest in ESG among their (mainstream) shareholders. They hardly receive any questions from mainstream analysts on ESG in general. They do not tend to receive comments on their ESG rating or ranking scores. Their shareholders, however, do claim to be interested but apparently fail to signal this to their portfolio companies. Companies indicate that investor interest is helpful, as this interest creates a sense of urgency for ESG internally. Moreover, it provides them with an informed idea of what is expected of them.

In another case, AOs often add in the extra intermediary as they outsource to AMs. This additional layer of complexity requires extra checks and balances in the form of monitoring and review processes. As if this is not complicated enough, they often outsource to 20 or more different AMs. It then becomes even more difficult to have an in-depth conversation about ESG with each of their AMs. The current situation is therefore that AMs do not detect a real interest for ESG among their clients. AMs indicate that tough questions need to be asked and in-depth discussions need to be held to make the interest clear. Given the finding that many AOs find ESG complex or difficult to understand, this dialogue becomes even more important. Of course, the finding that AOs do not truly believe in it also likely plays a role in the lack of comprehensive monitoring and review processes. The issue of education will be elaborated on in section 8.3.4.

8.3.3 Reporting the value-add

The belief in the value add of ESG appears to weaken as it travels upwards in the investment chain. This means that the message, which starts on the company level, gets lost in translation as it travels up to the AO. With the lack of clear sustainability reports (or rather how ESG links to the strategy) and lack of dialogue, ESG ratings and rankings emerged to supply the need for comparable ESG data. To some extent, they resolved the ‘’bad data’’ issue, but failed to demonstrate the value-add of ESG. For this, we need companies to improve their reporting efforts and to show us how ESG has enhanced their business. This will resolve several obstacles that were identified by this thesis. First, AOs indicated that they are not strong believers of the business case of ESG. This is especially pronounced compared to AMs and companies. Reporting that clearly demonstrates the value-add, will help convince these powerful investors. Second, AMs indicated that they need better data to make their investment-decisions and they acknowledged that ratings and rankings are not perfect. Once companies can better demonstrate the benefits of incorporating ESG, AMs can use this information (i.e. on cost savings achieved through ESG enhancements) to make investment-decisions as this both enhances their understanding and makes ESG more tangible. They can then also better communicate to their clients what their ESG strategy entails and what the value-add is. This then resolves the difficulty AOs have in distinguishing between AMs that integrate ESG well and those that do not. Third, this likely makes the ESG rating and ranking industry less crowded, as it greatly diminishes the need for a third-party opinion.

This brings us to the question of what this reporting could look like. As one size does not fit all in the case of ESG, it is preferably the company’s own opinion of how ESG enhances their business. It is helpful if companies focus on what is material to their business and then shed light on matters such as cost savings achieved through ESG (amongst other material items). An investor can then deduce (from the targets) how much more costs can potentially be saved. It would be even more helpful and credible if these numbers were audited. Given investors' large portfolios, however, it should also be somewhat standardized to make it comparable, yet provide sufficient flexibility for the individual cases. Another option is that these material items reported by companies are used to improve the accuracy of ESG ratings. If not, the material items are likely included on the Bloomberg Terminal, which can then be used by investors to analyze trends and screen their portfolios. Another, more elaborate possibility comes in the form of the Integrated Reporting movement. As mentioned briefly in chapter 7, this movement is chaired by the IIRC. A downside is that the Integrated Report may seem like a daunting task and it appears that many companies are unsure how to set it up (Burke and Clark, 2016). Some also consider this movement a failure, as it is focused on producing a report for investors and not for society (Flower, 2015). It nevertheless supports companies in integrated thinking. Once companies clarify the ESG message, it can travel up the investment chain to help AMs choose responsible companies and persuade those AOs that need convincing.

8.3.4 Educate and enable the consumer

Another recommendation, in line with SDG 12, is to target customers' irresponsible purchasing behavior. As previously suggested, there are different reasons why consumers may not be incorporating ESG in their purchasing behavior. There are also different ways to guide these consumers. The ones that are indifferent, uninformed or unsure as to how they can approach this, could be targeted by government campaigns. These awareness campaigns could explain what responsible products are and outline clear ways of how consumers can start making a difference. This will not only be informative, but it will also be more credible coming from the government. The next step would then consist of implementing clear product labelling. The ideal situation would be to let consumers know if they are buying a below average product for climate and society, or above average. This could be linked to the SDGs, but that is not likely feasible on a product-by-product level. More feasible is then to have a mandatory QR code on products that will provide you with more ESG information on the company you are buying from. Another possibility is the rollout of track and trace solutions in sectors besides retail. This can be a daunting task depending on the number of suppliers involved, but it can bring many benefits. It can tremendously improve visibility and thereby address accountability issues. It can also help validate claims made by the producer and of course improve general logistics and supply chain management.

8.3.5 Clear and consistent policies to transform the ‘’system’’

A number of respondents mentioned that a ‘’system change’’ is needed. To meet the targets laid out in the SDGs, the financial system needs to be reformed. This is clearly a collective action problem. Public policy and legislation can therefore play a significant role in changing the system. One could start by taking stock of various initiatives and by drawing up roadmaps for individual countries or regions (UNEP, 2016). An overarching roadmap for the EU was recently published by the EU High-Level Expert Group on Sustainable Finance. One main recommendation that follows from the review, is to clarify investor duties with regards to long-termism and ESG. It is likely that legislation will support this recommendation in the near future (HLEG, 2018), for example the 2017 update on the EU Shareholder Directive. This regulatory pressure will coerce investors to incorporate ESG, which will, if enforced thoroughly, likely alleviate impediments such as decoupling. However, it will not resolve impediments relating to the lack of belief or the crowded rating and ranking industry. Policies that focus on making certain issues more material on the other hand, will incentivize investors to make ESG part of the core business. For example, natural resources need to be measured and priced appropriately to ensure that they are no longer externalities (Cohen et al., 2017; Garrick et al., 2017; Hepburn et al., 2018). Currently, there is no place for natural capital in traditional economic (or financial) models, as it is assumed that it can be replaced by man-made capital. This is, of course, not the case (Cohen et al., 2017). To steer 'the system towards a more inclusive approach, clear and consistent policy formulation is necessary on issues ranging from a global price on carbon, to abandoning fossil fuel subsidies, to supporting environmentally beneficial innovations and to increasing the price of harmful products (Hepburn et al., 2018). Of course, there will be challenges in enacting climate change policy, such as the local culture of markets and tying together existing schemes (Knox-Hayes, 2016).

8.4 Limitations and further research

A limitation that has already been stressed is that the sample size is small, especially considering the fact that they are spread over three different countries. This was, to some extent, inevitable as the qualitative in-depth interviews are a time-consuming research method. It was also the only way to explore the reasons behind some of the pain points in the investment chain. Even though the sample is indeed limited, the respondents are significant investors and corporations with corresponding significant insights. Another limitation, is that I exclude a considerable number of potential respondents by only approaching UNPRI signatories. As previously stated, I still capture variety as there are a substantial number of approaches to ESG. The UNPRI signatory restriction also does not mean that everyone is at the same point in their journey. What is important, is that they need to have started their journey one way or another to have something to talk about.

As discussed in Chapter 2, there are also limitations with the methods of the research. After all, the novelty of my insights depends on the respondents I interview. Moreover, one respondent may be more willing to talk than others, which complicates comparison across the sample. To mitigate this issue, I offered anonymity to the participants and I decided not to record the majority of the sessions either. Nevertheless, I am aware that the insights are fully dependent on how honest and talkative the respondents are. Further complicating this matter is the qualitative nature of the analysis. As previously discussed, researchers are biased both in the way they interview and in the manner in which they interpret the results.

Although I believe that my industry experience helped in establishing rapport, conducting and interpreting the interviews, I acknowledge that my interpretation of the results is subjective.

As previously suggested, further research endeavors could use the findings of this thesis to construct a survey and thereby investigate the ideas among a larger group of respondents. This would be interesting for a few of the issues that emerged. One issue that has, since the publication of my fourth chapter, been examined by others is ESG reporting fatigue. The Conference Board has investigated this issue by conducting a survey among its 61-member companies. I am the lead author of their briefing paper because their findings are similar to those of my thesis; companies suffer from reporting fatigue. As mentioned in the corresponding chapter, this subject could also be further enriched by adding in response rates from ESG ratings. The downside is that they are likely difficult to obtain. Another topic that would lend itself well to a survey, was brought forward in chapter 7; What are the sources of ''ESG innovation''? It would be interesting to investigate this in a broader group of multinational companies in different industries and countries. A larger sample would then be more conducive to detecting certain industry or geographic patterns.

An interesting research topic that emerged in chapter 5, is why so many large AOs still outsource investment-decisions. Although building up in-house investment capabilities comes with its own challenges (Clark and Monk, 2013), several papers have demonstrated that it outperforms outsourcing (Ambachtsheer, 2016; Lum, 2006; MacIntosch and Scheibelhut, 2012). We do know that it takes a certain size threshold ($25 billion) after which it becomes more efficient to develop in-house capabilities (Dixon and Monk, 2014). Based on the sample in this thesis, it appears that AOs with AUM of more than $25 billion still tend to outsource investment decisions. Why do significantly large AOs choose this over developing investment capabilities themselves? To explore this avenue, several open-ended interviews could be conducted with large AOs. Based on the findings from these interviews, surveys could be conducted to target a larger sample size.

Other research endeavors could focus on how exactly ESG is developed and implemented internally. Case studies could provide in-depth insights from different people in the organization and investigate the role of champions when it comes to RI. They could also explore other, more subtle impediments, such as those relating to internal politics. This type of approach would also work well to further explore the nuances of decoupling processes at the AM level, or at other levels of the investment chain. Given the lack of research in this area, it would be an interesting avenue to explore the gap between what is said and what is done.

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Appendix 1: Timeline RI policies

1948 International Labor Organization Convention
1948 Universal declaration of human rights
1961 UN declaration on the prohibition of the use of nuclear and thermonuclear weapons
1966 International covenant on civil and political rights
1970 Campaign GM tries to push for diversity on the automaker's all white male board
1971 Formation of the Interfaith Center on Corporate Responsibility / Pax World creates first socially RI (SRI) fund
1972 Founding of the Investor Responsibility Research Center
1974 Geneva convention on weapons that may cause unnecessary suffering or have indiscriminate effects
1975 Formation of the Sullivan Principles for South African workplaces
Founding of Canada's Taskforce on Churches and Corporate Responsibility
Walden Asset Management becomes first institutional SRI firm
1976 International covenant on economic, social and cultural rights
Soweto riots in South Africa trigger stronger activism against apartheid
Founding of Calvert Investments
1977 OECD guidelines for multinational enterprises
Geneva convention and protocol §57-58 that the legal basis for negative cases on CCW & WMD
1978 Divestment movement on US campuses against companies operating in South Africa
1982 Trillium Asset Management launched by Joan Bavaria, later founder of Ceres
1984 Establishment of the Forum for Sustainable and responsible investment
Covenant on civil and political rights and general comment #14 on nuclear weapons and the right to live
1985 Founding of the Council of Institutional Investors
Creation of Institutional Shareholder Services
1986 Comprehensive Anti-Apartheid Act passes over Reagan veto
Founding of Pension Investment Research Center (now called PIRC) in the U.K.
1987 First US shareholder resolution on corporate governance at International Paper
1988 Major US companies withdraw from South Africa
Founding of Britain's Ecumenical Committee on Corporate Responsibility
1989 Exxon Valdez accident
Formation of Ceres
Financial action task force on money laundering
1992 Convention on biological diversity
Cadbury report on "Financial Aspects of Corporate Governance" (UK)
Founding of World Business Council for Sustainable Development
1995 International Corporate Governance Network formed
Former South African Supreme Court justice Mervyn King issues first report on corporate governance (King I)
1997 Ottawa convention on anti-personnel mines
Launch of Global Reporting Initiative
1999 UN Global Compact
First OECD corporate governance principles
Formation of Global Unions Committee on Workers' Capital
2000 UN millennium development goals
Wolfsberg standards
2001 UK Myners Report on fund governance
Enron collapses
Institutional Investors Group on Climate Change formed in Europe
2002 GRI becomes permanent standard-setting body

	Sarbanes-Oxley Act enacted in US
	Founding of European Corporate Governance Institute
	King II report issues
	Extractive industries transparency initiative
2003	UN convention against corruption
	First Investor Network on Climate Risk summit
	Founding of proxy advisory service Glass Lewis
2004	Second set of OECD corporate governance principles
2006	UN Principles for responsible investment launched
	Stern Review on the Economics of Climate Change released
2007	UN declaration on the rights of indigenous people
2008	Formation of Santiago Principles for sovereign wealth funds
2009	King III report calls for integration of sustainability and financial reporting
	Sustainable Stock Exchanges Initiatives (SSEI) launched
2010	SEC issues interpretive guidance on need to disclose climate risk
	UK Stewardship Code released
	Dodd-Frank Act enacted in US
	Oslo convention on cluster munitions (CCM)
	Unilever sustainable agricultural code
2011	Equator principles
	UN guiding principles on business and human rights
	Sustainability Accounting Standards Board created
2012	IFC performance standards
	US campuses embrace fossil fuel divestment campaign launched by 350.org
2013	International Integrated Reporting Council calls for adoption of multi capital model
2014	Ceres and INCR launch Clean Trillion campaign to boost global investment in clean energy to $1 trillion annually
2015	EU enacts Shareholder Rights Directive
	COP 21 meeting in Paris sets global decarbonization targets
	UN sustainable development

Source: (Hattem et al., 2016; Massie, 2016)

Appendix 2: Overview regulatory landscape ESG

8.5 The Netherlands

Institution	Year	Title	Classification	Status	Content
Corporate Governance Committee	2003, revised 2009	The Dutch Corporate Governance Code	Non-Government Imposed Corporate Governance Disclosure. Comply or Explain	Issued	Principles of good corporate governance and best practice provision implemented on a “comply or explain” basis by listed companies and large non-listed companies. It is divided into 5 chapters: compliance and enforcement of the code, the management board, the supervisory board, the shareholders and the AGM and the audit of financial reporting
Dutch Government	1838	Dutch Civil Code	Government Imposed Corporate ESG Disclosure. Mandatory	Issued	Article 2:391 subsection 1 of the code is the direct implementation of the EU Modernization Directive (2003/51/EC), and it requires that organizations should, to the extent necessary for understanding their development, disclose financial and non-financial information about the environment, employees and risks in their annual reports. This requirement is compulsory for all listed companies irrespective of size and all large non-listed companies.
	Updated 2015	Pensioenswet	Pension Fund ESG Regulation, Mandatory	Issued	States that the board is responsible for ensuring the investment policy includes an explanation of how the fund takes account of the environment and climate, human rights and social relationships.
European Union	2005, updated 2013	Emissions Trading Scheme	Government Imposed Corporate ESG Disclosure. Mandatory	Issued	Cap and trade system for emissions across 31 countries (EU, Iceland, Lichtenstein and Norway).
	2007, updated 2013	Shareholder Rights Directive (2007/36/EC)	Government Imposed Corporate ESG Disclosure. Mandatory	Proposed	Sets out minimum standards to ensure that shareholders have timely access to relevant information ahead of general meetings and can vote electronically.
	2014	Transposition of the EU Non-Financial Reporting directive 95/14	Government Imposed Corporate ESG Disclosure. Mandatory	In progress	The Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups amends the Accounting Directive 2013/34/EU. It requires companies concerned to disclose in their management report information on policies, risks and outcomes about environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues and diversity in their board of directors. This will provide investors and other stakeholders with a more comprehensive picture of a company’s performance. This is a legislative initiative with relevance for the European Economic Area (EEA). The EU member states are required to transpose the rules of the EU non-financial reporting directive by 1 Dec. 2016

	2014, 2016 update in progress	Revision of the Institutions for Occupational Retirement Provision Directive (IORP II)	Pension Fund ESG Regulation, Mandatory	In progress	The current draft requires pension funds above a certain size to consider ESG and disclose how their risks are considered in the Investment Policy Statement. The Directive is due before the European Parliament in late 2016 and must be transposed into Member State law within 24 months of approval.
	2015	Conflict Minerals Directive	Government Imposed Corporate Social Disclosure. Mandatory for certain companies	In progress	EU importers of tin, tantalum, tungsten and gold for manufacturing consumer goods need to be certified by the EU to ensure that they do not fuel conflicts and human rights abuses in conflicts and human rights abuses in conflict areas. In a vote of 343 votes to 331, with 9 abstentions, Parliament decided not to close the first reading position and to enter into informal talks with the EU member states to seek agreement on the final version of the law. Once approved, member states will have 24 months to adopt the provisions.
Federation of the Dutch Pension Funds and Dutch Labor Foundation	2014	Pension Fund Code (Code of the Dutch Pension Funds)- Section 2.7	Pension Fund ESG Regulation, Comply or Explain	Issued	Requires pension funds to define a RI strategy and disclose it publicly. Furthermore, the pension fund should take shareholder interests into account in the investment decision process. Compliance is on a “comply or explain” basis, with annual reporting on application.

Source: UNPRI (2016)

8.6 Germany

Institution	Year	Title	Classification	Status	Content
BaFin	2002	Insurance Supervision Act – Occupation Pension Schemes – Section 115 (4)	Pension Fund ESG Regulation, Mandatory	Issued	Pension funds must issue a statement to their beneficiaries disclosing if and how ESG factors are taken into consideration in the investment process.
BVI	2012	RI Guidelines	Other	Issued	German Investment Fund Association’s (BVI) guidelines for RI, to which members must adhere to on a comply-or-explain basis.
European Union	2005, updated 2013	Emissions Trading Scheme	Government Imposed Corporate Environmental Disclosure. Mandatory	Issued	Cap and trade system for emissions across 31 countries (EU, Iceland, Lichtenstein and Norway).
	2007, updated 2013	Shareholder Rights Directive (2007/36/EC)	Government Imposed Corporate ESG Disclosure. Mandatory	Proposed	Sets out minimum standards to ensure that shareholders have timely access to relevant information ahead of general meetings and can vote electronically.

	2014	Transposition of the EU Non-Financial Reporting directive 95/14	Government Imposed Corporate ESG Disclosure. Mandatory	In progress	The Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups amends the Accounting Directive 2013/34/EU. It requires companies concerned to disclose in their management report information on policies, risks and outcomes about environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues and diversity in their board of directors. This will provide investors and other stakeholders with a more comprehensive picture of a company's performance. This is a legislative initiative with relevance for the European Economic Area (EEA). The EU member states are required to transpose the rules of the EU non-financial reporting directive by 1 Dec. 2016
	2014, 2016 update in progress	Revision of the Institutions for Occupational Retirement Provision Directive (IORP II)	Pension Fund ESG Regulation, Mandatory	In progress	The current draft requires pension funds above a certain size to consider ESG and disclose how their risks are considered in the Investment Policy Statement. The Directive is due before the European Parliament in late 2016 and must be transposed into Member State law within 24 months of approval.
	2015	Conflict Minerals Directive	Government Imposed Corporate Social Disclosure. Mandatory for certain companies	In progress	EU importers of tin, tantalum, tungsten and gold for manufacturing consumer goods need to be certified by the EU to ensure that they do not fuel conflicts and human rights abuses in conflicts and human rights abuses in conflict areas. In a vote of 343 votes to 331, with 9 abstentions, Parliament decided not to close the first reading position and to enter into informal talks with the EU member states to seek agreement on the final version of the law. Once approved, member states will have 24 months to adopt the provisions.
German Council for Sustainable Development	2011, updated 2016	German Sustainability Code	Non-Government Suggested ESG Corporate Disclosure. Voluntary.	Issued	Companies that choose to comply with the Code disclose compliance against its 20 criteria which cover environmental, social and economic factors on a comply or explain basis. The EU Commission is considering using the code as a standard for compliance with the non-financial reporting initiative.
German Working Group on Corporate Governance for Asset Managers	2005	Corporate Governance Code for Asset Management Companies	Stewardship Code, Comply or Explain Governance.	Issued	The German Corporate Governance Code calls on investors to actively manage the companies in which they invest.
	Updated 2015	German Corporate Governance Code	Governance disclosure. Comply or Explain.	Issued	

Source: UNPRI (2016)

8.7 UK

Institution	Year	Title	Classification	Status	Content
European Union	2005, updated 2013	Emissions Trading Scheme	Government Imposed Environmental Disclosure. Mandatory	Issued	Cap and trade system for emissions across 31 countries (EU, Iceland, Lichtenstein and Norway).
	2007, updated 2013	Shareholder Rights Directive (2007/36/EC)	Government Imposed Corporate ESG Disclosure. Mandatory	Proposed	Sets out minimum standards to ensure that shareholders have timely access to relevant information ahead of general meetings and can vote electronically.
	2014	Transposition of the EU Non-Financial Reporting directive 95/14	Government Imposed Corporate ESG Disclosure. Mandatory	In progress	The Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups amends the Accounting Directive 2013/34/EU. It requires companies concerned to disclose in their management report information on policies, risks and outcomes about environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues and diversity in their board of directors. This will provide investors and other stakeholders with a more comprehensive picture of a company's performance. This is a legislative initiative with relevance for the European Economic Area (EEA). The EU member states are required to transpose the rules of the EU non-financial reporting directive by 1 Dec. 2016
	2014, 2016 update in progress	Revision of the Institutions for Occupational Retirement Provision Directive (IORP II)	Pension Fund ESG Regulation, Mandatory	In progress	The current draft requires pension funds above a certain size to consider ESG and disclose how their risks are considered in the Investment Policy Statement. The Directive is due before the European Parliament in late 2016 and must be transposed into Member State law within 24 months of approval.
	2015	Conflict Minerals Directive	Government Imposed Corporate Social Disclosure. Mandatory for certain companies	In progress	EU importers of tin, tantalum, tungsten and gold for manufacturing consumer goods need to be certified by the EU to ensure that they do not fuel conflicts and human rights abuses in conflicts and human rights abuses in conflict areas. In a vote of 343 votes to 331, with 9 abstentions, Parliament decided not to close the first reading position and to enter into informal talks with the EU member states to seek agreement on the final version of the law. Once approved, member states will have 24 months to adopt the provisions.
FRC	1992, most recently updated in 2014	UK Corporate Governance Code	Government Imposed Corporate Governance Disclosure. Comply or Explain	Issued	The code sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.

	2010	The UK Stewardship Code	Stewardship. Voluntary ESG	Issued	The code sets out a number of areas of good practice to which the FRC believes institutional investors should aspire. The FCA requires UK authorized asset managers to report on whether or not they apply the Code. Investors that apply the code report against its principles on a comply or explain basis.
LSE	2016	Voluntary ESG Reporting Guidance	Non-Government Suggested Corporate ESG Disclosure. Voluntary (in process)	In Progress	The exchange committed to create a voluntary ESG reporting guidance for issuers by the end of 2016 as part of the SSE campaign.
The Pension Regulator	2016	DC Code of Practice	Pension Fund ESG Regulation. Mandatory for certain funds	In Progress	On 28 July 2016, the Pensions Regulator released its new code of practice for DC schemes, which requires the consideration of material ESG and ethical factors.
UK Government	2015	Modern Slavery Act	Government imposed Corporate Social Disclosure. Mandatory for certain companies	Issued	Section 54 of the Modern Slavery Act 2015 requires certain organizations to develop a slavery and human trafficking statement each year.
UK Government	2000	Amendments to 1995 Pensions Act No. 3259	Pension Fund ESG Regulation. Mandatory for certain funds	Issued	Pension funds are required to disclose in the Statement of Investment Principles (SIP) the extent (if at all) to which social, environmental and ethical considerations are taken into account in the selection, retention and realization of investment.
UK Government	2016	The UK Gender Pay Gap Reporting Act	Government Imposed Corporate Social Disclosure. Mandatory for certain companies	In progress	Employers with 250 or more relevant employees will be required to report on pay parity.
UK Government	2011	Women on Boards	Government Imposed Corporate Social Disclosure. Voluntary	Issued	Recommendations to reach gender equality across corporate boards in the UK; includes recommendations to disclose several gender metrics
UK Government	2006, revised 2013	Changes to Companies Act 2006 (Strategic Report and Directors' Report) 2013	Government Imposed Corporate ESG Disclosure, Mandatory	Issued	Mandatory GHG reporting (Part 7: Disclosures concerning Greenhouse Gas Emissions) human rights and diversity by all listed companies in Directors' report.

UK Pensions Regulator	2005	The Occupational Pension Schemes (Investment) Regulations	Pension Fund ESG Issued Regulation. Mandatory	Local government Pension Funds' Statement of Investment Principles must cover "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realization of investment and their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to the investment

Source: UNPRI (2016)

Appendix 3. Final survey instrument and themes

	Questions for Asset Owners	Type	Proposition(s) tested
Perspective/ strategy	1. How would you define RI?	Open	Alignment
	2. Do you think RI increases returns? (agreement scale)	Interval scale	Alignment
	3. A) Do you think that the average holding period affects how corporations create long-term value? (agreement scale)	Interval scale	Alignment
	B) Explanation	Open	Alignment
	4. What would you say is the average holding period in the market?	Numerical	Alignment
	5. Why (objectives) and when did you start incorporating ESG into your investment strategy?	Open	Alignment
	6. What is your investment horizon?	Numerical	Alignment/short-termism
	7. A) Is RI incorporated into the compensation of the investment team?	Yes/No	Alignment
	B) If so, how?	Open	Alignment
	8. What is the timeframe upon which your bonus is evaluated?	Numerical	Alignment/short-termism
	9. A) Do prefer quarterly reporting from your AM or companies in general?	Yes/No	Short-termism
	B) Why?	Open	Short-termism
	10. Do you exert pressure on AM regarding RI? How?	Open	ESG demand and expertise
	11. Is there any training on RI?	Yes/No	ESG demand and expertise
Manager Selection Process	12. Do you select asset managers yourself?	Yes/No	Alignment
	13. Are ESG criteria somehow incorporated into the selection process?	Yes/No	ESG demand and expertise
	14. What do you look for when selecting an AM who integrates ESG?	Open	ESG demand and expertise
	15. Do you stipulate certain ESG targets or criteria in the IMA? Which?	Open	ESG demand and expertise

		Type	Proposition(s) tested
	16. What is the time scale on which your AM are evaluated?	Open	Short-termism
	17. A) Do you prefer external or internal ESG research (or don't know)	Categorical	ESG initiatives role
	B) Why	Open	ESG initiatives role
	18. A) Do you evaluate your asset managers choices based on ESG ratings?	Yes/No	ESG initiatives role
	B) Why and how did you choose your provider?	Open	ESG initiatives role
	19. Are you aware of academic research on the low correlation between ratings?	Yes/No	ESG initiatives role
Constraints	20. A) Do your asset managers generally act in line with your ESG goals?	Yes/No	Alignment/short-termism
	B) If not, what should be improved?	Open	Alignment/short-termism
	21. Do you ever feel like your organization can do more to advance ESG? If so, what is stopping you?	Open	Alignment
	22. Are there any other challenges you face in RI that you want to mention?	Open	Alignment
	23. What do you think would need to change for the market to shift toward a longer-term horizon?	Open	Alignment/short-termism

	Questions for Asset Managers	**Type**	**Proposition(s) tested**
Perspective /strategy	1. How would you define RI?	Open	Alignment
	2. Do you think RI increases returns? (agreement scale)	Interval scale	Alignment
	3. A) Do you think that the average holding period affects how corporations create long-term value? (agreement scale)	Interval scale	Alignment
	B) Explanation	Open	Alignment
	4. What would you say is the average holding period in the market?	Numerical	Alignment
	5. Why (objectives) and when did you start incorporating ESG into your investment strategy?	Open	Alignment
	6. What is your investment horizon? (Valuation models)	Numerical	Alignment
	7. A) Is RI incorporated into the compensation of the investment team?	Yes/No	Alignment

	B) If so, how?	Open	Alignment
	8. What is the time frame upon which your bonus is evaluated?	Numerical	Alignment
	9. A) Do you prefer quarterly reporting?	Yes/No	Short-termism/fatigue
	B) Why?	Open	Short-termism/fatigue
	10. Do you exert pressure on companies regarding RI? How?	Open	Company pressure/fatigue
	11. Is there any training on RI?	Yes/No	ESG demand and expertise
Investment decision-making process	12. How do you incorporate ESG into your investment decisions?	Open	Alignment/ ESG demand and expertise
	13. Do you feel pressured by AOs in any way when making decisions? How?	Open	Short-termism
	14. A) Do you do the ESG research yourself?	Yes/No	Expertise
	B) If so, by the same person?	Yes/No	Expertise
	C) Why don't you conduct it internally?	Open	ESG initiatives role
	D) Which research provider? How did you choose?	Open	ESG initiatives role
	15. If you use ratings and they change, do you look at why it has changed and then adjust your investment accordingly?	Yes/No	ESG initiatives role
	16. Do you make use of any other ESG initiatives, such as rankings? Why and how does this work exactly?	Open	ESG initiatives role
	17. Are you aware of academic research on the low correlation between ratings?	Yes/No	ESG initiatives role
Constraints	18. A) Are your clients (AO) 100% on the same page when it comes to your RI goals?	Yes/No	Alignment/short-termism
	B) If not, what can be improved according to you?	Open	Alignment
	19. Do you ever feel like your organization can do more to advance ESG? If so, what is stopping you?	Open	Alignment
	20. Are there any other challenges you face in RI you want to mention?	Open	Alignment
	21. What do you think would need to change for the market to shift toward a longer-term horizon?	Open	Alignment/short-termism

	Questions for companies	Type	Proposition tested
Perspective /strategy	1. How would you define RI?	Open	Alignment
	2. Do you think RI increases returns? (agreement scale)	Interval scale	Alignment
	3. A) Do you think that the average holding period affects how corporations create long-term value? (agreement scale)	Interval scale	Alignment
	B) Explanation	Open	Alignment
	4. What would you say is the average holding period in the market?	Numerical	Alignment
	5. Why (objectives) and when did you start incorporating ESG into your business model?	Open	Alignment
	6. Do you have a select sustainability team or the like, or is it part of everyone's job?	Multiple choice	Alignment
	7. Is there anyone on the board who brings ESG to the agenda?	Numerical	Alignment
	8. What is your investment horizon?	Yes/No	Alignment/short-termism
	9. A) Is ESG incorporated into the compensation of employees (plant managers?)	Open	Alignment
	B) If so, how?	Numerical	Alignment
	10. What is the timeframe upon which the bonus of i.e. the CEO/average is based?	Yes/No	Alignment/short-termism
	11. A) Do you report quarterly?	Open	Short-termism/fatigue
	B) Why? What purpose does it serve and do you consider dropping it?	Open	Short-termism/fatigue
	12. Do you feel pressure from investors regarding RI?	Yes/No	Company pressure/fatigue
	13. What is the effect of this pressure?	Open	Company pressure/fatigue
	14. Is there any training or extensive discussion on environmental or social efforts?	Yes/No	Expertise
ESG initiatives	15. A) Do you receive requests from ESG (ratings/rankings/awards/ certification)	Yes/No	Company pressure/fatigue
	B) If so how many?	Numerical	Company pressure/fatigue
	C) If not, how do you prioritize and how long does it take you?	Open	Company pressure/fatigue

	16. Why do you respond?	Open	Company pressure/fatigue
	17. A) Do you see any added value from these ESG initiatives/Important to score high?	Yes/No	ESG initiatives role
	B) Why?	Open	ESG initiatives role
	18. A) Do you think it is important to be part of an ESG ranking index?	Yes/No	ESG initiatives role
	B) Why?	Open	ESG initiatives role
	19. Do you ever receive negative comments from the investment community if you don't verify or correct your rating?	Yes/No	ESG initiatives role
	20. Do you receive positive comments if you increase your rating or become part of a ranking/index?	Yes/No	ESG initiatives role
	21. Do you use these ratings for internal evaluation (do you subscribe to any)?	Yes/No	ESG initiatives role
	22. Do you feel pressured by any of these ESG initiatives?	Yes/No	Company pressure/fatigue
	23. Do you keep an eye on the ratings or awards of your competitors?	Yes/No	ESG initiatives role
	24. A) Do you also apply to awards/certification?	Yes/No	Company pressure/fatigue
	B) If so, how do you prioritize?	Open	Company pressure/fatigue
	25. Do you receive surveys from customers or do you survey your supply chain?	Yes/No	Company pressure/fatigue
Constraints	26. Do you ever feel like your organization can do more in terms of social or sustainability efforts? If so, what is stopping you?	Open	Alignment
	27. Are there any other challenges you face when it comes to keeping up with the rise of ESG that you want to mention?	Open	Alignment
	28. What do you think would need to change for the market to shift toward a longer-term horizon?	Open	Alignment/short-termism

Appendix 4. ESG initiatives

This appendix contains an overview of the 218 ESG initiatives that are investigated. They were collected by means of google search, interviews, existing reports/literature and company reports. They were then divided into seven different categories:

1. ESG Awards – 8 observations
2. ESG Indices – 57 observations
3. ESG Rankings – 38 observations
4. ESG Ratings – 57 observations
5. ESG Research – 27 observations
6. Shareholder services – 15 observations
7. Other initiatives – 16 observations

It must be noted that there can be overlap between the categories, but the ESG organizations are categorized according to their main focus.

Organization	ESG Award
Effie Worldwide	Positive Change Effie Award
Ethical team limited	International Green Awards
Institute of Directors	Golden Peacock Awards
Terrapinn	Vaccine Industry Excellence Awards
The Ethical Corporation (FC Business Intelligence)	Ethical Corporation Responsible Business Awards
The PR News Group at Access Intelligence	PR News CSR Awards
US Chamber of Commerce Business Civic Leadership Center (BCLC)	Corporate Citizenship Awards
World Environment Center	World Environment Center Gold Medal for International Corporate Achievement in Sustainable Development
Organization	**ESG Indices**
BBGI Group	BBGI Group Indices
Bloomberg	Bloomberg new energy finance indices
BM&FBOVESPA	Carbon Efficient Index (ICO2)
BÖAG Börsen AG	Sustainability Index
Bolsa Mexicana de Valores (Mexican Exchange)	BMV Sustainability Index
Borsa Istanbul A.S	BIST Sustainability Index.
Boston College Center for Corporate Citizenship	Boston College Center for Corporate Citizenship-Reputation Institute CSR Index
Business in the Community (BITC)	CR Index and the Community Mark
Calvert	Calvert Responsible Index Series

Citizens Fund	Citizens Index
Cleantech Group (CTG)	Cleantech Indices
Deutsche Börse Group	Dax Global Sarasin Sustainability Indexes
ECPI	ECPI
Environmental Investment Organization	ET Index
ERI	ERI Scientific Beta
Ethical Screening	Ethical Screening
Ethinvest	Ethinvest Environmental Index
Etho Capital	Etho Capital index
Euronext	Euronext Vigeo Indices
Finvex Group	Finvex Group
Forum Ethibel	Ethibel Sustainability Indices & excellence label
Fossil Free Indexes	Fossil Free Indexes
FTSE	FTSE4Good Index Series
Goldman Sachs	GS SUSTAIN Focus List
Hawkamah	ESG Index
Hong Kong Quality Assurance Agency	Hang Seng Corporate Sustainability Index Series
HSBC	HSBC Global Climate Change Index
HypoVereinsbank Nachhaltigkeits Index	HypoVereinsbank Nachhaltigkeits Index
Indonesia Stock Exchange	KEHAIT SRI Index
International Securities Exchange Holdings	ISE Global Wind Energy Index
Johannesburg Stock Exchange	JSE Socially Responsible Investment Index (SRI)
Kempen SNS	Kempen SNS Smaller Europe SRI Index
KLD (Kinder, Lydenberg, Domini)	KLD (Kinder, Lydenberg, Domini)
Korea Exchange	Governance & SRI Eco Index
Landesbank Baden-Württemberg (LBBW)	Nachhaltigkeit Strategie Index
MSCI	MSCI Indices
Nasdaq	The NASDAQ OMX CRD Global Sustainability Index
Nataxis	Natixis Climate Optimum Prospective Index
NPI	NPI Social Index
Oeko Invest	Nature Equity Index

Rhein Asset Management	Deutschland Ethik 30 Aktienindex
Robeco & Dow Jones	Dow Jones Sustainability Indexes & Sustainability Year Book
S&P	S&P Carbon Efficient Index
Shanghai Stock Exchange	Shanghai Stock Exchange Indices
Shenzen Stock Exchange (SZSE)	CORP Governance Index
SIX Swiss Exchange	SIX Swiss Exchange Sustainability 25 Index
Solactive	Solactive
STOXX	STOXX Global ESG leaders (Broad Indices)
Tel-Aviv Stock Exchange - (TA) and Maala	Maala CSR Index
Thomson Reuters	Thomson Reuters Corporate Sustainability Indices.
UN Global Compact	UN Global Compact 100
VINIS Gesellschaft für nachhaltigen Vermögensaufbau und Innovation	VINIS Gesellschaft für nachhaltigen Vermögensaufbau und Innovation - Vonix Index
Walmart	Wal-Mart Sustainability Index
Wespac Investment Management	Westpac-Monash Eco-Index
Wiener Börse AG	The CEERIUS (CEE Responsible Investment Universe)
WilderShares	Progressive Energy Index
WM Company	Ex-vices Index

Organization	ESG Rankings
AARP	Best Employers for Workers over 50
Access to Medicine	Access to Medicines Index
Access to Nutrition Foundation	Access to Nutrition Foundation ranking
Access to Seeds Foundation	Access to Seeds Index
Channel NewsAsia	Sustainability Ranking
Computerworld ranking	100 Best Places to Work in IT
Corporate Knights	Global 100
CR Magazine	100 Best Corporate Citizens
CRD Analytics	Smart View™
Diversity MBA Magazine	50 Out Front for Diversity Leadership
DiversityBusiness.com	America's Top 50 Organizations for Multicultural Business Opportunities
DiversityInc	DiversityInc’s Top 50 Companies for Diversity
Equal Opportunity Magazine	Equal Opportunity's Top 50 Employers

Ethisphere	Ethisphere World's Most Ethical Companies
Forbes	Forbes' 100 Most Trustworthy Companies
Fortune (Time Inc.)	Fortune 100 Best Companies to Work For and Most Admired Companies
Glassdoor	Top 50 Best Places to Work
Great Place to Work®	Great Place to Work®
Greenpeace	Greenpeace Cool IT Leaderboard
Human Rights Campaign	Corporate Equality Index
Interbrand	Best Global Green Brands
LATINA Style	Latina style 50
Management Today	Britain's Most Admired Companies
Mediacorp Canada	Mediacorp Canada rankings
National Association for Female Executives (NAFE)	Top 50 companies for Executive Women
Newsweek	Newsweek Green Rankings
Points of Light & Bloomberg	Civic 50
Political Economy Research Institute (University of Massachusetts)	Toxic air polluters
Pride in Diversity	Pride in Diversity - ranking
PROhumana Foundation	PROHumana ranking
Rank a Brand	rankabrand.com
Ranking Digital Rights	Corporate Accountability Index
Stonewall	Top 100 employers
Sunday Times	Best Companies to Work for
The Brand Keys	Customer Loyalty Engagement Index
Transparantie Benchmark	Transparantie Benchmark
Universum	Universum - ranking
Working Mother Magazine	Working Mother ranking
Organization	**ESG Ratings**
Arese	Arese
ASI	ASI
Avanzi	Avanzi SRI Research
B Lab	B Ratings System (B Corporation)
BHF-BANK	BHF-BANK

Bloomberg	Bloomberg ESG data
BMJ ratings	BMJ ratings
Carbon Disclosure Project (CDP)	CDP Ratings & Indices
Center for Australian Ethical Research (CAER)	Center for Australian Ethical Research (CAER)
Champlain Research	Champlain Research
Climate Counts	Company Scorecards
CoreRatings	CoreRatings
Corporate Monitor	Rating
Covalence	Covalence
CSRHUB	CSRHUB Ratings
DNV GL	Tomorrow's Value Rating
Dutch Sustainability Research (DSR)	Dutch Sustainability Research (DSR)
Eco-Frontier	Eco-Frontier
EcoVadis	EcoVadis Supplier Sustainability ratings
Ecovalores	Ecovalores
EthiFinance	EthiFinance
Etikanalytikerna (Global Ethical Standard)	Etikanalytikerna (Global Ethical Standard)
Experts in Responsible Investment Solutions (EIRIS)	Company ratings
Frontis	Frontis Governance Rating Report
FTSE	FTSE4Good ESG ratings
Gender Diversity Directory	2020 Women on Boards
GMI Ratings	GMI Ratings
Governance Metrics International	Governance Metrics International
Greeneye	Greeneye
HIP Investor	HIP Impact Ratings
Innovest	Innovest
Inrate	Inrate Sustainability Assessments
Jantzi research	Jantzi research
KO-CSR	KO-CSR
Management and Excellence Ratings (M&E)	Management and Excellence Ratings (M&E)

MSCI	MSCI ESG Research
oekom	Oekom Corporate Ratings
RepuTex	RepuTex Sustainability / ESG Ratings
Responsible Research and CSR Asia	Asian Sustainability Rating
rfu (Reinhard Friesenbichler Unternehmensberatung Management Consulting)	rfu Sustainability model
Safety and Environmental Risk Management Agency (SERM)	Safety and Environmental Risk Management Agency (SERM)
Scoris	Scoris
SIRIS	SIRIS
SolAbility	SolAbility
Solaron	Solaron
Standard Ethics	Standard Ethics
Stock at Stake	Stock at Stake
Sustainability intelligence	Hidden Champion Rating
Sustainable Investment Research Institute (SIRI)	Sustainable Investment Research Institute (SIRI)
Sustainalytics	Sustainalytics
The Corporate Library	The Corporate Library
The Good Bankers	The Good Bankers
Thomson Reuters	ASSET4 ESG Ratings
TruValue Labs	Insight360
Underwriters Laboratories	GoodGuide rating
Vigeo	Vigeo Ratings
Züricher Kantonalbank	Züricher Kantonalbank

Organization	ESG Research
British Ethical Consumer Research Association (ECRA)	Corporate Critic
Centre français d'information sur les entreprises (CFIE)	Centre français d'information sur les entreprises (CFIE)
Co-op America	Co-op America
DZ Bank AG Deutsche Zentral-Genossenschaftsbank	Sustainability research
EthicScan Canada Ltd.	EthicScan Canada Ltd.

Ethix SRI Advisors	Ethix SRI Advisors
Forum for the future	Forum for the future
Fundación Ecología y Desarrollo - ECODES	Fundación Ecología y Desarrollo - ECODES
Global Footprint Network	Global Footprint Network
Institut für markt umwelt gesellschaft (Imug)	Institut für markt umwelt gesellschaft (Imug)
Investor Responsibility Research Center (IRRC)	Investor Responsibility Research Center (IRRC)
IW Financial	IW Financial
Oxfam International	Behind the Brands
P&G	P&G Supplier Environmental Sustainability Scorecard
Regnan	Regnan
RepRisk	RepRisk
SD-M	SD-KPIs
Source-Asia	Source-Asia
South Pole Group	South Pole Group
Sustanability Partners Inc.	Sustainability Partners Inc.
Sustinvest	Sustinvest
SynTao	Syn Tao
The Centre for Sustainable Organizations.	True Sustainability Index
The Climate Registry	The Climate Registry
Transparency International	Transparency in corporate reporting ranking
Trucost	Trucost
Verisk Maplecroft	Verisk Maplecroft Sustainability Performance Benchmark (MSPB)

Organization	Shareholder Services
Corporate Governance International (CGI)	Corporate Governance International (CGI)
Deminor Rating	Deminor Rating
Ethos Foundation	Ethos Services
Glass Lewis (Glass Lewis is a portfolio company of the Ontario Teachers' Pension Plan Board ("OTPP") and Alberta Investment Management Corp. ("AIMCo"))	Glass Lewis
Global Engagement Services (GES)	Global Engagement Services (GES)

Institutional Shareholder Services (ISS)	Institutional Shareholder Services (ISS)
IVOX GmbH	IVOX GmbH
Manifest	Manifest
Pensions & Investments Research Consultants Ltd. (PIRC)	Risk Rating
Proxinvest	Proxinvest
Proxy Australia	Proxy Australia
Shareholder support	Shareholder support
The Expert Corporate Governance Service (ECGS)	The Expert Corporate Governance Service (ECGS)
zRating	zRating

Organizations and initiatives included under “other initiatives”	
CAMRA Data Services	CAMRADATA ESG reporting
Centre Info	Centre Info
Ceres	Ceres
Conflict Risk Network	Conflict Risk Network
Diversum	Diversum Label & Ratings
Ethical Investors	Ethical investors
Eumedion	Eumedion
Forética	Forética
German Council for Sustainable Development	The Sustainability Code
Plastics Disclosure Project (PDP)	Plastics Disclosure Project (PDP)
Shareaction	Shareaction
Sullivan Principles	Sullivan Principles
The Interfaith Center on Corporate Responsibility (ICCR)	The Interfaith Center on Corporate Responsibility
The Prince's Accounting for Sustainability Project	The Prince's Accounting for Sustainability Project
The Water Footprint Network	The Water Footprint Network
VBDO	VBDO

Appendix 5. Interviews ESG ratings/rankings

The interviews were conducted with 3 Dutch, 3 German and 4 UK Asset Owners. The majority has more than €30 billion AUM. They were asked the following questions, relating to the ESG initiative industry;

Questions for Asset Owners	Type
• Do you prefer external or internal ESG research (or don't know)	Categorical
If so, why?	Open
• Do you evaluate your asset managers based on ESG ratings?	Yes/No
• Why and how did you choose your provider?	Open
• Are you aware of academic research on the low correlation between ratings?	Yes/No

Additionally, 15 interviews were conducted with Asset Managers. Of those, 6 are Dutch, 4 are German and 5 are located in the UK. They are all among the 400 largest in the world by AUM, according to IPE[24]. The following questions relating to the ESG initiative industry were asked;

Questions for Asset Managers	Type
• Do you do the ESG research yourself?	Yes/No
If so, by the same person?	Yes/No
If not, why don't you conduct it internally?	Open
• Which research provider? How did you choose?	Open
• Are you aware of academic research on the low correlation between ratings?	Yes/No
• Do you look at why ratings have changed before you adjust your investment accordingly?	Yes/No
• Do you make use of any other ESG initiatives, such as rankings? Why and how does this work exactly?	Open

[24] https://hub.ipe.com/top-400/total-global-aum-table-2016/10007066.article

On the company level, 20 organizations were interviewed. Of those, 8 companies have their headquarters in the UK, 7 in the Netherlands and 5 in Germany. These companies are all listed and about half have market cap between €1 billion and €20 billion. Only a quarter has a market cap of more than €50 billion. Different sectors are included such as food staples, retail, chemicals and technology. The financial sector is not included. The following questions relating to the ESG initiative industry were asked;

Questions for companies	Type
• Do you receive requests from ESG (ratings/rankings/awards/ certification)	Yes/No
If so how many?	Numerical
• How do you prioritize and how long does it take you?	Open
• Why do you respond?	Open
• Do you see any added value from these ESG initiatives/Important to score high?	Yes/No
Please explain?	Open
• Do you think it is important to be part of an ESG ranking index?	Yes/No
Please explain	Open
• Do you ever receive negative comments from the investment community if you don't verify or correct your rating?	Yes/No
• Do you ever receive positive comments if you increase your rating or become part of a ranking/index?	Yes/No
• Do you use these ratings for internal evaluation (do you subscribe to any)?	Yes/No
• Do you feel pressured by any of these ESG initiatives?	Yes/No
• Do you keep an eye on the ratings or awards of your competitors?	Yes/No
• Do you also apply to awards/certification?	Yes/No
If so, how do you prioritize?	Open

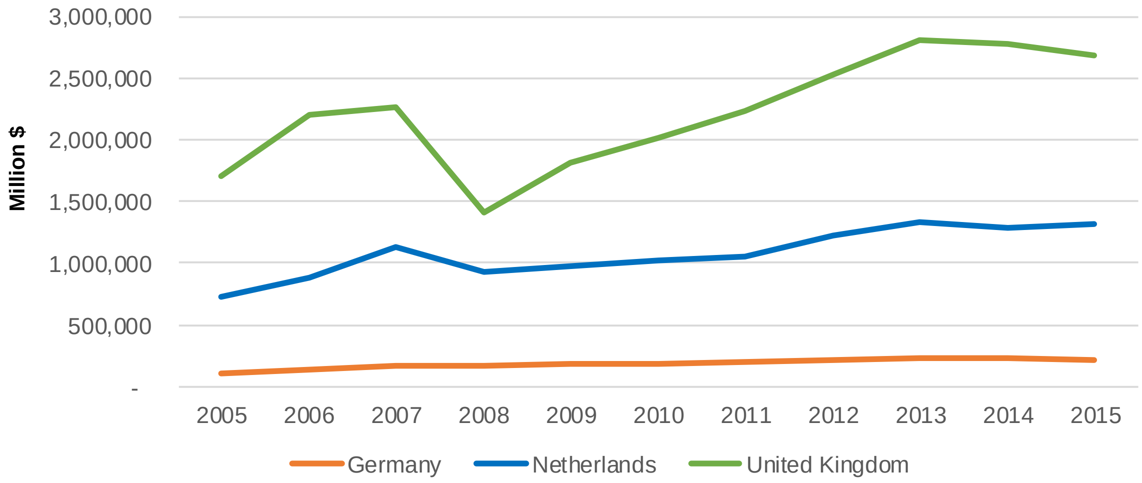
Appendix 6. Interview Participants AOs

The interviews were conducted with 3 Dutch, 3 German and 4 UK Asset Owners. The majority (7/10) has more than €40 billion AUM as of end of 2015. There are a few (4) very large ones with more than €150 billion. There are 3 smaller ones with €15- 20 billion, under €3 billion and < €1 billion. Not surprisingly, the large pension funds are based in the Netherlands and the UK as they have a long history of prefunded occupational pensions (Dixon and Monk, 2014). A significant portion of the assets are externally managed and invested in equity. In most cases, more is externally managed as opposed to internally managed. According to the UNPRI transparency documents, six of them manage between 10-50% of their listed equity externally. In 2 other cases, it is more specifically indicated with ~50% and ~30%. In the last 2 cases, there is not much invested in equity but all is managed externally (6%) or in one case less than 10% is managed externally and more is done in-house. It must be noted that German respondents do not manage as much equity investments in-house or externally, as they do not invest much in equity to begin with (see appendix 2, table 5).

As per the UNPRI categories in the transparency reports of the signatories, there are six that can be categorized as a ‘’non-corporate pension/superannuation/retirement/provident fund or plan’’. Furthermore, three are categorized as ‘’corporate pension/superannuation/retirement/provident fund or plan’’. These corporate pension plans were all located in the UK and most of the non-corporates are in the Netherlands. There is also one insurance company included, as this company is a very significant player in one of the countries. Most pension plans are Defined Benefit or a hybrid, but this was not discussed during the interviews.

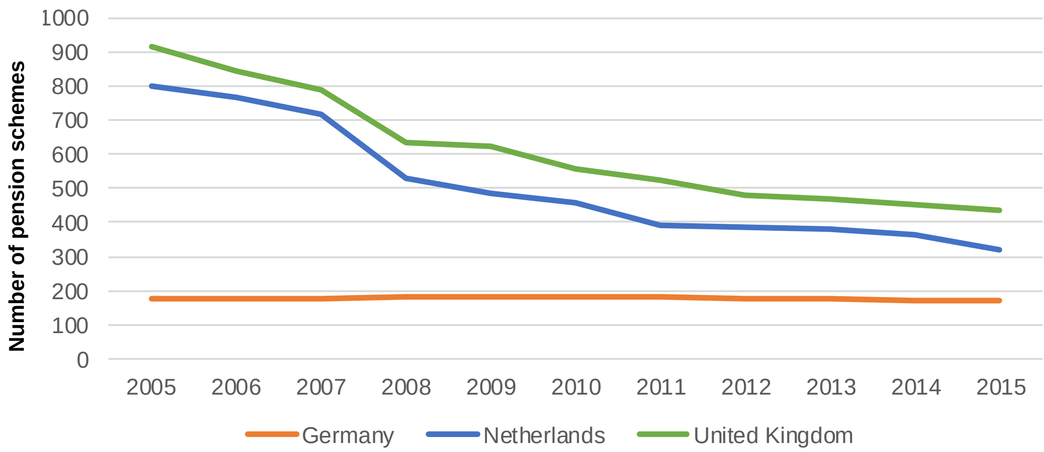
Appendix 7. Overview Pension Landscape

Figure 15. Total investments in million $



Source: http://w w w .oecd.org/finance/private-pensions/pensionmarketsinfocus.htm

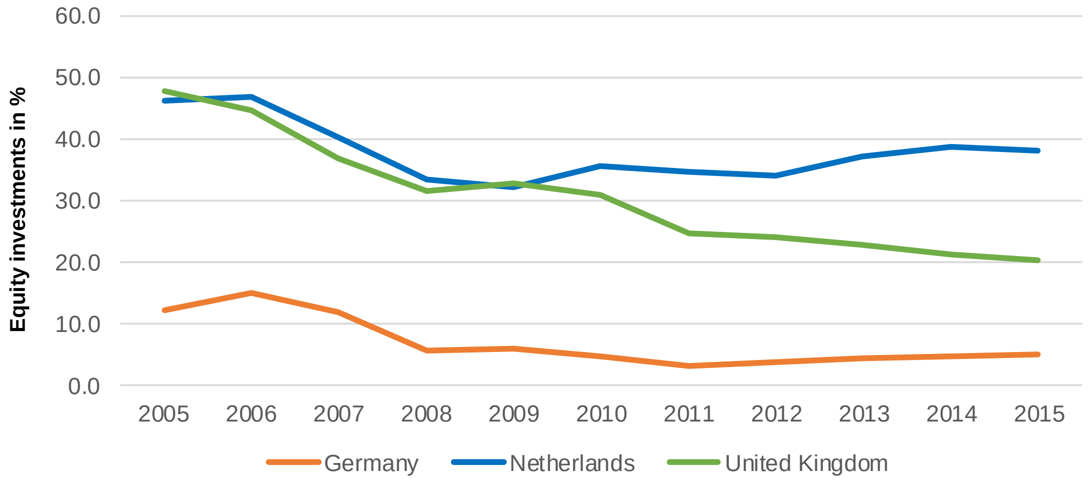
*Figure 16. Number of pension schemes**



Source: http://w w w .oecd.org/finance/private-pensions/pensionmarketsinfocus.htm

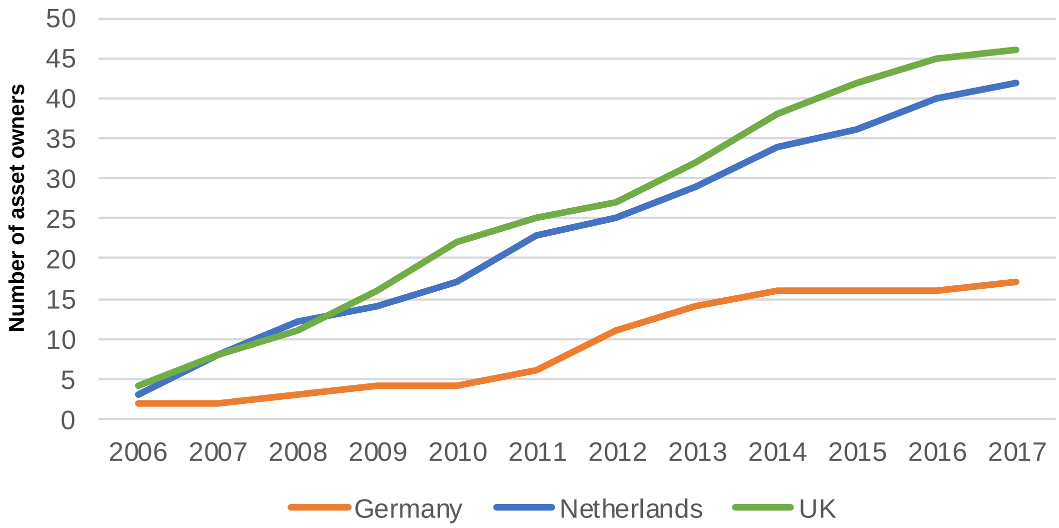
Note: UK numbers have been divided by 100. Thus, end of 2015 there w ere still about 43,000 pension schemes in the UK. This w ill be further reduced after the pooling of assets is operationalized in April 2018

Figure 17. Share of equity investments in portfolio (%)



Source: http://w w w .oecd.org/finance/private-pensions/pensionmarketsinfocus.htm

Figure 18. AO UNPRI signatories since inception



Source: UNPRI

Appendix 8. Interview participants AMs

The interviews are conducted with 15 AMs, located in the Netherlands (6), the UK (5) and in Germany (4). One of the participants has a parent company in Australia. These ‘’traditional’’ AMs are large, representing approximately. €5 trillion AUM. The UK respondents account for about 40% of this €5 trillion, and the Netherlands and Germany each around 30%. Not surprisingly, 14 of them are listed on the IPE 400 largest AMs in the world (see https://www.ipe.com/Uploads/j/z/r/IPE-Top-400-Asset-Managers-2017.pdf). Only one of them is a smaller bank, which is not on the list and not as useful for the research given that they are the parent company for one of the AMs. Nevertheless, this interview is still used given that the activities are rather separated. Out of the 15 interviews, 8 are conducted face-to-face.

Appendix 9. Interview participants portfolio companies

Twenty listed companies in the Netherlands, the UK and Germany participated. They are from various sectors, although most are consumer facing; 15 out of 20 are in the Consumer Staples or Consumer Discretionary sector. They range from €1.5 billion to €140 billion in market cap, with a total of ~€784 billion by the end of Oct. 2016. The Dutch sample is responsible for about 17% of this total market cap, the UK 45% and Germany 38%. Most of the interviewees have the term ''sustainable'' in their job title. Some, however (4), have external/ corporate affairs, reporting in their title. In a few cases (3) the respondents were the head of a specific aspect of sustainability, such as head of water and agriculture or environment and ethics. Only in one case the respondent was the Corporate secretary and once the CFO. This diversity in job titles is no surprise, given the lack of standardization (Aras and Crowther, 2016; Roca and Searcy, 2012). In two cases, the investor relations people were involved due to investor related questions which sustainability people could not answer. Of course, this was helpful but it questions the extent to which sustainability people are confronted with investors. The sustainability investment horizon also varies greatly, ranging from five to fifteen years.