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**THE INTEGRATION OF ESG INFORMATION INTO INVESTMENT PROCESSES:
TOWARD AN EMERGING COLLECTIVE BELIEF?**

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ABSTRACT

This paper examines the way new investor led collaborative initiatives are impacting on the integration of ESG information into mainstream investment processes and their potential to influence the standard valuation and investment practices of global fund managers. The objective is to identify how different approaches –be it collaborative initiatives, research platforms or incentive systems–contribute to the evolution of conventional investment practices and the integration of ESG information into the long-term shareholder value of investee companies.

Key words: ESG information, collective beliefs, conventional practices, institutionalisation, evolution

1. INTRODUCTION

ESG (Environmental, Social and Governance) considerations have been for a long time the domain of the so-called ‘(Socially) Responsible Investors’, a marginal and morally loaded group of investors using ESG information in addition to conventional financial criteria in investment strategy. During the 1990’s SRI has shifted from an activist movement to a commercial project [Louche, 2004] and many traditional banks and investment houses have started to develop socially responsible funds to capture the increasing market demand for SRI . Nevertheless, these developments remained marginal within the financial community and ESG disconnected from traditional investment activities. But during the last decade a new phenomenon is emerging. ESG factors seem to be entering the vocabulary of mainstream financial analysts and fund managers. In fact, an increasing number of analysts are declaring a commitment to ESG information integration into mainstream investment practices. This is confirmed by a number of surveys that highlight the financial community’s awareness and recognition of those extra-financial dimensions [McKinsey, 2009; Ambachtsheer, 2005; PLEON, 2005; Taylor Nelson Sofres, 2003]. The growing interest in ESG information within the mainstream investment community, is motivated and sustained by a number of individuals and institutional initiatives. Indeed, over the last few years, we have been witnessing the beginning of several coordinated efforts to encourage the integration of ESG into firms’ valuation and investment making processes such as the Enhanced Analytics Initiatives (EAI) and the Principles for Responsible Investment (PRI).

This paper examines the way new investor led collaborative initiatives are impacting on the integration of ESG information into mainstream investment processes and their potential to influence the standard valuation and investment practices of global fund managers. The objective is to identify how different approaches –be it collaborative initiatives, research platforms or incentive systems–contribute to the evolution of conventional investment practices and the integration of ESG information into the long-term shareholder value of investee companies.

The overarching research question addressed in the paper is: How do dominant conventions change? We argue that collective beliefs play an important role in a company’s stock valuation and investment strategies. More particularly, financial market participants coordinate their actions through dominant conventions --that is some norms of behaviour that determine the normality of a situation and give saliency to implementing decisions--shared and diffused across the market.

Following this logic, the integration of ESG information will become a mainstream practice if, and only if, there is a shared belief among investors that ESG information is relevant. The question is how can the dominant convention be changed? Our contention is that the myriad of investor-led initiatives that have emerged over the last few years to encourage the integration of ESG information represent endeavours towards changing the current dominant convention of valuing companies, (i.e. convention that does not include ESG information into company valuation). Indeed, these initiatives are helping to build mechanisms through which a change in the prevailing collective belief could occur. Building on DiMaggio and Powell [1983]’s framework, we investigate the collaborative initiatives along three institutional mechanisms, coercive, normative and mimetic to evaluate their potential to change the dominant conventions that prevail over financial market agents’ decision making processes.

The first part of the paper presents the theoretical framework. It introduces the role of collective beliefs in stock valuation and investment processes and develops the process and mechanisms of institutionalization. The second part presents the data analysis. We first look at the emergence of ESG integration and then explore the new collaborative initiatives. Finally, a concluding section discusses the results and the implications of our research.

2. THEORETICAL PERSPECTIVE

There are many theoretical perspectives explaining the use of information in financial markets for evaluation and investment purposes. On the one hand, modern portfolio theory assumes that investors are fully rational agents. According to efficient market hypothesis, there would be true, objective, and universal economic model underlying the price formation process. A new body of literature challenges this assertion and posits that it might be more realistic to consider the way in which investors inter-relate to each other and the link between investor behaviour, information and market returns. Part of what drives investor decision making when viewed through this lens is their pre-emption assessment of the way others will react to new information, “taking into account what average opinion expects the average opinion to be” [Keynes, 1936]. This approach suggests that investors faced with uncertainty converge towards a conventional model by adopting a mimetic behaviour. Therefore, they coordinate each other on “collective beliefs” [Orléan 2004, 2005].

After reviewing the different perspectives explaining the use of information in financial markets for evaluation and investment purposes, we introduce the theoretical framework based in institutional theory which will help us to evaluate the impact of the collaborative initiatives in changing dominant conventions.

2.1. The role of collective beliefs in stock valuation and investment processes

Modern portfolio theory assumes that investors are fully rational agents who can compute prices for all possible exogenous fundamental news. Equilibrium prices then result from a bottom-up aggregation of private investment values into market values. In this framework, investors immediately and correctly process all available information thus validating the Rational Expectation Hypothesis (REH) and subsequently the Efficient Market Hypothesis (EMH), [Fama, 1965; 1970].

Nevertheless, these hypotheses are clearly questionable because information is often difficult to interpret. Rational expectations easily break down in real life if agents lack computing power to interpret the tremendous flow of information impacting stock markets.

The neo-classical theoretical framework has been challenged from a number of different perspectives, although an alternative holistic theory has yet to overturn its conclusions. Some researchers have documented fundamental and technical anomalies that might come from the imperfect substitution of assets, information asymmetries, and presence of noise traders or rational bubbles. However, even if the standard theory has failed to resolve “paradoxes” like information revelation of Rational Expectation Equilibrium (REE) or use of resources for the production of information [Grossman and Stiglitz, 1980], standard academic research claims that it does not invalidate Efficient Market Hypothesis (EMH) and Rational Expectation Hypothesis (REH). Proponents of the EMH, such as Fama (1998), contend that as long as fund managers fail to systematically ‘beat-the-market’ over the long-term, the notion of market efficiency cannot be rejected.

Behaviourists have challenged this view by arguing that there are also irrational investors that are unable to determine the correct prices which can trigger temporary market inefficiencies [Shleifer, 2000]. Others argue more strongly that over time, economic agents are not able to learn what the process of determining a variable is; thus, they cannot use this knowledge to form rational expectations [Kurz, 1999]. On the contrary, each agent builds his own theory of the future and the distribution of the resulting private models of the economy constitutes “a social state of belief”.

Variations in the distribution of beliefs can cause volatility changes that are uncorrelated with fundamental information. These volatility changes, in turn, are the result of correlation in beliefs among investors who are influenced by reading the same newspapers and the same reports of the Wall Street analysts for instance. In this framework, price volatility observed on financial markets can be explained by endogenous changes of the structural link between private (primary) beliefs.

An alternative way to understand the role of beliefs in information processing is to consider that investors faced with uncertainty have to reach a coordination game, based on collective representations of the economy and react to new information in reference to these common beliefs [Orléan 2004, 2005]. This coordination game then consists in guessing the way other investors will react to news (knowing that others themselves adopt the same behaviour). To coordinate each other, investors have then to converge towards a conventional model by adopting a mimetic behaviour. Among other mechanisms, the « salient point » concept [Schelling, 1960] is proposed to explain how such conventional model (a “collective belief”) can emerge .

Collective beliefs are drastically different from individual (or private) beliefs, which concern what each individual thinks about the intrinsic significance of a certain proposition P (for example, “ESG information is relevant for long term stock valuation”). In our conventional model framework, a proposition P is a collective belief if each individual of a group G believes that, in the majority, the members of the group believe that P is true. This definition of collective beliefs is deemed in Orléan [2004] as “self referential” because it does not involve any reference to the primary beliefs of agents. It is also very different from a (simple) shared belief as each individual has to guess what the majority of the members of the group think the collective belief is . Thus, breaking away from the classical individualist model that views collective representation as the sum of individual opinions, this mechanism leads to the building of a self-governing/self-reinforcing social belief potentially disconnected from the primary beliefs of the agents. In this perspective, stock prices can be viewed as the result of “social conventions”.

Analysis of institutional investors’ behaviour indicates that a number of investment practices are ‘conventional’ meaning that they are recognised and accepted by all. For example, practices such as stock valuation models used by financial analysts (such as discounted cash flow models) or standard mean-variance portfolio optimisation are generally accepted and implemented by investment agents.

They are regarded as conventional practices. As mentioned in Boyer and Orléan [1992], once a convention is established, no agent has any incentive to deviate from it. Moreover, the convention is self-sustaining as each agent will behave in a certain way on the expectation that others will also behave in that way. Thus, the perceived risks of making decisions under uncertainty are diffused as investors seek behavioural conformity which constrain and influence their behaviour.

The dominant collective beliefs often obstruct the adoption of a new practice, in the context of this paper, eg. the integration of ESG information. In other words, established conventions generally impede (or slow down) the emergence of new ones. The research conducted by Guyatt [2005, 2006a] shows that dominant (external and internal) conventions could impede fund managers ability to integrate ESG information into investment decisions. External conventions relate to collective behaviour that prevails across the market, while internal conventions refer to conditions that are particular to an investment organisation (like the internal team structure, culture, incentive system and attitude towards SRI). This research found that short-termism and gravitation towards defensible investment decisions constitute the main behavioural impediment to the integration of ESG dimensions by institutional investors. This finding was corroborated by recent studies [BSR, 2008, McKinsey, 2009]. According to these surveys, some investors and analysts recognize that ESG factors can impact financial performance, however they judge the potential risks generated and value created too long-term compared to their investment horizon.

One of the other dominant and recurring themes that emerged from this research is the narrow company valuation model that has become widely adopted across the investment community. Indeed, analysis of institutional investors' behaviour indicates that a number of investment practices are 'conventional' meaning that they are recognised and accepted by all. Indeed, it has become standard practice for estimates of company valuations to over-emphasise the importance of tangible, financial criteria to derive the net present value of a stock's expected income stream, such that cash flow return on investment can be estimated. A study on Swedish investors by Hellman [2000] found that in making such estimates, close attention is paid to financial ratios such as return on equity, return on capital employed, sales growth, price/earnings ratios and technical/momentum indicators. The integration of 'other' intangible factors is often overlooked in this valuation process and a narrow framing of the valuation criteria is not only conventional at the 'external' market level, but is also ingrained within the 'internal' conventions and processes that prevail within investment institutions.

Actually, many investment professionals point out the difficulty inherent in translating ESG information into monetary terms. According to many surveys about the attitude of mainstream financial investors toward ESG information, the lack of universally accepted methods for quantifying extra-financial information is one of the major impediments against the integration of ESG information [Guyatt, 2006a,b, Jaworski, 2007, BSR, 2008, McKinsey, 2009].

Among the other impediments highlighted by these studies, the dissatisfaction of investment professionals with the ESG information disclosed: available information is not sufficient/ appropriate to enable effective assessment of ESG issues also impedes the integration of such information [Jaworski, 2007; BSR, 2008; McKinsey, 2009]. However, the most important barrier against the integration of ESG information by mainstream financial community is the scepticism about the link between ESG factors and financial performance.

Many mainstream financial analysts and fund managers are still unconvinced about the impact of ESG issues on stock value [Jaworski, 2007; BSR, 2008] . Indeed, there is no consensus about the relationship between ESG performance and stock value within both professional and academic communities [Orlitzky et al. 2003, Jemel, 2008].

However, we believe that the main barrier that impedes an effective integration of ESG information is the absence of a collective belief about their recognized relevance for long-term investment returns across the financial community. The absence of such a collective belief obstructs the emergence of new methodologies and perspectives of evaluating companies and making investment decisions, thus impeding the mainstreaming of ESG integration. Similarly, the development of a collective belief is influenced by the practices and efforts dispersed by the financial community representatives over time. In other words, there is a mutual reinforcement between the evolution of practices and the evolution of collective beliefs. Figure 1 provides a representation of the mutual reinforcement loop described above.

Insert Figure 1 About Here

According to Guyatt [2006a], since the industry is by nature conservative and mindful of fiduciary obligations to beneficiaries, a slow process of change is more likely than an abrupt change of existing practices. We argue that the change is more likely to happen through a long process of institutionalisation that will lead to a redefine or reshape the dominant conventions.

2.2. Process and mechanisms of institutionalisation

Zucker [1977] asserts that “institutionalisation is both a process and a property variable. It is the process by which individual actors transmit what is socially defined as real and, at the same time, at any point in the process the meaning of an act can be defined as more or less a taken-for-granted part of this social reality. Institutionalised acts, then, must be perceived as both objective and exterior” [Zucker, 1977]. So institutionalisation is viewed as the social process by which individuals come to accept a shared definition of social reality. It operates to produce common understandings about what is appropriate and, fundamentally, meaningful behaviour [Zucker, 1983]. “Institutionalisation involves the processes by which social processes, obligations, or actualities come to take on a rule like status in social thought and action” [Meyer & Rowan, 1977].

According to DiMaggio and Powell [1983] the process of institutionalisation is characterised by four elements that are recognisable in any institutionalised field [DiMaggio and Powell, 1983]:

1. An increase in interaction among organisations within a given field;
2. The development of inter-organisational structures of control and relational patterns;
3. An increase in the amount of information that organisations within the field must process; and,
4. The development of mutual awareness by members of the organizational field.

By organizational field, DiMaggio and Powell [1983] mean “those organizations that, in the aggregate, constitute a recognized area of institutional life”. This addresses attention “not simply to competing firms” but “to the totality of relevant actors”. Through the process of institutionalisation, fields become highly structured. This process serves to stabilise and make interactions between participants become routine by integrating them within the structure of the field. As a consequence, organisations within a highly structured field exhibit convergence towards normative practices, thereby lessening the diversity of practices and organisational forms within the field. As a result, in the long term, organisations tend to adopt similar and homogenous practices.

Institutional theorists consider organizational environments as the sources of norms and values that, over time, impregnate organizations and influence their practices. Within an organizational field, organisations tend to resemble one another. In response to direct or indirect, intentional or unintentional pressures, they develop similar practices. According to DiMaggio and Powell [1983] the pressures can be categorised in three types: coercive, mimetic; and normative influences.

Coercive forces stem from political influence and problems of legitimacy. They consist of the external pressures formally or informally exerted on organizations by other organizations upon which they are dependant. Such pressures can arise from government, regulatory agencies or other actors on which the organizations depend for resources. These pressures may be felt as force, as persuasion, or as invitation to join in collusion [DiMaggio and Powell, 1983, p.150]. In some cases, constraints come from government mandate and regulations (environmental regulations) and in others they can occur outside the governmental arena. Indeed, coercive pressures can result from exchange relationships such as relationships between business partners. The greater is the dependence of an organization on another one, the more likely the dependant organization is to conform to the imposed rules.

Mimetic changes result from standard responses to uncertainty. When organizations face uncertainty, they are inclined to model themselves on other organizations and to imitate their activities, systems, or structures. Conditions of uncertainty can be linked to misunderstanding of a technology, ambiguous goals or doubt about cause-and-effect relationships between variables. Under uncertainty, such imitation may be undertaken without any clear evidence of performance improvements. As a result, organizations tend to adopt practices of their peers that they perceive to be more legitimate or successful. “Models may be diffused unintentionally, indirectly through employee transfer or turnover, or explicitly by organizations such as consulting firms or industry trade associations” [DiMaggio and Powell, 1983, p.151].

Normative influences stem primarily from professionalization interpreted by [DiMaggio and Powell, 1983]. As “the collective struggle of members of an occupation to define the conditions and methods of their work”. Normative forces represent the professional standards resulting from the pressures exerted by professional groupings on organizations to adopt behaviours and practices considered to be relevant and legitimate. Two main vehicles for the definition and promulgation of normative rules are identified by the authors: universities and professional training institutions; and professional and trade associations.

The first are an important source of development of norms through education and academic production, while the second represent a powerful mean for diffusing new standards and models through networks that span organizations. In fact, socialization and exchanges of information among professionals help contribute to the definition of a common knowledge. Other vehicles for professional norms can be for example consultancies, trade magazines, or workshops.

The three institutional mechanisms create a certain dynamic that can change a convention. The mechanisms take place at the macro level; that is at the organisational field level. The identification of these mechanisms is very important in understanding the type of pressures that can support change. However they are somehow rather general and do not capture the dynamics of change, which is what we want to explore in this paper. Therefore we need to go to the micro-level to outline the dynamics. In other words, we want to understand the micro-activities that contribute to the institutionalization process and link them to the institutional mechanisms as defined by DiMaggio and Powell, [1983]. Scott [1994, 1995] insists on the need to address more micro-level explanations into institutional theory. Indeed, there is little empirical work that deals with a micro-level in the study of institutional processes. As [DiMaggio and Powell, 1991] notice: 'Most institutionalists prefer to focus on the structural environments, macro to micro-level effects, and the analytic autonomy of macro structures'.

2.3. The theoretical framework

Our theoretical framework presents three levels as represented in Figure 2. The first level focuses on micro-level. Actors have developed a number of micro-level actions that contribute to the second level, the coercive, normative or mimetic mechanisms suggested by DiMaggio and Powell [1983]. We argue that the cumulation of micro activities can help to legitimize ESG integration and thereby contribute to the change process of the dominant convention, the third level. The institutional mechanisms are useful to describe an institutional process but also “to predict empirically” the emergence and the diffusion of new norms and standards among an organizational field [DiMaggio and Powell, 1983, p.154]. The three levels are in constant interactions.

Insert Figure 2 About Here

3. DATA ANALYSIS

3.1. Methodology

The empirical work consists of an exploratory research based on semi-structured interviews and secondary data.

25 face to face semi-structured interviews were conducted between July 2007 April 2009 with financial and extra-financial analysts and fund managers in France. Sell-side financial analysts are employed by brokerage firms, their research and recommendations are distributed to their investor clients. Buy-side analysts are employed by institutional investors, their research and recommendations are intended for the sole use of their company's portfolio managers. Often, buy-side analysts use the research provided by sell-side analysts to evaluate companies. The analytical processes of buy-side and sell-side analysts are not very different.

Table 1 gives an overview of the interviews. The main objective was to identify the main initiatives and levers that encourage the integration of ESG information and assess their potential to become integrated by the mainstream investment community.

Insert Table 1 About Here

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In addition to the interviews, we collected information on the different initiatives through internet websites, surveys, reports and press publications. The rational was to gather the maximum of information about the initiatives in order to analyze their potential to influence investment practices..

Empirical data collected are qualitative data. In order to capture the essence of the data, analyze and interpret them, we followed Miles and Huberman [1984] approach consisting in data reduction, data display, and conclusion drawing/verification [Miles & Huberman, 1984]. The interviews were analyzed by using the qualitative the qualitative data analysis software program QSR NVivo was used to facilitate the analysis of the interviews.

Based on the data collected, we can retrace the emerging dynamics that seek to mainstream the integration of ESG information into investment decision processes.

3.2. ESG integration: an overview of an emerging trend

Responsible investors have been the precursor in using ESG information in investment decisions. The growing attention to ESG issues across the more traditional investment community is considered as the mainstreaming of SRI. However, it is important to note that the integration of ESG information by mainstream investment companies is a fundamentally different approach than SRI. While SRI derives from moral and ethical concerns, the new trend of integration of ESG information by mainstream investors is motivated by purely financial considerations.

In fact, the historical roots of SRI are closely connected to faith based organizations. The first SRI practices were initiated by church organizations that didn't want to support or be associated with certain activities or companies [Kinder, Lydenberg, & Domini, 1994; Kinder & Domini, 1997; Kreander, Molyneaux, & McPhail, 2003; Sparkes, 1995]. They have developed a negative screening strategy of investments consisting in avoiding the so-called 'sin' stock usually referring to alcohol, tobacco, gambling and weapons. One of the emblematic and first SRI mutual funds was the Pioneer fund set up in 1928 in the U.S. to meet church institutions' needs. In the 1970s-80s SRI moved to a new phase, shifting from a moral and ethical logic to a more activist logic embedded into the political and protest movements of the day . This period marks the beginnings of SRI in the contemporary sense of the term. It then began a gradual transition to a less confrontational approach to expand towards the mainstream financial community . At its beginning, this expansion has consisted in the development of SRI funds within traditional investment institutions. Gradually, SRI research has flourished inside investment houses and independent research providers to support professional investors in their decision process according to the investment strategy adopted .

On the other hand, the idea of including ESG aspects into mainstream investment has emerged just recently within analysts and fund managers. The first claims and practices linked to the integration of ESG information into mainstream investment decision making appeared publicly at the beginning of 2001. It was isolated projects launched by some pioneers convinced that ESG analysis can help asset managers and financial analysts to better assess the risks and seize the opportunities for companies. Nonetheless, in a short time period, the integration of ESG information into mainstream investment decision-making has created a growing attention within the financial community; and many other initiatives have emerged to encourage traditional institutional investors and research providers to consider ESG issues. The paragraphs below, try to summarize the main indicators of the increasing trend of ESG integration by the mainstream financial community.

- **ESG research providers' development**

Historically ESG research activity has been linked to SRI. Indeed, the main target of the first research providers focusing on ethical, social and environmental issues was the responsible investors -in particular, institutional investors. Following the increasing demand for SRI in the late 1980's, a number of research organizations have sprung up to serve the growing need for data to implement SRI strategies and tactics. During the 1990's, an increasing number of independent SRI research organizations were created to provide institutional investors with background data on the ethical, social and environmental records of a sample of publicly traded companies. Besides these independent organizations, many research teams have been developed inside investment management houses to support asset managers to manage SRI funds. These SRI teams remained however obviously totally separated from the mainstream financial analysts and fund managers. In fact, as noted by Louche [2004], when SRI is part of a mainstream financial institution, it often remains an island in its own organization: there is no or limited communication between the SRI community and financial analysts.

At the beginnings of 2000, the research on environmental, social and governance issues crossed a new stage with the creation of the first ESG research teams inside brokerage houses. In fact, the development of ESG research teams within sell-side companies symbolizes the first concrete steps towards the mainstreaming of ESG information integration. In November 2001, HSBC was the first sell-side brokerage firm in Europe, and the second in the world , to offer ESG research.

The creation of such a team within a major sell-side broker constituted a shift for ESG research as sell-side brokers do not target only responsible investors but the whole investment universe. Indeed, these teams were created with the objective of broadening the scope of ESG information from a marginal to a global use. Since 2001, the number of ESG research providers targeting mainstream investors has registered an important growth. As we can see in figure 1, the increase was accelerated markedly around 2005. This acceleration probably results from the activity created by some influential professional initiatives, in particular the Enhanced Analytics Initiatives.

- **Institutional investors' collaborations**

The ESG integration has rapidly moved from scattered initiatives to organized joint programmes. Among the most influential professional collaborations developed with the objective of promoting the integration of ESG information into mainstream research are the Enhanced Analytics Initiative (EAI) and the Principles of Responsible Initiatives (PRI).

The EAI “is an international collaboration between asset owners and asset managers aimed at encouraging better investment research, in particular research that takes account of the impact of extra-financial issues on long-term investment” [EAI, 2007]. The EAI was launched at the end of 2003 by a founding group composed of 7 institutional investors managing some 364 billion in assets. Today, EAI has 27 members and represents total Assets under management of more than 1,8 trillion Euros. To encourage sell-side analysts to produce ESG research, EAI members have agreed to allocate at minimum five percent of their respective brokerage commissions to the brokers providing the best analysis of extra-financial issues. In this perspective, EAI commissioned a consulting company to evaluate twice a year the research submitted by the different research providers and to rank the best ones. Some years later, the bet seems to have paid off, as the number of ESG research providers has registered a significant growth since EAI was launched. In fact, figure 3 below shows that the number of ESG research providers increased from 8 in December 2003 (launch of EAI) to 33 in June 2006. In the same period, the number of submitted reports increased from 16 to 173.

Insert Figure 3 About Here

The PRI were launched in April 2006 by former UN Secretary General Kofi Annan in collaboration with 20 major institutional investors. The initiative consists of six principles that provide a framework to incorporate ESG issues into mainstream investment decision-making and ownership practices (See Appendix 1). The six principles are not prescriptive, the signatories publicly commit to adopt and implement them, where consistent with their fiduciary responsibilities. By 2009, the PRI had grown into a coalition of more than 400 of the largest institutional investors and asset managers worldwide representing some \$15 trillion dollars under management [Hobbs, 2008].

Recently (end of 2008), the PRI and the EAI announced their merger under the PRI name. Their alliance is aiming at supporting the generalization of ESG research and the effective inclusion of ESG information into investment decision practices: “this new approach will represent a single, powerful voice within international investment markets, continuing to encourage the production of better integrated and longer term research” [PRI, 2008]. This decision will necessitate changes to the existing EAI process, however, the new entity assures research providers that they will continue to support those producing high-quality ESG research through the allocation of commissions.

The Investor Network on Climate Risk (INCR) represents another important initiative. INCR is a network of institutional investors and financial institutions that promotes better understanding of the financial risks and investment opportunities posed by climate change. INCR is coordinated by Ceres, a coalition of investors and environmental groups working to advance sustainable prosperity.

- **Financial analysts’ collaborations**

The financial analysts’ community has also witnessed the emergence of professional collaborations addressing the inclusion of ESG information. In France for example, some members of the SFAF, the French association of financial analysts, founded in 2002 a commission to discuss and exchange ideas about the analysis of sustainable development information and to increase investment community awareness of the importance of this issue.

At a European level, the EFFAS CESG (European Federation of Financial Analysts (EFFAS) Commission on ESG Environmental, Social & Governance (CESG)) was founded in October 2007 with the objective of “Facilitating the integration of ESG aspects of corporate performance into investment processes”.

- **Other professional initiatives**

Many consultancy companies have positioned themselves in the emerging market of services related to ESG information and financial advice. Some of them rely on their skills in financial investment domains to propose new services combining ESG issues analysis and investment advice. The British consulting company Mercer is among the pioneer investment consulting firm that developed such new services. Its newly-created division specializing in responsible investment is progressively striving for the extension of its services to mainstream investors. Indeed, in 2007 Mercer created the PRI Implementation Service, including the monitoring of ESG factors within investment at fund managers [Responsible Investors, 2008]. And in 2008, Mercer announced its intention to rate all fund managers on their strategic responses to environmental, social and governance concerns. This information is added to its global database listing the characteristics of funds managers on which investors base their choice for the appropriate fund or asset manager.

Several others consultancy companies have also launched services to help investors to develop investment approaches that integrate ESG issues within a fiduciary framework (See Appendix 2).

- **Surveys, reports and publications**

The number of reports, articles and surveys published the last years about ESG information, usefulness to the financial community and ESG integration into investment decisions, represent another indicator of the growing interest in these issues.

The EABIS/European CSR Alliance research project , ‘Valuing Business’ [Amaeshi 2009] has identified 82 reports from accounting firms, investor associations, business coalitions, investment banks, multinational institutions, consultancies and think tanks, governments and multi-stakeholder fora published between 2000 and March 2009 (see Figure 4, EABIS/EU Laboratory, 2009). Although this list is not exhaustive it provides a good indication of the most significant and used reports and of the increasing number of reports on

the topic. It is also interesting to note that about 50% of the reports have been produced by multinationals, multi-stakeholder coalitions, Accounting firms and think tanks.

Insert Figure 4 About Here

Similarly, the specialized press has shown a greater interest in the inclusion of ESG issues in investment practices. A search in the Financial Times, Wall Street Journal and the Australian Financial review reveals a significant increase of articles published on the topic since 2006-2007. “Environmental, social and governance as key words” were used as key words.

3.3. Micro-level actions aiming at institutionalize ESG integration

The preceding section retracing the genesis of ESG integration shows reveals that there is an apparent willingness from many actors to mainstream the integration of ESG information into investment decision-making. In this next section, we analyze the emerging collaborative initiatives in the light of the three institutional mechanisms, coercive, normative and mimetic. It is however important to note that the three types of mechanisms defined are not always empirically distinct. Indeed, within the identified micro-level actions, some can contribute to one or several mechanisms. For example, efforts implemented by EAI members can be considered both as micro-level action supporting coercive mechanisms and mimetic mechanisms.

3.3.1. Micro-level actions supporting coercive mechanisms

We have identified two main actors who have developed micro-level actions exerting coercive pressures on the financial community, namely institutional investors especially pension funds, and governments.

Institutional investors are essentially exercising pressures through contractual restrictions. Fund managers and sell-side financial analysts may be contractually required by the institutional investors to integrate ESG issues in the management mandate. Such requirements constrains fund managers and financial analysts to consider ESG information. Indeed, over the last ten years, many institutional investors have launched calls for tenders for bond and equity mandates including such a restriction.

As a result, many fund managers have agreed to implement the necessary measures to meet the requirements and win the mandate. Indeed, such calls for tenders issued by major institutional investors as for example the FRR in France have contributed to the development of extra-financial research within investment companies.

“We were not opposed to introduce social aspects in our investment strategy but it was not our priority. It was a potential project. We had had already discussed several times about the creation of an SRI team and the launch of an SRI or a thematic fund but it was not a short time project... Let’s say that the FRR mandate helped us to accelerate its implementation... yes, it was important for us to win this mandate”
[Fund manager].

In France, the call for tenders launched by the FRR’s and the EARP between 2004 and 2007 has served as a catalyst for change. Although it has not led to an effective integration, it has contributed to the increased interest of the mainstream investment community in ESG information. It was an explicit objective of the calls as Nada Villermain Lecollier, head of responsible investment at FRR, confirmed in an interview published in Responsible Investor in 2008 :

“It’s a strategy that’s worked well, even if it was ambitious. We haven’t imposed any method of ESG research onto our managers; we’ve just be directional. [...] In our mandates, we say that we are attentive to ESG integration over the lifetime of the mandate. [...] Part of our identity is to get our managers to integrate ESG into their investment. It’s hard-wired into the mandates”. He also adds: “We don’t say that from one day to the next we want to see results, but we do question the managers regularly on what they are doing”.

Norwegian and Sweden pension funds were among the first to launch tenders to bring asset managers to include ESG issues. This has probably been stimulated by the UN PRI which has been endorsed actively and at an early stage by Denmark, Norway and Sweden [Pension News, Oct 7th, 2008]. Similarly, an increasing number of UK institutional investors have adopted this strategy.

The April 2009 Fair Pension's report has pointed out a "trend among large UK pension schemes to be more assertive with fund managers about their responsible investment credentials, notably when hiring for investment mandates".

The mandate requirement can be different from mandate to mandate. It may involve the implementation of a specific criterion regarding one or more ESG aspects, a strategy of shareholder engagement, and/or excluding certain sectors or activities. For example, the tender launched in December 2007 by the UK Environment Agency's Pension Fund specified that it would favour managers according to investment in climate change themes as well as adherence to the UNPRI [Responsible Investor, 8 September 2008]. Similarly, London Pension Fund Authority (LPFA) said it "would no longer hire fund managers that failed to comply with certain criteria on ethical, social and governance issues, including those that do not sign up to the UN Principles for Responsible Investment"[Responsible Investor, 2008]. The Government Pension Fund of Norway is another example of using a combination of engagement, negative screening, and exclusion. Companies can be excluded from the investment portfolio when violating human rights, the environment or involved in corruption. This has led to the June 2006 Wal-Mart case. Because of labour right violation suspicions, the Norwegian Government Pension Fund decided to divest from the company. They held at that time stocks of about US\$ 430 million. This event had large media coverage. Other groups of investors give priority to engagement and shareholders activism. For example, in its December 2008 investment mandate, the fund of NILGOSC (Northern Ireland Local Government Officers' Superannuation Committee) required an engagement strategy.

These micro-level actions implemented by institutional investors are considered as coercive pressures. They are developed in a context of dependency and power inequality. Asset managers are very often dependant on large institutional investors such as the pension funds. Institutional investors are their most important clients in terms of assets under management. With assets of approximately €270 billion (as of December 31, 2007), the Norwegian Government Pension Fund-Global is the largest pension fund in Europe and the second largest pension fund in the world [Eurosif, 2008]. In France the FRR and ERAFP represent about 38bn euro of assets under management. As an increasing number of these major investors are considering ESG integration, fund managers are constrained to accept their conditions to survive.

Another source of coercive pressures that target research providers, in particular sell-side financial analysts, is the EAI. Obviously, EAI's objective is to push mainstream financial analysts to cover ESG information by proving to them that 1) investors are interested in ESG analysis and 2) institutional investors are prepared to pay for it. As EAI represents an important coalition of institutional investors, its pressures can be felt as a constraint. Indeed, this professional collaboration is constituted of major institutional investors in the world representing a total Assets under management of more than 1,8 trillion Euros. As highlighted by one of its founding members in an article published in 2004 in *Social Funds*, EAI members' goal was to create the necessary context to push brokers to produce ESG research:

"The founding members recognized that there was a chicken and egg situation: sell-side analysts currently do not routinely provide analysis of extra-financial issues in their reports and their clients, the fund managers, do not ask for it. [...] The fund managers do not ask for it [because] they are often unaware of the implications that these issues could have on the companies in which they invest. [...]. By providing the financial and business case for the sell-side to incorporate these issues, the EAI will break this negative cycle".

Coercive pressure is also coming from regulations initiated by governments. Over the last decade, many governments have launched new regulations to establish ESG disclosure requirements for pension funds. According to research published by SHARE (Shareholder Association for Research & Education) in 2008. The first jurisdiction to establish a formal obligation for pension fund ESG disclosure was the United Kingdom in 2000. Indeed, since July 2000 the trustees of an occupational pension fund are required to declare "the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realization of investments" and "the policy (if any) directing the exercise of the rights (including voting rights) attaching to investments". Following this pioneer initiative, many other governments put similar rules in place. Figure 5 below recapitulates the regulations established worldwide up to February 2009.

3.3.2. Micro-level actions supporting mimetic mechanisms

Many sources of uncertainty surround the domain of ESG information. As discussed above, the main uncertainties stem from the lack of clear evidences on 1) the impact of ESG aspects on companies' financial performance and 2) the relevant methods to quantify these impacts [Guyatt, 2006a,b, Jaworski, 2007, BSR, 2008, McKinsey, 2009]. As a response, actors within the financial community have developed several micro-level actions.

One of them is the creation of professional collaboration networks about ESG information such as EFFAS C ESG or CERES . The main objective of these initiatives is to facilitate the sharing of knowledge, methodologies and expertise among the investment community: "CESG will not confine itself to discussions but rather strive to define positions on extra-financials, produce outcomes such as papers, recommendations and seek to play an active role in the dialogue with both investment professionals and corporates" [EFFAS,2008] .

Consulting firms, being viewed as experts, are also playing a role by diffusing models. Consultants develop relationships with numerous organisations to which they deliver similar advice. In addition, their multiple interventions in these organizations allow them to pick out best practices and to transfer them from one organization to another. Likewise, the production and diffusion of reports and studies by consulting companies and research centres help the transfer of ideas and methods. Indeed, as many issues regarding ESG information are surrounded by uncertainties, many organizations tend to get solutions and innovative practices suggested by experts. For example, in June 2006 the consultancy Trucost published a study on the correlation between CO2 emissions and financial performance in the United Kingdom. The same year, Yachnin & Associates published a report in which concrete examples were given to illustrate methodologies that allow quantifying and isolating the effect of corporate sustainable development practices on share price performance. Such advices and ideas represent a vehicle for the diffusion of norms and standards that help actors to reduce uncertainties and to coordinate their actions.

EAI can also be considered as a vehicle of mimetic behaviours. By advocating the importance of including ESG information into investment decisions, EAI members influence the investment industry.

In fact, through their initiative, EAI members indirectly influence their peers in the investment sector by demonstrating their own interest to ESG information and by making ESG research available to asset managers and then potentially considered by them. Another interesting development has been the launch of several of the EAI's bi-annual rankings since 2004. The EAI rankings have had a significant impact on sell-side companies to create a devoted ESG research team. First, because, they wanted to be among the pioneers providing extra-financial research and second because the nominated companies are rewarded through the financial commissions allocated by EAI members. This was confirmed in the interviews conducted with sell-side analysts working in brokerage houses. Being on those rankings was important to them:

“to appear among the brokerage companies able to adapt quickly their competencies and services in response to changing market demand”;

and “to take advantage of the resources that derive from these activities” [sell-side analyst].

Rankings and rewards regarding ESG research providers seem to have gained interest as many of them have been established in the last few years such as the Thomson Extel Social Responsible Investment Survey (in 2003) and the ESG Leaders Awards (in 2007). These ranking and awards contribute by highlighting the efforts undertaken by the financial professionals in the domain of ESG integration. By putting them in the spotlight, they encourage many others to join the movement.

A last factor contributing to mimetic behaviour is employee transfer. Many financial analysts have moved from one company to another over recent years. For example, in order to launch its extra-financial research activity in 2004, Citigroup hired the analyst who founded the ESG research team in HSBC. In the same way, Société Générale recruited two senior ESG analysts from CM CIC to initiate its ESG research activity in 2004. Those transfers are helping the diffusion of models among different organisations because individuals come with methods and practices developed in their original employer and tend to replicate them in the new company.

3.3.3. Micro-level actions supporting normative mechanisms

As the integration of extra-financial information into investment processes is a relatively new practice, many efforts have been undertaken to organize the field.

Some members decided to collaborate in order to define the “profession” and the acceptable methods of work in the field of responsible investment research providers. A good example is the creation of the AI CSRR (Association for Independent Corporate Sustainability and Responsibility Research). The three first missions defined by the association express its ambition of “developing and promoting high professional standards for organisations in the field” [AI CSRR, 2009]. These missions are:

- “to defend and promote the interests of the independent CSRR sector;
- to represent the CSRR sector – inside and outside Europe - to professional users, public authorities and the SRI community and the general public, by way of direct communication, open dialogue and transparency;
- to develop, promote and maintain high professional standards, expertise and codes of conduct for the CSRR sector” .

The AI CSRR has developed the first quality standard for corporate responsibility and SRI research and analysis. This standard named CSRR- QS 2.1 provides a general description of principles and requirements regarding the activities of the field of responsible research. It focuses mainly on the operational requirements of SRI-related products and services.

Other normative micro-level actions also appear through the growth of professional initiatives based on knowledge produced by university specialists and legitimated through academic credentials. Several collaborations have been developed between professional associations and academic groups to promote research linking finance with social responsibility and sustainability issues. The creation of the French SIF Award is an example of such initiatives. This award was launched in 2005 in order to support academic research, still an emerging area in the domains of finance and sustainable development: “By building bridges between universities, stakeholders and the financial world, the Award aims to increase investigative research allowing for new and innovative management. The Award will also give value to French and European university research, as well as help promote Socially Responsible Investment (SRI)”.

In 2008, PRI representatives initiated the PRI Academic Network to consolidate and develop research in the domain of social responsibility and finance. It aims at “stimulating interest in responsible investment research and provides multiple avenues for greater interaction between academia and practitioners”. Conferences and meetings are organized on a regular basis to encourage the production of innovative research able to help professionals and organizations to enhance their expertise. The European Centre for Corporate Engagement (ECCE) is amongst the most active research centres that have joined the PRI Academic Network. ECCE was founded in 2004 by researchers from Maastricht University and RSM Erasmus University in the Netherlands. It aims to help practitioners and scholars to “understand how businesses and financial markets can promote sustainable development by considering Environmental, Social and Corporate Governance (ESG) issues”. In May 2009, an agreement was achieved between PRI and the Danish Government to promote academic research on responsible investment. Governmental support to such initiatives gives more weight to ESG integration & gives a significant signal to the financial community that these issues are more than a temporary trend.

In February 2009, another similar initiative was launched in Australia. The Australian government announced \$(Australian)2.5 million funding over three years to establish the Responsible Investment Academy. This Academy will be managed by the Responsible Investment Association Australasia (RIAA) and governed by an Australian and international Advisory Council. Its main goal is “to offer a range of premium Continuing Professional Development (CPD) courses as well as diploma and certificate courses”. The implementation of a specific academic course is another way to establish and legitimate the area of responsible investment.

4. CONCLUDING REMARKS

This paper has investigated way new investor led collaborative initiatives are impacting on the integration of ESG information into mainstream investment processes and their potential to influence the standard valuation and investment practices of global fund managers. The results of this explorative study show that actors have developed a myriad of micro-level actions to stimulate the integration of ESG factors. The micro-level actions support and reinforce three institutional mechanisms: coercive, mimetic and normative which are vehicles through which the dominant collective belief may potentially evolve and change to integrate ESG information.

At this stage, it is difficult to predict if these micro-level actions will succeed to induce a change in the dominant collective belief. The strategies implemented are relatively recent while the diffusion and adoption of new conventional practices often necessitates a long time, especially within a conservative industry like the financial investment sector.

This study is a first stage in the investigation of this emerging trend. It reveals that micro-level actions may play an important role in changing dominant conventional practices. DiMaggio and Powell (1983) have identified three mechanisms –coercive, mimetic and normative—that are very important in understanding the institutionalisation process. However they are somehow rather general and do not capture the dynamics of change. This analysis suggests that change of conventional practices is a complex and progressive process [Whashington and Ventresca, 2004] created through actions of, and interactions between, actors and involving a portfolio of micro-level actions that go on in combination and interrelation with each other.

The micro-level actions described above are only illustrative and need to be further explored. They are of a different kind and nature, happening at different levels and different times. They do not necessarily occur independently; on the contrary they are combined and interwoven. They generate different outcomes but all contribute to the change in the dominant convention and thereby to the integration of ESG into mainstream investment.

Future research would benefit from systematic empirical investigation of how multiple levels, from personal through community to national and international organisations, are implicated in whether and how individuals choose to take action (or not), both as individuals (private sphere behaviours, cf. Stern, 2000) and/or as members of networks such as professional collaborations.

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APPENDICES

Appendix 1: The Principles of Responsible Investment (PRI)

The six principles

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

APPENDIX 2:

Examples of investment consulting companies offering services related to ESG integration

Creation	Name	Description	Country
2000	Trucost Plc	An environmental research organisation that was established to help companies and investors understand the environmental impacts of business activities. Trucost provides data and analysis on company emissions and natural resource usage and presents these in financial as well as quantity terms.	UK
2002	onValues Ltd.	A specialist investment consulting and research company. Its distinguishing feature is a focus on investment strategies that take into consideration long-term value drivers, including environmental, social and governance issues.	CH
2003	ASSET4 Milestones	A consulting company offering investment research information on the key economic, environmental, social and governance aspects of corporate performance that are material to the competitiveness and share price of companies.	CH
2004	Mercer (Responsible Investment Services)	Mercer's global Responsible Investment (RI) business unit provides advice to investment fiduciaries and practitioners on all aspects of RI. The RI business unit helps institutional investors to develop investment approaches that integrate environmental, social and corporate governance (ESG) issues within a fiduciary framework. Mercer is a leading global provider of investment consulting services, and offers customized guidance at every stage of The investment decision, risk management and investment monitoring process.	UK
2005	Yachin & Associates (Y&A)	A consulting group specialized in sustainable development and corporate social responsibility. Y&A is very active in helping integrate considerations of SD into investment decision-making and promoting related dialogue.	CA
2006	Sinclair & Company, LLC	An investment advisory firm. We offer tailored investment consulting to institutional investors integrating environmental, social, and governance [ESG] factors into investment practice. Sinclair & Company helps investors and their clients understand the threats and opportunities of the sustainability mega-trend.	US

FIGURE 1

Mutual reinforcement loop

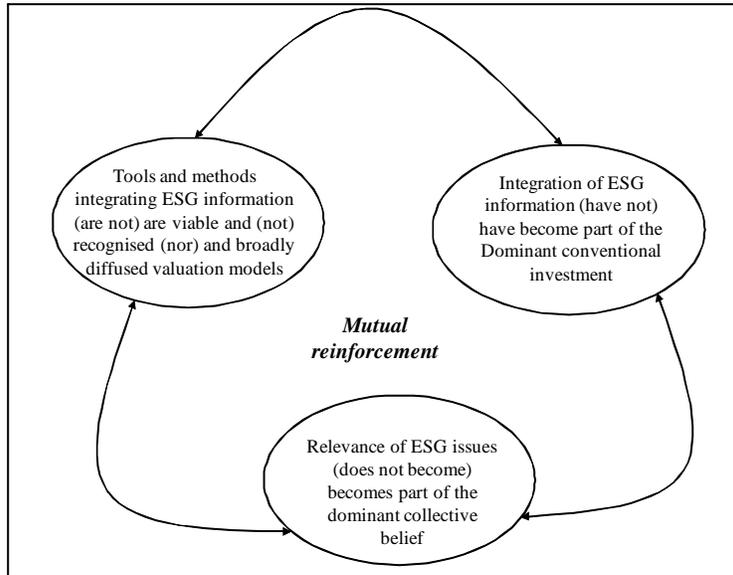


FIGURE 2

Research framework

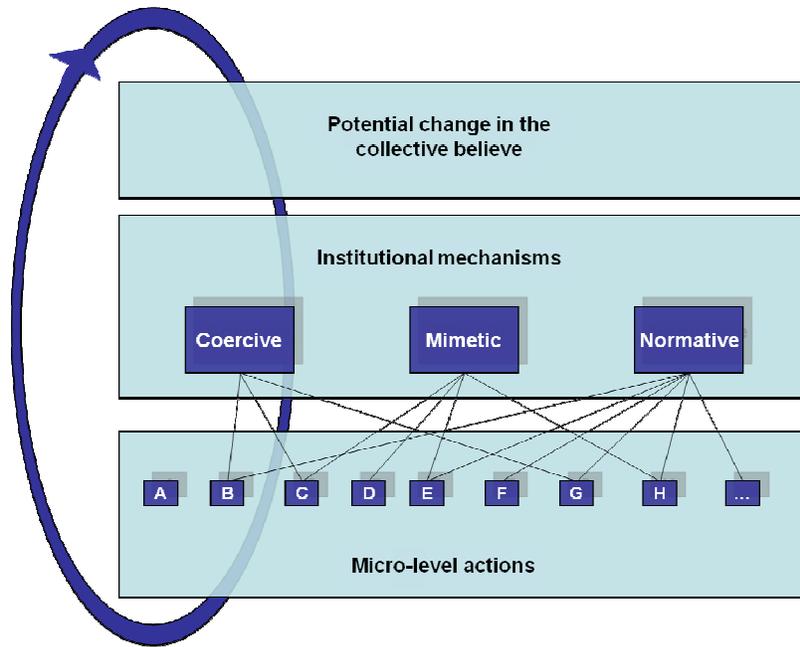


TABLE 1

Interviews

Financial Analysts	SRI.	Buy side	4
		Sell side	5
	Mainstream	Buy side	4
		Sell side	4
Fund managers	SRI		4
	Mainstream		4

FIGURE 3

Growth in reports and Research Providers since beginning of EAI Evaluations

(source: EAI Report, June 2006)

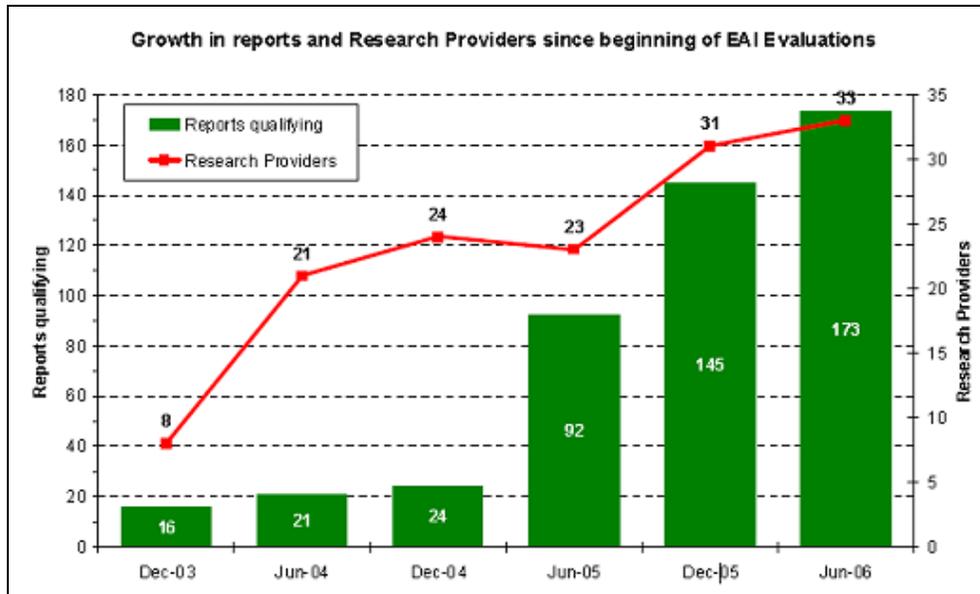


FIGURE 4

ESG reports published between 2003 and 2009 (as of 07 July 2009)

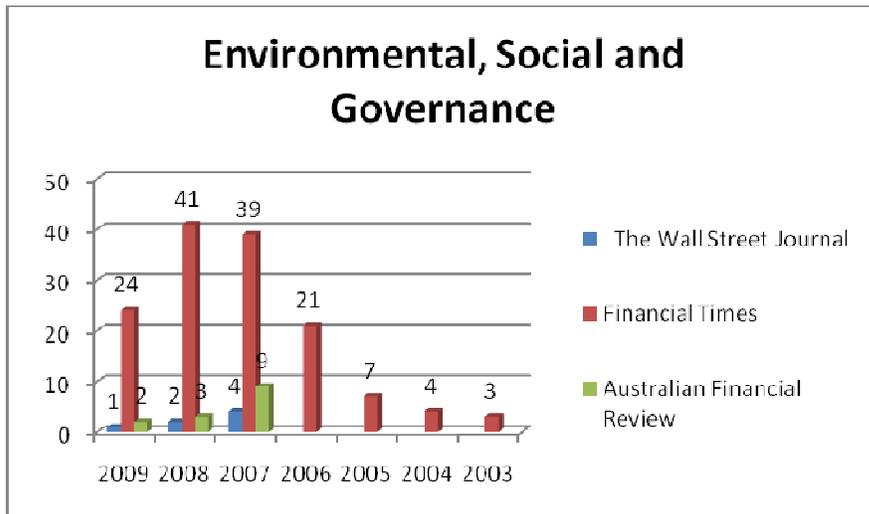


FIGURE 5

Disclosure regulations for pension funds

