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Article issued by CGF Research Institute and Element Investment Managers

Johannesburg
29 October 2012

RESPONSIBLE INVESTING IN SOUTH AFRICA

Given the height of the social unrest currently being experienced in South Africa, and considering the manner in which the media and global rating agencies have portrayed our country as heading toward a downward spiral; it's imperative noting the impact this situation brings upon South Africa and its business communities. Irrespective of whether these views are correct or not, the manner in which investors perceive and regard a country for sustainable investing is what *really* counts. The decisions taken by investors to support or withdraw their investments are largely dependant upon their risk appetite, as well as their confidence levels that their investments will flourish. As local and foreign investors can be fickle, particularly if there is uncertainty linked with political and economic matters -- being the case in South Africa -- they generally disinvest and redirect their much needed investments and support to areas where they have a better understanding of their risks, and the ability to protect and grow their investments.

Notwithstanding the fact that South Africa's economy is struggling -- which is not too dissimilar to other developing countries at this point in time -- not only has there been a massive job loss in the country, but there has also been a net sell-off of R26bn in South African equities by foreign investors since January 2011. Moreover, the latest UN Global Investment Report shows that South Africa has seen a decline of its foreign direct investment of 43 per cent in the last year alone; this being the largest decline amongst all developing countries.

That said, as the confidence levels in South Africa may be somewhat shaken, it is critical to note that informed investors are becoming more demanding that ESG (environmental, social and governance) factors are also taken into account, prior to their investment making decision. Understandably one cannot separate the matters of a government and the impacts their decisions have upon its citizens, and the implications upon businesses. The cause and effects upon these players are inextricably linked, as they are all in the same supply chain. Clearly, if government and business intends to retain and attract local and/or foreign investment -- whilst at the same time allaying investor's fears which are linked to our country's political and economic turbulence -- government and SA businesses will need to offer its existing and potential investors a lot more reasons for maintaining investor's confidence.

Against this backdrop, the South African government and business will be required to implement extraordinary 'partnership' measures that demonstrate exemplary principles of good governance if we are to achieve and maintain an environment where investors are comfortable with their investment choices and their returns. To this end, South Africa is well regarded for the governance principles contained in the *King Report of Governance for South Africa*, 2009 (King III), being an aspirational code for all South African businesses, organisations and organs of state. But the principles in themselves are not enough; all stakeholders concerned about South Africa's future need to be seen *actually* practicing good governance across the extended supply chains.

"Within the global investment arena there is a deepening understanding that, socially, environmentally and biophysically, ours is a world in transition, and that this growing awareness is eliciting a considered response from the industry and, as a result, ESG [environmental, social, governance] issues are finding their place in the mainstream."

Source: "Responsible investing is the new normal"

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Some of the more obvious areas of good governance would include factors such as ethical leadership, transparent business and financial reporting, fair labour practices, equitable remuneration and policies, sustainable environmental management and Responsible Investing (RI).

Whilst King III provides a number of guidelines geared toward the organisation's board, including the organisation's structural, operational, legal and ethical components, it does not provide specific guidelines for the manner in which an organisation may position itself to either attract, or make investments using the ESG criteria. Specifically then, on July 19, 2011, the *Code for Responsible Investing in South Africa* (CRISA) was launched, making South Africa the first country worldwide, where an investor code requires the integration of ESG factors, unlike the other investor codes found across the world. Interestingly, CRISA hails from more or less the same pioneers of King III, and it should be read in conjunction with King III as both documents provide guidance for sound governance and RI decisions.

As expectations for sound governance practices intensify, more countries across the world have also adopted RI Codes. Other RI Codes include the UK's Stewardship Code, the European Fund Asset Management Association (EFAMA) and the Dutch Code, Eumedion. In all cases, the principles found within these RI Codes -- including CRISA -- distinctly call upon investors to ensure that they do not make 'narrow' decisions based only upon financial terms, but that they include in their decision making the ESG factors which impact the long-term sustainability of the organisation.

Expectedly, these RI Codes provide guidance on how a responsible institutional investor should execute investment analysis and their investment activities. Clearly, non-compliant organisations who do not offer responsible investors the elements required to meet the criteria for such investing, will be passed down with obvious impacts as their investment sources become starved.

Upon reflection, and with the call for improved governance; government, business and society needs to understand that this is not some passing fad, or that it can simply be warded off, or that any of the constituents are unaffected through the poor governance practices of others. Good governance across the supply chain needs to be a combined effort and which is supported by all the actors; it is required at all levels to ensure there's a collective performance to improve the 'attractiveness' of a country and its businesses as a whole. Unlike times gone by, where the first responsible investors screened their investments for moral acceptability, the manner in which RI is adjudicated today is far more complex. RI usually involves various strategic forms of positive or negative screening, or best-in-class screening, which underpins various forms of activism or particular ESG related causes.

Undoubtedly RI is growing worldwide; not only in its importance, but also in its size of investments as it moves from peripheral to mainstream investing. According to a recent report* from Booz & Company (a leading global management consulting firm), the United States is currently the largest RI market with USD 2.7 trillion AUM (Assets Under Management), followed by the United Kingdom (UK) with USD 1.2 trillion AUM. The researchers of this report expect the RI market to reach between 15%-20% of the total global AUM (USD 26.5 trillion) and a total revenue of circa USD 53 billion by 2015. Of course there are many reasons why RI is gaining significant attention across the globe, and this phenomenon can also be ascribed to a new generation of thinking, where people are increasingly questioning the ethical and sustainability factors that underpin organisations, including their motives and impact upon people and a planet which has limited resources.

Additional factors which are contributing toward the growth of RI include;

- higher standards for organisational disclosure on ESG and ethical issues, incorporating guidelines found within investor codes,

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- inflows and development into existing or new SRI (socially responsible investments) products and services,
- adoption of RI strategies by organisations that were previously not involved in ESG issues,
- client demand for the incorporation of ESG issues into investments,
- new ESG legislative and regulatory demands,
- growing investor demands to control environmental risks and improve clean and green technologies,
- institutional investors collaborating to coordinate their work and advance shareholder advocacy, and
- raised social awareness and media attention.

RI appears set to stay. It would be sensible for the shareholders and leaders of organisations to rethink the manner in which they are directing their business. They should move away from the 'old-fashioned' transaction based, short-term actions which demand unrealistic quarterly returns upon their investments. Responsible investors adopt a more pragmatic view upon long-term sustainability, which is underpinned by sound governance principles and collective efforts which contribute toward promoting good corporate citizenship. These are the ingredients used to build a more stable, and sustainable economy.

* Responsible Investing: A Paradigm Shift - Article by Booz & Company and Robeco (www.booz.com; www.robeco.com)

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About CGF Research Institute (Pty) Ltd

CGF is a Proudly South African company that specialises in conducting desktop research on Governance, Risk and Compliance (GRC) related topics. The company has developed numerous products that cover GRC reports designed to create a high-level awareness and understanding of issues impacting a CEO through to all employees of the organisation.

Through CGF's strategic partners -- supported by our Corporate Patrons *iS Partners, Rifle-shot Performance Holdings and DQS South Africa* -- our capabilities extend to GRC management consulting, executive placements, executive mentoring, company secretariat and the facilitation of Corporate Governance and Risk Awareness workshops. To find out more about CGF, our patrons and our associated services, please access www.cgf.co.za or www.corporate-governance.co.za

About Element Investment Managers

Element Investment Managers is an independent, owner-managed company established in 1998. The company provides discretionary investment management services to individuals, institutions and retirement funds. Element Investment Managers were the first South African Investment Managers to sign the United Nations Principles for Responsible Investment (PRI) and the company is also committed to the Code for Responsible Investing in South Africa (CRISA). To find out more about Element Investment Managers, please access www.elementim.co.za

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