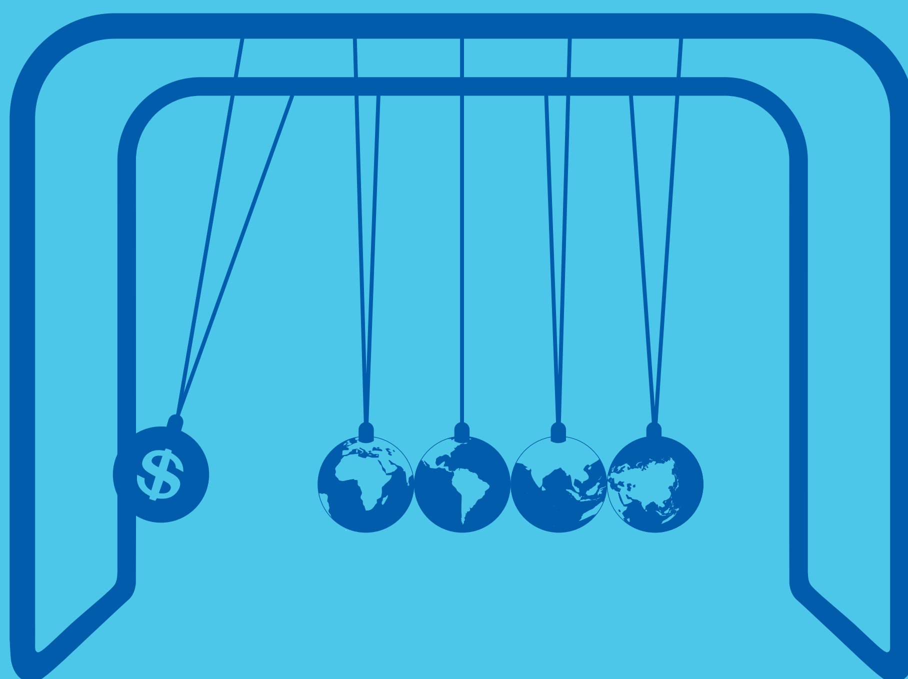

Responsible investment: a force for poverty alleviation. Framing the debate.

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With the support of
Insight Investment

The current crisis offers the opportunity to re-think the contribution that investors can make to eradicating global poverty.

Introduction

The unprecedented turmoil in the world's financial markets has resulted in a significant loss of trust in the global financial system. Financial institutions and the market as a whole have been criticised for short-termism, for lacking transparency, and for not being properly accountable to regulators or to wider society. The credit crisis has also raised wider questions about the proper role of investors in society, both in terms of the specific investments that they make and the manner in which they use their influence to ensure that the positive social and environmental impacts of their investment activities are maximised, and the negative impacts minimised.

Oxfam sees that the current crisis offers the opportunity to rethink the contribution that investors can make to eradicating global poverty. Oxfam believes that investors have a critical role to play in poverty alleviation, through supporting economic growth, building infrastructure, and helping to create a vibrant, entrepreneurial private sector. Oxfam also believes that investors can play a wider role through encouraging companies to attain higher standards of corporate responsibility performance.

However, the influence of investors (or of investment more generally) has not been unambiguously positive. For example, concern has been expressed about the negative consequences for development of volatile capital flows (as seen in the 1997 Asian financial crisis),[1] the negative social and environmental impacts of many large infrastructure projects,[2] the emphasis of investors on short-term profit rather than the creation of long-term successful and sustainable businesses,[3] and the downsides of trade and investment liberalisation.

It is in this context that Oxfam has launched a new project, 'Better Returns in a Better World'. The project's objectives are: to analyse the role that institutional investors can play in poverty alleviation; to encourage investors to take account of poverty issues in their investment decisions; and to identify the key barriers to long-term investment in developing countries.[4]

This discussion paper is the first part of the project. It has three objectives. The first is to make a *prima facie* case for why investors are of critical importance to the development agenda. The second is to provide an analytical framework for the project. The third is to identify some of the core questions that the project will seek to explore.

Under the right conditions, steady inflows of long-term private investment can provide substantial social and development benefits.

1. Why are investors of critical importance to the development agenda?

The power of institutional investors – including investment banks, insurance companies, retirement or pension funds, hedge funds, and mutual funds – lies primarily in their role as managers of immense pools of capital. Of particular importance to this discussion is the potential contribution that this capital can make in overcoming the economic barriers to development and poverty alleviation. Investors are also important because of both their influence over the governance and conduct of the companies they invest in, and their wider influence on public policy.

Capital allocation

The case for investing in developing countries is not unequivocal. Many of these economies have been characterised by economic and political instability, underdeveloped financial markets, lack of transparency, and weak investor protections. The consequence has been that investors have often sought greater protections or higher returns than they would if investing in equivalent activities or companies in developed countries.

While acknowledging existing difficulties, there are strong reasons for investors to consider investing in developing countries as such investments can provide potentially higher returns, particularly in countries experiencing strong economic growth.[5]

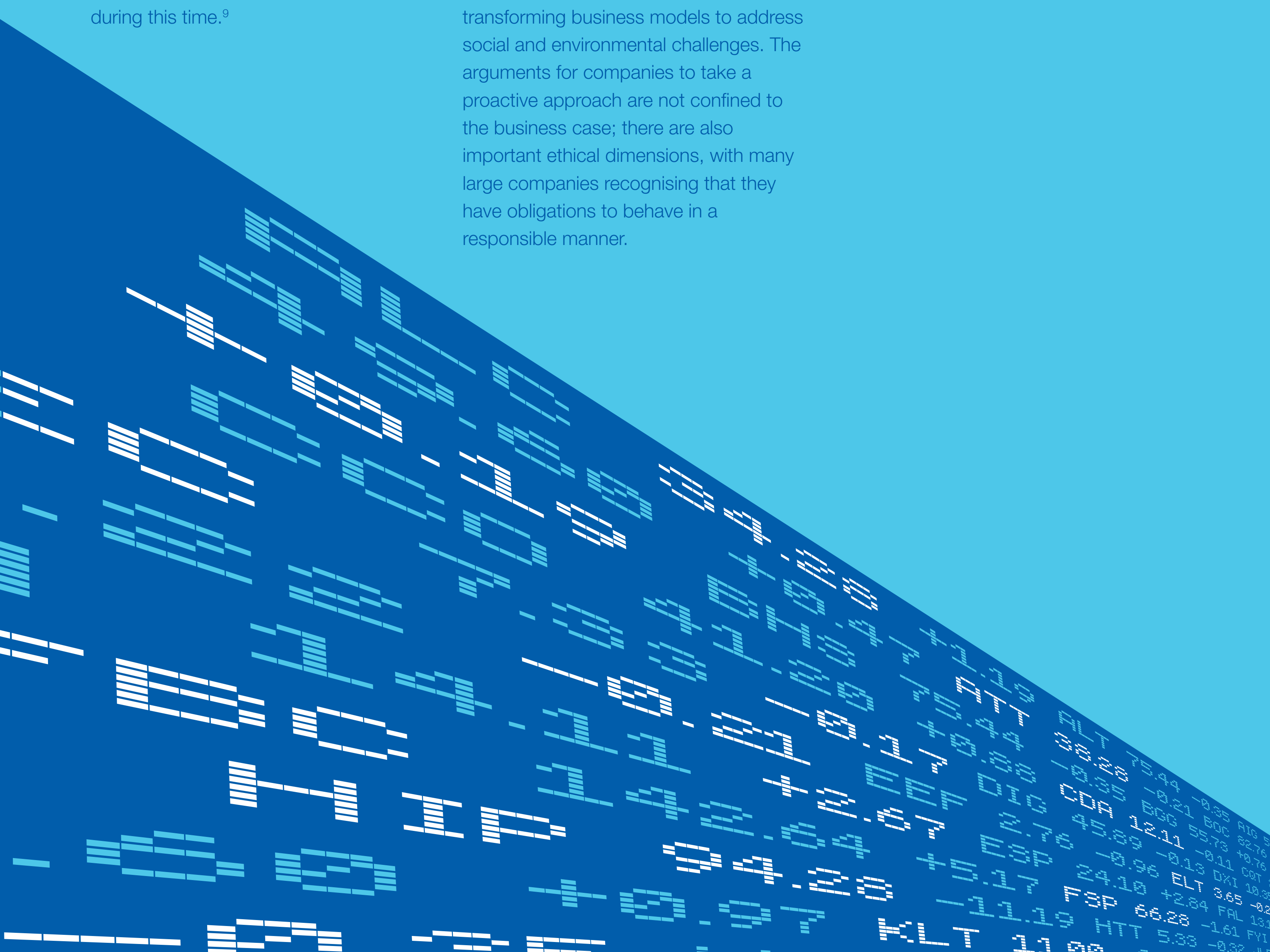
Furthermore, under the right conditions, steady inflows of long-term private investment can provide substantial social and development benefits through supporting economic growth, providing capital to build essential infrastructure, contributing to a vibrant, entrepreneurial private sector, and paying taxes that governments need to provide schools, hospitals, and other essential infrastructure and services. In addition, investments in areas such as microfinance (whether directly or through microfinance investment vehicles (MIVs)) can directly contribute to improving access to finance, a critical issue for poverty reduction.[6]

However, investments in developing countries have not been unambiguously positive from a development perspective. First, the distribution of these investments has been concentrated in a handful of large, middle-income countries such as China, India, and Thailand, with low-income countries receiving relatively little investment.[7] Second, investment flows can be highly volatile and subject to sudden reversal. For example, the outflow of funds from Indonesia during the 1998–99 financial crisis contributed to a significant decline in the country's GDP which, in turn, resulted in a significant increase in unemployment (e.g. in Indonesia to 15 million people) and saw extreme poverty increase four-fold.[8] This pattern of capital outflows undermining the hard-won development gains of previous decades was a common feature across the East Asian and Pacific region during this time.[9]

Influencing company operations

There are compelling business reasons for companies to proactively manage their social and environmental impacts. Issues such as environmental degradation, climate change, HIV and AIDS, ethnic conflict, and inadequate health and education systems can impact negatively on business costs and present significant risks to corporate assets and reputations. There are also wider business benefits to be derived from operating in increasingly prosperous and stable societies, such as having access to a healthy and competent workforce, prosperous consumers, predictable trading and financial systems, and a well-governed economy. In addition, companies may be able to access new business opportunities through, for example, developing new products, services, and technologies, or even transforming business models to address social and environmental challenges. The arguments for companies to take a proactive approach are not confined to the business case; there are also important ethical dimensions, with many large companies recognising that they have obligations to behave in a responsible manner.

These arguments are increasingly recognised by investors. An increasing number of institutional investors have worked to encourage improvements in companies' corporate governance and, more recently, corporate responsibility performance. In recent years, investor influence has been key to the delivery of important outcomes. These include dramatically reduced prices of AIDS medicines, the withdrawal of companies from unhelpful industry lobby groups, the adoption of environmental standards, and improvements in labour conditions in retail supply chains.[10] Investors have used a range of strategies to effect these outcomes; some examples are presented in Box 1 on the following page.



Investors have a role to play in constructively influencing public policy on social and environmental issues.

Box 1: Exerting influence – some examples

Research and engagement Since 2002, Insight Investment has actively encouraged companies to improve their supply chain management practices. Insight researched the impacts of buying and pricing practices on supply chain labour standards. It also examined listed companies' exposure to the worst forms of child labour. It benchmarked the performance of retailers and supermarkets on supply chain labour standards and subsequently engaged with these companies to encourage improvements in their management, auditing, and reporting processes. These activities have led to a number of companies, in particular in the retail sector, significantly improving their management of these issues.[11]

Divestment Norway's Global Pension Fund has withdrawn its holdings from a number of companies that do not meet its social and environmental criteria. Examples include Wal-Mart, BAE Systems, Boeing, EADS and, more recently, Rio Tinto.[12]

Using shareholder rights (voting) In 2008, over 50 climate change-related shareholder resolutions were filed in the USA, reflecting growing investor concerns about the risks of global warming. Almost half of these resolutions were subsequently withdrawn when the companies made commitments to setting targets to reduce their greenhouse gas emissions.[13]

Partnering with other stakeholders In 2001, Oxfam launched its *Cut the Cost* campaign, calling for pharmaceutical companies, in particular GlaxoSmithKline (GSK), to improve access to medicines in the developing world, especially anti-retrovirals (ARVs) for the treatment of HIV and AIDS. Investors, concerned by the risks to the industry's reputation, engaged with GSK and other companies to encourage them to respond constructively to the issues raised by Oxfam. This engagement was an important contribution to GSK's decision to substantially reduce the price of first-line ARVs, a critical initial step towards improving access to these medicines.[14]

Despite these positive outcomes, investors have been criticised for overemphasising short-term financial return; it has been argued that this focus means that companies do not consider the longer-term implications of their strategies and may not properly incorporate social and environmental factors into their decisions. For example, in the pharmaceutical sector, investor pressures on pharmaceutical companies to maintain double-digit profit growth have reinforced a business model that focuses on developing a small number of 'blockbuster' drugs at high prices, at the expense of longer-term financial performance and public health gains.[15] The result has been a lack of investment in new drugs, higher prices, higher marketing costs, and a focus on mergers and acquisitions rather than new product development as a means of business growth.

It is relevant to note that some large investors, concerned about the industry's future growth prospects, have called on the industry to transform its business model to take account of the urgent need to improve access to medicines for poor people in developing countries. Investor-led initiatives such as the Pharmaceutical Shareowners' Forum and PharmaFutures have shown that such a change could improve both financial and social performance over the longer term.[16]

Public policy influence

The role of investors in constructively influencing public policy on social and environmental issues is an emerging issue. However, there are signs that investors may have an important role to play in ensuring that public policy delivers positive social and environmental outcomes. One example is the role that investors have played in the debate around revenue transparency. Over 70 investment managers, representing £12.3 trillion of assets under management, have actively supported the Extractive Industries Transparency Initiative (EITI) – an international multi-stakeholder initiative involving developed and developing country governments, companies, and NGOs, including Oxfam.[17] EITI encourages extractive companies to be more transparent about their payments to host governments. Enhanced transparency on contracts and payments is a first step towards greater accountability for the terms of contracts and for governments' management of revenues derived from oil, gas, and minerals.

2. Framing the discussion

Attitudes have changed, with business now recognised as a key actor in the delivery of the MDGs.

We believe that the most useful way to frame the discussion is to locate our work within internationally recognised goals and objectives for poverty alleviation. We therefore use the Millennium Development Goals (MDGs) as the basis for defining the key poverty-related issues on which investor interest should be focused. Similarly, we use the UN Principles for Responsible Investment (UNPRI) as the starting point for defining the role and responsibilities of investors.

Business and the Millennium Development Goals

In 2000, world leaders gathered at the United Nations and adopted the MDGs, committing themselves to take co-ordinated action to reduce extreme poverty. The MDGs are a set of eight targets to be achieved by 2015, ranging from halving income poverty to tackling the spread of HIV and AIDS and providing universal primary education.[18] Together, the MDGs – agreed by all the world's countries and leading development institutions – form the principal framework for global efforts to tackle poverty (see Box 2).

In 2008, halfway to the target implementation date, there has been encouraging progress in some areas. For example: the number of people living on less than $1 a day fell by 278 million between 1990 and 2004, and has fallen by 150 million in the past five years alone; about 40 million more children are in school; gender disparity in primary and secondary schools has declined by 60 per cent; two million lives are saved every year by immunisation; and two million people now receive AIDS treatment.[19]

There is, however, a long way to go: 1.4 billion people still live in extreme poverty; ten million children a year die before their fifth birthday; and 1.1 billion people do not have access to safe drinking water. Furthermore, many of the gains that have been made to date are fragile. The current global financial crisis fuelled by the credit crunch, economic slowdown in developed countries, and rising inflation, are likely to hamper economic growth in the developing world, threatening to hinder or even reverse progress towards the MDGs.[20] The full impacts of the financial crisis on developing countries are unknown, although estimates suggest that flows of funds for emerging markets could fall by as much as 25 per cent,[21] exacerbating problems caused by high fuel prices and the possibility of a reduction in international aid. Beyond the financial crisis, there are other issues: food prices are estimated to have risen by 83 per cent in the past three years, driving an extra 100 million people below the poverty line, [22] and changes in weather patterns are already negatively affecting poor communities in developing countries as a result of more erratic rainfall and the increased incidence of droughts and floods.[23]

When the MDGs were first developed, the primary obligations to meet them were considered to rest with governments and

Box 2: The Millennium Development Goals

Goal 1 Eradicate extreme poverty and hunger
Goal 2 Achieve universal primary education
Goal 3 Promote gender equality and empower women
Goal 4 Reduce child mortality
Goal 5 Improve maternal health
Goal 6 Combat HIV and AIDS, malaria and other diseases
Goal 7 Ensure environmental sustainability
Goal 8 Develop a global partnership for development

international institutions; business was seen as playing a minor supporting role. Since 2000, attitudes have changed, with business now recognised as a key actor in the delivery of the MDGs.[24] In 2007, the Business Call to Action Declaration was launched. This has now been signed by 77 major corporations – including Accenture, Anglo American, Barclays, Cemex, KPMG, McKinsey & Co, SABMiller, Swiss Re, and Vodafone. The Declaration encourages companies to proactively seek to support growth and poverty reduction in developing countries through increased investment, job creation, technology, and innovation.[25]

Responsible investment and the UN Principles

That investors have social and environmental responsibilities is increasingly accepted in the investment industry. This is perhaps most clearly seen in the level of investor support for the UNPRI, which are summarised in Box 3. The Principles, launched in 2006, were developed by institutional investors, and are supported by the UN Global Compact and the UN Environment Programme, with the direct support of the UN Secretary-General. They are intended to develop and promote best practice in the area of responsible investment, through facilitating the integration of environmental, social, and governance issues into mainstream investment practice. The Principles have now been signed by over 400 institutional investors, representing some $15 trillion of assets under management.[26]

Box 3: The UN Principles for Responsible Investment

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes, and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

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.

3. Linking the UNPRI to the MDGs

The integration of poverty and development issues into investment activity offers the potential to significantly improve the lives of millions of people living in poverty, while also enhancing long-term investment returns.

The Principles are intended as a generic framework for asset managers and asset owners, rather than as a detailed implementation framework on the priority issues identified in the MDGs. The questions that, in our view, need to be addressed in order for the Principles to be made much more relevant to the development agenda (and which will be the subject of Oxfam's 'Better Returns in a Better World' project) include:

1 Why should poverty-related issues be integrated in asset allocation and investment decision-making? Does their omission put financial value at risk or does their inclusion help create financial value?

2 Can poverty-related issues be incorporated into investment analysis? Can company performance on poverty-related issues be measured? How can this data be incorporated into investment analysis and decision-making?

3 What are the appropriate timeframes for considering poverty-related issues in investment practices? Are current investment time horizons appropriate?

4 What should be the objectives of investor engagement, on poverty-alleviation and development? Is engagement best conducted on specific issues within the development agenda or is it possible to have an integrated approach? Are there specific issues that are presently overlooked by investors?

5 What reporting is required? What information should companies report to enable their contribution to poverty alleviation to be assessed?

In addition we expect that the project will also canvass some wider, cross-cutting issues such as:

- How does the role of investors differ between asset classes (e.g. between equities and bonds)?
- Should investors have different expectations of companies from developed and developing countries?
- To what extent do investment time horizons influence investors' views on poverty alleviation?
- What are the barriers (e.g. motivations, assumptions, incentives) to longer-term investment in developing countries?
- What regulatory changes or other incentives might be used to produce better outcomes for pro-poor development?

Conclusion

The current financial crisis provides us with a unique opportunity to rethink our views and assumptions about the role of institutional investors in development. Oxfam's starting premise for its project 'Better Returns in a Better World' is that the integration of poverty and development issues into investment activity offers the potential to significantly improve the lives of millions of people living in poverty, while also enhancing long-term investment returns.

We expect that this project will provide Oxfam with much-needed clarity regarding the specific contribution that investors can make and the limitations to this contribution, as well as providing us with a framework for discussions with investors and with governments about how the development contribution of the investment community can be maximised.

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This paper is the initial publication from Oxfam's project 'Better Returns in a Better World' which aims to assess the potential for investors to contribute to poverty alleviation through their investment activities.

For further details please see www.oxfam.org.uk/business

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