

Corporate Responsibility and Global Business: Implications for Corporate and Marketing Strategy

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Outline:

- 1. SRI → CSR: Introduction**
- 2. Screening / Exclusion Restrictions in SRI**
- 3. “Second Generation” SRI Fund → CSR**

Introduction

- ◆ **“The cumulative investment portfolio of the combined SRI mutual fund industry is virtually no different than the combined portfolio of conventional mutual funds...the screening methodologies and exceptions employed by most SRI mutual funds allow practically any publicly-held corporation to be considered as an SRI portfolio company” (Hawken et al (2004, p. 16).**
- ◆ **“CSR is best understood as a niche rather than a generic strategy: it makes business sense for some firms in some areas under some circumstances” (Vogel (2005, p. 3).**

Screening / Exclusion Restrictions on SRI

◆ What is market mechanism for SRI → CSR?

Stock Price ↓ → Cost of Capital ↑

=> If SRI is “effective -> Fund Underperforms

“Total Return” = [Lower Monetary Return + “Good Conscience”
Utility]

Deadweight Loss in the System.....

◆ Evidence:

South-Africa-Free Portfolio Divestments

Equilibrium Investor Models: Henkel et al (2001)

Screening / Exclusion Restrictions on SRI (contd.)

- ◆ **“Bad News” – Not much direct impact on corporate policy...**

- ◆ **“Good News” – Can set up an SRI Fund with exclusion restrictions and minimal expected underperformance (“tracking error”)**
 - » Example: Appendix (Negishi (2005))

- ◆ **Aside: Potential non-stock-market mechanisms:**
 - Direct Shareholder Action
 - Endogenize Ownership Structure, e.g. Private Equity Holders
 - Influence Product Demand (Consumer Boycotts etc.) or Employee Satisfaction
 - General influence on “Shareholder Relations” on Stock Prices and Liquidity

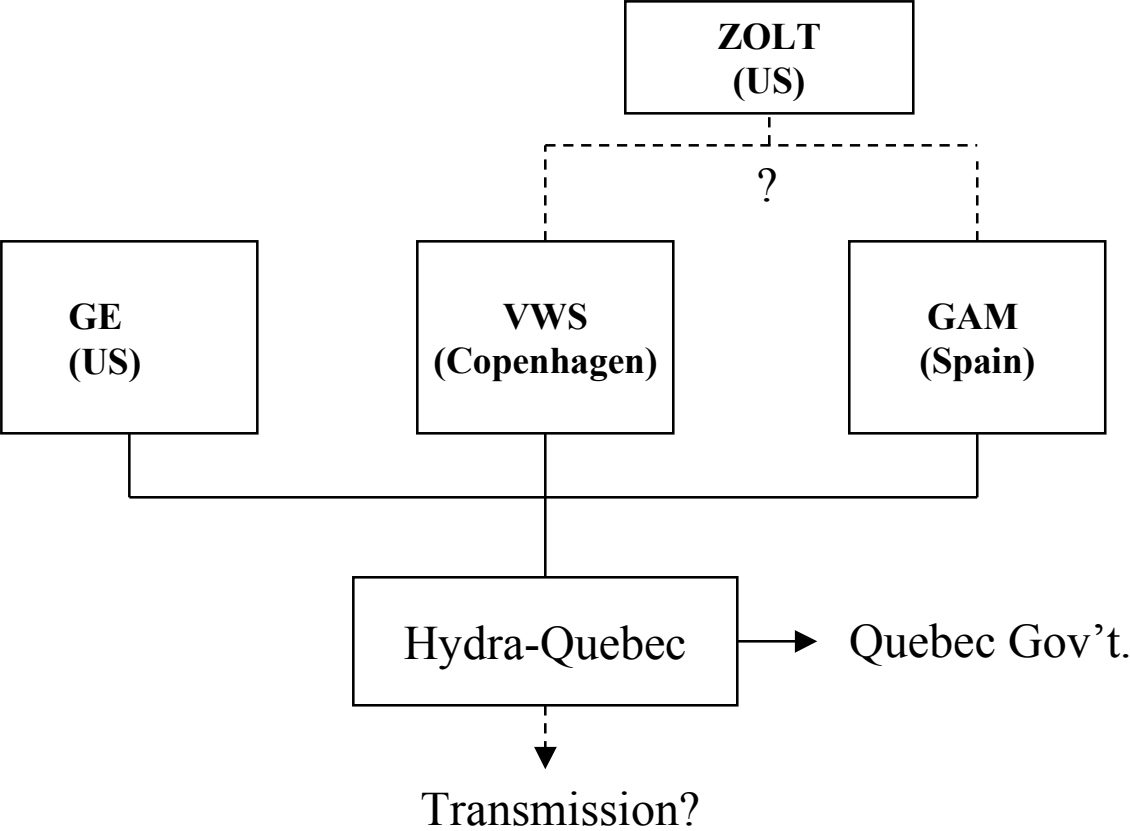
“Second Generation” SRI Fund

- ◆ **Publicly Traded Equities Only – but even large companies are supposed to “re-invent” themselves every few years!!**
- ◆ **Objective: Technology/Knowledge for Reducing Carbon Emissions**
- ◆ **Guiding Principle:**
 - » **Tilt toward stocks of companies that “do well by doing good”**
 - » **Tilt away from stocks of companies that “do well (or not so well) by doing bad”**
- ◆ **Analysis → Which stocks are more likely to “do well”**
 - » **Cost-and-Pollution Reduction**
 - » **Marketing**
 - » **Flexibility (Real Option)**

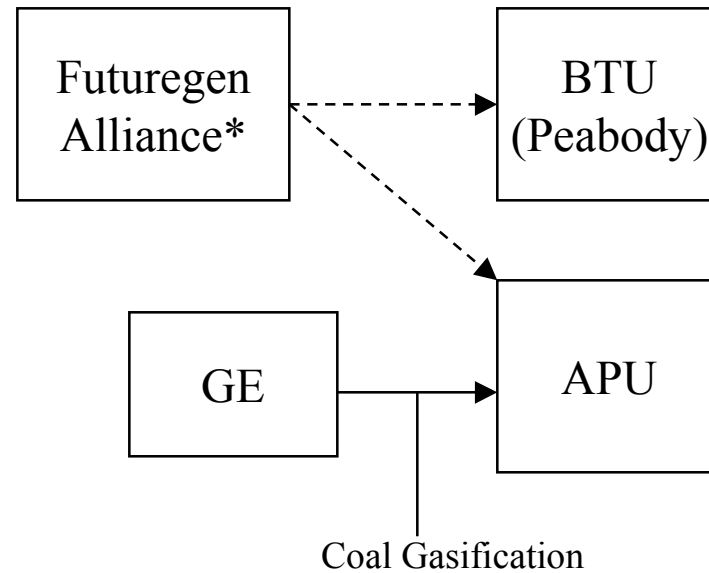
“Second Generation” SRI Fund (cont’d.)

- ◆ **Neutralize Common Factor Exposure**
- ◆ **Back-testing: Control for By-product tilts toward smaller companies, tech companies, etc.**
- ◆ **Relatively small universe (about 50 stocks), but can change**

Example 1 for Discussion



Example 2 for Discussion



*“Information that is ‘proprietary’ will not be available”

- Regulation and competitive positioning

Discussion:

- ◆ **“A technology fund in SRI clothing”?**
 - Not technology *per se*, but Stock of Knowledge (in P. Romer sense)
 - Mapping to profitability (GE Ecomagination: “Green is green”) via reduced costs, enhanced market share, etc.
 - Spillover Effects (“Non-rival” goods in P. Romer sense): Ameliorated by cross-linkage in equity ownership. E.g. Fee, Hadlock, Thomas (2006).
 - Non-linearity: Trying to use principles behind Emergent systems, e.g. feedback from localized “neighboring” components.

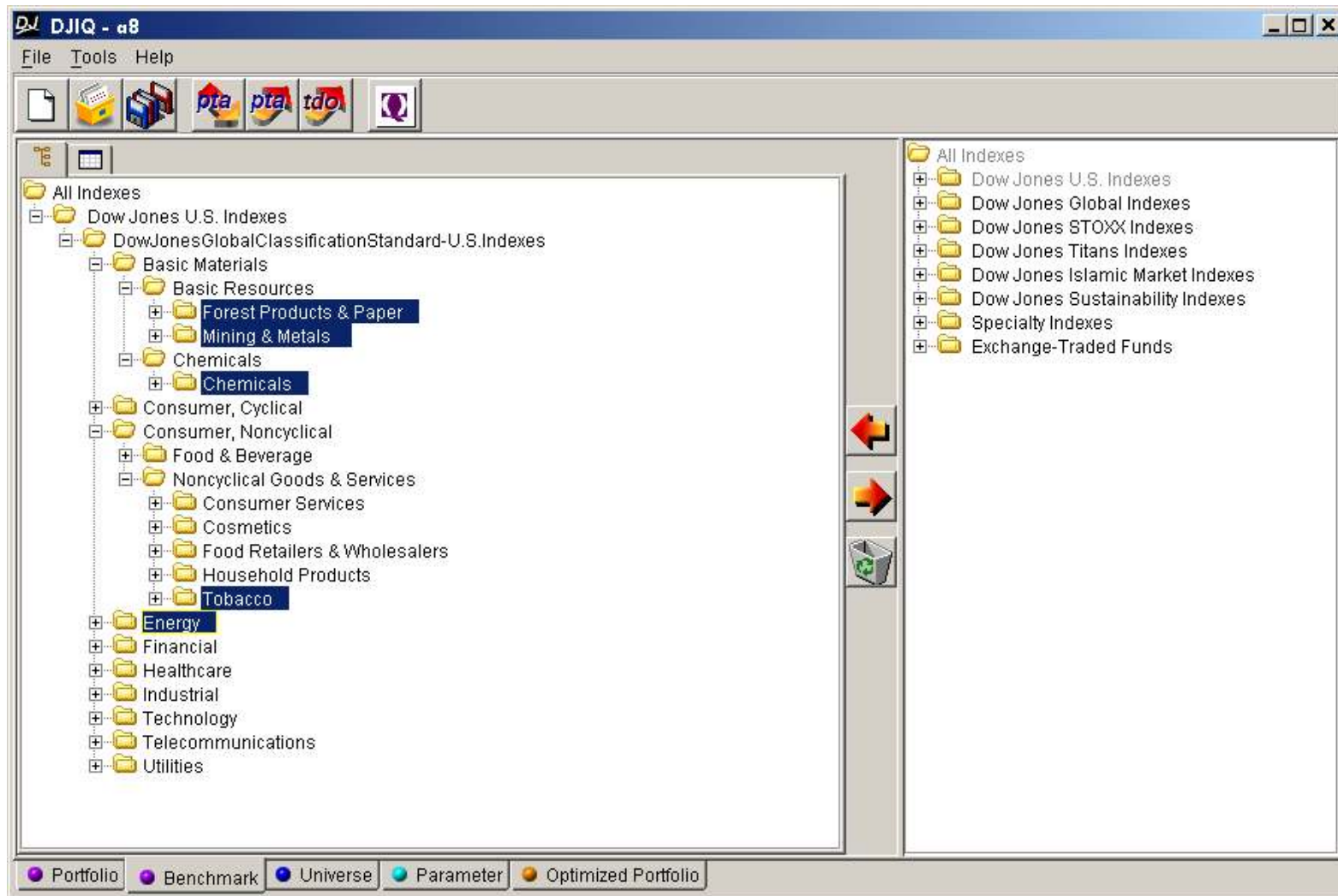
- ◆ **“Isn’t the Fund just looking to beat the market (given the universe of stocks), not to fostering CSR?”**
 - Yes and No: Objective is to use better information and analysis to ferret out the “green from green” companies ahead of other investors.
 - High elasticity of investment flows --> Make the biggest difference in CSR in the shortest period of time

Discussion:

◆ Role of Government Regulation?

- Reduce inconsistency (e.g. Lovins)
- OK on our criteria if one firm/stock helps re-shape regulatory structure
- Subsidies to investment can be optimal (P. Romer)


Appendix: SRI Portfolio with Exclusion Restrictions (Negishi (2005))



Appendix: SRI Portfolio with Exclusion Restrictions (cont'd.)

Total Distribution by Industry				
	Industry	Portfolio	Bench...	Differen... ▲
1	Energy	.00%	6.04%	-6.04%
2	Chemicals	.00%	1.40%	-1.40%
3	Tobacco	.00%	1.04%	-1.04%
4	Mining & Metals	.00%	.47%	-.47%
5	Forest Products & Paper	.00%	.46%	-.46%
6	Software	4.40%	4.81%	-.41%
7	Biotechnology	1.62%	2.02%	-.40%
8	Pharmaceuticals	7.81%	8.07%	-.26%
9	Semiconductors	4.28%	4.48%	-.20%
10	Fixed-Line Communications	3.46%	3.65%	-.19%
11	Communications Technology	2.35%	2.42%	-.07%
12	Automobile Manufacturers	.48%	.51%	-.03%
13	Broadcasting	3.19%	3.22%	-.03%
14	Technology Hardware & Equipment	3.49%	3.51%	-.03%
15	Airlines	.25%	.25%	-.01%
16	Entertainment	.20%	.21%	-.01%
17	Food Retailers & Wholesalers	.73%	.71%	.03%
18	Wireless Communications	.42%	.39%	.03%
19	Technology Services	.61%	.58%	.03%
20	Healthcare Providers	1.34%	1.30%	.04%
21	Heavy Construction	.13%	.07%	.06%
22	Water Utilities	.11%	.05%	.06%
23	Beverage	2.46%	2.39%	.07%
24	Consumer Services	.66%	.58%	.08%
25	Advertising	.45%	.37%	.08%
26	Medical Products	2.40%	2.29%	.11%
27	Textiles & Apparel	.45%	.33%	.13%
28	Electric Components & Equipment	.74%	.60%	.14%
29	Industrial Equipment	.45%	.30%	.15%
30	Auto Parts & Tires	.60%	.44%	.16%
31	Advanced Industrial Equipment	.68%	.52%	.16%
32	Cosmetics	.90%	.74%	.16%
33	Diversified Financial	5.44%	5.27%	.16%
34	Food	1.54%	1.37%	.17%
35	Industrial Transportation	1.50%	1.31%	.19%
36	Securities Brokers	2.17%	1.98%	.20%
37	Aerospace	1.54%	1.33%	.21%
38	Publishing	.97%	.76%	.21%
39	Building Materials	.47%	.26%	.21%
40	Containers & Packaging	.44%	.22%	.22%
41	Home Construction & Furnishings	.66%	.41%	.25%
42	Retail	7.28%	6.98%	.30%
43	Household Products	1.89%	1.58%	.31%
44	Leisure Goods & Services	2.10%	1.77%	.33%
45	General Industrial Services	2.58%	2.24%	.34%
46	Gas Utilities	.57%	.14%	.44%
47	Industrial Diversified	5.75%	5.08%	.67%
48	Insurance	4.81%	3.99%	.82%
49	Real Estate	2.42%	1.15%	1.28%
50	Electric Utilities	4.39%	2.81%	1.58%
51	Banks	8.81%	7.15%	1.66%

Appendix: SRI Portfolio with Exclusion Restrictions (cont'd.)

Total Risk Exposure by Industry				
	Industry 	Index Sensitivity	Old Sensitivity	New Sensitivity
1	Advanced Industrial Equipment	.4574	.0000	.4401
2	Advertising	.4065	.0000	.3911
3	Aerospace	.5794	.0000	.5575
4	Airlines	.3156	.0000	.3036
5	Auto Parts & Tires	.6117	.0000	.5885
6	Automobile Manufacturers	.2901	.0000	.2791
7	Banks	.8146	.0000	.7838
8	Beverage	.3157	.0000	.3038
9	Biotechnology	.4218	.0000	.4058
10	Broadcasting	.4160	.0000	.4002
11	Building Materials	.4988	.0000	.4800
12	Chemicals	.5219	.0000	.4993
13	Communications Technology	.2913	.0000	.2802
14	Consumer Services	.4606	.0000	.4432
15	Containers & Packaging	.5461	.0000	.5254
16	Cosmetics	.4088	.0000	.3934
17	Diversified Financial	.6253	.0000	.6016
18	Electric Components & Equipment	.4092	.0000	.3937
19	Electric Utilities	.6591	.0000	.6342
20	Energy	.5893	.0000	.5585
21	Entertainment	.2110	.0000	.2031
22	Fixed-Line Communications	.5440	.0000	.5234
23	Food	.4329	.0000	.4166
24	Food Retailers & Wholesalers	.4539	.0000	.4367
25	Forest Products & Paper	.4638	.0000	.4448
26	Gas Utilities	.7925	.0000	.7625
27	General Industrial Services	.8543	.0000	.8220
28	Healthcare Providers	.4089	.0000	.3936
29	Heavy Construction	.3110	.0000	.2992
30	Home Construction & Furnishings	.4880	.0000	.4695
31	Household Products	.3718	.0000	.3577
32	Industrial Diversified	.4155	.0000	.3998
33	Industrial Equipment	.4673	.0000	.4496
34	Industrial Transportation	.7158	.0000	.6887
35	Insurance	.6956	.0000	.6692
36	Leisure Goods & Services	.8432	.0000	.8112
37	Medical Products	.5729	.0000	.5512
38	Mining & Metals	.3710	.0000	.3550
39	Pharmaceuticals	.5717	.0000	.5500
40	Publishing	.9217	.0000	.8868
41	Real Estate	1.5927	.0000	1.5326
42	Retail	.7428	.0000	.7146
43	Securities Brokers	.4375	.0000	.4210
44	Semiconductors	.2798	.0000	.2692
45	Software	.4216	.0000	.4056
46	Technology Hardware & Equipment	.4306	.0000	.4143
47	Technology Services	.3973	.0000	.3823
48	Textiles & Apparel	.4594	.0000	.4421
49	Tobacco	.1695	.0000	.1560
50	Water Utilities	.7247	.0000	.6973
51	Wireless Communications	.1556	.0000	.1497

Appendix: SRI Portfolio with Exclusion Restrictions (cont'd.)

