



SRI – a Win-win Path for Germany?

Joachim H. Böttcher

**WISSENSCHAFTLICHE BEITRÄGE
AUS DEM TECTUM VERLAG**

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Dedicated to my wife Andrea, to my family, and to my pal
Oliver Schnekenburger (1 Nov 1969 to 14 Aug 2009)

“Why does the eye see a thing more clearly in dreams
than the imagination when awake”?
Leonardo da Vinci (1452 – 1519)

Abstract

We aim to demystify the concept and the economic impact of so-called socially responsible investments (SRI) in Germany. In this context we provide a background of its historic roots, the dilemma of the de-fragmented definitions available of varying ethical concepts, and of different applied responsible investment research methodologies. We also present a classification of institutional and private customer segments and of other SRI stakeholders and of their motifs. There we identify performance, business-case orientation, risk avoidance, and promotion of environmental, social, and corporate governance (ESG) topics as motifs and driving factors with a potential to boost the economic impact of SRI further. An overview of obstacles to SRI such as the current regulatory environment of this type of investment in Germany rounds out the picture.

Furthermore, we investigate the effects of an investment culture that strives for sustainability based on the integration of soft non-financial ESG data-based factors. For this our research is twofold: (1) we investigate the level of ESG integration cross-financial actively and passively managed instruments in Germany and assess the current size of this financial sector’s niche; (2) we try to give an outlook on the future impact SRI could have. For this assessment we investigate optional paths in regard to effects on eco-, social and corporate governance innovation. In particular, we find that – in the light of the public corporate social responsibility debate – SRI may even replace our current paradigm of how money gets invested, how fiduciary duties are interpreted, and how performance is measured. In this regard

further acceptance, advocacy, and action of the financial industry and of SRI stakeholders are needed. While future responsible investors target for an accepted rate of financial return, they also strive to gain an accepted ESG add-on performance. We conclude that the traditional way of how the financial industry allocates its investments is likely to shift to reflect different individual ethical concepts of target groups and take weak to strong patterns of sustainability into account. Once institutional and retail investors and the financial industry alike start to accept the SRI business case, advocate it, and finally act in the light of this new paradigm, ESG-driven investment methodologies may well enter into the mainstream and gain more economic relevance.

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List of abbreviations

°C	Degree Celcius
ACAFI	Atkinsson Compass Assessment for Investors
AG	Aktiengesellschaft – public limited company; plc
AGBG	Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen (AGB-Gesetz) – General Terms and Conditions Act
AGM	Annual General Meeting
AI	Alternative Investment
AI CSRR	Association for Independent Corporate Sustainability and Responsibility Research
AIA	American Institute for Architecture
AIDS	Acquired Immunodeficiency Syndrome
AIMR	Association for Investment Management and Research
Aka. / aka.	Also known as
AktG	Aktiengesetz (Stock Companies Act)
AltZertG	Gesetz <i>über</i> die Zertifizierung von Altersvorsorge- und Basisrentenverträgen – Act on Certification of Retirement Arrangement Contracts
AMD	Acid Mine Drainage
AO	Abgabenordnung (General Fiscal Law)
AuM	Assets under Management
B.A.U.M.	Bundesdeutscher Arbeitskreis für Umweltbewusstes Management – German Association of Environmental Management
B.C.	Before Christ
B2B	Business-to-business
BACO	Best Available Charitable Option
BAFA	Bundesamt für Wirtschaft und Ausfuhrkontrolle – Federal Office of Economics and Export Control
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht – Federal Financial Supervisory Authority
BASIC	Brazil, South Africa, India and China
BBC	British Broadcasting Corporation
BCG	The Boston Consulting Group
BEPA	Bureau of European Policy Advisors
BfG	Bank für Gemeinwirtschaft
BGB	Bürgerliches Gesetzbuch – Civil Code

BilReG	Bilanzrechtsreformgesetz – Act on Reformation of Accounting Standards
BMJ	Bundesministerium der Justiz – Federal Ministry of Justice
BMU	Bundesamt für Umwelt, Naturschutz und Reaktorsicherheit – Federal Ministry for Environment, Nature Conservation and Nuclear Safety
BMWi	Bundesamt für Wirtschaft und Technologie – Federal Ministry for Economics and Technology
bn	Billion
BörsG	Börsengesetz – Stock Exchange Act
BREEAM	Building Research Establishment Environmental Assessment Method
BRIC	Brazil, Russia, India, and China
BSC	Balanced Scorecard
BVI	Bundesverband Investment und Assetmanagement – German Association for Investment and Asset Management
CAPM	Capital Asset Pricing Model
CDU	Christlich Demokratische Union – Christian Democratic Union
CEF	Closed-end fund
CEPAA	Council on Economic Priorities Accreditation Agency
CEQ	Council on Environmental Quality
CERES	Coalition for Environmentally Responsible Economies
CFA	Chartered Financial Analyst
CFB	Central Finance Board of the Methodist Church
CGAP	Consultative Group to Assist the Poor
CHAMP	Charity Assessment Method of Performance
CIS	Community Innovation Survey
CO ₂	Carbon dioxide
COP	Conference of the Parties
CSR	Corporate Social Responsibility
CSR EMS Forum	European Multi-Stakeholder Forum on CSR
CTA	Commodity Trading Advisors
DBL / 2BL	Double Bottom Line
DCF	Discounted cash flow
Destatis	Federal Statistical Office of Germany

DGNB	Deutsche Gesellschaft für Nachhaltiges Bauen – German Sustainable Building Council
DIW	Deutsches Institut für Wirtschaftsforschung – German Institute for Economic Research
DJSI	Dow Jones Sustainability Index
Dow	Dow Chemicals
DRS	Recommendations of Accounting Standards Committee of Germany
E.g. / e.g.	Exempli gratia – for the sake of example
e.V.	eingetragener Verein – registered association
EC	European Commission
ECHR	European Convention on Human Rights
EEG	Erneuerbare Energien Gesetz – Renewable Energy Sources Act
EFQM	European Foundation for Quality Management
EKD	Evangelische Kirche in Deutschland – Protestant Churches of Germany
EMAS	Eco-Management and Audit Scheme
EMH	Efficient Market Hypothesis
EnEV	Energiesparverordnung – Energy Saving Ordinance
EPA	Environmental Protection Agency
EPC	European Patent Convention
EPO	European Patent Office
ESG	Environmental, Social, and Corporate Governance
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
et al.	et alii / et aliae / et alia – and others
ETC	Exchange Traded Commodity
ETF	Exchange Traded Fund
ETN	Exchange Traded Note
EU	European Union
EU-27	The 27 member states of the European Union
EUR	Euro
Eurosif	European Sustainable Investment Forum
EVCA	European Private Equity & Venture Capital Association
f./ ff.	Following page(s)
FCCC	Framework Convention on Climate Change
FH	Fachhochschule – University of Applied Sciences
FMEA	Failure Mode and Effects Analysis
fn.	Footnote

FNG	Forum Nachhaltige Geldanlagen – German Sustainable Investment Forum
Fo(H)F	Fund-of-(Hedge)-Funds
FRUG	Finanzmarkttrichlinie-Umsetzungsgesetz – Markets in Financial Instruments Directive
G-20	Group of 20 major economies
G-7	France, Germany, Italy, Japan, UK, USA, and Canada
GAAP	Generally Accepted Accounting Principles
GBC	Global Business Coalition
GBP	Pound sterling
GCGC	German Corporate Governance Codex
GDP	Gross domestic product
GewO	Gewerbeordnung – Industrial Code
GG	Grundgesetz – Federal Constitution
GII	Global Innovation Index
GmbH	Gesellschaft mit beschränkter Haftung – Limited company
GRI	Global Reporting Initiative
HF/ HF's	Hedge Fund(s)
HGB	Handelsgesetzbuch – German Commercial Code
HIV	Human Immunodeficiency Virus
HNWI	High-net worth individuals
Ibid./ ibid.	Ibidem/ ibidem – the same place
ICLEI	International Council for Local Environmental Initiatives
ICMM	International Council on Mining and Metals
ICT	Information and Communication Technologies
IEKP	Integrated Energy and Climate Protection Programme
IFA	Independent Financial Advisor
IFRS	International Financial Reporting Standards
IIGCC	Institutional Investors Group on Climate Change
ILO	International Labour Organization
IMUG	Institut für Markt-Umwelt-Gesellschaft – Institute for Market-Environment and Society (Hannover)
INSEAD	Institut européen d'administration des affaires
InvÄndG	Investmentänderungsgesetz – Act Amending the German Investment Act
InvG	Investmentgesetz – Investment Act
IPCC	Intergovernmental Panel on Climate Change
IPO	Initial Public Offering

IPR / IPRs	Intellectual Property Rights
IRM	Institute of Risk Management
IRR	Internal Rate of Return
ISC	Investment Stewardship Code
ISO	International Organization for Standardization
IT	Information Technology
JEREMIE	Joint European Resources for Micro and Medium Enterprises
JPO	Japan Patent Office
KfW	Kreditanstalt für Wiederaufbau – Reconstruction Credit Institute
Kirchliche VwO	Kirchliche Veraltungsordnung – Church Administration Act
KonTraG	Gesetz zur Kontrolle und Transparenz im Unternehmensbereich – Corporate Sector Supervision and Transparency Act
KPI/ KPIs	Key Performance Indicator(s)
KWG	Kreditwesengesetz – Banking Act
LBMA	London Bullion Market Association
LEED	Leadership in Energy & Environmental Design
LEM	Local Economic Multiplier
LIBOR	London Interbank Offered Rate
LOHAS	Lifestyle of Health and Sustainability
LTCM	Long Term Capital Management
m	Million
MaRisk	Mindestanforderungen an das Risikomanagement – Minimum requirements for Risk management
MDG-scan	Millennium Development Goal scan
MFI	Micro-finance Institution
MIF	Measuring Impact Framework
MiFID	Marketing in Financial Instruments Directive
MOP	Meeting of the Parties
MPT	Modern Portfolio Theory
MSCI	Morgan Stanley Capital International
NAI	Naturaktienindex – index of environmentally friendly stocks
NAMA	National Appropriate Mitigation Actions
NAV / N.A.V.	Net Asset Value
NEPA	National Environmental Policy Act
NGO	Non-governmental organisation
NIS	National Innovation System

NIW	Niedersächsisches Institut für Wirtschaftsforschung – Lower Saxony Institute for Economic Research
NPV	Net Present Value
NPW	Net Present Worth
OASIS	Ongoing Assessment of Social Impacts
OECD	Organization for Economic Co-operation and Development
OEF	Open-end fund
OLG	Oberlandesgericht – higher regional court
OTC	Over-the-Counter
p. / pp.	Page / pages
P/L	Profit and Loss
PE	Private Equity
PFKapAV	Pensionsfonds-Kapitalanlagenverordnung – Pension Fund Investment Decree Act
PISA	Programme for International Student Assessment
PRI	Principles for Responsible Investment
PSIA	Poverty Social Impact Assessment
PVSC	Public Value Scorecard
Q	Research Question
R&D	Research & Development
RDED	Rio Declaration on Environment and Development
REDD	Reduce Emissions from Deforestation and forest Degradation
RJC	Responsible Jewellery Council
ROI	Return on Investment
RTD	Research Technology & Development
S&P	Standard & Poor's
SA	Social Accountability
SAM	Sustainable Asset Management
SCA	Social Compatibility Analysis
SCBA	Social Costs-Benefit Analysis
SCEA	Social Cost-Effectiveness Analysis
SEAT	Socio-Economic Assessment Toolbox
SEC	Securities and Exchange Commission
SEE	Social, Environmental, and Ethical
SIA	Social Impact Assessment
sic	Intentionally so written
SIF	Sustainable Investment Forum
SME	Small and medium-sized enterprises
s. n.	sine nomine – without name
SolvV	Solvabilitätsverordnung – Solvency Act

SPD	Sozialdemokratische Partei Deutschlands – Social Democratic Party of Germany
SPDR	Standard & Poor's Depository Receipt
SRA	Social Return Assessment
SRI	Socially Responsible Investments
SROI	Social Return on Investment
s. t.	sine tempore – without time
StAG	Staatsangehörigkeitsgesetz – German Immigration Act
SVA	Stakeholder Value Added
TAP	Technology Action Program
TBL / 3BL	Triple Bottom Line
tn	Trillion
TransPuG	Gesetz zur weiteren Reform des Aktien- und Bilanzrechts – Transparency and Public Disclosure Reform Act
TRM	Total Responsibility Management
UCITS	Undertakings for Collective Investment in Transferable Securities Directives
UEAPME	European Association of Craft, Small and Medium-Sized Enterprises
UHNWI	Ultra high-net worth individuals
UK	United Kingdom
UK GBC	UK Green Building Council
UN	United Nations
UNCED	United Nations Conference on Environment and Development
UNCHE	United Nations Conference on the Human Environment
UNEP FI	United Nations Environment Programme Finance Initiative
UNEP FI RPI	United Nations Finance Initiative Responsible Property Investing
UNEP SBCI	United Nations Environment Programme Sustainable Buildings and Construction Initiative
UNFCC	United Nations Framework Convention on Climate Change
US / U.S.A.	United States / United States of America
USCCB	United States Conference of Catholic Bishops
USD	US-Dollar
USPTO	United States Patent and Trademark Office

UWG	Gesetz gegen den unlauteren Wettbewerb – Act Against Unfair Practices
VAG	Versicherungsaufsichtsgesetz – Insurance Supervision Act
VC / VCF	Venture Capital / Venture Capital Financing
VerkaufsprospektG	Verkaufsprospektgesetz – German Prospectus Act
VermVerkProspV	Verordnung über Vermögensanlagen-Verkaufsprospekte – Regulation of Investment Prospectuses
VersVermR	Verordnung über Vermögensanlagen-Verkaufsprospekte – Directive on Insurance Mediation
VGf	Association of non-tradeable Closed-end Funds
VorStOG	Vorstandsvergütungs-Offenlegungsgesetz – Act on Disclosure of Management Board Compensation
VVaG	Versicherungsverein auf Gegenseitigkeit (Mutual Insurance Society)
WCED	United Nations World Commission on Environment and Development
WGC	World Gold Council
World GBC	World Green Building Council
WpHG	Wertpapierhandelsgesetz – Securities Trading Act
WTO	World Trade Organization
ZEW	Zentrum für Europäische Wirtschaftsforschung – Centre for European Economic Research
ZKB	Zürcher Kantonalbank

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List of variables

α	Alpha, Jensen's alpha
β	Beta, market risk
σ	Standard deviation
σ^2	Variance
T/ t	Time duration of calculation (in periods).

1 Introduction

We are living during an age where a minority within the financial sector has permission, fully compliant with legislation, to badly damage social welfare for the creation of personal wealth.¹ We argue that such a *modus operandi* may be called post-democratic.² One may partially blame the system itself, as it is comprised of suppliers of financial services and of customers who in turn provide these suppliers with a “licence to operate”³ when they buy such financial services. While doing this, they approve the despoliation of the environmental and the social resources of the Earth, which – as society nowadays more and more recognises – deserves protection.⁴

On a regular basis we hear that trust of the globalised markets has to be regained and that these markets have to be calmed through monetary policy actions. We argue that calming down and regaining trust of these traditional financial markets would reward the wrong group. It would publicly tolerate exactly such actions which – based on speculation for one’s own or other people’s financial profit maximisation – almost made the financial system collapse. Another ideology in the context of globalisation is the unconditioned striving for growth. We argue that growth seen completely in isolation is pretty useless. The ultimate, overarching principle should be to consider multiple aspects of benefits or add-on performances. Such benefits can be of an economic nature but should also reflect at least neutral to

1 See Marx 2010: 138-142; see Meran 1988: 51-78; see Fung / Law / Yau 2010; see Farmer / Mestel 2011: 24

2 See Fisahn 2010: 225-231; see Reich 2007.

3 See Epstein 2008: 22; see Schäfer / Lindenmayer 2004; see Hansen 2006: 9; see Black 2010: 6; see Thomson / Boutilier 2011; see Warhurst 2001: 58.

4 See Reich 2007.

positive societal and environmental impacts. This is because positive revenue streams often create a negative cash flow somewhere else.⁵

We argue that socially responsible investing (SRI) is an optional pathway to integrate more democracy in investment decisions, whether done by retail or professional institutional investors. If a commonly accepted definition and a set of widely accepted criteria and measurement indicators are made, SRI are seen as an option for politics to further regulate the financial markets. This regulation can be done in ways that would abandon and replace the present harmful structures with principles that could create social and environmental benefits or at least are no longer harmful for societal systems.⁶

In this context we analyse the recently emerged field of SRI for its potential economic impact and its impact on ESG innovation in Germany. We argue that in the long run: (1) SRI have the potential to lead to a paradigm shift toward more sustainability within the German financial industry; and (2) SRI have the potential to favourably feed back into the financing of innovations for further striving towards more sustainability.

1.1 Theoretical and practical relevance

When discussing the theoretical and practical relevance of SRI, we explicitly want to debate the contribution and impact of such recently emerged financial instruments. On the one hand, one may argue that until now the vast majority of investors have directed their focus on the creation of an acceptable economic performance when investing their capital and that this paradigm still holds true. In this light SRI would have to be seen either as a hobby activity of investors and suppliers or as a set of activities entirely focused on peace of conscience.

5 One example is the multi-billion European Financial Stability Facility (EFSF). The money put into this bailout fund is no longer at the disposal of social enterprises, where it is desperately needed for entities such as kindergartens, creches, the educational system, hospitals, retirement homes, hospices, and the like (see *Bundesministerium für Familie, Senioren, Frauen und Jugend* (ed.) 2012).

6 See BUND *et al.* (ed.) 2009: 387-393; see Dieter 2002: 55-77; see Kronauer 2010: 226-228.

On the other hand, one may want to discuss that today's society has already started to undergo or is at the edge of undergoing a significant change: We claim that the paradigm of what we consider as value, how we do business in general, and how we invest our money in particular is about to shift.⁷ We evaluate the argument that just acting within and being compliant with the legislation applicable for an organisation still holds enough to be accepted by today's society. This is, as one may also want to argue, that a society accepting such an argument would also accept e.g., an organisation's exportation of ESG problems into a region with softer regulations, and hence being confronted with less legal resistance.⁸

Perhaps society's perception of organisational action, meanwhile, has shifted to a "comply or explain" approach, where organisations need to legitimate their activities further towards their critical shareholders. However, one may want to argue that ESG criteria have grown so significantly in importance that the concept of what we understand under profit has shifted – or at least has started to do so. To make an informed assessment, we discuss if the demand for such forms of investments are of significant relevance at all, including their economic relevance. We argue that this would be an indicator that SRI has reached a stage of conscious awareness in German society.

Our work is guided by the following research questions:

- Q1: To what extent are today's SRI economically relevant in Germany?
- Q2: What would be the ESG, and economic impact of SRI, if SRI assets under management (AuM) move into the mainstream by a significant increase in volume?

Finally, we try to achieve practical relevance by discussing options and concepts to enable SRI to gain further awareness and advocacy and to finally trigger more action in the financial industry and among other stakeholders. We attempt to introduce pathways that we think would enable SRI to move from its current bilateral oligopoly to a bilateral supply and demand polypoly. One argument in this context is

7 See Gates 2009: 7-16; see Buffet / Gates 2009: 20-39; see Kinsley 2009: 40-47; see Landsburg 2009: 58-59; see Fox 2009: 201-203; see Boatright 2008.

8 See von Nauckhoff 2011: 108-109; see BUND *et al.* (ed.) (2009): 141-142.

that currently SRI is represented by a community of a few suppliers and few buyers; it would only reach significant ESG and economic impact if the shift into mainstream investing is achieved.

1.2 Purpose of this dissertation

This work is concerned with finding answers to questions, to solve problems, and to create new knowledge.⁹ Conceptually, we try to apply a process common in social academic research and very much focused on a literature review to use documents as sources of data. By doing so, we try to observe and draw conclusions from the experiences of others.¹⁰

Besides their economic effect, investments have an ESG impact that affects stakeholders such as the environment and communities. Increased expectations with regard to responsible personal and organisational environmental and social behaviour has already led to a debate. The debate is about whether investors can be held responsible for the negative impacts caused by their investments. As a consequence to this request to take responsibility for an investment's effects on the environment and the society, SRI suppliers (as niche players in the financial industry) emerged. These suppliers aim to improve investment impact by applying a fragmented variety of overlays: these include filters, strategies, and research approaches to increase stakeholder satisfaction and, arguably, to solve environmental and social problems.

The relatively young area of SRI is showing rapid growth rates around the world. We expect this asset class to continue its growth due to increasing awareness of investors for ESG issues. We argue that this may lead to a relative importance of this asset class and may have a potential impact e.g., on innovation effects on areas related to the environment, society, and, last but not least, on corporate governance¹¹ in Germany. One effect may include, for example, easier access to financial resources for ESG-driven innovation, the invention and introduction of products, processes, or services to solve ESG issues.

9 See Goldhaber / Nieto 2010: 940.

10 See Bryman 2008: 514-534.

11 See Leyens 2007: 1061-1112.

This is because organisations and investors as well are more and more held accountable for the ESG consequences of their activities.¹²

This trend is reflected by environmental innovations such as eco-efficiency and the aspiration for more sustainability. Furthermore, we outline social innovation concepts such as social entrepreneurship,¹³ strategic philanthropy,¹⁴ and corporate social responsibility (CSR).¹⁵ Lastly, we outline corporate governance¹⁶ innovations such as corporate citizenship,¹⁷ and corporate responsiveness.¹⁸ We argue that such trends imply that suppliers of financial products and investors alike need to think about it, if at all, and if so, how to best take soft ESG criteria besides hard facts based on conventional financial criteria into account.¹⁹ The considerations behind that can be based on controversial motifs such as the creation of a higher return, the avoidance of systemic market and reputation risk,²⁰ business case considerations, and the support of ESG pioneering projects and spirit. In turn this would lead to beneficial effects e.g., for Germany's national innovation system (NIS),²¹ mainly due to emerging patents on technological

-
- 12 Environmental, and social responsibilities of organisations have been under discussion since the 1950s. The trend toward eco-efficiency – to reduce environmental impacts – emerged in the 1970s. The 1980s and 1990s saw increased public awareness of social issues (stakeholder issues in general, human rights, child labour, and the like; see Clark *et al.* 2004; see Braungart *et al.* 2006: 1-12; see Maas 2009: 10).
- 13 See Hsu 2005.
- 14 See Bishop / Green 2009: 22-23; see Fisman / Heal / Nair 2006.
- 15 For an overview of academic literature on CSR, see Carroll 1999: 268-295; see Crane 2008.
- 16 See Leyens 2007: 1061-1112
- 17 See Carrol 1998: 1-4; see Dettling *et al.* 2001; see Habisch / Schmidtperer 2003; see Marsden 2000: 9-25; see Matten *et al.* 2003: 109-120; see McIntosh *et al.* 2003; see Habisch 2003; see Dubielzig / Schaltegger 2005: 235-238.
- 18 See Sethi 1975: 58-64; see Ackermann / Bauer 1976.
- 19 See Wood / Thornley / Grace 2012: 7.
- 20 See Kiernan 2007: 478-485; see Cheng / Ioannou / Serafeim 2011; see see Mackenzie / Rees / Rodionova 2011: 9.
- 21 See Lundvall 2010: 18-19; see Nelson 1993.

innovations for a more sustainable and better use of the natural environment.

However, ESG criteria are traditionally not yet included in conventional financial instruments. A further inclusion may be beneficial for social innovation (to improve the well-being of human beings in general), and may trigger changes in legislation towards one that would better support the implementation and growth of SRI.²²

22 See Varadarajan / Menon 1988.

1.3 Structure of dissertation

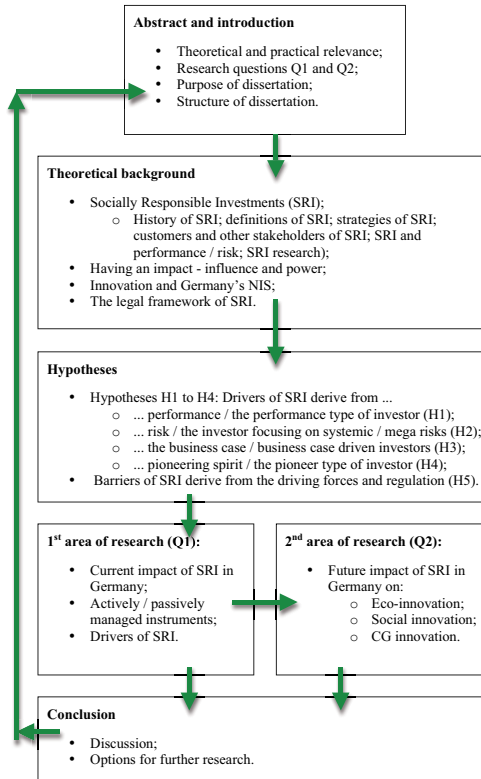


Figure 1: Structure of dissertation.

This dissertation focuses on outlining the academic and practical relevance of SRI and its impact in Germany. We attempt this by demystifying SRI through outlining its historic roots, definitions, concept, strategies, and the regulatory framework applicable in Germany. One focus is on finding an answer to the question whether SRI are currently economically relevant at all. Here we state that SRI investors may be grouped by their motifs and what such investors and other stakeholders consider valuable. Up until now, environmental and social impacts are not sufficiently reflected by the market, as they are not yet