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The implications of reform-oriented investment for regulation and governance

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ABSTRACT

Emergent practices of reform-oriented shareholder engagement are characterised as a professional social movement which gains credibility by influencing the institutional networks imbricating investors. The limitations of structuralist and atomistic tendencies in social movement analysis are resolved with an inductive, dialectical approach which is used to illustrate two cases of internal attempts to change investment policy at pension funds. Linkages are identified between organizational responses to pressure for change, and mobilization strategies of embedded proponents of change. The paper urges the involvement of governing boards in vehicles that promulgate reformist engagement, and identifies institutional networks as warranting greater regulatory attention.

1. Introduction

This paper identifies hitherto unrecognised regulatory and governance implications associated with reform-oriented shareholder engagement. The networks of contracts to which governing boards of investors are accountable and which account to governing boards consist of intertwined and often unreported contracts with brokers, bankers, analysts, actuaries, and custodial, depository, governance and proxy voting services. The complexity and opaqueness of these linkages have increasingly concerned regulators (see, Clark, 2006; Pemberton et al., 2006).[2] Attention has been directed to the two principal internal methods of controlling governance at the business end of pension funds, insurance

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[2] Governments in countries with rationalised social security nets and pay-as-you-go, flat-rate pension systems, such as in Europe, have voiced concerns over the rigour of investment governance and have called for better self-regulation. Several

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companies and mutual funds: namely, reliance on financial evaluation models (e.g., Penman, 2001), and consultation with invested companies on matters of governance, compliance and operational risks. At some investors, such consultation (also known as intervention, engagement and shareholder activism) has extended to reformist agendas (see, Davis and Thompson, 1994; Den Hond and De Bakker, 2007; Guyatt, 2005).[3]

Recently, proponents of reform-oriented engagement have sought to operate collectively to bring pressure on investment intermediaries, quasi-governmental associations and regulators and so, it is hoped, influence organizational governance. This paper adds to investigation of such reform-oriented engagement by examining its influence on the governance of investors, rather than on the governance of invested companies (e.g., Gillan and Starks, 2003; Prevost and Rao, 2000). The paper makes a theoretical contribution by adopting a dialectical approach to describe the ways competing rationalities gain credibility by influencing the institutional networks imbricating organizations. This is illustrated with two cases of pension funds that both faced internal and external pressure to be more engaged and 'socially responsible' in their asset management function.

The paper is structured in four sections. Section 2 justifies characterisation of networks of promoters of reformist engagement as a social movement. Section 3 justifies the analytical approach and draws some explicit expectations with regards to organizational responses to change pressure. Section 4 presents illustrative cases of attempts to change the investment policies of two large, European pension funds. Section 5 analyses the dialectical linkages between the sources and objects of change pressure, and identifies some implications for regulatory policy and organizational governance.

2. Social movement analysis and investor governance

Corporate governance and corporate social responsiveness have become important issues in the governance of pension funds. Europe has witnessed the merger of conventional governance-related and more reformist modes of shareholder engagement. The latter, which broadly aims to reform invested corporations by encouraging the acceptance of social and environmental responsibilities, has been encouraged by the European Directive for occupational retirement provision of 2003 (2003/41/EC, http://europa.eu/scadplus/leg/en/lvb/l24038b.htm). The Directive led to legislation in the Netherlands and the UK, as examples, requiring industry pension funds to disclose to members

> "[...] the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments".

Davis and Thompson (1994) document how shareholder rights are the result of a social movement that arose out of institutional challenges to managerial corporate governance. The extension of shareholder rights to reformist engagement has historical roots in the investment policies of organized religions and nineteenth century social reformers (Waygood and Wehrmeyer, 2003). The first time a group of modern pension funds divested from organizations on non-economic criteria was in the international boycott of companies operating in South Africa during the apartheid regime (Kumar et al., 2002), which formed part of a wider international social movement sustained for two decades.

Social movement theory distinguishes social movements from other form of collective action as, one, having access to the objects of desired change (Tarrow, 1999) and, two, exhibiting some form of internal solidarity around a set of beliefs concerning a need for social improvements (Gamson, 1992). Both features are present in loose collaborations of institutional investors that have sought to engage in

European countries as well as Australia and New Zealand have passed similar legislation to the ERISA legislation in the US, which requires private sector pension plans to disclose the exercise of their voting rights attached to their investments (see, ERISA, 1974).

[3] The standard test of the relevant risk-return relationship for portfolio construction is the capital asset pricing model (Markowitz, 1952, 1971). On occasion, the CAPM has been combined with more normative concerns. As examples, five of the world's largest eight pension funds have sought to address social, environmental and governance issues connected with their investments. The five funds, which represented in excess of USD 1 trillion at September 2007, are The Government Petroleum Fund (Norway); Algemeen Burgerlijk Pensioenfonds (Netherlands health services); California Teachers' Retirement System; California Public Employees' Retirement Systems; and New York City Retirement Systems.

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collective consultation of investment intermediaries, industry bodies and regulators on specific social and environmental issues affecting their investments. (Examples of reformist practices can be found at TIAA-CREF: http://www.tiaa-cref.org/pubs/pdf/governance_policy.pdf.) The paper characterises such reformist engagement as a professional social movement; that is, as a historically specific form of collective action that challenges institutional arrangements (Meyer and Tarrow, 1998), embedded in organizations that form the object of change pressure. While grassroots social movements typically operate outside the objects of change pressure, actors in reformist movements may have vested interests (may be employees) in the organizations they seek to influence, and seek to reform organizational practice. In this sense, we characterise the proponents and activities of reform-oriented shareholder engagement as a professional social movement.

3. Methodology

Success of attempts at organizational change has been argued as dependent on actors' tactics, including the "entry points", communication and influence processes impacting on their organizational reception (Strang and Meyer, 1993). Our starting point is the conceptual schema in Laughlin (1991). Fig. 1 characterises four possible organizational responses to change pressure. Evolution would describe an organization that would embrace change, whereas colonisation would describe more reluctant responses. Rebuttal and reorientation models represent business as usual and would, respectively, neutralise and contain disturbances. Attempted change enters an organization at any of three levels. In evolution models, entry points will be at the level of interpretive schemes, which consist of organizational beliefs and norms. In colonisation models, entry points are the archetypes, which consist of organizational structures, decision processes and communication systems. Attempted change in the remaining models enters at sub-systems, which contain structural elements such as resources, inter-relations of job functions and organizational documents.

Analysis of the source, timing and nature of collective attempts at change demands an additional framework to the skeletal framework depicted in Fig. 1. Social movement theory has treated the problem of analysis of collective action by structuralist and atomistic approaches. The former tend to recognise movement success in terms of mediating institutional structures. Subjectivist approaches, in the obverse, place importance on the agency of movement actors (McAdam et al., 1996, p. 7). Both approaches describe movement actors' behaviours along twinned processes of legitimation and illegitimation. Illegitimation of the status quo is achieved by discrediting the object of desired change and hence its relative hegemony (McAdam et al., 1996, p. 9). Legitimation of change is achieved by skilfully exploiting contradictions between competing organizational rationalities so as to embed desired change (Coleman, 1999, p. 128).

Criticism has followed the tendency of social movement studies to make much of presumed invariant institutional arrangement and its interactions with movement actors (Buechler, 2000, pp. 2–15; Davis et al., 2005, pp. 1–20). While usefully drawing out resources available to movements, a structuralist epistemology that treats institutions as "relatively stable over time and outside the control of movement actors" (Goodwin and Jasper, 2003) cannot handle the unequal relationships between the movement actor and the object of change. To avoid this, the problem of the level of analysis needs to be addressed.

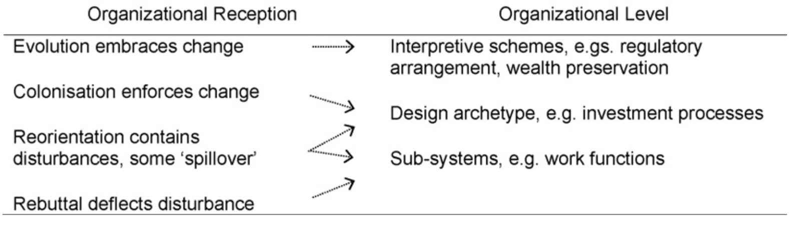

Fig. 1. Models of organizational responses to change pressure.

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An analysis of embedded professional social movements—e.g., when movement actors are paid by the organizations that form the object of movement pressure—faces a problem of how to treat relations between actors and objects. We rely on the argument in Seo and Creed (2002) that a dialectical approach is superior to other foundations that might contribute to an understanding of attempts to change somewhat established institutional fields, such as the governance of financial markets. In contrast, Weberian analyses, which seek to understand the "ideal types" that govern whatever individuals impute to their actions, interpret organizations primarily as structure. Giddensian approaches play a comparable extensive role in social analysis, yet, interpret organizational transformation in terms of individuals' strategies to resolve subjectively experienced situations (e.g., Whittington, 1992).

Our approach makes use of a body of progressive literature on financial markets which relies on praxis as the basic unit of analysis (e.g., Mintz and Schwartz, 1990). Praxis has been as human "agency embedded in a totality of multiple levels of interpenetrating, incompatible institutional arrangements (contradictions) [and] as an essential driving force of institutional change" (Seo and Creed, 2002, p. 222). The locus of praxis is likely to be where multiple, incompatible institutions intersect. Praxis can combine with a processual, dialectical analysis "focused upon the transformation through which one set of arrangements gives way to another" (Benson, 1977, cited in Seo and Creed, 2002, p. 227). The resultant approach moves the unit of analysis from the individually interpreted case (idios) to the relational case and in so doing, identifies the opportunities available to the change proponent (Clegg, 1994).

Building on Laughlin (1991) and subsequent work, Seo and Creed (2002) argue that the source, timing and collective nature of contextual change can be described along processual aspects of organizational change. Attention is drawn to how institutional arrangements create various inconsistencies and tensions within and between social systems (contradictions). Four sources of contradictions are proposed: (1) as organizations become isomorphic with their institutional environments to gain needed legitimacy (Meyer and Rowan, 1977), functional efficiency is undermined; and (2) as structures and activities become institutionalised, adaptability is undermined.

> "Institutions are likely to be both psychologically and economically locked in and, in a sense, isolated from or unresponsive to changes in their external environments. This unresponsiveness creates a space where contradictions between those institutions and their external environments develop and accumulate over time" (Seo and Creed, 2002, p. 228).

Remaining sources of contradictions are (3) incompatibilities between intra-institutional and inter-institutional levels; and (4) conflicts between institutional isomorphism and divergent interests, especially those interests of the less powerful actors whose ideas and interests are not adequately served by the existing social arrangements.

Praxis works on this divergence of interests to transform the embedded social actors into potential change agents of the very institutional arrangements. Organizational contradictions can exacerbate conflict, produce drastic disruptions, and/or fragment organizational members into overlapping, partially competitive interest groups. These effects are seen as strong driving forces for organizational and institutional change.

Seo and Creed's (2002) approach is to describe when and how proponents of change enable and foster change processes. A dialectical perspective points to important ways in which institutional contradictions may influence this later stage of praxis. At one end of a spectrum of possible outcomes, institutional contradictions may influence the political dynamics by undermining the hegemonic position of dominant groups or coalitions. An outcome at the other end is that collective action by a group of institutional challengers or entrepreneurs may not always result in the intended change because of (1) opposition by vested interests better served by the existing institutional arrangements, and (2) insufficient effort by challengers related to their own vested interests in existing arrangements. From a dialectical perspective, this may result in producing another source of contradiction.

A case approach allows us to investigate at depth the phenomena of interest: namely, the relations between change processes and institutional contradictions. The period of study is from October 2005 to December 2007. The main discriminating variable governing case selection is a history of reformist engagement. Both are located in the public sector and are prominent in reformist engagement in Europe. One organization operates in the Netherlands; the other is located in the UK. The scale

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of each organization's investments places both among the biggest investors in Europe. Their equity holdings are diversified similarly and track the major indices. Institutional arrangement is similar in both countries, with fully funded defined contribution industry pension schemes that are privately and competitively managed and subject quasi-public accountability obligations (although the poor transparency of the mutualised structure of Dutch pension schemes is noted by the EC: see, Clark and Bennett, 2003). The similarities between the cases lead us to expect similar organizational reception to change pressure coming both from regulators and internal proponents of change.

Sources of data are reports issued to scheme members (employees and pensioners), interviews, written recordings of conversations, emailed responses to requests for information, public reports and press releases, and participant observation. 22 in-depth, semi-structured interviews were conducted inside the funds and with advocacy groups and other professionals working in financial services. (In most cases, interviewees agreed to interviews after being given guarantees that personal and organizational identities would not be disclosed.) This material was complemented by examination of relevant Parliamentary Bills, Acts and regulations, industry codes of behaviour and commissioned research reports placed in the public domain (listed in Appendix A). Detailed holdings of the funds' portfolios are not made public knowledge and were not revealed to us.

We distinguish our dialectical approach from the Hegelian end, the synthesis, as used by Plowman et al. (2007). Hence we do not predict the direction or the resolution of outcomes: "the syntheses produced by dialectical processes seldom turn out to be what institutional entrepreneurs initially anticipate or desire, and they are rarely if ever the end of the process of change" (Hargrave and Van de Ven, 2006, p. 865). Reporting of reformist engagement practices, which is required in the Netherlands and the UK, has been noted as inconsistent (e.g., Dijkstra and Sprengers, 2005; Just Pensions, 2006; Mathieu, 2000). Hence, we expect that the cases will rebut pressure to bring reformist engagement into the asset selection and management function.

4. Reformist engagement at two pension funds

This section presents two cases of attempts of embedded actors to persuade their boards to adopt reform-oriented engagement practices. Each case begins by presenting evidence of organizational reception to external and internal pressures for policy change, then examines the organizational influence of Responsible Investment professionals and identifies the strategies of those actors. Each case closes with examination of the board's responses to change pressure at the end of the period of study. The Dutch case is presented first.

4.1. *The Dutch fund*

In both the Netherlands and the UK, pension fund governance is underpinned by existing corporate governance theories, such as agency theory, stewardship theory, and resource dependence theory, and by public governance theories, such as the social contract (Whiteside, 2006a). Dutch industry pension funds are overseen by representatives of employers and scheme members, with direct control vested in financial-service subsidiaries charged with actuarial prediction and fund management. The latter is the responsibility of commercial asset liability managers. Regulatory pressure for reformist engagement policy in Dutch pension funds was renewed in 2006 with concurrent reviews of implementation of the national corporate governance code and the launch of a counterpart code for pension funds.

The Dutch occupational pension scheme claimed two million members in 2007, at which time its investments were valued at 85 billion euros, making the fund one of the largest five pension funds in the world. 30 percent of its assets are in equities (relatively low by Dutch standards) of which 60 percent are offshore. A Responsible Investment (RI) unit in place since 2002 maintains an investment policy to exclude portfolio holdings in companies involved in weapons-manufacturing and infringements of recognised conventions on human rights. Four 'socially responsible' investment products were launched between 2000 and 2007. Only one of those, an index-tracking product based on the UK-based FTSE4GOOD social investment equities index, was operational after 2005. (The FTSE4GOOD is a proprietary derivation of the Financial Times Stock Exchange index.)

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Public sources indicate that the board had approved a plan as early as 2000 to operationalise research on environmental, social and governance issues associated with its investments. In 2000, the chairman issued a press release that there was wide-scale resistance in the investment industry to using social/environmental issues in portfolio construction (Tamminga, 2000). In 2002, the same chairman issued another press release stating that the fund would devise a strategy to implement sustainable criteria in in-house portfolio management (Munsters, 2002). Outcomes of that particular announcement were not reported publicly by the fund. 3 years later, the same chairman issued another press release reiterating the board's intention to develop a "comprehensive" reformist engagement policy. Subsequent experimentation by some of the fund's portfolio managers did not, reportedly, produce concrete outcomes to the fund's portfolio construction and governance monitoring processes (Bos, 2006).

Members' reports issued 2002 through 2007 referred readers to websites of certain investor associations for details of local engagement practices. Mention of the pension fund could not be found on those websites at the time of study, which raises a question as to where (and if) engagement policy was reported to members. A website link claiming a link to the fund's report on corporate engagement relating to its offshore portfolio stocks remained broken over this period. An adviser working in the RI unit was interviewed and queried on the reports. The opinion given was that the reporting of reformist engagement practices was made to satisfy regulators and "the odd member that might be interested". Little influence on investment policy was expected. The following extract illustrates:

> A decision to buy or disinvest a company depends purely on the financial economic modelling. It's all determined. Environmental, social and governance research cannot be used since the final investment decision is married to capital asset pricing models. It's almost impossible to change as practice is market-driven.

The interviewee was probed on the reasons for the fund's issuance of a reformist governance policy if there were no plans to practise it. Seven factors were suggested.

One, the two staffers were responsible for casting votes at local Dutch companies, activity which exhausted available time in the reporting cycle. By industry standards, 60 company meetings to be covered by two analysts is a relatively heavy load (Mills, interview). Two, a functional isolation of the RI unit from the asset management function had frustrated the RI unit staffers. The unit reported to the chief strategist, which was three levels below the chief investment officer, who reported to the board.

Three, reformist engagement practices pertaining to offshore stocks had been delegated to an offshore agent, which the RI unit had been unable to monitor. As the majority of the fund's stocks are international, this had compromised the RI unit, with responsibility for the monitoring of global and local portfolios. Four, although related parties are not uncommon in the Dutch context (Clark and Bennett, 2003; VVB, 2006), it was mentioned that the 2006 nomination of the former CEO to chair of the supervisory board had compromised the board's review function.

The two remaining identified influences on reformist engagement relate to Dutch corporatism. One, "aggressive shareholder activism practices" was considered incongruent with the stewardship model holding sway over pensions governance in the Netherlands.

> We are all struggling with how to integrate the regulator's call to report publicly how we monitor the governance of our investments. But when it comes to pressuring companies on the floor, it's not very nice. It's not Dutch practice to force people. After all, we are all gentlemen. The problem is the strong Anglo-Saxon owner orientation of current corporate governance. In the Netherlands, it's not normal to talk about ownership.

Finally, the legal requirement for Dutch companies to include social objectives (of cohesion) in their articles of association substantially precluded opportunities for management consultation. The influence on RI unit policy is suggested by the following interview extract.

> U.S. and U.K. private equity and hedge funds are trying to change the Dutch governance system so that shareholders can attack companies, independent of companies' objectives. The Dutch system, on the other hand, has been designed as a balancing power between shareholders and other stakeholders.

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Citing EU pressure for open financial markets and a timely example from the United States, the board announced in 2006 a plan to restructure from a mutualised foundation to a separate entity that would be charged with governance policy of the pension scheme. The RI unit interpreted the announcement as a decision of the board that the fund would be an active investor only in index-tracking investment products (which mimic the composition of major stock exchanges) and would not invest actively in equity stocks. This was expected to weaken even further the influence of the RI unit on the fund's asset management function.

The members of the RI unit decided to focus on the unit's memberships in various external interest associations. These associations, which are largely constituted by advisers working in RI units at various institutional investors, have sought to bring pressure on intermediaries and stakeholders such as brokers, custodians, depositories, regulators, industry associations, the finance media and business schools.

The RI unit participated in three associations in 2006–2007, as follows. The unit increased its involvement in Eumedion, a group of Dutch investors which monitors corporate governance in the Netherlands, and founded and chaired by the fund's Chief Executive Officer since 1998. As example, Eumedion participated in evaluating the draft Dutch code on corporate governance. The RI unit also became active in Enhanced Analytics Initiative, a group of institutional investors in the UK, US and the Netherlands that has both urged institutional investors to offer financial incentives to their intermediaries and lobbied the SEC to make certain amendments to pieces of financial services legislation. Three, on behalf of its board, the RI unit signed the UN-issued Principles for Responsible Investment document (http://www.unpri.org). Launched in 2005, the PRI, which derives from the Global Compact of the UN Environment Programme Finance Initiative (http://www.unepfi.org/work_streams/investment/index.html), requires investor signatories to undertake to report their use of environmental, social and governance considerations in their investment valuations.

By 2007, such activities represented a significant component of RI unit operations. The interviewee believed the unit's various memberships had led to two turnaround decisions of the board. In January 2007, the board issued a press release announcing a commitment of .25 billion euros to a multi-asset class investment focusing on ecologically sustainable energy and healthcare development projects in emerging markets (e.g., Hebb and Wójcik, 2005). A subsequent board decision, announced later in 2007, was to commit a further .5 billion euros in a foundation to finance the construction of commercial wind parks and biomass power stations in Western Europe. When taking submissions and sourcing information for both decisions, the board had asked the RI unit to take an active part, behaviour which marked a contrast to previous constraints placed on the unit.

The turnaround decisions of the board, if that is not too strong a term, can also be associated with at least three locations of external pressure. One, the Institutional Investors Group on Climate Change (http://www.climatechangecapital.co.uk), of which the fund is a founding member, sponsored training in 2005 to asset managers and wrote letters to sell-side investment brokers on investment opportunities associated with climate change. Some of those brokers used their research capability to investigate alternative energy projects and make recommendations to asset managers contracted to this pension fund, who recommended that investment opportunities be sought. Two, the London-based Climate Change Capital Banking Group launched several large investment vehicles in 2006. The Dutch board, on receiving invitations to invest, consulted its Chief Investment Officer, who consulted the RI unit, which used its own research capability to explain to the board the investment momentum behind carbon (emissions trading) funds.

Three, public documents issued by the fund suggest that the groundswell of investor momentum emitting from the City of London in 2006 concerning carbon fund investments, together with the influence of the European Council summit on climate change and energy in 2007, were significant factors in strategy formulation. Internal sources of change pressure included position papers written by the RI unit on energy investments and delivered to the board.

The involvement of the RI unit in the two investment decisions described above led to an elevation of the unit's status. A long-standing request for funding to expand the RI unit was approved and at the board's request the unit started work on an investment strategy targeting sustainable energy projects.

4.2. The British fund

Industry pension funds in the UK divest control in much the same way as do Dutch pension schemes, except that boards of trustees assume the oversight function. External pressure for improved governance in British pension funds was renewed in 2004 with a review of the implementation of a government-recommended code of institutional investment decision-making (the Myners Principles: see Appendix A). Regulators' attention in the area of pension reform (example, see http://www.dwp.gov.uk/pensionsreform) led to issue of a slew of behavioural and reporting codes from industry associations.

The British scheme held over 200,000 members in 2007, at which time its investments were valued at more than 20 billion Great British pounds. Over 2005–2007, eighty percent of its assets were in equities (the relatively high level is a feature of British pension funds). International equities (one-third) were managed by external managers and local equities were managed in-house. Reformist governance policies, in place since 2000 for several financial products, are administered by the Responsible Unit, which has three staffers. The fund has historically refrained from adopting a policy that would exclude portfolio investments on social and environmental matters alone.

The board responded to renewed external pressure for engagement policy (the Myners review of progress 2004: see Appendix A) by announcing a policy to consult invested companies and by increasing resourcing levels to its Responsible Investment unit. In interview, the interviewee in the RI unit related that the unit's policy of not "beating up this company or that" had attracted criticism from Fair Pensions, a London-based organization that has lobbied various British pension funds on their investment and benefits policies. Such criticism, on top of the external pressures mentioned above, had led to announcement of a modified engagement policy that, so it was thought, "should keep everyone happy". Reflecting that amended policy, the fund's public website in 2006 reported a "comprehensive active engagement policy" that would require its "investment managers to take governance considerations into account when making investment decisions". The website also supplied copies of questions that the unit had put to three companies on governance-related issues.

The board made several decisions during 2005 and 2006 which served to curtail the operations of the RI unit. One, the removal of a reporting line between the RI unit and the Investment Committee in 2006 restricted involvement of the RI unit and the asset management function to determination of regulatory risk in invested companies. Two, training in governance issues previously provided by the RI unit to in-house asset managers were restricted to an instruction session used to demonstrate access to governance reports loaded onto the corporate intranet. Three, the board reacted hostilely to a proposal from the RI unit in 2005 that the staff remuneration system be altered from a system of salary plus bonuses based on investment profitability, to salary plus bonuses based on completion of divisional work programs. Finally, the board refused a suggestion from the RI unit to redesign its custodial lending of securities to require consideration of environmental, social and governance issues. Custodians are legal owners of an investment organization's certificates of financial securities. Lending of certificates between custodians (for a fee) is commonplace. The board had allowed custodial lending of its securities since 1998 without applying its qualitative portfolio screening and reformist engagement policies.

The interviewee at the RI unit pointed at three factors to explain these actions of the board. One, the Chief Investment Officer (who reported directly to the board) interpreted reformist engagement policy as addressing company-specific and singular issues and not overall investment risk. Two, the board and the CIO were thought to both believe that longer-term investment considerations were incompatible with the short-term investment horizons (3-month and on occasion shorter) of asset managers, brokers and custodians. Three, metrics and mechanisms to integrate RI policy into the asset management function were not available.

The decisions, however, were sufficient to persuade the RI unit to change tactics. The unit adopted a policy to further reformist engagement practices solely by means of its memberships of independent pressure groups. To quote from the interviewee:

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> We haven't done a lot of engagement. We are better off trying to change the processes of the investment sector rather than seeking to affect operating policy in individual firms in which the fund has an ownership stake.

Items on the 2005 work program of the RI unit included labour hiring policies, environmental management systems and community consultation programmes of invested companies: the types of targets one might expect in an RI unit of an asset owner (see, Schueth, 2003). Their method of execution was more unexpected. Most of the items on its 2005 work program were directed at institutional processes affecting the wider investment sector.[4] Rationale for what, at least to us, appeared as circuitous attempts to change internal governance was given as follows.

> By definition, the nature of the most intractable and controversial issues are such that no single fund, no matter how powerful, can address such issues on its own. Progress requires systemic change and in turn, that requires complementary but different strategies by different players. Pension funds are suited to acting as the catalyst for change amongst the sector as a whole.

5. Analysis

The goals of this paper are to identify and understand the possibility of bottom-up change in institutional investment, and the governance and regulatory implications that brings. Although the inductive method used would not allow analysis to extend further than governing organizations of large pension schemes in the countries examined, the analysis provides theoretical advances on operations of organizationally embedded social movements and offers illuminating empirical details on pension fund governance.

Guided by Seo and Creed (2002), the ensuing four sections present an analysis of the case data. Three of the following four sub-sections describe, respectively, how institutional arrangements led to organizational tensions; how change proponents responded to those tensions; and what methods were used to resolve blockages and further change. A fourth section identifies the outcomes of change pressure for the actors and organizations involved. A discussion of the policy implications of self-regulated institutional linkages in financial services closes the paper.

5.1. How institutional arrangements create various inconsistencies and tensions

One of four sources of disrupting institutional contradictions identified by Seo and Creed (2002) is an undermining of functional efficiency in organizations as they become isomorphic with their

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[4] The 2005 work program of the UK fund's RI unit included using its position as chair of the Enhanced Analytics Initiative to persuade the board to supplement investment brokerage commission if brokers showed how they used environmental, social and governance issues; participating in the drafting of the United Nations Principles for Responsible Investment document (which was launched in 2006 in New York by the former Secretary-General of the United Nations) and other parts of the work program of the UN Environment Programme. Also in 2005, the unit made a presentation to the Board of the British Columbian Investment Management Corporation; signed and delivered a letter to the US Securities and Exchange Commission advocating certain corporate governance disclosures; consulted the International Accounting Standards Board on extra-financial corporate performance reporting; and formed, re-launched and joined the following six reform-oriented associations:

(i) The International Round Table on Executive Remuneration, which has lobbied the US Securities and Exchange Commission to mandate disclosure of corporate remuneration packages.
(ii) Pharma Futures, a version of an earlier association, the Pharmaceutical Shareownergroup which, in 2002–2004, lobbied selected pharmaceutical companies to change their business models as concerning distribution of non-patented medicines in Africa.
(iii) The Institutional Investors Group on Climate Change, which has designed and delivered educational seminars to various large asset managers.
(iv) The Marathon Club, which has promulgated information and seminars on 'long-term investment perspectives'.
(v) The Carbon Disclosure Project, which has lobbied selected companies to disclose carbon emissions data.
(vi) The Extractive Industries Transparency Initiative, which has sought to promote reporting of governmental revenues received from companies involved in oil and gas operations.

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institutional environments. The obverse occurs in pension funds, where legitimacy is established by maintenance of the functional efficiency of the asset management function. Both cases are mandatorily funded schemes with a rapidly increasing proportion of members reaching retirement age, aspects which can be associated with their competitively determined strategies to increase funds under management. Influences on strategy are legitimate and legitimised to the extent that they produce expectations of fund inflows. In such a conditioning environment, regulators' calls for reformist engagement, when received at the board level without accompanying recommendation of the Chief Investment Officer, were treated as hindrances rather than adjuncts to operational success.

Organizational contradictions in both cases included the maintenance of RI units while at the same time restricting their resources and functions, and patchy reporting to members. Absence of available metrics and data on social and environmental aspects of corporate operations was seen by all interviewees (both inside and outside the funds) as a limitation and conditioned their expectations of change. Further, the Dutch case was unable to monitor an agent responsible for monitoring the governance of some of its offshore investments. Local factors such as permanent cross-shareholdings and cultural practice may also have been significant.

Two further sources of contradiction associated with the institutionalisation of structures and activities are undermined organizational adaptability, and incompatibilities between intra-institutional and inter-institutional levels. The data demonstrate an intriguing tension between professionals hired by organizations to bring change and organizational resistance to pressure for change. For more than 5 years, boards contained pressure coming from regulators and RI units. Mixed responses to such pressure issued from the Dutch board during 2000–2005. Corollary programs and portfolio outcomes were not forthcoming. The UK fund was involved from an early stage in the development of reporting and practice recommendations issued by regulators and industry associations. The reception of the British board to these recommendations, however, was as lukewarm as the Dutch case.

If it is political processes that determine which institutional logic should regulate particular and contradictory institutions (Friedland and Alford, 1991), then operationalization of engagement policy in this period was more about silencing than allowing multiple discourses. In terms of the schema in Fig. 1 above, both boards acted to protect the archetype (the asset management function), which we characterise as a rebuttal. Organizational responses to pressure for change in this earlier period operated at the sub-systems level.

5.2. When and how institutional contradictions transform embedded actors into proponents of change

A final source of institutional contradiction arises when isomorphism conflicts with divergent interests of less powerful actors whose ideas and interests are not adequately served by the existing social arrangements. Professionals in both RI units were frustrated that they had been hired to implement programs of policy change and yet had been hampered in their execution. The contradictions which were outlined in Section 5.1 above operated to construct a virtual wall between RI units and the strategic thrust of their organizations. Facing a seemingly intractable institutional arrangement against which their organizational influence was set to remain minimal, individuals working in the RI units decided to initiate and participate in efforts to change the very institutional processes they saw their employing organizations (and themselves) locked in.

5.3. When and how institutional contradictions enable proponents of change to foster change processes

In this stage, praxis moves to collective action to reconstruct the existing arrangements which inhibit desired change. At one end of a spectrum of possible outcomes, institutional contradictions may influence the political dynamics by undermining the hegemonic position of dominant groups or coalitions. At the other end, collective action by a group of institutional challengers or entrepreneurs may not always result in the intended change because of opposition by vested interests better served by the existing institutional arrangements. A peculiarity of a social movement embedded in financial services is that the challengers themselves partially represent the same vested interests. It is worth noting that remuneration bonuses of individuals working in the RI units were tied to economic profit

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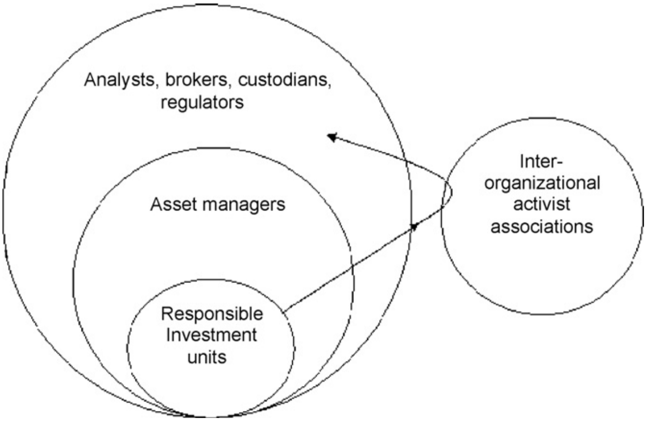

Fig. 2. Change pressure from embedded actors.

produced by asset managers. From a dialectical perspective, this may result in producing another source of contradiction.

Both RI units adopted dual capacities: one as external lobbyists, which was mainly exercised through involvement in interest associations; the other as change proponents in their organizations. In the former, various activities were pursued at the institutional level. These included lobbying of national regulators, quasi-governmental bodies, and professional associations; issuance of press releases; entreating institutional investors to 'join' interest associations; and creation of new associations. In their capacities as agents of change in their own organizations, RI units directed boards' attention to industry and media attention paid to the interest associations and the issues that they were highlighting. The two-pronged approach was followed to institutionalise and legitimise the case for change.

Fig. 2 below characterises the approach of both RI units to promoting reformist engagement. The outermost circle at the left represents institutional processes associated with asset management. These include the conventions of capital asset pricing, asset analysis, brokerage, custodial services, regulatory review, and finance academia and media. Governing boards occupy the next inner circle, the archetype, wherein investment policies are legitimised. The line leading from the innermost circle, which represents the organizational location of the RI units, depicts the mobilisation phase of a social movement. Counter-responses of individuals in the units to boards' containment of reformist engagement initiatives were to mobilise with other professionals working in similar units at other investors. This move created a space, depicted as the free-standing circle in Fig. 2, in which policy could be formulated and articulated.

The line leading back to the left of Fig. 2 depicts pressure brought on institutional networks. The stratagem is used to build political capital in attempt to persuade host organizations (and other investors) of the merits of reformist engagement. The evidence presented above suggests that two prominent advocates in Europe have come to rely on such a dynamic as their main legitimate and legitimising mode of action.

It is helpful to survey the formation, memberships and activities of the associations. Table 1 below lists 15 reformative interest associations which the RI units had joined, formed and been active in through 2004–2007. Table 1 notes catalysts for formation, objectives and selected activities.

In characterisation with the typical diffusion of social movements, memberships overlap and new associations have replaced others (Meyer and Whittier, 1994). As example, the UN Principles for Responsible Investment and the Enhanced Analytics Initiative have announced intentions to join their work programs. Most of the associations listed in Table 1 can number grassroots activist associations as members. As examples, the UK Social Investment Foundation counts as members the 'activist' NGOs Oxfam, World Wildlife Fund, Amnesty International, UNICEF and Traidcraft Exchange (Fair Trade);

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Table 1
Investor interest associations.

Association and launch date	Funding members	Stimulus	Selected activities[a]
Carbon Disclosure Project 2000	315 institutional investors	Rockefeller Foundation, World Wide Fund for Nature & a UK asset manager contacted various UK pension funds	Lobbying—companies Research—questionnaires on carbon emissions data Communications—requested FT Global 500 companies for investment-relevant emissions data Outcomes—carbon trading funds; reporters have publicised memberships
Enhanced Analytics Initiative 2004	27 UK pension funds & asset managers	UK pension funds, asset managers & FTSE 4GOOD index manager	Lobbying—supply-side analysts, brokers Research—qualitative rankings of brokers that use RI research Communications—'virtual network' Initiatives—a UK pension fund provides incentive if brokers perform qualitative research
Eumedion 1998	Dutch institutional investors	A Dutch pension fund sought to raise profile of investment governance	Lobbying—participated in commission that formulated Dutch corporate governance code, consulted EC, Dutch governmental authorities & sectoral organizations Research—differential voting rights of Dutch investors Communications—advice sent to 75 Dutch-listed companies was evaluated by a governmental commission
European Social Investment Forum 2001	Various national NGOs advocating social investment, also sponsored by EC	Former Dutch Association of Investors for Sustainable Development	Lobbying—amendments to EC Sustainable Development Scheme Research—selected sector studies Events—speaking engagements at EC Communications—European press coverage, reporting guidelines Initiatives—drafted OECD guidelines
Extractive Industries Transparency Initiative 2002	World Bank, governments of UK, France, Norway, US, Canada. 78 investors. London board.	Announced at UN World Summit for Sustainable Development 2002, thence at GRI (below)	Research—commissioned by World Bank and governments Events—speaking engagements at World Bank Outcomes—78 corporate signatories have undertaken to disclose government revenues
Global Reporting Initiative [GRI] 1997	Private donations, governments, businesses, asset owners. Amsterdam board.	Coalition for Environmentally Responsible Economies and Tellus Institute	Lobbying initiatives—invited by EC to collaborate with Club of Madrid, Globe Europe and Respect in a UN forum on climate change, 2009 Research—climate change, Communications—reporting guidelines for financial institutions
Institutional Investors Group on Climate Change 2001, 2nd initiative 2005	39 European institutional investors	EC Emissions Trading Scheme prompted research from UK pension funds	Lobbying—with The Carbon Trust, sponsored training material for a UK asset manager Research—survey of broker research on climate change Events—disclosure framework for European electricity utilities Communications—letter to selected sell–side brokers Initiatives—spoke at UNEP event

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International Global Investor Governance Network 1995	250 investors, regulators, academics, labour unions. London-based.	Council of Institutional Investors	Lobbying—EC on Investment Prospectus & Regular Reporting Directives; companies on OECD Principles of Corporate Governance Research—cross-border voting rights & accounting disclosures Initiatives—database of corporate governance standards Events—annual conference Communications—guidance on application of OECD guidelines Outcomes—support from SEC
International Round Table On Executive Remuneration 2005	10 US & European investors	Initiated by a UK pension fund	Lobbying—SEC and certain Delaware-domiciled companies Events—spoke at US investors' conference on corporate governance
Marathon Club 2004	London Pensions Fund Authority. 18 European & US investors.	Competition run by UK fund USS & Hewitt Associates prompted by review of financial services	Lobbying—selected asset managers; Association of British Insurers; UK-based National Association of Pension Funds Outcomes—Wide industry response to a discussion paper on long-term investment policy
Pharmaceutical Shareowners Group 2002, closed 2004	14 UK, 4 European, 1 US investors.	Industry discussions led by UK fund USS on business models	Lobbying—selected companies operating in pharmaceutical sector Research & Communications—interviews with pharmaceutical industry analysts widely publicised in investment media in 2004
Pharmafutures 2003, 2nd initiative 2006	UK Govt. Dept. for International Development, Rockefeller & Nathan Cummings Foundations. 3 pension funds.	UK Social Investment Forum sponsored 3 investors to identify management of risks in sector	Lobbying—individual companies Initiatives—planned workshops with companies, investors & health associations Planned communications—statement of measures that identifies investment risks and co-signed by pharmaceutical companies
United Nations Principles for Responsible Investment 2005	UNEP. 11 asset owners. 276 signatories.	Devised by UNEP Finance Initiative	Events—momentum maintained in UN Environment Programme summit, 2007 Outcomes—the PRI document has been signed by most large institutional investors
Triple Bottom Line Investing Group 1999	Investment bank, congress fees	Former worker in Dutch financial services	Events—annual congresses in Europe and Asia have been attended by 500+ representatives of investors, consultants, social NGOs, universities
UK Social Investment Foundation 1998	161 pension funds, asset managers, social NGOs[b] Board & research staff.	Counterpart association in US	Lobbying—UK Environment Minister Research—programmes for member categories: banks, pensions, asset managers, research providers, financial advisers, social NGOs Communications—public information website

Data are relevant at December 2007.

[a] Data sources: Internet websites, printed materials and media reports. The basis of the selection is ad hoc.

[b] Two members of the UKSIF appear separately in the Figure: the Carbon Disclosure Project and the European Social Investment Forum.

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Table 2
Organizational responses to change pressure.

	Rebuttal 2002–2006	Reorientation 2006–2007[a]
Dutch fund	In 2000, RI unit starts with one part-time employee on corporate governance	RI unit grows from two to five
	In 2002, one full-time employee on corporate governance and sustainability	Fund approves new RI policy end-2006
	Board announces RI policy (then formulated as corporate governance and sustainability)	RI unit develops monitoring policies for external managers
	In 2004, two members in RI unit	Board strengthens its alternative investment department
	Board keeps RI unit separate from investment process	RI unit uses Eumedion to play a role in the evaluation of the draft Dutch code on corporate governance
	Activity of offshore agent not monitored	RI unit joins IIGCC
	One member of RI unit resigns	Inaugural member of Principles for Responsible Investment
	At the end of 2005, board decides to reformulate its RI policy	Archetype: Board announces plans to invest .75B€ in 'sustainable energy' projects
		Increased resources and organizational influence of RI unit
British fund	Installs Responsible Investment unit	RI-unit tries to develop internal change programs
	Announces RI policy	RI unit devises work program outside fund
	RI unit separated from investment process	RI unit co-edits Principles for Responsible Investment document
	RI unit devises work program outside fund	Archetype: Board director appointed to UN board
	RI unit co-founds Enhanced Analytics Initiative, Investors for Climate Change, Pharma Futures	Increased resources and organizational influence of RI unit
	In 2006, board decides to reformulate its RI policy	

[a] According to Laughlin (1991), a reorientation to change pressure will contain disturbances while allowing some 'spillover' into the archetype.

while the European Social Investment Forum counts World Wildlife Fund and Greenpeace as members. The decision of the British fund's RI unit to create and join external associations also, reportedly, was influenced by the professional history of its former manager, with a history in grassroots organizations such as Safer World and Action Aid.

A common belief that can be deduced from analysing the differences in the objectives of these associations is that investors and corporations should drive social change. All hold an objective to filter pressure for change through institutional linkages. Their reformist nature can be seen in the emphases of many of their publications on the economic case, often taking the form of a long-term wealth preservation argument (e.g., Marathon Club: http://www.marathonclub.co.uk/Docs/MarathonClubFINALDOC.pdf). Their conservative programs have been pursued using methods adopted by more radical activist organizations, some of whom (e.g. World Wildlife Fund and Greenpeace) act in advisory capacities. Activities have included lobbying of regulators and industry associations, issuance of press releases, commissioning of research studies, consultation of corporate management and regulators, seeking modifications to investors' service contracts, and contributions to the work programs of the World Bank and the United Nations Environment Programme.

Strategic decision-making in mature social movements (the average age of the associations in Table 1 at 2007 was 6 years) is shaped by a need to establish legitimacy (McAdam et al., 1996, p. 17). We were shown and occasionally copied into email communications within this "virtual community" (Rothaermel, 2001) which discussed such as the best choice of methods to attract new members, registrations to the UN Principles for Responsible Investment, reception afforded by the Securities and Exchange Commission to a visit from association delegates, and access granted to heads of industry associations.

Our analytical framework is used to illustrate the shifts in organizational reception to pressure for change. Table 2 below provides a summary.

The leftmost column of Table 2 notes that both boards, in the period 2002–2006, rebutted external and internal pressure for reformist engagement. RI units responded by bringing various kinds of

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pressure on institutional processes in which investors are imbricated. Moving to the rightmost column of Table 2, in 2006 and 2007, regulators renewed their pressure for reformist engagement as boards experienced growing member interest and investor momentum in alternative assets (carbon trading funds and sustainable energy projects). Decisions of the boards of both pension funds to invest in alternative assets in this period were followed by (renewed) announcements of policies to consult invested companies. Both funds became signatories to the UN-sanctioned Principles for Responsible Investment programme, and a member of the board of the British pension fund joined the board of the UN Environment Programme.

We characterise these actions as marking a reorientation of both boards and, partially at least, as a successful program of change. Implied in the right-hand column of Table 2 are amplified organizational statuses of RI units which carried increased resources, widened work programs, and creation of new reporting lines between RI units, boards and Chief Investment Officers. As example, the size of the RI unit in the Dutch fund increased from two to five members in 2007, and from two to three staffers in the British case.[5]

5.4. *Policy implications of policy change*

Policy implications for the regulation of pension arrangement in Europe and elsewhere have been identified and are not repeated here (e.g., Clark, 2006; Cremer and Pestieau, 2000; Disney, 2000; Whiteside, 2006b). The case analysis presented above suggests that reformist engagement practices present hitherto unrecognised implications both for regulators and governors of pension funds. The implications for each group are discussed below.What are the regulatory policy implications of emergent patterns of reformist engagement? At issue is the type of response required from regulators. Encouraging the types of collective action we have described might be of benefit to regulators insofar as regulatory oversight might be expected to improve organizational governance. The significance of institutional linkages in financial systems is evinced by the case analysis presented above. To date, regulators have opted for sets of rather relaxed reporting requirements (Haigh and Guthrie, 2008; refer Appendix A for legislative measures and reviews). While issuance of reporting requirements is part of the answer to the question of monitoring the financial system, it cannot represent a comprehensive solution. Comprehensive regulatory policy is that which also brings attention to investment practices, extending to oversight of contracts with intermediaries.Investors' contributions to the work programs of supra-national, quasi-governmental bodies such as the United Nations are significant from a national perspective. Hebb and Wójcik (2005) illustrate the extent to which investment strategy in the California Pensions Employees Retirement Scheme, known for its reformist engagement practices, is out of reach of US regulators. The near-unassailability of the governance of privately managed pension schemes can be associated with the magnitude of their investments, itself a product of the institutionalisation of industry-wide schemes and mandatory contributions by employers (Clark, 2006). As a result, larger and not-so-large pension schemes have been forced to internationalise their investment portfolios, which brings a question of governance.The self-regulatory regimes in financial services represent arrangements borne of historical circumstance more so than of design. Is it acceptable for the regulation of reformist engagement to default to such as the UN Environment Programme? There appears no immediately available alternative. The advisory board of the Principles for Responsible Investment programme does not count a single government as a member, yet, is claimed by some to represent a pragmatic mechanism of governance. A pragmatic response from regulators might be to adopt an 'observer' role in this supra-national movement association.The potential for reformist engagement to improve shareholder value (e.g., Hendry et al., 2007) begs a question as to how a pension fund board might articulate its constructive social responsibilities (Clark and Bennett, 2003) through its financial products. At least two governance implications

[5] The reader may question the significance of isomorphic influence on boards' decisions to invest in energy assets. It is outside this paper's frame of reference to disentangle the influences of lobbyists and institutional awareness of the financial ramifications of climate change. Within our dialectical frame of analysis, it is sufficient that we point at the elevated organizational statuses of the RI units that followed these decisions.

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arise from the collective monitoring of investment portfolios of disparate, competitive organizations.

One, in the zero-sum game of equity and property investment markets, an economic argument can be constructed that it is working against strategy for a fund to collaborate significantly with its competitors. Anti-trust legislation has been restricted to economic grounds (collusion, market rigging) but, in the abstract at least, might extend to parties acting in concert. The investment processes of large investors are conditioned by their regular involvement in networks, which governors see as necessary to develop investment policies and execute fiduciary responsibilities. In that respect, concerns as to the legal opinion of collective shareholder resolutions (e.g., Ali et al., 2003; Black and Tolbert, 1994; Richardson, 2002) have been confined largely to academic interest. The existence of multiple associations of interest associations, formed by intermediaries and representatives of large investors, brings the legal aspect of acting in concert into more immediate relief.

Two, collective action displaces pensions governance from the board room. It can be noted that in the British case, a board member joined the board of the United Nations Environment Programme after the board agreed to become a signatory to the UN-sanctioned Principles for Responsible Investment. The operations of financial markets bear little relation to the independent agents and complete information sets on which portfolio theory is based (e.g., Markowitz, 1952). If boards decide to adopt reformist engagement policies, it is in the interests of effective governance that they involve themselves in vehicles that promulgate and validate those policies.

Future research is needed to answer the questions that this paper raises on the regulatory oversight and organizational governance of institutional investment. Short-term and longer-term effects of institutional pressure on investor governance in this area are moot. While we have argued that the activities of proponents of reformist engagement in Europe constitute a mature social movement, we cannot show that they have been remarkably successful in reconstructing the field of investment management. Although the individuals working in the RI units considered their networking and collaborative policy work had created new possibilities of influence, ongoing organizational resistance was expected. Expected sources of conflicts were differences in the organizational status of the investment function and governance advisory, and organizational distrust of policies whose starting points are not wealth maximisation.

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Appendix A. Official publications relating to reformist engagement

INTERNATIONAL

Principles of Responsible Investment 2006, United Nations Environment Programme Financial Sector Initiative, Geneva.

Reynaud, E. (2000) (Ed.), Social Dialogue and Pension Reform, International Labor Organization, Geneva.

Organization for Economic Co-operation and Development Guidelines for Pension Fund Governance, 2002, Paris.

UNITED STATES

Conference Board, The (2002), Report—Equity ownership and investment strategies of US and international institutional investors, Institutional investment report 4, Washington, DC.

Employee Retirement Income Security Act of 1974 (ERISA) (Pub.L. 93-406, 88 Stat. 829), US Department of Labor, Washington DC.

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Appendix A (*Continued*)

EUROPEAN UNION

Committee of Wise Men (2001), Report—The Regulation of European Securities Markets, Brussels, February 2001 ["Lamfalussy Report"].

Communication—Financial services: building a framework for action, Commission of the EC, Brussels.

Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision, EC Directorate-General Internal Market and Services, Official Journal of the European Union, Brussels. http://eur-lex.europa.eu.

Financial Services Policy 2005–2010, Commission of the EC, Brussels.

UNITED KINGDOM

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Pensions Acts 1995 and 2004, Her Majesty's Treasury, UK.

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Pensions and Savings Funds Guarantee Act, The Hague.

Peters report and recommendations—Corporate governance in the Netherlands, Committee on Corporate Governance, European Corporate Governance Institute, Brussels.

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AUSTRALIA AND NEW ZEALAND

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