Adoption of Socially Responsible Investment Practices in the Chinese Investment Sector – A Cost-Benefit Approach

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Introduction

In 2003, ten of the world's largest private banks, in cooperation with the International Finance Corporation, voluntarily committed themselves to adopting social and environmental investment-standards. Since then, 54 institutions from 21 states, active in over a 100 countries have adopted these standards.[1] Although the implementation of Socially Responsible Investment (SRI) demands sweeping reforms, the established part of the private investment sector considers SRI to play a significant role. Recently though, this process appears to be threatened to be undermined by the appearance of new, powerful investors from countries that derived financial benefits from their outstanding economic development.

As the most significant example of this trend, the article focuses on Chinese investors emerging on the global investment scene. China's "Go-Out" Strategy, a nationally concerted effort to promote international expansion of the Chinese corporate sector, was launched in its 10th 5-year plan in 2001. By 2005, Chinese companies' overseas direct investment amounted to a staggering $ 200 billion (USD) and Chinese banks are now the leading lenders on the African continent.[2] However, examination of the international agreements shows that Chinese investors are acting without the social and environmental restraints of SRI. In the following section, we have identified the various pressures which have an impact on the decision of whether an investor incorporates SRI into its corporate identity.

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1 "The Equator Principles" – Become an Adopting Institution. (http://www.equator-principles.com/join.shtml).

2 Michelle Chan-Fishel (2007), *Time to Go Green: Environmental Responsibility in the Chinese Banking Sector*, Friends of the Earth US, (http://www.foe.org/pdf/Chinese_Bank_Report_5-9-07.pdf).

The Cost-Benefit Analysis

At the heart of any activity in the financial sector, the cost-benefit analysis remains as an overarching principle due to the rules of competition on a free market. Accepting this, it becomes clear that traditional financial actors have adopted sustainable investment principles not because they feel they have a social obligation *per se*, but largely because doing so affects the cost-benefit analysis in some way or another. This section will therefore attempt to shed some light on the reason for the differences in the pace of adoption of sustainable investment standards in Western and Chinese bank by identifying the difference in pressures on the cost-benefit analysis in Western and Chinese contexts in a number of areas. We will also comment on the degree Western and Chinese companies are exposed to such pressures, thus enabling us to make postulations regarding whether and how quickly the Chinese investment sector is likely to implement SRI in the future.

Long-term risk calculation

Negative "side-effects" of unsustainable investment, such as the fuelling of conflict in unstable regions, unsustainable modes of resources extraction, etc., can contribute to instability and subsequently in the inability of debtors to pay back loans, thus creating negative financial repercussions for the investing actors. As a result, old assumptions that sustainability would impose costly duties and regulations on business have begun to break down in the international discourse.[3] While the corporate culture of Chinese investors is still geared towards short-term profit-seeking,[4] a discernable trend towards the incorporation of long-term risk assessment strategies can be observed.

Availability of access to social funds

SRI assets, capital only invested in projects that adhere to certain social and environmental standards, are a rather recent phenomenon in the financial world. Yet they have mushroomed in size and made up $ 2.29 trillion (USD) in 2005[5] – a significant incentive by anyone's standard. As with long-term risk

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3 In a survey conducted by the International Finance Corporation in 2007, 86% of financial institutions reported that positive changes had resulted from their integration of social and environmental sustainability issues into their long-term risk assessment. Not a single one reported negative consequences. (International Finance Corporation (2007), *Banking on Sustainability – Financing Environmental and Social Opportunities in Emerging Markets*, The World Bank Group, January 2007, (http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_BankingonSustainability/$FILE/FINAL_IFC_BankingOnSustainability_web.pdf).

4 See Chen R. and Chen C.P. (2005), "Chinese professional managers and the issue of ethical behaviour", *Ivey Business Journal Online*, London: May/June.

5 The Social Investment Forum (2006), *2005 Report on Socially Responsible Investment Trends in the United States,* (http://www.socialinvest.org/areas/research/trends/sri_trends_report_2005.pdf).

assessment, access to social funds as a result of implementing CSR will confer direct benefits to Chinese financial actors and is thus likely to quickly find its way into Chinese financial practice.

Internal norms

A poll conducted among young professionals in the UK by British Telecom in August 2007 found that more than a third of respondents viewed working for a socially and environmentally responsible employer as more important than the salary and 44% said they would discount an employer without good CSR credentials.[6]

In China, however, such internal pressures are of a much lesser degree. Due to a combination of media censorship[7] and uncritical education, Chinese employees lack the necessary informational base to build up the same consciousness for SRI as it has developed in Western countries. Additionally weak channels of legal recourse, personal hardship, and a very large pool of excess labor[8] restrict the employee's possibilities and desire to confront their employers with normative qualms.

Investor pressure

As a result of awareness campaigns by the media and civil society about cases and negative impact of unsustainable investment global investors have found their reputation tarnished to the extent that they had to register large-scale investor flight. As is the case with Chinese employees, all-encompassing censorship in the Chinese autocratic system precludes Chinese investors from gathering the necessary information on SRI. Furthermore, the Chinese private investment sector is very immature and the regulation on foreign acquisitions very restrictive – meaning that the Chinese investment landscape remains very firmly in the hands of a selected group of Chinese nationals and the government.

As the world's largest recipient of FDI, expected to surpass $ 60 billion (USD) this year,[9] China is not impervious to external investor pressure – recently, the "Save Darfur Coalition" managed to force two large US investment firms, Berkshire Hathaway Inc. and Fidelity Investment, to withdraw their investment in China's No.1 oil producer, PetroChina, due to its

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6 Reported by www.startups.co.uk (http://www.startups.co.uk/Get_socially_responsible_to_attract_talent_firms_told.YbKI3jRoS63Ijg.html).

7 BBC Monitoring Media (2007), *China: Watchdog report disputes government media freedom "promise*", 7 August 2007.

8 Although the official urban unemployment rate is 4.2%, unemployment across the countryside remains rampant. CIA World Factbook (https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html).

9 Denise Tsang, "Foreign investment in mainland leaps 11.9pc", *South China Morning Post,p. 3*.

activities in war-torn Darfur.[10] However, given the magnitude and complexity of international financial flows, much of socially irresponsible investment remains under the radar and subsequently leverage on Chinese financial actors remains weak.

Political Pressure

Although liberal systems of governance are much more sensitive to citizens' concerns, the Chinese government also derives its final legitimacy from the citizens. However, in the case of SRI it is unlikely that political actions are taken which may be contrary to the national interests. These are defined first and foremost as economic development and the secure supply of natural resources. Moreover while the threat of social unrest and upheaval could initiate political actions, SRI does not affect the Chinese citizens in a direct way. Unlike in liberal democracies, there is little incentive for the Chinese government to enact reforms on SRI due to the absence of a strong civil sector and the lack of environmental and social lobbying.

Legal Frameworks

Were there is sustained public and political pressure, an issue will be incorporated into national or international (or both) legal structures. Legal structures obviously affect a cost-benefit analysis as their disregard can result in hefty fines for the company and prosecution of individuals.

In today's China, national legislation on SRI remains weak and there is little oversight and transparency. Furthermore, the balance of power within the Communist Party apparatus remains shifted in favor of investors. Thus, on the 23rd of August 2007, China's two major state-owned oil companies, China National Petroleum Corporation (CNPC) and the China Petroleum and Chemicals Corporation (Sinopec), who are directly supervised by the State Assets Supervision and Administration Commission (SASAC), openly and resolutely rejected a program drawn up by the State Environmental Protection Agency and the China Insurance Regulatory Commission that would have forced them to buy "environmental protection insurance".[11]

Conclusion

The issues raised in the above discussion are by no means covered in their full scope. Due to the limited space of this article the last section points out

[10] Barry Schweid (2007), "Coalition presses investment firms to divest China company's Sudan oil interests", *The Associated Press,* 1st May 2007, (http://www.uofaweb.ualberta.ca/chinainstitute/nav03.cfm?nav03=60111&nav02=57273&nav01=57272).

[11] Reported by SynTao.Com, (http://www.syntao.com/E_Page_Show.asp?Page_ID=5032). Original article in Chinese (http://news.eastday.com/c/20070823/u1a3060982.html).

some trends which will affect the further development of SRI in the Chinese sphere of influence.

The various pressures referred to in this article do not remain constant, but are in a continuous state of flux. While ‘long-term risk assessment’ is more likely to be incorporated into Chinese banking practice as it has been shown to be a viable business model increasing financial competitiveness, other factors, such as ‘consumer pressure’, will certainly lag behind for the above-mentioned reasons.

Especially one trend should be taken into account which breaks down the black and white picture and blurs any comparisons between Western and Chinese investors. Rather than national investors acting in isolated ways due to their cultural development and political system, the ongoing dissemination of the Chinese market makes for a perfect example for the effects of global interconnectivity. Just in 2006 major Western financial institutions purchased minority stakes in Chinese banks.[12] This surprising shift of the Chinese economic policy is closely connected with the radical, state-driven shake-up of the Chinese banking sector. While experts are concerned about a clash of the different corporate’ cultures, it can be asked if the share of experiences and the initiation of structural reforms based on Western companies will have the effect of guiding Chinese investment practices more towards social investment standards. But not just internal changes initiated by foreign investors are likely to happen. Additionally acting in cooperation with several investors in bigger projects could confront Chinese investors with the procedures and benefits of SRI. But unfortunately the positive imagine of Western investors is not as convincing as it likes to portray itself in PR campaigns and the signing of SR-principles. Under the guise of Chinese investors, the attraction of enjoying some of the short-term benefits of unsustainable investment is also a likely reason for investing in Chinese banks. Yet, given the magnitude and complexity of international financial flows, much of socially irresponsible investment remains undiscovered.

[12] Colin Hawes, Thomas Chiu (2007, February), “Foreign Strategic Investors in the Chinese Banking Market: Cultural Shift or Business as Usual?”, *Banking & Finance Law Review*. Bd. 22, Ausg. 2; pg. 203.

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