SRI
IN ASIAN EMERGING MARKETS

ASrIA Reports

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SRI in Asian Emerging Markets

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Also find on our website the following related reports:

Japan
Hong Kong
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Taiwan

All these Reports are also freely available on the ASrIA website at:
www.asria.org/publications

Each individual country report, with associated documents, appendices and other related information will also form the basis of the relevant country pages of the ASrIA website at:
www.asria.org/sri/asia/sriasia

ASrIA sincerely welcomes receipt of any updated information relevant to any part of the reports. Please direct to david@asria.org

Methodology

This Report was produced in collaboration with researchers in each country. Research has largely been conducted by telephone, face to face interviews, media and internet searches.

Disclaimer

ASrIA does not guarantee that every relevant organisation and individual has been covered in each market. With the resources available in each market, the reports make every effort to focus on key areas of relevance, to deliver data that is accurate and opinions that are objective and balanced.
Foreword

The expansion of Asia's private sector and its accompanying investment opportunities are forever changing the global economy. Yet as home to roughly half of the world's population, rapid industrialization, expansion of information technology, and urbanization underway throughout East and South Asia pose enormous challenges that must be recognized by private investors and governments alike. Hundreds of millions of people are in the process of moving permanently from the countryside to cities. Rapidly expanding businesses are making further demands on resources. Throughout the region, clean water, clean air, biodiversity, fisheries, fertile soils, and improved standards of living are all at risk because of unsustainable development.

For the most part, portfolio investors in Asia have yet to explicitly recognize the complex array of issues that could hinder long-term private business and investment returns. The socially responsible investment industry - a $2.4 trillion worldwide industry that includes 760 retail funds and hundreds of institutional investors - has only just begun surfacing in Asia and has yet to fully demonstrate how its techniques can contribute to business performance. Research commissioned by IFC on the SRI industry indicates that SRI assets amount to only $2.2 billion in all emerging markets, including Asia. That is less than one tenth of 1 percent of the worldwide total. Only $1 billion in SRI assets is held by developing country investors.

Evidence shows that SRI investment approaches provide returns at least as strong as funds that don't take social, environmental, or corporate governance factors into account. Well-constructed and well-managed SRI funds have consistently proven to match or outperform their benchmarks. In the context of such enormous challenges facing Asia today, SRI has potential for contributing further to improved environmental and social conditions. SRI investors can also be a factor in improving long-term economic competitiveness by positively influencing corporate behavior and governance.

The International Finance Corporation, the private sector arm of the World Bank Group, shares the caution and conservative nature of most other financial institutions, in line with our fiduciary responsibility to shareholders. Yet in the process of nearly 50 years experience investing in developing countries we have learned how good investment returns are compatible with creating employment, a healthy environment, and an improved quality of life in developing countries. We set high standards for corporate governance and environmental and social performance and innovation, not only to fulfill our development mission, but because our investments in nearly 3,000 companies in 140 countries have demonstrated that there are valuable business benefits from initiatives that help progress toward sustainable development. IFC's experience would indicate that SRI investors likewise may be able to gain insight and better exploit hidden market opportunities by focusing on sustainability leaders.

The International Finance Corporation is fortunate to have been able to work with a partner like ASrIA to bring the message of sustainable investment to a wider audience. SRI has great potential in the emerging markets. Realizing this potential requires objective and thorough analysis of the investment opportunities and barriers; targeted programs of research, awareness raising and capacity building; and strong international partnerships to influence framework conditions and catalyze the market. The pioneering research undertaken by ASrIA and its partners for this report is another significant step forward. More needs to be done, and IFC and its Sustainable Financial Markets Facility look forward to playing their part.

We are grateful to the governments of the Netherlands, Switzerland, and Norway, whose cofounding enabled IFC to sponsor this important work.

Javed Hamid  
Regional Director for East Asia & Pacific  
International Finance Corporation
Executive Summary

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1.0 THE AIM OF THE COUNTRY REPORTS

The purpose of this set of reports is to provide up-to-date and comprehensive information on the status of SRI in seven of Asia’s Emerging Markets and, through this work, to advise on potential next steps for further developing SRI in Asia. The Reports are primarily directed at global SRI investors on the one hand and local investors on the other, as well as to governments, development agencies, corporates, civil society organisations and all others interested in and instrumental to sustainable investment in Asia.

**Global SRI Investors:** To alert them to the opportunities for SRI investment in Asia’s emerging markets. As the research proceeded it also became clear that global SRI investors have a critically important role to play in introducing SRI investment models and practices into these markets, in addition to highlighting investment opportunities. We hope these Reports will encourage global SRI investors to help establish SRI and to promote the long-term value of introducing SRI practices and products into these markets while they are still in the developmental stage.

**Local Investors:** To introduce a wider audience to SRI and to provide new insights for local investors into the potential of SRI in their home markets. In addition, to indicate the role that SRI can play in orientating investment and development towards sustainable goals.

Governments, development agencies, corporates and civic society organisations will also find the Reports provide both a useful introduction to SRI and alert and educate them on the new business and investment ethos emerging around the world. Globalisation is uncovering the costs to economies, society and the environment of corruption, exploitation and inertia, whilst also demonstrating the benefits of a win-win ‘triple-bottom line’ approach to integrating economic, social and environmental criteria together. It is not therefore a matter of if SRI can or should be introduced into Asia’s emerging financial markets, but how and in what forms.

2.0 WHAT IS SRI?

Sustainable and Responsible Investment (SRI), also known as socially responsible investment, is an investment approach that integrates social and environmental considerations into investment decisions. SRI provides a means by which the financial community can direct investment towards sustainable development. SRI is also a means of exerting leverage on the corporate sector to orient business practices towards ethical and sustainable goals. In addition SRI funds have played a role in influencing governments and regulatory bodies to introduce policies that will encourage the ethical performance and transparency of financial markets.

SRI is a concept that has proven itself over several decades in the West. It has already been adopted in some parts of Asia, in particular Australia and Japan. SRI funds now form a significant percentage of many developed markets and are tracked with indices such as the Dow Jones Sustainability Index, the Domini 400 Social Index and the FTSE4Good Global Index. Morningstar also produce an SRI index for Japan. SRI funds have been studied by the financial and academic communities and there is considerable evidence to show that SRI can perform as well as, if not better, than regular investments over the long term.

Finally, SRI provides individual investors with the opportunity to 'know what they own' and invest in-line with their personal values.

To learn more about SRI, visit www.asria.org, the primary resource for SRI in Asia.

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3.0 THE SCOPE AND METHODOLOGY OF THE REPORTS

The Reports, which have been sponsored by the IFC, covered the following Asian emerging markets:

China
India
Indonesia
Malaysia
Philippines
South Korea
Thailand

In addition, ASrIA has also conducted similar surveys of four of the more developed Asian markets. A summary of the findings of these reports are also presented in this Executive Summary:

Hong Kong
Japan
Singapore
Taiwan

All the Reports are freely available on the ASrIA web-site at:
www.asria.org/publications

The Reports were all carried out by one or more dedicated researchers in each country. The period and resources available for the research were limited, however. Most research was carried out by face to face and telephone interviews, text, media and internet searches. Though every effort was made to ensure the objectivity of each Report, there is no doubt that each Report also expresses its own unique flavour, providing additional insights into the issues, concerns and values that might come to define SRI in each country.

Each Report is designed to form the basis of a special section on each country on the ASrIA website. In each country section you will find the full pdf. report and also, where we have it, additional appendices and other information gathered during the research process. Updated information on funds and other noteworthy news will be added to the Country Pages on the ASrIA website over time, thereby ensuring that these remain an ongoing current source of information on the development of SRI in Asia.

4.0 REPORT SUMMARIES

As well as the Executive Summaries at the beginning of each Country Report, there is a final section providing an assessment of the future of SRI in each country. This includes a bullet-pointed summary for each country.
5.0 WHY SRI IN ASIA?

SRI has already gained a firm foothold in several Asian markets, in particular Japan. However, it is still very early days and the concept is still virtually unknown to most investors. ASRIA is committed to promoting SRI as widely as possible in Asia because we believe that the financial sector has a critical role to play in steering economic development towards sustainability. However there is some debate over the extent to which the model of SRI as developed in the USA and Europe is applicable in Asia, where cultures are diverse and stages of development are very different across the region. The debate on Asian values that took place both before and since the Asian financial markets crisis of 1987-9 is relevant here. Essentially there is no hard and fast answer to the question of the appropriate forms of SRI for Asia. However there is no doubt that from a purely financial perspective, US and European SRI firms have extremely valuable experience in managing SRI funds and conducting the necessary research. All the reports highlight the value to their markets of having this technology and experience brought to bear, via the registration of global SRI funds, or joint-ventures between local and global SRI fund houses.

On the other hand, there is also no doubt that the introduction of SRI into Asian markets will cause new forms of SRI to emerge, widening and broadening the debate on what values, screens and approaches are most effective in each market, and even feeding new energy back into the more established global SRI markets and the wider SRI dialogue. As mentioned in the Philippines Report, SRI needs to be shown to be relevant to the broad development goals of each Emerging Market in order to be seen as relevant and to gain support.

Illustrating the impact that SRI funds can have on corporate reporting, transparency and on corporate CSR, showing the influence that SRI funds have had on Government policy, for example on pension fund policy, and illustrating other ways in which the finance sector can contribute to sustainable investment, show the valuable influence that SRI can have on the sustainable development objectives in each country.

6.0 THE ROLE OF ASRIA

ASRIA was established in response to the grave environmental and social situation in Asia, the growing SRI trend in the West and the early indications that the market opportunity for SRI in Asia is significant. Environmental pollution in Asia is "pervasive, accelerating and unabated" (ADB). Asia is home to 12 of the 15 most polluted cities in the world (WHO), yet massive infrastructural investments in Asia are still needed. There exists a one-off opportunity to introduce clean technology and infrastructure development up-front to reduce pollution and avoid worsening the 'clean up later' approach. In addition building a social agenda that embraces vulnerable groups of society remains a deep-seated challenge for Asian economies. Issues such as poverty alleviation, provision of health care, access to potable water, shelter and education are key social issues that must be balanced and considered in relationship to environmental issues. Other social issues that are of direct concern to the investment industry, also include labour rights, health and safety in the workplace, pension provision, community involvement by corporates and the extent to which corporates reach out to stakeholders.

ASRIA’s mission is to raise public awareness and educate corporations and financial institutions about sustainable development and their role in making a safe, healthy, equitable and ecologically rich future. Most importantly ASRIA aims to do this in an Asian context, to help develop the Asian agenda for SRI so that it meets the demands of Asian companies and communities where cultures and priorities may be different from the West.

2 ADB; www.adb.org/Documents/News/2001/nr2001057.asp
3 WHO; www.who.int/en/
These Reports are one important step in revealing the status and potential for SRI in Asia and providing some pointers to the benefits that would flow from adopting and integrating SRI criteria into investment as widely as possible throughout the region.

ASrIA has developed resources and expertise that can be made available to any group interested to act on any of the Report recommendations or otherwise pursue SRI in an Asian context.

7.0 WHAT IS AN EMERGING MARKET?

The term "emerging market" as defined by Standard & Poor (S&P)⁴ implies a stock market that is in transition, increasing in size, activity, or level of sophistication, that is in a low or middle income economy as defined by the World Bank, and that has a relatively low investable market capitalization relative to its most recent GDP figures. Furthermore, stock markets that retain or introduce investment restrictions such as foreign limits, capital controls, extensive government involvement with listed companies, and other legislated restraints on market activity, particularly on foreign investors, are generally considered emerging markets. Pervasive investment restrictions on foreign portfolio investment should not exist in developed stock markets, and their presence is a sign that the market is not yet "developed."

The Asian markets that were covered in this Report are considered to be emerging markets. However one trend that stood out with all of the markets that were covered was very significant, if not uniform, efforts to reduce constraints on foreign investment and free-trade. One of the underlying themes of this Report was to look for ways in which the opening of markets and embracing of free trade could also act as a catalyst for embracing fair trade and adopting ethical forms of investment in order to orient financial flows towards investment in the infrastructures of sustainability. SRI is also recognized as a valuable tool for educating and empowering individual investors in the emerging markets.

8.0 BRIEF MARKET SUMMARIES

The Reports have enabled us to update and illustrate the scope of SRI investment around the region. The following provides an overview of developments. Full details of all the funds and other initiatives mentioned below are available in the individual country reports.

Australia

We have not produced a Country Report for Australia, however for comparative purposes with other Asian markets, we reproduce the financial data below from the Australian 'Ethical Investment Association', 2002 Benchmarking Report⁵, as well as noting some other points from ASrIA's own records. Australia has been the leader in the region for introducing SRI.

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Australia

- Well developed retail driven SRI market
- AU$13.9 billion / US$ 8.9 billion under management in SRI funds in Sept. 2002
  - US$ 1.2 billion in managed SRI funds
  - US$ 82 million in private SRI portfolios managed by financial advisors
  - US$ 4.4 billion in investments by religious organisations
  - US$ 76.5 million invested by charitable trusts using SRI criteria
  - US$ 3.3 billion in employer superannuation funds using SRI overlays
  - US$ 108 million in community finance investment

- SRI funds register over 700% growth since 1996
  - 1996: 11 funds, 217 million
  - 2001: 46 funds, 1,347 million
  - 2003: 74 funds, 1,760 million

- 24 financial advisors
- Several domestic SRI research providers
- SRI industry association: the 'Ethical Investment Association'
- SRI industry magazine: www.ethicalinvestor.com.au
- SRI pensions legislation requiring all superannuation funds to declare whether they have taken social, environmental and ethical criteria into consideration during the investment process was introduced by the Government under pressure from the SRI industry.

The following four Asian markets, which have well developed financial markets, were not covered in the reports sponsored by the IFC, however ASrIA has produced similar reports on these markets which are available on the ASrIA web-site, www.asria.org

Japan
- A major market for SRI has developed in Japan, with strong retail support
- Some significant institutional mandates also awarded, e.g. Tokyo Teachers Pension Fund
- Nikko-Eco Fund is one of SRI’s biggest success stories globally
- There are 10 other SRI fund providers
- Yen 70 billion / US$ 599 million invested in SRI funds as of Feb 2003
- Several domestic and international SRI research providers
- Many companies ISO14000 approved and providing environmental reports. Social reporting starting to take place
- ASrIA Annual SRI conference in Tokyo, Oct 2002 (see www.asria.org for papers)

Hong Kong
- 1 domestic SRI fund provider
- 6 Global SRI funds registered for sale
- Several global SRI funds have some investment in Hong Kong companies
- The Hong Kong stock market provides a gateway for investment into mainland Chinese companies for SRI funds
- Growing coverage by international research providers
- Early days for social and environmental corporate reporting
- 1st Annual Conference on SRI by ASrIA, 2001 (see www.asria.org for papers)
- Significant awareness raising with the business, financial and NGO communities by ASrIA
- Significant retail investment community amongst whom ASrIA is starting to raise awareness

Singapore
- 1 domestic SRI fund
- 3-4 Global SRI funds known to be marketed in Singapore
- Several global SRI funds invested in Singapore market
- 1 carbon trading fund just launched on the market
- Early days for research coverage by international research providers
- Some environmental reporting taking place
- 2 domestic Islamic Fund providers (incl. HSBC)
- ASrIA SRI Seminar April 2002
- ASrIA Annual SRI Conference scheduled for April 2004

Taiwan
- No domestic SRI funds registered in Taiwan
- Very limited investment by SRI global funds
- 1 global fund registered for sale
- ASrIA/BCSD SRI conference in 2002
- Very active retail investment community and strong potential for SRI in the future
The following seven emerging markets were researched for this Report. Though SRI is a very new concept in all these markets, as is evident from the data below, the Reports uncovered plenty of evidence that would support the successful introduction of SRI into all these markets.

**Common themes in most of the markets were:**
- opening to foreign investment;
- encouragement by regulatory authorities for adoption of higher standards of corporate governance;
- institution of awards for corporate reporting;
- gradually improving corporate transparency and reporting with some shining stars;
- adoption of corporate standards such as ISO14001;
- traditions of corporate philanthropy evolving with introduction of environmental and CSR management;
- increasing number and sophistication of civil society organisations;
- growing environmental and social awareness within society and among investors and investment professionals

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<th>Country</th>
<th>Remarks</th>
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| Korea     | 1 domestic SRI fund provider  
Some investment in Korea by global SRI funds  
Several domestic and international SRI research providers  
The first SRI conference held in 2003, with the support of ASRI and the Korean Government  
Major potential for SRI to develop in the short to medium term |
| Malaysia  | 1 domestic SRI fund  
34 Islamic funds (RM 2.872 billion/USD756 million)  
Some limited research by domestic and global SRI funds and research providers  
The Government has committed to make Malaysia a major centre for Islamic investment  
Limited micro-finance sector |
| India     | 2 small domestic SRI funds  
Limited research or investment by global SRI funds  
First SRI conference held in September 2003 by CSM with support of ASRI  
Developing micro-finance sector |
| Indonesia | No known domestic SRI funds  
Limited investment by global SRI funds  
Research by global SRI providers has been conducted  
Very significant Islamic investment  
Developing micro-finance sector |
| Thailand  | No known domestic SRI funds  
Very limited evidence of investment or research by global SRI funds  
Developing micro-finance sector |
| Philippines | No known domestic SRI funds  
Very limited evidence of investment or research by global SRI funds  
Developing micro-finance sector |
| China     | No known domestic SRI funds  
Some evidence of research by global SRI research providers, mainly through the HK Gateway. (i.e. of H shares and red chips listed in HK)  
Developing micro-finance sector |

Malaysia and Indonesia in particular have already established very significant track-records with values-based ethical investment via Islamic investment. Korea probably shows the most promising conditions and potential for the rapid growth of SRI investment. India, however, is also well positioned for the significant adoption of SRI in the future. India and China provide the biggest potential markets in Asia, if SRI can be introduced as a strongly differentiated, fresh and viable investment alternative.
A total of 17 domestic SRI fund providers in Asia were identified by the Reports, of which eleven are in Japan (not including Australia or New Zealand). However, in addition a number of global SRI funds are also either registered for sale, or invested, in regional stock-markets. This trend looks set to continue. The industry in Japan grew exponentially within the first three years, far exceeding the expectations of market professionals. As with the US and Europe surveys of investors showed that the Japanese SRI funds were attracting many first-time investors, typically female investors younger than 40. A survey of investors in the Singapore UOB UNIFEM fund indicated a similar profile. Previous research by ASrIA into the potential markets for SRI in Hong Kong and Taiwan, as well as this current research, suggests that the potential for SRI elsewhere in Asia could be huge and attract previously untapped investors.

The drivers and opportunities for SRI in each country are also summarised in more detail in boxes in the final section of each country report - 'Assessment for the Future Market for SRI'.

Report Conclusion:

This Report identifies a substantial market for SRI in Asia, particularly among non-traditional retail investors. However funds must understand the customer and how to communicate SRI objectives appropriately. They must also be operated as far as possible according to SRI best practice, in order to maintain performance standards and generate long-term support for SRI. The introduction of superficial SRI funds may mobilise investment interest in the short-term but harm long-term support for SRI, threatening the many positive influences that SRI can have on investment practices in Asian emerging markets.

Attaining best-practice is a learning curve in which financial institutions, investors, corporates and regulatory authorities can all participate. For instance, even where best-practice SRI research methodologies are introduced, companies also need to be persuaded of the value of improving transparency and providing accurate data upon request. Investors and civil organisations can also play a role by engaging in debate on the issues that concern them, as has happened in the retail-driven markets of the US, Europe and Australia. In some cases it is reasonable for funds to start with fairly straightforward screens, avoiding investment in certain broad-brush issues, and then refine their approach as the fund managers and fund investors gain more detailed data from corporates on the one hand, and a more sophisticated understanding of the issues on the other. Introducing SRI into the investment process, as with introducing Corporate Social Responsibility (CSR) to companies, is a first step on an upwards spiral of constant improvement for all players.

9.0 SRI, RELIGION AND ETHICS

The earliest ethical funds in both the US and Europe were set up and driven by the concerns of religious groups, such as the Quakers. The connection between religion, ethics and investment in Asia is also very strong in several markets. This is most notable with respect to Islamic investment in Malaysia, Indonesia and Singapore. However, the Philippines also has very deep rooted religious (primarily Christian) traditions which are also reflected in the strong philanthropic traditions of Filipino companies. Over 50% of Koreans are members of religious bodies (primarily Buddhist and Christian), and Thailand has very strong Buddhist traditions. In India the two existing small SRI funds both have screens related to the care for animals and biodiversity which reflects the Hindu and Ghandian concern for all living beings.

It is therefore almost certain that SRI will be driven in Asia not only by a concern for sustainable development, but as an issue of religious and ethical values, just as happened in the West.
Traditionally the religious driven ethical funds have relied on negative screening, in other words simply avoiding investment in certain companies or sectors which run counter to their values. Typically these are sectors such as gambling, tobacco, pornography and anything military related. This 'avoidance' screening is the approach primarily taken by the Islamic investment funds.

However, when the earliest ethical funds were established in the West, sustainable development was not a major public issue, and also there were no models available for positive screening and what is known as 'shareholder engagement'. Shareholder engagement is where funds take a long term position as 'owners' of a company and communicate directly with corporate management to encourage continuous improvement with respect to sustainability and ethical issues. In fact, Islamic investment also takes this approach to a certain extent, with a strong emphasis on the shareholder being an 'owner' and therefore 'responsible' for any decisions taken by the company. As is noted in the Malaysian Report, 'shareholder activism is not an option but a requirement for Islamic investors'. These 'best-practice' models from the modern SRI investment industry, and all the other related experience, research and investment technologies are now available to Asian investors. Although the religious communities in Asia will have a very significant role in the adoption of SRI, SRI funds in Asia also have the potential to leapfrog the early SRI stage of simply adopting negative screening and grasp the opportunity to adopt more sophisticated investment approaches from the word go, as is happening in Japan.

Islamic Investment

The Islamic investment markets in Malaysia, Indonesia and Singapore are covered in some depth in the country reports.

There are approximately 100 Islamic funds operating in several financial centres worldwide, with a net asset value calculated at between US$3 7 and US$5 8 billion, growing by 12-15% a year. Furthermore, today, more than 250 Islamic banks are operating globally, managing funds to the tune of US$ 200 billion. Western banks, through their Islamic Units in U.K, Germany, Switzerland, Luxembourg, etc. also practice Islamic banking.

Over the past few years quite a few funds have failed and closed due to poor marketing, however the industry is getting more experienced and sophisticated. It has also received a boost from the perceived anti-Islamic position of the US and the resurgence of Islamic consciousness, which has caused Islamic investors to look for investment options closer to home. Most of the funds tend to target high net worth individuals and corporate institutions, minimum investments ranging from US$50,000 to as high as US$1,000,000.

Malaysia has taken a very proactive stance in attracting Islamic investment, with a clear aim strongly supported by the Government, to make Malaysia a hub for Islamic investment. At present there are 34 Islamic funds with some RM 2.872 billion/USD756 million under management. Indonesia seems to be less organized than Malaysia in this respect, however there is very significant Islamic investment taking place in Indonesia and the sector is no less ambitious.

Islamic banks appeared on the world scene as active players over two decades ago. But "many of the principles upon which Islamic banking is based have been commonly accepted all over the world, for centuries rather than decades". Islam prohibits Riba (dealing in interest) but also dealing in liquor, pork, gambling, pornography and anything else, which the Shariah (Islamic Law) deems Haram (unlawful).

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6 Malaysian Country Report: para. 6.0
8 www.islamic-banking.com/ibanking/ief.php. This page includes a comprehensive list of Islamic funds.
9 www.islamic-banking.com/ibanking/ifi.php
10 www.islamic-banking.com/ibanking/ief.php
11 www.islamic-banking.com/ibanking/whatib.php
Report Conclusion:

This Report recommends that SRI funds entering or setting up in any of the Asian markets should consider taking careful account of religious sensibilities within the country. Including criteria which are attractive or at odds with the values local religious groups could influence a fund’s success significantly.

Where there are flourishing Islamic funds, this Report recommends that SRI funds could consider joint-ventures with them, as Islamic fund houses have existing markets and research expertise already established.

This Report recommends that the centralization of expert advice, based on the Islamic example, could provide a useful tool for developing SRI, not only in Asia, but globally. At present the supply, not to mention the available time, of environmental, social and sustainability experts from NGO’s, academia and other stakeholder groups, is often quite limited. Yet, at present each SRI fund, and each corporate that wants comments on their reports, attempts to gain the exclusive attention of these experts. Providing central pools of SRI wisdom, which all SRI investors and corporates could refer to, might prove a valuable and time saving resource, among many other benefits.

10.0 CORPORATE GOVERNANCE

Proponents of corporate governance tend to see environmental and social performance as an extension of good corporate governance, whilst SRI proponents tend to see corporate governance as one important SRI criteria. Which ever way, there is no doubt that corporate governance is a critical issue in all the emerging markets and one that SRI funds should consider.

CLSA, a leading provider of brokerage and investment banking services, which specialises in global emerging markets, has produced annual reports on corporate governance in Asia over the last three years. In their most recent report, jointly produced with the Asian Corporate Governance Association, they have shown how Asian governments are increasingly throwing their weight behind corporate governance reforms, but how many corporates are still dragging their feet on these issues. This is a theme that is also apparent from the sections on corporate governance in the individual country reports. However, the Country Reports, as well as the CLSA reports, also show that a significant number of companies are significantly improving aspects of their corporate governance including their reporting standards and transparency. Furthermore, Asian Government's are generally acting to introduce codes of practice, to promote the concept of corporate governance, to tighten up enforcement and shareholder protection, and to support award schemes. Assuming that Asian Government's keep up their

12 www.islamic-finance.net
13 fatawa.al-islam.com
14 www.clsa.com
15 CLSA Corporate Governance in Asia, 2003. Fakin’ it, Board Games in Asia, www.acga-asia.org/content.cfm?SITE_CONTENT_TYPE_ID=19
16 www.acga-asia.org/index.cfm

Asian governments are increasingly promoting corporate governance, but corporates are still dragging their feet. SRI funds can play a valuable role in promoting CG.

Whereas SRI funds tend to elect a board of experts from NGO’s and academia to provide guidance on environmental and social criteria, Islamic investors have resource to guidance from religious experts. For instance, Cyberfatwa.com contains a large assortment of fatwas by well-known contemporary scholars and jurists on various issues relating to Islamic business, banking and finance. The fatwas are neatly classified into various categories: for financial institutions and individuals and further subcategories to make an investors search easy, fast and productive. Soon Cyberfatwa hopes to facilitate online seeking of fatwa from their panel of jurists. Another similar service is provided by Fatawa Online, which offers Sharia opinions on matters relating to Islamic financial dealings.
momentum on this issue, the trends would indicate that CG is likely to continue to improve steadily in the region from its previous very low base. The Asian Corporate Governance Association’s new website\(^\text{17}\) is also an excellent source of current data on corporate governance developments.

SRI funds can benefit from the increasing quantity and quality of data available on corporate governance around the region, and can even play a role in encouraging it, particularly via their direct engagement with the corporate sector. The influence of the fund management industry as a whole on improving corporate governance standards will become very much more significant as the influence of both global and local major institutional investors, such as pension funds, develops.

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<th>Markets ranked by CG</th>
<th>(Table reproduced from CLSA 2003 Report on CG in Asian Emerging Markets.)(^\text{18})</th>
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<td>Rules &amp; Regulations</td>
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<td>Singapore</td>
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<td>Malaysia</td>
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<td>Thailand</td>
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<td>China</td>
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<td>Indonesia</td>
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The CLSA report also notes that the two countries that have seen most improvement on CG score, Korea and Malaysia, have also seen the most significant market performance. "Korea in particular is up 56.8% in the past two years (by the MSCI Index), comparing very favourably against MSCI Asia Ex-Japan which is down 15.5% for the two years."\(^\text{19}\) It is notable that the ASrIA Country Reports also highlight Korea as the market with the highest present potential for SRI growth. India has also shown rapid improvement in corporate governance in the last three years.

The action of CALPERS, the Californian Pension Fund, which is notable for its adoption of SRI type criteria, by withdrawing from a number of Asian markets because of poor corporate governance, provided a shock to the local markets. However, ideally, institutional investors can have a more positive influence by investing into the markets not only as committed long-term investors but as active advocates for change. Domestic institutional investors, such as local pension funds, can also play a similar role.

**Report Conclusion:**

This Report recommends that SRI funds encourage high Corporate Governance standards as well as the adoption of other SRI criteria in all the Asian markets. Though markets with the most improved CG such as Korea may appear most

\(^{17}\) www.acga-asia.org/index.cfm

\(^{18}\) CLSA Corporate Governance in Asia, 2003, Fakin’ it, Board Games in Asia www.acga-asia.org/content.cfm?SITE_CONTENT_TYPE_ID=19, p.16

\(^{19}\) CLSA Corporate Governance in Asia, 2003, Fakin’ it, Board Games in Asia, p 17
attractive to SRI funds, even the countries with the lowest CG score, notably the Philippines and Indonesia, should not be dismissed by the SRI community. Both these countries are recognising that market openness and improved corporate governance are critical to the development of their markets and they both have corporates that stand out from the crowd with respect to CG and overall SRI performance. SRI funds, by entering these markets and actively engaging with leading corporates, can play a significant role in encouraging the adoption of improved CG, CSR and SRI by the wider market.

11.0 SRI, DEVELOPMENT AGENCIES AND PRIVATE EQUITY

Much more work needs to be done on reviewing private equity and development funding in Asian emerging markets. By its nature, it is a difficult area of financial activity to research. We were not able to achieve comprehensive reviews of private equity or development funding in all the markets. However, the Reports did gather enough information to reveal certain clear trends, and to indicate the critical role that development and private equity funding is already playing and can play in the future in directing investment towards sustainability.

Firstly, it is clear that the role of development funding in particular, varies tremendously across the different markets. The more developed markets, such as in Japan, Singapore, Hong Kong and Taiwan, and to a certain extent also Korea, are sources for raising private equity and development funding for elsewhere in the region. Some private equity and venture capital funds which are based in these markets and invest in sustainable projects around the region were identified. Countries, which have less well developed retail investment markets, such as Indonesia, Thailand and the Philippines, on the contrary have been significant recipients of development oriented investment. However, there is a notable shift in the forms that this investment is taking. Traditionally there may have been more emphasis on direct loans to governments or to development banks, who then invested the funds into infrastructural projects. This form of investment is still continuing. However, investment has also been directed into professionally managed investment funds that aim to help to improve market performance and the overall investment climate.

For instance, development funding agencies, such as the ADB and the IFC have been injecting capital investments into funds, alongside private sector and corporate partners. These funds are managed by global or domestic investment managers and invest primarily into non-listed corporates, into stock-market reform and into other projects designed to provide investment return and stimulate further investment. The aim of their investments is to provide development capital to domestic companies on the one hand, and to help improve market operations, governance and transparency on the other. Significant long-term investments are made into corporates or projects, but under certain stringent conditions, such as improving corporate governance and environmental reporting. Lists and descriptions of a number of funding agencies, private equity investors and notable projects can be found in the Reports.

Report Conclusion:

This Report recommends that further research is carried out to establish in more detail the extent and influence of development and private equity funding, and to come up with more detailed recommendations on how this funding can be directed towards improved corporate governance and sustainable investment goals.

This Report recommends that development agencies should consider partnering with experienced global and domestic SRI fund managers, as a means to inject the expertise of the global SRI community into developing markets via the formation of SRI funds and other products and services.
12.0 SRI ORGANISATIONS, PUBLIC AWARENESS AND INVESTOR ACTIVISM

The Reports examined civil society in each country, listing and describing significant organisations, reviewing polls on public awareness to SRI or related issues, and looking for any evidence of investor activism. Overall the Reports all identified significant organisations, mainly Non Governmental Organisations (NGO’s), in each country who are already either engaged with promoting SRI, actively working with investors on corporate governance, with the corporate sector on CSR or lobbying Governments on these issues. All the countries covered had various degrees of active and organised civil society, even China, which has seen an extraordinary growth in the numbers of NGO’s within the last few years. Countries, such as India, Indonesia, Thailand and the Philippines, which have not yet seen much if any SRI activity, and generally scored low on corporate governance in the CLSA reports, however have among the most active and vibrant civil society groups. They need to be convinced of the relevance of SRI to the development agendas and other issues that are close to their hearts. In many cases it was clear that it is not always immediately easy to explain the relevance of SRI. However, once this is achieved, they have the potential to become active partners in promoting and supporting SRI and acting as guardians on SRI standards.

In addition there have been a number of polls and surveys conducted in the different countries, which show growing environmental and social awareness among the general population, and in particular among consumers and the new urban middle classes. However, there is still a gap between awareness on the one hand and empowerment on the other. For example, a survey conducted in Korea, to examine the potential for SRI found that awareness of SRI was very low (approximately 3%). However, support for the concept (once it had been explained) and readiness to embrace SRI was very high (56% of citizens and approximately 75% of experienced investors and fund managers considered SRI a correct investment principle). In most countries it would be true to say that retail investors are often short-term speculative investors, and encouraging them to invest in long-term funds is a major challenge. However, the majority of the public are in fact very conservative with their savings, keeping them in bank accounts and investment penetration levels into the markets are still very low among the general population. The challenge, therefore, as identified in the India Report, is to encourage the large majority of conservative savers to see that long-term investment in funds can provide an alternative option to leaving their savings in extremely low interest bearing bank accounts.

Report Conclusion:

The Report recommends that educational activity should be conducted with civil society organisations to gain understanding and support for SRI and that SRI funds should look for civil society partners. Once SRI funds are launched it is important that they are actively and effectively marketed to the public, with the support of civil society groups and the media. When the first Nikko Eco fund was launched the expectation was that it would only attract about US$50 million. However within six months, it had attracted US$1 billion, twenty times the initial target. Nikko partnered with a specialist domestic research provider, Good Bankers and prominent environmental experts to advise on the issues. It mounted an active marketing campaign, in particular via its sales networks. The fund also generated significant media interest in Japan which helped subsequent eco and SRI funds. All these conditions were necessary to make the Nikko Eco fund attractive and helped establish SRI in Japan. However, maintaining high standards, especially of research, investment policy and communication, is also critical to maintaining investor interest and support for the concept over the longer term.
13.0 SRI AND GOVERNMENTS

The Reports found that the record of different Asian governments in supporting corporate governance, CSR and SRI varied widely. However, certain overall trends did emerge. For instance, all the governments surveyed are showing more awareness of the importance of improving corporate governance both as a means to attract more foreign investment, but also to protect domestic shareholders and build up a stronger retail investment culture. Most governments have taken action to introduce codes of conduct on CG, however the levels of enforcement vary widely.

The Korean Government has taken a leading role, in co-operation with a number of civil society pressure groups, to enforce higher standards of corporate governance, whereas the Thai authorities on the other hand have shown significant bias, in a number of recent significant cases towards protecting the rights of local majority shareholders over overseas and domestic minority shareholders.

The same pattern also appears with respect to awareness and levels of support for CSR and SRI. The Government of Korea was most notable in not only encouraging corporates to adopt CSR, but in actively supporting the concept of SRI. At the 1st International SRI-Conference held in Korea on 17th June 2003, which the Korean Government supported, Kim Jin-Pyo, Deputy Prime Minister and Minister of Finance and Economy, stated that the "Government will support the market's effort to adopt SRI positively, such as the development of an SRI Index". He also pledged that "from now on the Government will strive to promote the necessary conditions for corporations to put social responsibility into practice." This active support for the concepts of CSR and SRI by a senior government representative is to be applauded. The reason for this support is a clear government agenda within Korea to support and encourage foreign investment and best practice in Korea. On the other hand Thai authorities have shown significant suspicion of concepts such as CSR and SRI, seeing in them something of a threat to Thai business. As a representative at the Stock Exchange of Thailand commented when SRI was explained to her: "This is just another form of non-tariff trade barrier to Thai exports!" However, in all the countries studied, governments have shown varying levels of support for encouraging companies to adopt international standards, such as the ISO14001 standards and demanding that foreign direct investment in physical projects in their countries meets certain environmental and social standards. However, of all the countries surveyed, only the governments of Japan and Korea have shown some support as well as awareness of SRI. The Governments of Hong Kong and Singapore have shown some openness to SRI, partially due to lobbying by ASrIA, but are yet to take positive steps in support of SRI.

Micro-finance, on the other hand, has generated significant interest and support from governments throughout Asia's Emerging Markets, often in partnership with local development banks. The Chinese Government has taken steps to tightly monitor and control micro-finance throughout China. Micro-finance is also largely a government sponsored activity in Thailand. Micro-finance schemes also receive significant government support in the Philippines, Indonesia and India.

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20 See Appendix to Thai Report on CG case studies
21 For an example of Korean determination to attract foreign investment see: korea.net
Report Conclusion:

The Report recommends that international and domestic NGO's, development organisations and financial institutions continue to hold events, and involve governments and domestic media, in learning about corporate governance, CSR and SRI. It is also important for lobby groups to illustrate how CG, CSR and SRI are compatible with economic development, making economies more competitive in the short and long term. High standards in these areas help countries to attract more Direct Foreign Investment and private equity investment, and foster best practice in business. In other-words, these concepts should be seen as supporting an upward spiral of economic, social and environmental development, rather than creating obstacles to economic development.

14.0 CORPORATE RESPONSE

The Reports found that the corporate sectors in all the countries surveyed are becoming significantly more aware of issues such as corporate governance, corporate environmentalism and corporate social responsibility.

Historically, in all the countries surveyed, corporate philanthropy has long and deep roots. Corporate philanthropy has been institutionalised in countries such as the Philippines, with a number of NGO's and associations focused on managing philanthropic projects and it has resulted in corporate support for many excellent projects. However, corporate philanthropy to a certain extent also reflects the unequal divisions between the wealthy and the poorer sectors of societies, with a focus placed on benevolence and charitable projects.

The introduction of the concepts of CG and CSR has enabled a shift in awareness within the corporate, NGO and government sectors on the nature of corporate ethical, social and environmental responsibility. The focus has changed from the provision of charitable contributions and the direct support of charitable projects, to seeing high CG standards and environmental and social management as integral to the internal competitiveness and culture of the companies.

All the countries surveyed had instituted some awards for corporate governance, and in some cases awards for corporate reporting or for CSR had also been introduced. There are also increasing numbers of companies attaining recognised standards, such as the ISO14001 standards, in each country. There has been a very high uptake of ISO14001 in Thailand. As of June 2002 552 companies were registered in Thailand, compared to 333 in Singapore, 367 in Malaysia, 199 in Indonesia & 120 in Philippines. Thai companies have embraced ISO14001 partly because they are dependent on the export market and have realized that there is a need for ISO standards to fully access these markets. This is having a beneficial knock-on effect inside Thai corporations, as once companies have an environmental policy, targets and objectives, they increasingly take environmental issues on board. This process is often assisted by the appointment of environmental champions within companies who are committed to making improvements. Companies in China have also been active in attaining ISO14001 certification for the same reasons. The State Environmental Protection Administration started promoting ISO1400 standards in 1996. There are now already over 1,000 Chinese companies, many of which are foreign or joint venture companies, which have obtained the ISO1400 certification. However, verification of the quality of these standards in China is still an issue.

Corporates reporting on environmental issues is lagging somewhat, however there is a clearly improving trend in all the countries surveyed. Most reports are brief summaries within the annual financial reports, and in nearly all cases are not audited by outside agencies. A very
few outstanding companies have also started to produce social as well as environmental reports, or even stand-alone sustainability reports. Fine examples can be found in almost every country. In Korea, environmental reporting has become established with approximately 40 companies issuing environmental reports, however no companies have yet issued a social or sustainability report. Some social organizations, including the Citizens’ Action Network (CAN), have begun to call for the introduction of corporate social reporting and one corporate, Samsung Electronics Co. has announced that it is preparing a sustainability report.

Finally, a close relationship has been shown between corporate awards, corporate standards (such as ISO14001) and corporate reporting, both in quantity and standards, and with SRI. SRI funds have established sophisticated and detailed questionnaires on a very wide range of ethical, social and environmental issues. Once SRI funds become established in a market, companies start coming under strong pressure from the funds to provide detailed data and this encourages them to improve their own standards of corporate reporting. For instance in Japan, levels and quality of corporate reporting jumped dramatically in line with the establishment of SRI funds. Today, 9,467 companies are certified ISO 14001, and in 2002, approximately 600 companies published an environmental report. According to a study in June 2002 by the Network for Environmental Reporting (NER)22, a multi-sector NGO promoting environmental reporting, a significant number of Japanese companies recognised the need for social reporting (86% out of 205 responses). Approximately 30% of the companies have published a 'Sustainability Report' (for the first time for most of the companies), while another 30% are preparing the shift from strictly environmental report to sustainability report.

Though the pressure from SRI funds was by no means the only influence on Japanese companies mentioned above, they have definitely contributed to overall awareness raising and the level of standards expected. Therefore, even though they may be a small sector of the overall financial market, SRI funds can swing above their weight in having an influence on corporate awareness, attitudes and response to these issues.

**Report Conclusion:**

The introduction of SRI funds, supported by high quality SRI research, provides a significant incentive to companies to adopt best practice in the management of CG and environmental and social responsibility. However global SRI funds are hesitant to enter some of the markets, such as the Philippines, Indonesia, Malaysia and Thailand that would benefit from their expertise the most. The Report recommends that ways need to be found to encourage SRI managers to enter these markets, and one way is partnerships with development agencies in the management of development oriented funds (see 11.0).

### 15.0 MICRO-FINANCE

Sustainable development is often seen as a concept imported from the West. However, micro-finance, perhaps one of the most effective and elegantly simple tools of sustainable development, originated in Asia. It has now been taken up in many countries, West and East alike. Devised originally by Professor Muhammad Yunis, who established the Grameen Bank23 in Bangladesh, the Grameen 'model' of micro-finance has now been adopted in many Asian countries, reaching into millions of poor households and empowering hundreds of thousands of micro-entrepreneurs. The Grameen Bank has, as of September, 2002, 2.4 million borrowers, 95 percent of whom are women and 1,175 branches providing services to 41,000 villages, covering more than 60 percent of the total villages in Bangladesh.24

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22 NER sent a questionnaire to around 380 Japanese companies expected to publish environmental or sustainability reports and received 205 responses. www.sustainability.com/news/articles/core-team-and-network/goto-csr-japan.asp
23 Grameen Bank (Grameen means ‘rural’ or ‘village’ in the Bangla Language) www.grameen-info.org/index.html
24 www.grameen-info.org/bank/index.html
Almost unknown in the more developed urban centres, such as Singapore and Hong Kong, micro-finance has been adopted widely wherever there are poor communities that otherwise have no, or virtually, no access to credit. The basic concepts are: tiny loans (rarely more than US$50); group responsibility for the loans (because the receivers have no other form of acceptable collateral); interest rates that are often more than for regular bank loans, but way below the extortionate rates of money-lenders; and short repayment periods. A primary goal of micro-financing is to educate people to achieve economic independence and self-sufficiency. Micro-credit schemes are usually funded and administered by partnerships between global development agencies, national and provincial governments, local development and agricultural banks, domestic NGO’s and increasingly - corporates. However, the primary relationships are right at the village level between a group of borrowers and a local NGO or bank representative.

Generally speaking repayment rates have been very high. For instance, the only micro-finance scheme in Korea so far claims a repayment rate of 100%. However, micro-finance schemes are also open to abuse. In Thailand there are tales of micro-financing schemes being used for political advantage at elections or otherwise being threatened by corruption. Almost certainly similar examples could be found for all the other countries with major micro-financing schemes in place. In Malaysia, the primary micro-finance scheme has effectively failed and been temporarily put on hold. The primary reason is that the spirit of ensuring very small loans was lost and the majority of loans were creeping up in size beyond the limits of recipients to easily re-pay. One of the key issues identified by the Reports with respect to micro-finance was that of balancing interest levels so that the providers can cover their administrative costs, without putting undue pressure on the borrowers. In Thailand for instance, micro-finance is very well established with some 8 million borrowers, of which over 50% are women. However, interest rates are considered to be too low to make the schemes attractive to the administering banks.

In China there are approximately 500 schemes, tightly administered by the Government, which reach into both rural and urban households (over 43 million rural borrowers as of June 2002), and ensures that loans are kept at a preferential rate of interest which is hardly enough to cover administrative costs. In contrast, the Philippines, where 386,431 borrowers (mainly women) support a total micro-finance portfolio amounting to 2.1 billion Pesos as of year-end 2002, most lending is at interest rates above par (i.e. at what could be considered commercial levels). Micro-finance schemes therefore often survive with support from developmental agencies or government subsidies. Finding the right balance, at a level that both borrowers and lenders can agree on, could be a key to the future of development of micro-finance.

Not only have micro-finance schemes generally maintained steady repayment rates, they have even stood out from other sectors of the economy. Even as Indonesia's financial system collapsed during the crisis, the leading micro-finance institutions remained liquid, profitable and stable. Steady progress since on key constraints in the business environment, things like security, inefficient bureaucracy, misguided policy and legal uncertainty, is creating a climate for micro-finance infrastructure and services to flourish. Bank Indonesia now requires all banks to have a strategy and business plan related to micro-finance portfolio development. According to the Director of Rural Bank Supervision, over Rp. 170 trillion has been channeled into the micro-finance sector to date with another Rp. 43 trillion set aside for qualification and disbursement - average annual Return on Interest (ROI) has hovered around 25%.

**Report Conclusion:**

Micro-finance has clearly proven its effectiveness, even though, as with all financial programs it is and has been shown to be subject to mishandling or abuse. However, the micro-finance sector also has to evolve. In the first instance, micro-finance has largely focused on micro-credit (extending loans). In China, for instance, only micro-credit is allowed and recipients are not permitted to build up savings. However, as the poor gain a firmer foothold on the economic ladder, there needs to be a facility to meet evolving financial needs, including the ability to build up micro-savings,
however modest, to take out micro-insurance and micro-mortgages, and contribute to micro-pensions. For instance, a scheme in India, supported by DFID (the British Government development agency) provides micro-insurance.

This Report recommends that SRI funds explore ways to support micro-finance, taking the lead from groups such as Calvert and their 'High Social Impact Investments' program.25

16.0 SRI OPPORTUNITIES

Overall the Reports identified significant opportunities in Asia for SRI to be developed and clearly show that the foundations on which SRI can grow, such as faith-based investing, improving corporate governance, government support, active civil society organisations, corporate awareness and community investment schemes, are all, to a greater or lesser extent, on the increase. The Reports also illustrate some of the different characteristics in each markets which also must be understood for SRI to succeed.

The Drivers and Opportunities for SRI in each country are also spelled out in a chart in the final section of each Country Report.

This Executive Report has already made a number of Key Recommendations. In summary we would like to suggest the following:

1. SRI funds, both global and local, can find investment opportunities and potential investment fund markets in all the countries surveyed, not only in the more developed retail investment markets. With respect to investment opportunities, there is increasing corporate environmental and social reporting in all the markets providing a growing wealth of data that SRI funds can act upon. Some of the least well developed markets have the most data available, whilst some of the more mature retail investment markets, such as Singapore and Hong Kong, are relative laggards at reporting. With respect to demand for investment funds, all the Reports show that popular awareness of environmental and social issues is steadily growing in all the countries covered and that there are potential markets among the less traditional fund investors, such as women and the under 40's. The power of the religious networks and the popularity of existing values-based investment funds in several of the markets should not be underestimated as a platform to build on.

2. Global SRI fund managers and global SRI research providers also have a key role to play in bringing their expertise into all the markets covered, both to stimulate the local SRI market, and also to exert pressure on corporates, to rapidly improve the quality and quantity of their transparency, reporting and management, and to encourage governments to introduce policies and legislation to support SRI investment.

25 The Calvert ‘High Social Impact Investments’ (HSII) program channels investment capital to local non-profit organizations with the goal of ending poverty through investment. www.calvertgroup.com/sri_650.html
3. There is potential for the leading SRI fund providers, and SRI research providers, to join forces with development agencies and other private equity investors, to set up funds that can invest according to appropriate SRI criteria. This is an effective way to introduce best practice into all the markets, thereby hastening the wider and more rapid adoption of SRI. There are also growing opportunities for other relevant specialists in Corporate Governance, reporting, campaigning and so on to form partnerships with local organisations and/or relevant professionals in these areas.

4. The developmental angle of SRI in Emerging Markets should not be overlooked, especially in tackling absolute poverty. Mechanisms by which financial institutions can partner with Governments, NGOs and Development Agencies to expand and enhance existing micro-financing activity in a way that contributes to sustainable economic development should also be explored.

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I would like to thank all the researchers, members of the ASrIA team, and others for contributing to the data and opinions in these reports. I would like to thank the IFC for sponsoring the Reports on the seven emerging Asian markets. Lastly, I wish to thank Louisa Mitchell for her overall contribution to the project, and Carissa Chan Siu Wai for managing the layout and design.

David St. Maur Sheil
September 2003
SRI IN ASIAN EMERGING MARKETS:

CHINA

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Project Sponsor: Sustainable Financial Markets Facility, SFMF & International Finance Corporation, IFC
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1.0 EXECUTIVE SUMMARY

The concept of Socially Responsible Investment (SRI) is still in the very early stage of being introduced into China. Two decades of fast-paced economic reform and rapid economic growth have left numerous environmental and social problems in their wake. However, the government and increasing numbers of ordinary people realize the importance of following a more balanced development track despite the overall emphasis on economic growth. A number of companies have also started adopting more socially benevolent and environmentally responsible practices.

Facing growing environmental and social challenges as well as increasing competition since China's accession into the World Trade Organization (WTO), a number of new laws and regulations have been drafted to regulate corporate governance, protect the environment and promote social issues. However, the concepts of corporate social responsibility (CSR) and socially responsible investment (SRI) and the basic principle that financial, social and environmental criterias need to be balanced, are still relatively new. The reality of continuing poverty for millions of people can make these issues seem abstract to many in the population. Yet, as this report shows, environmental awareness in particular is quite wide-spread within the general population. Overall, China still faces a steep up-hill task in continuing to spread awareness and encourage the practice of social and environmental responsibility among the population, as well as among the corporate and financial sectors.

2.0 SRI FUNDS

The Chinese financial market is at an early stage of development and investors still face limited investment options. There are no SRI funds and there has been little incentive given the relatively low income of people working in the caring professions, such as nursing and teaching. However, this may change as many innovations are happening in the fund market, including the entry of foreign fund management companies and the need to encourage people to make their own retirement savings.

2.1 Domestic SRI Funds

There are no known domestic SRI funds at present.

2.2 Global SRI Funds Registered For Sale In China

There are no Global SRI funds registered for sale in China at present.
2.3 Global SRI Funds With Significant Holdings In The Domestic Market

There is limited data on Global SRI Funds with significant holdings in China. However, foreign investment into Chinese corporations has been facilitated by the listing of Chinese corporations on the Hong Kong Stock Exchange (2.05) and recent moves to facilitate direct foreign investment into the Shanghai and Shenzhen stock markets (2.06). Furthermore, research into major Chinese listed corporations has been undertaken by international SRI research providers (see 3.02) which indicates an interest by global SRI funds.

2.4 Rapid Development Of The Chinese Fund Market

The development of the Chinese fund market can be generalized into three stages:

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<th>Development of China Fund Market</th>
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<td>Stage 1 - Market started under PBC jurisdiction.</td>
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Important events in the three stages of developing the Chinese Fund Markets:

**Stage 1:**

- By 1997, China had 73 investment funds with a total capital of Rmb7.3 billion (US$0.88 billion), and less than 10 specialized fund management companies.
- Funds also used for purposes other than security investment.
- Small-sized close-ended funds.

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Stage 2:

- Nov 1997, China issued the *Temporary Regulations on Security Investment Fund Management*.
- Mar 1998, first security investment fund management company was founded.
- By 2000, over three million fund investment accounts had been opened.
- By the end of 2001, China has 48 close-ended security investment funds totaling about Rmb 81bn (US$9.76bn).
- Most are growth funds and have very similar structures.

Stage 3:

- Sep 2001, China's first open-ended fund, Hua'an Innovation Investment Fund, was founded.
- Massive capacity building with more competition and product innovation.
- By September 2002, there were 18 fund management companies managing 59 China stock funds with total assets over RMB100 billion (US$12.05bn), about 2% of the Chinese stock market.²

2.5 Investment In Chinese Corporations Via The Hong Kong Stock Market

Investment in Chinese corporations was initially facilitated for global investors as a number of Chinese corporations can be invested in via listings on the Hong Kong Stock market. These are known in the market as H-shares and red chips.

H-share companies refer to companies incorporated in the People's Republic of China and approved by the China Securities Regulatory Commission for a listing in Hong Kong.³ Shares of these Chinese enterprises are listed on the Stock Exchange, subscribed for and traded in Hong Kong dollars, or other currencies, and referred to as H shares. The letter H stands for Hong Kong. On 15 July 1993, Tsingtao Brewery Company Limited became the first mainland enterprise to list its H shares on the Stock Exchange.

A red chip company is a company that has at least 30% shareholding held in aggregate by Mainland China entities, and/or indirectly through companies controlled by them, with the Mainland China entities being the single largest shareholders in aggregate terms. Or if the shareholding of the company held in aggregate directly and/or indirectly by Mainland China

³ From the Hong Kong Stock Exchange Web Site: www.hkex.com.hk/index.htm
entities is below 30%, but is 20% or above and there is a strong influential presence, on a
judgemental basis, of Mainland China-linked individuals on the company's board of directors.
Mainland China entities include state-owned enterprises, and entities controlled by provincial
and municipal authorities.

The most important difference between a red chip company and an H-share company is that
a red chip company is not incorporated in Mainland China."

In 1999, the China Securities Regulatory Commission also started to approve private-owned
companies in China to list on the Hong Kong stock market. At present, over 50 privately-
owned company have listed in Hong Kong. Their role is now even more important than that of
H-shares and red chips. However the reliability of the accounting of some of these companies
have aroused the attention of investors in Hong Kong.

2.6 Growing Competition Encourages Product Innovation

The Chinese fund market has undergone substantial development in terms of the total number
of products available in the market. However, much of the growth is from the supply side as
fund management companies compete with each other with largely un-differentiated fund
products. As a result there is potential for SRI funds to stand out as a fresh and differentiated
product. Demand for fund products from individual investors is still weak.

Domestic fund management companies are highly competitive in trying to tap into the vast
household savings of the Chinese people, much of which has been staying out of volatile
stocks, including the various stock funds that dominate the Chinese fund market. Traditionally
Chinese are very conservative and prefer to keep their savings in savings accounts in Chinese
banks, even at really low interest rates. The entry of the National Social Security Fund into the
fund market further illustrates the growing demand for less risky fund products.

Growing competition among fund management companies, including the newly established
joint ventures with foreign financial institutions, further highlights the need for the development
of innovative fund products that cater to different investor segments, such as listed open-
ended fund (LOF), umbrella funds and principal-protected funds. Introducing these new
products will help attract more investors into the fund market. In 2003, China Southern Fund
Management Co., Ltd (CSFMC), launched the open-ended contractual 'CSFMC Principal
Protected Fund', whose Rmb5 billion (US$ 0.6 billion) allocation was taken up by investors
within a month of launch.4 This further highlights the potential for an SRI product.

Also, foreign institutional investors now have finally gained access into the Chinese security
market through the Qualified Foreign Institutional Investor (QFII) model. Since the coming
into effect of the Temporary Regulation on Domestic Security Investment of Qualified Foreign
Institutional Investors in December 2002, the People's Bank of China (PBC) has already
approved six Chinese banks and the Shanghai branches of three foreign banks (Standard
Chartered, HSBC & Citibank) to handle QFII accounts and manage QFII assets. A number of
QFIIs have already been approved (UBS, Nomura Securities, Morgan Stanley, Goldman Sachs,
and Citigroup) or are in the process of reviewing. It is estimated that total investment may
reach US$1.5 billion.5 Though the amount of investment is not very significant given the total
market value of the Chinese security market, the entry of foreign institutional investors will
surely introduce more internationally accepted practices and criteria to China.

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csnews/20030528/369521.asp)
2.7 Social Security/ Pension Funds

From 1991, China started adjusting its previous universal pension system under which the employer shouldered the full burden. The current system can be described as a unique "pooled social security fund plus personal retirement account" model. Social security or tax authorities collect funds from both the employers and the employees, and manage the pooled funds.

Now pensions in China consists of three parts:

- **Basic retirement insurance**: decided and enforced by the government

- **Employer supplement retirement insurance**: decided by employer under government guidelines, managed by institutions approved by government social security authority.

- **Individual retirement saving**: voluntary individual retirement account opened at social security institutions accounts in banks.\(^7\)

The State Council decided in 1995 that the burden on the employer should not go above 20% of basic salary. Basic retirement insurance will be 11% of salary; 8% from individual contributions and 3% from employer contributions.\(^8\)

The rural population (all the population without urban residency - the so-called *hukou*) in China have not been served by any pension system before and have had to rely on themselves. Now China is promoting a rural pension system that is based on individual accounts, mainly funded from flexible individual contributions (usually from age 20–60). Participants start receiving their annuity from the age of 60, and if they die within the first ten years (i.e. before age 70) then the balance remaining in their account will be paid to their relatives. The funds are mainly invested in treasury bonds and bank deposits.

The National Council for Social Security Fund of the PRC (NaCSSeF) was founded in November 2000. It has the responsibilities of setting investment strategy for the national social security fund, organising the fund's implementation, selecting and authorising fund managers, accounting and auditing, and handling funds per the instructions of the Ministry of Finance (MOF), Ministry of Labor (MOL) and Ministry of Labor and Social Security (MOLSS). The use of funds is limited to bank deposits and treasury bonds (handled by the NaCSSeF directly) and other financial instruments with high liquidity (handled by the fund managers). By the end of FY2002, the national social security fund totaled Rmb124 billion (US $14.9 billion) of which 80 billion (US $9.6 billion) from last year, 42 billion (US $5.0 Billion) from the new fiscal appropriation, and 2 billion ($0.24 billion) from investment proceeds. Annual yield for FY2002 was 2.75%.\(^9\) By December 2002, the NaCSSeF had selected the Bank of China and six domestic fund management companies to act as fund managers. It is estimated they will manage Rbm14 billion (US$1.69 billion), which will increase to Rmb30 billion (US$3.61 billion) when more fund managers are assigned.\(^10\)

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\(^7\) MOLSS web site, www.molss.gov.cn/column/ybx/ybxqgt.htm

\(^8\) MOLSS web site, www.molss.gov.cn/column/ylbx/ylbxgn.htm


2.8 Private Equity Investment And International Funds With Known SRI

A small number of international funds, with socially responsible criteria, are also known to be looking for opportunities in China. For data on other development funds see section 4.01 below:

New Ventures
www.new-ventures.org.cn

New Ventures (a joint-venture of the Citigroup Foundation and the World Resources Institute) targets China as its first step in Asia, seeking investment opportunities of less than US$1 million (with foreign holdings less than 49%) in small and medium-sized private enterprises in the sustainable development field, such as organic agriculture, clean technology, renewable energy, etc. All investments must adopt a social and environmental bottom line.¹¹

Asian Development Bank Venture Capital Fund

In October 2002, the Asian Development Bank (ADB) approved a US$10 million equity investment to establish the first venture capital fund dedicated to China’s environment sector, especially opportunities involving the private sector. The fund will invest in 10-20 companies, providing equity capital and leading technology and taking a controlling stake or acquire strong protective rights to enable its active management. The targeted enterprises include waste treatment, environmental monitoring and data management, water sector services, air pollution control, solid industrial waste recycling, and water and energy use management. The fund focuses on the services sector rather than infrastructure projects, trying to protect the environment and promote private sector growth in China. The fund’s sponsor is Leading Environmental Services & Solutions Limited (LESS), an investment company with an aggressive international investment program in the environmental sector. The fund aims to mobilize up to US$40 million of equity capital. LESS has agreed to invest an initial US$15 million and could increase this to up to US$60 million in this and similar funds over the next several years.¹²

The China Funds
www.waldenintl.com/main/chinahongkong.htm

China Walden Venture Investments Ltd. and CWV Investment L.P., known as the China Funds, were organized jointly by Walden International and its partners, the International Finance Corporation (IFC), J.P. Morgan Capital International Corporation, Tat Lee Bank Ltd. and ECICS Holdings, Pte., Ltd. Institutional investors in the China Funds include university endowment funds such as the President and Fellows of Harvard College, Regents of University of Michigan, University of Minnesota Foundation and the Common Fund. ¹³ The IFC invested up to $7.5 million in 1993 as its first investment in a venture capital fund in China. The purpose of the fund is to make profitable investments in joint venture projects in China. Investment will focus on telecommunication products and services, building materials, health care and biotechnology, software, and infrastructure.¹⁴

¹⁴ IFC web site, ifc1.ifc.org/ifcext/pressroom/ifcpressroom.nsf/7fd52748c77703585256d6200295d26/da6eb0e692883a6285256962006b1314?OpenDocument
IFC - SMEloan (Asia) Joint Investment

The IFC has signed agreements to invest US$20 million in a specialty finance company, SMEloan (Asia), to help expand the company's innovative business model beyond its current market in Hong Kong and southern China to the Asia-Pacific region.15

There is a huge amount of privately-invested funds in the Chinese security market which have not been officially registered with the Government. A PBC report estimated that there was RMB 700bn (US$84.3bn) such funds in China16; however a more conservative estimate is about RMB 200bn (US$24.1bn). These privately-raised funds are primarily in a gray area with no legal status and regulation. These "underground" funds first appeared in 1993 from various sources and have maintained a rapid growth despite being high risk and having little legal protection. The underground nature of these funds actually makes this market more focused on performance. If this market is legalized, the investment market in China will become much more competitive, with more expertise and market orientation.

2.9 Potential Demand For SRI Investment From Charitable Funds

There are a number of charitable funds in China that have invested in low risk, values based portfolios. Some of them are domestic, and comprise donations earmarked for specific charitable missions, such as the China Youth Fund for Prevention of AIDS (www.sos-aids.org); some are affiliates of international charity organizations, such as the New Path Endowment (www.newpathchina.org)17. One article estimates that a number of charitable and other public-benefit funds (including the Shanghai Philanthropy Fund and the China Youth Fund) have over Rmb1.7 billion (US$200 million)18 in total. Though these funds represent only a tiny fraction of the overall market, their higher awareness of social responsibility issues and less growth-oriented investment strategy might make them the strong potential candidates to support SRI fund products once these are available in the local market.

16 Report of Private-Raised Fund, Xia Bin, July 2001
17 The Rmb2.4 million private Newpath Endowment is financially supported by New Path Foundation in New Jersey based on its 2001 agreement with the China Youth Development Foundation (CYDF). Newpath Endowment focuses on service for the elderly, disabled people and other vulnerable groups as well as helping capacity building and resources matching of grassroots community organizations.
3.0 SRI Research

3.1 Domestic SRI Research

None that we know of.

3.2 International SRI Research Groups Covering The Domestic Market

The Ethical Investment Research Service (EIRIS)

EIRIS states that it covers 53 companies in Hong Kong and all major global companies with subsidiaries or significant presence in particular countries where human rights issues are of high concern - including China, Burma and North Korea.19 Chinese companies listed in the Hong Kong Stock Exchange covered by EIRIS have included:20

- Beijing Enterprises Holdings
- China Merchants Holdings
- China Mobile
- China Overseas Land & Investment
- China Unicom
- CNOOC
- Cosco Pacific
- Legend Group
- Shanghai Industrial Holdings

SAM Sustainable Asset Management (SAM)

SAM's coverage of Asia includes selected companies listed in Hong Kong. Chinese companies listed in the Hong Kong Stock Exchange covered by SAM include:21

- China Mobile
- China Unicom
- CNOOC

Innovest

Innovest covers limited number of companies in Hong Kong. Chinese companies listed on the Hong Kong Stock Exchange covered by Innovest include:22

- China Mobile

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19 ASrIA, www.asria.org/sri/asia/research?expand_all=1
4.0 SRI RELATED ORGANISATIONS IN CHINA

4.1 International Development Agencies And Funds

4.1.1 Global Environment Fund (GEF), China
www.gefchina.org.cn

GEF is an international fund that promotes environmental cooperation, especially in biodiversity, climate change, persistent organic pollutants (POPs) and land degradation. The UNDP, World Bank and UNEP act as its executive vehicles. In China, the Ministry of Finance serves as the focal point for implementation of GEF projects. The State Environmental Protection Administration (SEPA) acts as the technical support entity to the MOF. It provides the MOF with GEF policy research, operational consulting and project management. The domestic executive agencies for GEF projects in China are wide-ranging, including a number of government ministries and agencies. The China GEF Office was established in September 2000 by MOF and the SEPA. During GEF’s trial operation from 1991 to 1994, China had six projects approved and received US$54.61 million from the fund. From 1994 to June 2001, China had over thirty projects approved and/or implemented, with GEF funding of US$322 million, among which 80% related to climate change and 15% to protecting biodiversity.

4.1.2 World Wide Fund for Nature (WWF)
www.wwfchina.org

WWF launched the Corporate Alliance program to develop corporate partnerships. The major target of the program is to promote the awareness of corporate responsibility towards the environment. By sponsoring WWF, companies can have the "opportunity to visibly demonstrate (their) recognition of customers concern for the environment - a financial and moral competitive edge". Participating companies include ABB, BP, Carrefour, HSBC, IKEA, Lafarge, Novozymes, Ogilvy & Mather, Tetra Pak, That's Magazines, 3 Suisses.

4.1.3 The World Bank
www.worldbank.org

As of June 30, 2002, the World Bank Group had funded 239, mainly government, projects in China, totaling approximately US$33.9 billion (net of cancellations), making China’s portfolio by far the largest in the Bank. These projects cover all major economic sectors and wide geographic areas in China. Infrastructure (transport, energy, industry, urban development) accounts for more than half of the total portfolio. Agriculture, social sectors (health, education, social protection), environment and water supply and sanitation comprise the remainder. All projects, directly or indirectly, have some impact on poverty alleviation. China is also one of the Bank’s best performing member countries in terms of project implementation.

4.1.4 The International Finance Corporation
www.ifc.org

As one of its fastest growing client countries, China is IFC’s ninth largest country portfolio. IFC operations in China are focused on encouraging private sector development, promoting corporate governance, supporting the development of China’s western and interior provinces (by 2001 eleven projects have been implemented), and promoting private investment in the infrastructure, social services and environmental industries.


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23 GEF China web site, www.gefchina.org.cn
26 Search result of IFC project documents from IFC web site.
4.1.5 Asian Development Bank (ADB)  
www.ADB.org

China has been a member of ADB since 1986. ADB annual lending to China increased from US$1.0 billion during 1999 - 2001 to US$1.3 billion in 2002, and is projected to increase to US$1.5 billion during 2003 - 2005. About 77% of recent lending will be used to finance projects in China's poor middle and west regions. Though the transportation sector still keeps its dominant position in ADB lending, funds earmarked for social infrastructure have been increasing.

4.1.6 International Center for Sustainable Development (ICSDC)  
www.solarcities.org/index.htm

ICSDS has been working on a number of projects in China since its establishment. Its current projects include the 'Guanghan Model Sustainable Village' project and the 'Greening Beijing for the Olympics' project.

4.2 Non Governmental Organizations (NGO's)

Along with the development of the market economy and the transition of government functions, non-government organizations have started growing in number as well as developing their role in offering social services and promoting the public good. Though the Government presently thinks more positively of them than before, there are still many limitations in regulations and administrative procedures that impede the further development of NGOs in China.

However, it is likely that the NGO movement in China will continue to play a more important role in the future environmental movement, public awareness and even the SRI movement in China.

Before 1996, all the so-called NGO's in China had to register with the Ministry of Civil Affairs, and associate themselves with a Government agency. NGOs which wish to maintain a higher degree of independence and seek ways to bypass these regulations forgo the legal status of a social organization. In 1996, Miss Sheri Liao started the Global Village of Beijing, which was widely recognized as the first real NGO in China. As China doesn't have any laws on NGO's, all the independent NGO's (including the Global Village of Beijing) have to be registered as normal businesses.

The outside world, at the Earth Summit Johannesburg in the year 2002, started to realize that there was a rapidly growing NGO movement developing in China. However, though vast in numbers it is not necessarily flourishing. According to statistics of the Chinese Ministry of Civil Affairs (MCA) "at the end of 2001 China had 129,000 'social organizations' and 82,000 'private non-profit' organizations."27 Experts say there may in fact be around 100,000 'private non-profit organizations' in China, with the number increasing every year. "Unregistered NGO's,

27 www.usembassy-china.org.cn/sandt/ptr/ngos-prt.htm
finally, are perhaps the most numerous type of organisation. The Tsinghua NGO Research Center estimates that nationwide there are 1,400,000, while NPO Network puts the number at 2,000,000. A few months ago, Miss Sheri Liao met with the Chinese government and pushed them to launch new laws to legalize NGO's in China. The feedback was quite positive. The Chinese Government seems to be working on this issue now.

Given the sensitivity of social and political issues, it seems that environmental NGOs dominate the Chinese NGO stage. Most of these organizations are volunteer organizations that engage in environmental protection and awareness promotion. In terms of geographic region, they are most active in Beijing, Guangzhou, Chongqing and Fuzhou. The active role of university students (For example, in 1999, there were 13 student environmental groups in 11 universities out of the 36 universities in Beijing) makes these organizations camps for training a more environmentally conscious new generation in China. Some of these organizations are:

4.2.1 Institute of Contemporary Observation (ICO)  
ico-china.org/english/index.asp

The Institute of Contemporary Observation (ICO) is a grassroots nonprofit and non-government organization for Chinese labour issues. It is the first civilian labour research and serving institution in the Chinese Mainland, and is located in Shenzhen, South China. It includes specialists and scholars from Beijing, Guangzhou, Shanghai and Nanjing who are active in the sociological research, labor protection and training. ICO is continuously seeking to improve the working conditions and promote the social development of Chinese labour.

4.2.2 Friends of Nature (FON)  
www.fon.org.cn

FON focuses on public environmental education with lectures, publications, summer camps, public campaign, seminars and field trips. By the end of 2000, FON had about 1000 individual members and more than 30 group-members from different universities and colleges.

4.2.3 Global Village of Beijing (GVB)  
www.ifce.org/gvb/introduction.html

GVB registered in March 1996 as an independent NGO in China. It has 11 full time staff and over 1,000 volunteers. Its mission is to enhance public awareness and to promote public involvement in environment protection. In March 1998, co-endorsed by GVB and China Environmental Protection Administration (CEPA), GVB published Citizen's Environmental Guide, China's first guidebook for environmental behavior in citizen's daily life.

4.2.4 The China Green Student Forum (CGSF)  
www.civa.org.cn/public/four-1.htm

CGSF is a Beijing-based network of university student environmental groups that has linked around 270 student groups on university campuses throughout PRC.

Environmental NGO's are taking a leading role.

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28 www.tsinghua.edu.cn/eng/index.htm  
29 www.usembassy-china.org.cn/sandt/ptr/ngos-prt.htm  
31 FON web site, www.fon.org.cn  
4.2.5 Religious NGO’s

There are also some religious charities in China, such as the Shanghai YMCA/YMCA, which have been engaged in providing community services, especially in serving the urban unemployed, since the 1990s. These organisations could be receptive to SRI investment principles in the future.

4.2.6 Environmental and Social NGO’s based in Hong Kong

See our related Hong Kong report for a summary of these organisations.

5.0 PUBLIC AWARENESS

Along with the benefits of economic growth have also come rising social and environmental problems such as pollution, deforestation, failing health care systems in rural areas and broken-down social security systems. However, as the living standards of the Chinese people increase, more and more people are now in a position to think about the environment and the quality of the society that they are living in.

5.1 Growing Public Awareness Of Environment Issues

Public awareness of environment issues has been growing steadily in China. Air quality reports are regularly included with weather reports in the bigger cities. Also many cities have taken initiatives to replace the use of plastic bags and fast food containers with paper or more environmental friendly bags and packaging to control “white pollution”. Furthermore, recycling bins are increasingly appearing in the city streets.

A 1997 survey of junior middle school students in Beijing showed that over 40% read air quality reports, 31% believe their parents show adequate environmental consciousness and actions, and 89% knew the right answers to questions about garbage recycling. A survey conducted in Lanzhou, Gansu province (a far Western province of China) in early 2000 shows how people’s purchase decisions were influenced by the environmental logos on product packages. The numbers shows that public awareness of environmental issues is quite good, and it can be promoted even further by establishing a trustworthy labeling/screening system for consumer products and companies. Another survey in Guangzhou on the local home improvement market showed that 97.7% people are willing...
to spend more on environment friendly products. It also showed that consumers are suspicious about the genuineness of environmental logos on products.\textsuperscript{36}

In addition to these three surveys, similar results from other surveys show that progress has been made to promote people's awareness of environmental issues. It also reveals that there is a demand for the development of public information sources where reliable information can be obtained by consumers about companies and products. The recent SARS epidemic further raised people's concerns about health and environmental issues. It triggered a series of campaigns to stop some people's habit of eating wild animals.

In 2001, the China Consumers' Association (CSA) proposed that "green consumption" should be an important theme for the new century. More than 3,400 branches of the CSA joined the movement and created a strong influence.\textsuperscript{37} The CSA was established in 1984 with the approval of the State Council. So instead of being a voluntary body, it is a semi-governmental body that protects the rights of consumers. Its functions include supplying consumers with product information, accepting consumer complaints, supporting product liability lawsuits, consumer rights education, and providing product and service inspection. The CSA or its branches have also developed certain Green labels and organic labels, but the enforcement of the use of these labels is still quite weak and some large companies have been known to acquire their labels by paying money.

Many companies have already recognised this trend and started showing more environmental concerns to improve their public relations image as well as their brand recognition. Mobil China donated Rmb10 million (US$1.2 billion) to the State Environmental Protection Agency of China to establish the "Mobil China Environmental Education Fund", which will support a series of environmental education programs in the following five years. McDonald's puts used battery recycling containers in most of its restaurants. Some foreign retailers promote the use of reusable cloth shopping bags instead of plastic ones.

5.2 Awareness Of Other SRI Related Issues

Public awareness of SRI related issues other than environmental issues is significantly less, due to the sensitive nature of such issues in China. One of the primary goals of the government is to maintain social stability as the social and economic structures of China rapidly transform. Therefore, the government usually does not allow the public to express the concerns on touchy issues such as urban unemployment, poor conditions in sweatshops, and fraud and corruption in the securities market.

With respect to the private sector, foreign-invested companies conducting manufacturing in China, especially the subsidiaries of the bigger multinational companies, sometimes face scrutiny of the labour conditions in their factories by international labour watchdogs as well as by increasingly socially conscious customers.

Labour conditions in small factories in China are often still protected from supervision, as local governments maintain cozy relations with investors to boost the local economy. China also has a very poor record on health and safety in the workplace, with 140,000 workplace deaths recorded by the Government in 2001 (up from 109,000 in 2000).\textsuperscript{38} But labour conditions in some cases are improving, and a major reason is because export-oriented factories now face increasing scrutiny from their clients.

\textsuperscript{36} New Express Daily, Oct 25, 2002. www.ycwb.com/gb/content/2002-10/25/content_441021.htm
\textsuperscript{37} Consumers' Associations' Role in Promoting Sustainable Consumption, Ning Wanglu, www.gvbchina.org.cn/lib/susconsumption/ningwanglu.htm.
\textsuperscript{38} Lives Sacrificed to Progress; SCMP, Tues 8 April, 2003; pA9
As a mass export country of manufactured goods, Chinese companies increasingly face requests from their buyers to meet certain standards. Labour practice is increasingly used in trade disputes as a de facto trade barrier against China's exports. For example, Wal-Mart created a labour supervision department in Guangdong and Fujian with over 30 staff. Many foreign companies (such as Wal-Mart, Carrefour, GE, Adidas, Nike, Reebok, Disney, etc.) have paid for the inspection of labour conditions in over 10,000 Chinese factories. Over 50,000 factories have been requested to agree to receive random inspection. There are already companies in China designed to service this need, such as a company called Social Responsibility China that offers SA8000 consulting services.39

Further information about labour conditions in China and the steps that financial organizations can take to encourage the improvement of labour conditions, is published in a report by ASrIA, “Labour Standards in China, The Business and Investment Challenge.”40

6.0 CORPORATE GOVERNANCE

6.1 Development Of The Chinese Stock Market

China's securities market is growing very fast. But it still needs improvement in many aspects, such as legal structure, market standardization and investor training.

Since its first stock exchange, the Shanghai Stock Exchange, opened in December 1990, China's stock market has undergone significant growth. By June 2003, there were 1250 companies listed in the domestic market (A and B shares), with total market value of Rmb 4163bn (US$502 billion), among which Rmb1345bn (US$162 billion) is traded on the market by over 70 million investors.41

However, the Chinese security market still has a long way to go to become a secure and transparent market. Many of the shares of listed companies are in the hands of a small number of entities, mostly the state-owned enterprises (SOEs) or related government agencies, which usually have close ties with the management. Some of these so-called "state-owned shares" are not traded in the market. Small investors, mostly individual investors, often become victims of market manipulation of insiders and large shareholders.

39 www.sa8000.com.cn
40 ASrIA Publications; www.asria.org/publications
6.2 Investment Composition Of The Chinese Stock Market

By April 2002, individual investors accounted for over 90% of the total number of stock trading accounts opened.\(^{42}\) Their moves make the Chinese stock market more volatile. However, institutional investors have picked up speed in entering the stock market. Foreign financial institutions have also started entering the Chinese security market. The China Securities Regulatory Commission approved the entry of a number of Qualified Foreign Institutional Investors (QFII) that can invest in China’s domestic A shares. Also, a number of joint venture investment management companies have been established.

6.3 The Legal Infrastructure And Code Of Conduct

The concept of corporate governance was introduced to China in the late 1980s and early 1990s, as the country tried to transform its state-owned enterprises (SOE) into market oriented modern corporations. Corporate governance initiatives are focused on those companies that listed on China’s domestic stock market. The 1993 Corporate Law established the basic legal framework which governs corporate operation and governance.

As the regulatory body of the Chinese stock market, the China Security Regulatory Commission (CSRC) has kept initiating moves to promote corporate governance standards and performance in China.

Typically, for an SOE listed in the domestic market, only a small fraction of its total shares are traded, while the major shares remain under the control of various entities associated with the government. Small shareholders’ rights are easily and often abused by the larger shareholders. Therefore, recent measures have been targeted to strengthen corporate boards, educate investors, conduct independent outside audits, promote information transparency, and establish a stronger regulatory mechanism.

China has revised accounting and auditing rules, making information more transparent to investors. In August 2001, CSRC issued ‘the Guidelines to Establish Independent Board Members of Listed Companies’. It established the guidelines of the qualification, hiring procedures, responsibilities and rights of independent board members.

In January 2002, CSRC and the State Economic and Trade Commission issued the Corporate Governance Principles for Listed Companies. It covers the basic regulations about corporate governance, investor protection (especially small investors), and codes of conduct and ethics for corporate management personnel. CSRC will also keep the records of agencies and personnel in the security market. CSRC also holds training programs for independent board members.

The PBC has also issued a series of policies and regulations regarding corporate governance for commercial banks. For instance, a series of guidelines on corporate governance, independent boards of directors and outsider supervision were issued in June 2002, whilst in May 2002, policies on information reporting were published. The policy on information reporting for commercial banks requires all commercial banks, whether domestic, joint-venture or foreign, to adopt the new reporting standards no later than January 2006, depending on their current practice.

Legal frameworks have also been improved. In January 2002, the China Supreme Court gave notice that it will consider civil cases about false information reporting under certain conditions. It has since tried a series of civil law suits against a number of listed companies. This was the first step towards protecting investors interests by granting civil compensation in security related cases.\(^{43}\)

\(^{42}\) Speed Up the Growing of Institutional Investors, www.people.com.cn/GB/jinji/36/20020615/753390.htm

\(^{43}\) CEI, www1.cei.gov.cn/hottopic/doc/zjzt2002042/200207250524.htm
The Government realizes the vital importance of investor protection to the health and development of the domestic security market. At an International Forum on Investor Protection hosted by the Shanghai Stock Exchange in June 2002, Mr. Zhou Xiaochuan, then CSRC chairman, laid down the following measures to protection investors:  

- Transparent information reporting
- Investor education
- Regulatory protection of investor interests
- Promote the understanding of shareholder rights in society

The China Security Regulatory Commission has established a set of rules about corporate reporting to protect the interests of investors. The rules govern the content, format, reporting procedure and certain specific cases. Also, the CSRC has strengthened its powers of enforcement. By November 2002, a total of 114 violations of over 90 companies had been dealt with either by the stock exchanges the company was listed on or the CSRC. Punishment ranged from public reprimand to administrative punishment. In 2001 alone, the CSRC investigated 33 cases about untruthful information reporting, punished 80 managers from 8 listed companies, and 37 CPAs from 3 accounting firms.

China’s legislature passed the **PRC Securities Law** in December 1998, which came into effect on July 1, 1999. The main goal of the law is to "standardize the issuing and trading of securities, to protect the lawful rights and interests of investors, to safeguard the social and economic order and the public interest and to promote the development of the socialist market economy." The courts have started playing a role in disputes in the financial sector. For example, in 2001, a local court in Shandong province ruled that a stock analyst’s article had misled an individual investor and granted the plaintiff's compensation claim.

In early 2000, two local courts turned down two lawsuits filed by investors based on the **Securities Law** due to lack of appropriate legal interpretation. Furthermore, in September 2001, the Supreme Court issued a circular that suspended the acceptance of cases based on charges of fraudulent reporting, insider trading and market manipulation. Later amendments made by the Supreme Court in January 2002 and January 2003 opened the door again for investors to file lawsuits on charges of fraudulent reporting. An example is the ST Dongfang case in which individual investors in several provinces hired law firms to handle their suits against the company. By July 2003, the local court that had jurisdiction over the ST Dongfang’s headquarters had already received over 200 individual claims for compensation totaling over Rmb28 million (US$ 3.37 million).

However, interpretation regarding insider trading and market manipulation is still insufficient. The problem of legal independence in China also further hinders the protection of investors.
6.5 Investor Governance - Auditing And Supervising Listed Companies

As mentioned above, the major problem of the Chinese stock market is the over-concentration of shares in the hands of government related entities, as most companies listed are SOEs whose majority shares are still controlled by the enterprise, or related government agencies, such as local state-owned asset management administrations. Many large companies in China are also controlled by Princelings (the children of high Government officials or former high Government officials). They have a very good network with banks and the district Governments. These types of relationships form a very strong network that can gain control of loan sources, market share, and district government policy making. There is virtually no limit on the extent to which this kind of network can produce false accounting statements. This is the main reason for current speculation that the bad debt of the Bank of China is like a bottomless black hole.

Murky ownership increases the risk of moral hazard, and in most such cases, the interest of individual investors is at risk, such as has been shown in the fraud case of Yin Guangxia. The company made up false sales revenues of over Rmb1 billion ($ 0.12 billion), which later led to a loss of Rmb 6.8 billion ($0.82 billion) of its market value.

The Standards of Listed Companies Administration was issued on January 9, 2002. It explained the basic standards of listed companies, ways of investor protection and the obligations and responsibilities of board members, auditors and senior managers. However, there is still a long hill to climb before listed companies can be persuaded to discipline their behavior according to these compulsory standards.

6.6 Investor Education

The majority of individual stock investors in China have little financial knowledge. For them, the stock market is more about speculating than investing. Most of the investors have little awareness of self-protection and risk control. Chinese securities regulatory bodies began to emphasize investor education in 2001 after disruptions in the market. Many investor education activities have been offered to investors, but almost all these educational activities are for the market promotion of related services and products, such as technical analysis and more recently, for financial planning.

Compared with more developed markets, investor education in China is still in its infancy. Lack of resources results in inefficient investor education, which makes investors more suspicious of such activities. However, the government has realized that investor education is one of the best ways to prevent fraud and corruption in the security market and has been giving increasing importance to it.

The media plays an increasing important role in keeping the market clean. The Chinese media is in a transition phase and has started playing something of a watchdog role in promoting market development. Increasing competition among mushrooming media companies is pressuring them to improve the quality and integrity of their reporting. However, political sensitivities, which can be very inclusive in China, often put a significant restraint on the media.

Pressure on corporate governance issue has also been exerted on Chinese corporates listed on the Hong Kong stock market, where shareholder activism is increasingly influential. This could prove a major gateway for introducing corporate governance reform into the Chinese financial markets.
7.0 CORPORATE RESPONSE

In response to both government regulations and the popular perception of investors, more and more companies are now taking action to promote their own image by following the code of conduct of good corporate governance behaviors. Accounting, auditing and reporting is increasingly being brought into line with reality.

7.1 Environmental Standards And Reporting

As mentioned above (5.2) increasing numbers of companies in China are coming under pressure, particularly from clients, to adopt higher environmental and social standards. As a result many companies have taken steps to enable them to meet international standards such as ISO14001 or other standards set by individual clients (which are usually similar).

The State Environmental Protection Administration started promoting ISO14000 standards in 1996. There are now already over 1,000 Chinese companies, many of which are foreign or joint venture companies, which have obtained the ISO14000 certification, such as VW Shanghai, GM Shanghai, Legend, Haier, Konka, Kelong and Huawei. There are also a number of industrial parks that obtained the certification, such as in Suzhou, Dalian, Shanghai and Shenzhen.

"Generally speaking, brand names are doing a better job than retailers; popular brands are doing better job than companies with less reorganization; companies in footwear, toys, garments pay closer attentions to these issues than companies in other industries such as electronics, pharmaceutical, chemical, etc.; and American and European companies are ahead of companies from Japan, Korea, Singapore and other regions."^49

Also, some companies have begun first steps to include environmental issues into their reporting. This is particularly the case where the companies are meeting the ISO14001 environmental management system, such as China National Petroleum Corporation.

Subsidiaries of some multinational corporations, who are required to report in other countries, have been leaders in adopting environmental reporting. However a number of domestic companies that have realized that it is one way to meet popular concerns about environmental issues.

7.2 Environmental Awards And Other Environmental Initiatives

Companies also show their environmental concerns as a way to establish better PR among more environmentally conscious consumers. For example, Ford set up the Ford Motor Environment Award program to sponsor programs in environmental protection and education. For more information on environmental awareness also see 5.1.

^49 Kaiming Liu, Executive Director, The Institute of Contemporary Observation; ico-china.org/english/Newstype.asp?Title=CSR%20in%20China
7.3 Philanthropy By Chinese Corporations

Many Chinese companies do practice philanthropy, such as donating to funds that help rural poor children gain access education, or which provide disaster relief. For instance within the last year, many companies donated money and materials to help fight SARS.

According to Chinese tax laws, personal donations to education and other charities can be deducted from taxable income; corporate donations made to public-interest and disaster relief programs are tax deductible to the limit of 3 percent of total tax payable. The Government also issues policies concerning the tax treatment of specific purpose donations. For example, donations made to not-for-profit senior citizen care services and donations funding nine-year compulsory education (elementary and junior middle school) in rural areas are tax deductible. 50

7.4 Awareness Of Social Responsibility And Adoption Of CSR

Some multinational companies have provided some information about social responsibility on their web sites as part of their global image building efforts, such as SAP, Dupont and Dow Corning.

At a conference on "Labour Relations and Corporate Social Responsibility under Globalization", held at Renmin University, Beijing in 2002, representatives of global corporations and anti-sweatshop activists came together to discuss issues related to corporate social responsibility (CSR), working conditions and labour relations. "The various presentations on CSR trends and initiatives revealed quite clearly that the contemporary CSR agenda is still in its infancy. Not only are new methods, tools and approaches being tried out, but the number of companies involved remains relatively small. CSR is, nevertheless, gradually evolving and maturing. The most obvious change is the shift from so-called "corporate self-regulation" - where, for example, companies unilaterally designed and implemented codes of conduct - to "co-regulation" or "multistakeholder" initiatives where some companies collaborate with NGOs, trade unions and bi-lateral and multilateral organizations in voluntary initiatives associated with codes of conduct, monitoring, verification, reporting and certification." 51

China Youth Development Foundation 2001/07/04
8.0 MICRO-FINANCE AND COMMUNITY INVESTMENT

8.1 The Special Character Of Micro-Finance In China

Development of micro-finance in China can be described in three stages. The first stage, from the early 1980s to 1993, was characterized by several small-scale trial projects supported by international organizations. These trial projects succeeded and micro-finance in China started scaling up. The second stage, from 1993 to 2000, was a major part of the national poverty alleviation plan, mostly targeting the rural population. The third stage began in 2000 when micro-finance started being accessible to the unemployed and other disadvantaged groups in urban areas. The development of micro-finance is also the result of increased international micro-finance activity, an increasing demand for more credit and poverty-reduction tools in a deepening marketing economy, and the necessity to improve rural financial services in less developed areas of China.\(^{52}\) Dr. Tang Min of ADB estimates that by 2003 there were about 500 microfinance programs operating in China.

Micro-finance is mostly referred to as "microcredit" in China, and it has the following two characteristics:

1. It is a government-lending program mainly focused on poverty alleviation rather than private financial services. The government funds the programs at preferential rates. In 2002, the average annual lending rate of microfinance in China is 8% while the national standard lending rate is 5.3%, which is much lower than the other countries’ 15%~20%.\(^{53}\) However, the financial service charges hardly cover the costs of making the loan. These programs therefore provide little return to participating financial institutions. However, the government is trying to help by increasing the interest rate ceiling to twice the state rate of 6% this year. Further easing of the ceiling in future is also believed to be possible. Experience in other Asian countries, such as the Philippines, has shown that interest rates slightly higher than the regular bank lending rate is sustainable; for the banks and the borrowers, as long as the loans are very small.

2. Programs are governed by strict rules set by the government, such as in the newly issued ‘Managing Rules of Microcredit Collateral Loan For Laid-off Employees’,\(^ {54}\) Including such as: a strict ceiling on interest rates, the nature of the fund source, and who can be participating institutions. The People’s Bank of China (PBC) lays down most of the regulations. Microcredit institutions, eligible only after being sanctioned by the Government or the PBC, have very limited flexibility in adjusting interest rates. The sole source of funds comes from Government poverty alleviation funds or aid from international organizations. No savings are allowed into the microcredit process.

Some international NGOs have been trying to introduce international best practices for microfinance in China, within the limitations of the government-regulated framework. Though limited in volume and availability, these funds constitute an indispensable part of microfinance in China.

\(^{52}\) Sun, Ruomei, The Development of Microfinance in China


8.2 Government - Supported Microcredit Programs

Microcredit funds in China only target three socioeconomic groups: the rural poor, urban lay-offs, and college and graduate students (new graduates for seed money or for students to pay the costs of studying abroad).

Microcredit for the rural poor consists of microcredit loans and group-liability loans. Rural Credit Cooperatives (RCCs), supervised by the PBC, are the official operating institutions. The RCC micro-loan program was introduced in 1999 but become active at the end of 2001, after the PBC ordered all RCCs to start microfinance businesses to initiate credit in villages and townships. By September 2002, over 90% of all RCCs were providing microfinance services to farmers. Their main source of funds comes from the PBC. Over the ten-year development period, PBC statistics show the following numbers by June 2002. Combined, the two kinds of loans serve 46% of the rural households that need a loan:

<table>
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<th></th>
<th>Microcredit Loan</th>
<th>Group-guaranteed loan</th>
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<tr>
<td>Volume of loans made (RMB)</td>
<td>69.6 billion</td>
<td>26.8 billion</td>
</tr>
<tr>
<td>Providing RCCs as in numbers</td>
<td>31,446</td>
<td>17,195</td>
</tr>
<tr>
<td>Providing RCCs as percent of national total</td>
<td>90%</td>
<td>49%</td>
</tr>
<tr>
<td>Number of rural borrowers (households)</td>
<td>43.18 million</td>
<td>9.54 million</td>
</tr>
</tbody>
</table>

Inspired by successes in rural areas, the Chinese government initiated another large-scale microcredit activity to cope with growing urban unemployment. In June 2003, the PBC issued 'Managing Rules of Microcredit Collateral Loan For Laid-off Employees', requesting all local city government fiscal agencies to establish microcredit collateral funds to serve "the laid-off employees", who can apply for loans of up to Rmb20,000 (US $2410) with maturity within 2 years. Meanwhile, some provinces and municipalities, such as Guangdong and Tianjin, also launched some trial microcredit programs for new university graduates to start micro-enterprises.

For rural microfinance projects, the government is targeting the poorest regions, mostly in the west and inland China. Also, different emphases have been given to farmers applying for microfinance loans in different areas. In Northeast and Northwest China, the main aim is to help farmers manage their farming needs; in Central China, loans can be used flexibly if the purpose is to reinvest in production; in the coastal areas in East China or rural areas close to major cities, farmers can apply for loans for business other than agriculture, even including consumption, such as child education and house-building.

International organizations fund several microfinance projects in China. The UNDP funded 16 poverty reduction projects in China with total funding of US$19.32 million, among which US$8.21 was for a revolving fund. The UNDP projects adopted the Grameen model of group borrowing. AusAID also funds a project in Qinghai with a total of US $1.67 million.

58 Sun, Ruomei, The Development of Microfinance in China
8.3 Private Sector Financing Activities

As the market economy takes root in China, the need for private sector financing has been growing significantly. But the lack of an appropriate legal and operational framework hinders development. Much private financing still remains underground. Many starting entrepreneurs do not have access to formal sources of credit despite their urgent need. Kellee S. Tsai said, "The vast majority of private businesses in China rely on informal finance, or what economists call the "curb market", for their start-up and working capital needs. These informal financing mechanisms range from interest-free loans between friends and relatives, to sophisticated financing arrangements that circumvent national banking laws in creative ways."59

In responding to the situation mentioned above, China has already begun private financing trials in cities such as Shanghai, Guangzhou, Jinan and Chengdu. The trials showed a number of problems: insufficient information about private financing solutions, lack of reliable credit records, lack of good communication and collaboration among different banks and banks in different areas, and the lack of an appropriate legal framework. The latter makes it especially hard for microfinance institutions to get funding from channels other than government poverty alleviation funds.

Overseas organizations fund some micro-credit projects in China. For example, the Jianhua Foundation in Hong Kong funds a program in the city of Zhangjiakou, Hebei province, northeast of Beijing. And Oxfam Hong Kong began supporting development and relief projects in China in 1987. From 1996 onwards, Oxfam has conducted efforts in micro-credit and poverty alleviation.60

8.3.1 The Funding the Poor Cooperative (FPC)

Funding the Poor Cooperative (FPC) microfinance project was an action-research program launched in 1993 by the Rural Development Institute (RDI) of CASS. It was modeled after the Grameen Bank solidarity group methodology to provide loans to the rural poor. Since 1994, FPC of CASS has set up 15 sub-branches within 3 county level branches in Yixian County of Hebei Province, and Yucheng and Nanzhao Counties of Henan Province. It is undergoing a transition from a pilot program to an institution.61 Now it has served over 15,000 households (90% in poverty) and lent out over Rmb 68 million (US $8.2 million) with repayment rates as high as 95%.62 The funds mainly come from overseas donations and aid from individuals and organizations. Citibank recently committed US $1.3 million through the Grameen Trust to the Center, which might be used by FPC. Limited by funding, the FPC limits the amount of the initial loan to Rmb1,000 (US $120.5), and the total amount below Rmb 3,000 (US $361.4). FPC sources indicate that this is the only microfinance project with a clear sanction from the PBC.

8.3.2 China Micro-Credit Center

The Micro-Credit Center was founded by the Rural Development Institute of CASS, in which Professor Du Xiaoshan is an important leader, in cooperation with the CGAP (Consultative Group to Assist the Poorest). It helps with micro-credit related training (using CGAP materials) and has established the China Micro-credit Member Network, which engages in setting up a micro-credit database and websites, running seminars and exchanging best practice ideas.63

61 Sun, Ruomei, The Development of Microfinance in China
63 Ibid.
8.3.3 The Longshuitou Mini-credit Poverty Relief Foundation

The privately founded and non-profit Longshuitou Foundation was established in 1993. Now it has grown to Rmb250,000 (US$54,000) and spread over three villages in Shanxi province in North China. The fund was implemented by economists, Mao Yushi and Tang Min. The fund adopts the Grameen bank model and includes a zero interest "fund for helping the poor" and a 6 percent "interest bearing fund" from private contributors. The fund is loaned to farmers at 12%.

8.3.4 The Beijing Fuping Domestic Service School

The school is another project funded by economists Mao Yushi and Tang Min. The school recruits and trains women from poor rural areas (average household cash income around Rmb2,000/year) to become domestic helpers, then helps them to find jobs in Beijing. The tuition and living expenses for the training period will be covered from their salary after work, usually equal to one months salary, about Rmb5~600. The school is a non-profit organization and all revenues will be used to maintain and expand its operation. It has trained over 1,000 domestic helpers and will train about 5,000 per year. There is also plans to create jobs for urban laid-offs by employing them as community level managers of the trained domestic helpers.

8.4 Impediments And Prospect Of Microfinance In China

Though China has successfully reduced its poverty population during the last two decades at a dazzling speed, there are still many remaining in poverty. Official statistics show that by the end of 2002, China still has 28.2 million people in absolute poverty and 58.25 million as low-income in its vast rural area. Whilst the urban unemployed totalled 4.64 million by June 2002. Meanwhile, income disparity has been growing fast. Under such a severe situation, the potential market for micro-finance is very high.

After ten years of trial, microcredit has achieved certain goals in terms of poverty alleviation, but it is still in a nascent stage and faces a series of impediments.

The current strict management of the PBC is far from enough for the long-term development of micro-finance in China, such as the establishment of independent micro-finance institutions and audit systems. Another necessary step is to build up the research and consulting capacity of the microfinance institutions so that a competent local personnel team can offer related help to borrowers.

With its accession into the WTO, China will open its financial markets, including the micro-finance market. More and more foreign financial institutions and social organizations will try to tap this huge market with their expertise. With such external supports and stimulus, we expect that China will eventually have to respond more actively to the existing problems and build up a more competitive micro-finance capability.

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9.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in China

- Export market drives corporate environmental and social standards
- Government strongly behind corporate governance improvement, supports improved corporate environmental standards and starting to show understanding and support for CSR
- Huge strategic and economic focus on the environment by the Government
- Future opportunities such as the Beijing Olympics
- Growing NGO sector in China and surveys show awareness of environmental issues in the general population
- Nascent fund industry and growing investment culture, however uniformity of products
- Some SRI research of Chinese companies has already been conducted

Conclusion

- SRI funds may be an angle for future participation in the market
- Focused education of the financial sector on SRI very important
- Engagement in the market by global SRI funds would provide a model

China’s National Report on Sustainable Development, published on August 23, 2002, notes that the Government has set specific objectives and goals for sustainable development as well as promulgating a number of laws, these includes a law on a population plan, six laws on environmental protection, and thirteen laws on natural resource management. All these measures are formalizing and codifying strategies and policies for sustainable development, thus laying down the foundation for the future development of SRI in China.

The report has found that there is a growing awareness of sustainability issues both within the general population and the government and that there is increasing planning, legislating and investment by the government on environmental infrastructures and other initiatives. However, on the other hand, growing awareness must be balanced with the increasing materialism of the Chinese urban population on the one hand and the massive numbers of Chinese that still live in poverty on the other. Also, the positive initiatives by the government need to be balanced by an awareness of the clear problems in enforcing legislation or verifying the effectiveness of sustainable development programs.

One of the key issues one has to take account of in China is the sheer scale of initiatives. The fact that the NGO sector is a new and fragile phenomenon, but that it already numbers hundreds of thousands of groups is one striking example. The fact that there are estimated to be over 500 micro-finance programs active in China is another.

The future market for SRI in China will grow as people increasingly become not only more aware and concerned about the environmental and socio-economic problems which accompany economic development but also educated on how to respond to these challenges.

Chinese stock markets are growing, both in size and sophistication, but they still face huge, if not overwhelming, corporate governance challenges. Fraud, corrupt networking at the highest levels and untrustworthy accounting and reporting are among the prime issues that the market faces. Market investors still have few channels for challenging or verifying company information or in appealing against market manipulation. The report has established that Chinese investors
are overwhelmingly conservative, with the vast majority keeping their savings firmly in bank savings accounts. However those that have ventured onto the market have adopted a primarily speculative, short-term approach. This is partly a function of a lack of effective education, but it is also a reflection of the lack of trust that investors probably have in the potential for finding long-term safe investment in the stock market. Almost certainly corporate governance standards will have to be seen to be radically improved before small investors can be encouraged to consider more long term investments in the market. The chances are that investors will respond with more willingness to invest in longer-term options such as funds once higher corporate governance standards can be demonstrated. SRI funds have the potential to stand out as fresh and interesting options to the current undifferentiated fund products on the market.

With respect to the corporates, it is clear that environmental and social awareness standards are improving, and that concepts such as CSR are being introduced into China. The pressures of export trade have encouraged the adoption of standards such as ISO14001 and SA 8000 by many companies. However these are still relatively new concepts and it will still take some time for them to really take root within the wider corporate sector. A primary role that SRI funds can play within the corporate sector is to encourage more transparency and the wider adoption of environmental and social reporting. SRI funds can therefore play a role in drawing together the ongoing corporate governance initiatives with the environmental and social trends that are also taking place. If the more positive trends that this report has identified develop then it will attract long-term SRI investors into the market. Foreign SRI funds, if they can be encouraged to enter the market, can potentially play a very important role in fostering SRI, by introducing their established practices and their years of expertise.
10.0 RESEARCH PARTNER

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## 11.0 GLOSSARY

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<th>Full Form</th>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>CASS</td>
<td>China Academy of the Social Science</td>
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<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
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<td>CGSF</td>
<td>The China Green Student Forum</td>
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<td>CSFMC</td>
<td>China Southern Fund Management Co., Ltd</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>CSRC</td>
<td>China Security Regulatory Commission</td>
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<tr>
<td>EIRIS</td>
<td>The Ethical Investment Research Service</td>
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<td>FON</td>
<td>Friends of Nature</td>
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<td>FPC</td>
<td>Funding the Poor Cooperative</td>
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<tr>
<td>GEF</td>
<td>Global Environment Fund</td>
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<td>GVB</td>
<td>Global Village of Beijing</td>
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<tr>
<td>H Shares</td>
<td>H-Share Companies refer to companies incorporated in the People's republic of China an approved by the China Securities Regulatory Commission for a listing in Hong Kong.</td>
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<tr>
<td>ICSDC</td>
<td>International Centre for Sustainable Development</td>
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<td>LESS</td>
<td>Leading Environmental Services &amp; Solutions Limited</td>
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<td>LOF</td>
<td>Listed Open-ended Fund</td>
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<td>MOF</td>
<td>Ministry Of Finance</td>
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<td>MOL</td>
<td>Ministry Of Labour</td>
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<tr>
<td>MOLSS</td>
<td>Ministry Of Labour and Social Security</td>
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<tr>
<td>NaCSSeF</td>
<td>National Council for Social Security Fund</td>
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<tr>
<td>PBC</td>
<td>People's Bank of China</td>
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<td>POPs</td>
<td>Persistent Organic Pollutants</td>
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<tr>
<td>PRC</td>
<td>People's Republic of China</td>
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<tr>
<td>QFII</td>
<td>Qualified Foreign Institutional Investors</td>
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<tr>
<td>RCCs</td>
<td>Rural Credit Cooperatives</td>
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<tr>
<td>RMB</td>
<td>Ren Min Bi (1 US$ = Rmb8.3)</td>
</tr>
<tr>
<td>SA 8000</td>
<td>SA 8000 is a standard for social accountability in the workplace</td>
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<tr>
<td>SAM</td>
<td>Sustainable Asset Management</td>
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<td>SEPA</td>
<td>The State Environmental Protection Administration</td>
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<td>SME</td>
<td>Small and Medium sized Enterprises</td>
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<tr>
<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>SRI</td>
<td>Socially Responsible Investment</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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REPORT
October 2003

SRI
IN ASIAN EMERGING MARKETS:

INDIA

Research by:
Centre for Social Markets

Project Manager:
David St. Maur Sheil, Director ASrIA

Project Sponsor: Sustainable Financial Markets Facility, SFMF & International Finance Corporation, IFC
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1.0 EXECUTIVE SUMMARY

This SRI Country Profile for India provides the first overview of relevant recent trends and developments in the country.

To date, Socially Responsible Investment (SRI) funds have been notably scarce in India, but this situation may be set to change. If trends in East Asia are anything to go by, and if regulatory reforms are put in place, then the Indian investment market could soon witness a reasonable range of SRI funds for ethical investors in the not too distant future.

For example, two years ago, Japan had just two SRI funds. Now, however, the country boasts eleven funds, with projections of a fivefold increase over the next two years.

Given the scale of development activity in India, a rich tradition of civil society organisations active on social welfare issues, and a vast consumer class, SRI could find fertile ground in the Indian investment market.

However, contra-indications also exist. Many within the Indian mutual fund industry believe that domestic demand for SRI funds does not exist at present. Specifically, there is a belief that a key prerequisite for SRI to find favour domestically - namely, socially-minded investors - does not exist in the country at present. However, there was a similar assumption by investment professionals in Japan before the launch of SRI funds proved them wrong. With strong religion and civil society tradition there is every reason to relieve that Indian investors may be attracted to SRI funds if given the option, and if the funds are set-up and marketed effectively.

It may be too early to take a pro- or contra-view, but what is certain is that India Inc. is now much more attuned to the necessity of good corporate governance, and socially and environmentally responsible business (CSR) practice. Today the country is rightly able to boast leadership in certain sectors such as ICT and a number of leading companies are looking to go beyond rhetorical commitment to CSR to a sincere embrace. If this trend can be strengthened by domestic consumer and investor pressure, and government leadership, then prospects for SRI in India may look bright indeed.

In conclusion, our review of the situation in India has shown that the following appear to be key factors for the successful adoption of SRI in India:

- imagination in identifying key potential domestic markets and designing appropriate financial products;
- awareness-raising around SRI issues to create a receptive local culture on both the business benefits AND the social and environmental gains from an SRI approach to investment;
- embedding of a credible corporate governance regime in India, and sincere take-up by domestic corporates, to gain confidence from international investors;
- education, leadership and mobilisation by key financial institutions, corporates and civil society actors to promote SRI in India;
- supportive economic reforms, and public policy regimes, that emphasise core SRI principles of sustainable development, equity and profitability.
2.0 SRI FUNDS

2.1 Domestic SRI Funds

We have been able to identify three SRI options in India at present: JM Mutual Fund's JM Heritage Fund, Inheritance India's investment opportunities, and TATA AIG Life Insurance's scheme for the rural poor. This is in itself quite an encouraging sign given the challenges in creating an SRI-friendly domestic environment.

2.1.1 JM Asset Management Company

www.jmmutual.com

JM Heritage Fund is perhaps the only true SRI fund in India. The fund launched by JM Asset Management Company caters to the needs of investors with strong personal ethic codes. The scheme, structured as a balanced fund, will invest in equity and debt, would focus on 'ahimsa' or non-violence. The 'Ahimsa' fund would provide investors with two options - income and balanced. The second plan is a growth-cum-income plan that invests in both equity and debt. A small percentage of the fund management fees are kept for donation to charities involved in animal welfare. Typically, JM Heritage fund invests in areas like petrochemicals, auto, metals, banking and finance, engineering and technology. It might also consider FMCG and pharmaceutical companies, provided such outfits meet the requisite criteria with respect to cruelty issues. Animal rights activists and organisations such as Beauty Without Cruelty and People for the Ethical Treatment of Animals (PETA) are advisors to the ethical fund.

2.1.2 Inheritance India Land Conservation Company Private Limited

www.inheritanceindia.co.in

Inheritance India invests in land close to ecologically sensitive areas, and in related conservation projects. In its publicity material, the company notes that this brings meaningful returns for clients, while preserving and restoring precious natural land and heritage structures.

Currently, Inheritance India invests in land lying along the Western Ghats in Kerala, the southern most state of India. This area is one of the 25 "biodiversity hotspots" of the world as declared by the United Nations. This area has over 1700 species of plants, 22 species of small mammals, 95 species of reptiles and 90 species of amphibians. In just 2 hectares, over 55 species of trees measuring over 10 meters in height have been identified.

Inheritance India follows stringent guidelines to find land with important ecological aspects that are underdeveloped. Restoration work is then done to bring the local ecology back into balance before development begins. Buildings and communities are developed with the intention of having little to no impact to the earth while also working to benefit the heritage of local people. The company declares that its business model is a coming together of conservation planning with financial expertise to produce a win-win strategy that makes money for the investor as well as contributing to the health of the planet.

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1  www.karvy.com/articles/ethical30062001.htm
2  www.inheritanceindia.co.in/index.htm
2.1.3 Tata AIG Life Insurance Company Ltd  
www.tata-aig.com

Tata AIG Life Insurance Company Ltd has launched 'Project Micro-Insurance' for the landless daily-waged rural poor in Andhra Pradesh. The objective of this project is to alleviate poverty through significant initiatives, including financial reforms.

The rural insurance initiative of Tata AIG is being financially supported by the Financial Deepening Challenge Fund (FDCF) set up by the British Government's Department for International Development (DFID). This fund will help in micro-insuring the lives of landless daily waged rural poor in the state of Andhra Pradesh. As per this agreement, FDCF will be contributing Rs 65 lakh³ while Tata AIG will contribute Rs 75 lakh, thus taking the total corpus for 'Project Micro Insurance' to Euro 193,500 (Rs 1.4 crore). This is in addition to the ongoing initiative of spreading rural insurance in the states of Tamil Nadu and Karnataka through the strategic tie-up with the Bridge Foundation.

2.2 Mutual Funds

2.2.1 An Overview

The mutual fund industry in India began with the establishment of the Unit Trust In India (UTI) in 1964 by the Government of India. Over the last 39 years, UTI Asset Management Company has grown to be a dominant player in the industry presently managing 42 NAV based domestic SEBI (Securities Exchange Board of India) compliant schemes and four Offshore funds having a corpus Rs.15,243 crore (US$317.56 million) from about 10 million investor accounts.

The UTI is governed by special legislation, the Unit Trust of India Act, 1963. In 1987 public sector banks and insurance companies were permitted to set up mutual funds and accordingly since 1987, six public sector banks have set up mutual funds. Also the two insurance companies LIC (Life Insurance Corporation) and GIC established mutual funds. The Securities Exchange Board of India formulated the Mutual Fund (Regulation) 1993, which for the first time established a comprehensive regulatory framework for the mutual fund industry. Since then several mutual funds have been set up by the private and joint sectors.

2.2.2 Growth of Mutual Funds

The Indian Mutual Fund industry has passed through three phases or generations of development. The first phase was between 1964 and 1987 when the only player was the UTI. The second phase was between 1987 and 1993 which saw eight funds being established (six by banks and one each by LIC and GIC). During this time, the total assets under management grew to Rs 61,028 crores (US$1271.42 million) by the end of 1994 and the number of schemes to 167.

The third phase began with the entry of private and foreign sectors in the mutual fund industry in 1993. Kothari Pioneer Mutual fund was the first fund to be established by the private sector in association with a foreign fund.

As on March 31, 2003, 382 schemes with an aggregate sale of Rs. 314,673 crores (US$6555.68 million) were operated. Assets under management were Rs.79,464 crores (US$1655.50 million)

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³ 1 Lakh = Rs 100,000
without taking into account the assets under management of the Specified Undertaking of the Unit Trust of India which were Rs.29,835 crores (US$621.56 million) as on January 31, 2003.

In the past two years, private funds have been consolidating and gaining ground. They now manage three-quarters of the Rs 1 trillion (US$21 billion), up from 47 per cent a year ago. The value of assets managed by private firms has climbed by 69 per cent since June 2002.

2.2.3 List of Asset Management Companies in India

<table>
<thead>
<tr>
<th>A) Bank Sponsored</th>
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<tr>
<td>a. BOB Asset Management Co. Ltd.</td>
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<td>b. Canbank Investment Management Services Ltd.</td>
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<td>c. PNB Asset Management Co. Ltd.</td>
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<td>d. SBI Funds Management Ltd.</td>
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<td>e. UTI Asset Management Company (P) Ltd.</td>
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<th>B) Institutions</th>
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<td>a. GIC Asset Management Co. Ltd.</td>
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<td>b. IDBI Principal Asset Management Co. Ltd.</td>
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<td>c. IL &amp; FS Asset Management Co. Ltd.</td>
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<td>d. Jeevan Bima Sahayog Asset Management Co. Ltd.</td>
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<th>C) Private Sector</th>
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<td>1. Indian</td>
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<td>a. BenchMark Asset Management Co. Ltd.</td>
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<td>b. Cholamandalam Asset Management Co. Ltd.</td>
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<td>c. Escorts Asset Management Ltd.</td>
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<td>d. J.M. Asset Management Ltd.</td>
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<td>e. Kotak Mahindra Asset Management Co. Ltd.</td>
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<td>f. Sundaram Asset Management Company</td>
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<td>g. Reliance Capital Asset Management Ltd.</td>
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<td>2. Joint Ventures - Predominantly Indian</td>
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<td>b. Credit Capital Asset Management Co. Ltd.</td>
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<td>c. DSP Merrill Lynch Fund Managers Limited</td>
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<td>d. First India Asset Management Private Ltd.</td>
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<td>e. HDFC Asset Management Company Ltd.</td>
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<td>f. Tata TD Waterhouse Asset Management Private Ltd.</td>
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<td>3. Joint Ventures - Predominantly Foreign</td>
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<tr>
<td>a. Alliance Capital Asset Management (India) Pvt. Ltd.</td>
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<td>b. Deutsche Asset Management (India) Pvt. Ltd.</td>
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<td>c. Dundee Investment Management &amp; Research (Pvt.) Ltd.</td>
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<td>d. HSBC Asset Management (India) Private Ltd.</td>
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<td>e. ING Investment Management (India) Pvt. Ltd.</td>
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<td>g. Prudential ICICI Management Co. Ltd.</td>
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<td>h. Standard Chartered Asset Mgmt Co. Pvt. Ltd.</td>
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<tr>
<td>i. Sun F &amp; C Asset Management (I) Pvt. Ltd.</td>
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<tr>
<td>j. Templeton Asset Management (India) Pvt. Ltd.</td>
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4 Association of Mutual funds in India: www.amfiindia.com
5 Source: www.indiainfoline.com
2.2.4 Future Scenario

The asset base is expected to continue to grow at an annual rate of about 30 to 35 per cent over the next few years as investors shift their assets from banks and other traditional avenues. Takeovers are likely to hit the headlines and result in further consolidation with more multinational players entering the Indian market.

The industry is also having a profound impact on financial markets. While UTI has always been a dominant player on the bourses as well as the debt markets, the new generations of private funds, which have gained substantial mass, can now be seen flexing their muscles. A much-welcomed development is that many fund managers have forced corporate governance on the industry through careful selection criteria for stocks. By rewarding honest and transparent management with higher valuations, a system of risk-reward has been created where the corporate sector is more transparent then before. Funds have shifted their focus to the recession free sectors like pharmaceuticals, FMCG and technology.

Mutual funds are now also competing with commercial banks in the race for retail investors' savings and corporate float money. In this process, the power shift towards mutual funds has become obvious. The coming few years will show that the traditional saving avenues are losing out in the current scenario. Many investors are realising that investments in savings accounts are as good as locking up their deposits in a home safe. The trend in fund mobilization by mutual funds in the recent period clearly indicates that money is heading their way in a big way.

2.3 Pension Funds

The pension funds market in India is virtually untapped compared to other developed markets of the world. For example, whereas in the USA, pension accounts for about 49 per cent of the insurance policies sold each year, in India less than one per cent of the market has been covered with pension items.

Pension funds in India are twice the size of mutual funds and if given the freedom to invest productively they can even make a significant contribution to the development of India's capital markets.

The Confederation of Indian Industry (CII) has called for speedier pension reforms as the Indian population is ageing rapidly and about 9 per cent of the population expected to be over 60 years of age by 2016. At present, however, the Employee Provident Fund (EPF) and Employee Pension Scheme (EPS) cater to only about 11 per cent of the organised sector.

These funds are currently estimated to amount to Rs. 2.5 trillion (US$52.1 billion). Historically, these funds could only be invested in government securities, and tended to earn low returns.

There are signals, however, that an 'interim' Pension Fund Regulatory Development Authority may be set up soon to draw up new legislation for the pensions sector. This body will decide on the number of pension fund managers that should ideally operate in view of economies of scale criteria, as well as oversee nodal agencies such as a proposed central record keeping agency and other intermediaries. A concrete pension reforms package is expected to come into force with effect from January 1, 2004.

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6 Business Standard, 14 July 2003
Of the 12 private sector life insurance companies, almost all are planning pension products to cash in on the boom time. In the private sector pension market, ICICI Prudential Life holds 73 per cent share as of January 2003, despite the entry of many new entrants during the year. This translates into a 24 per cent share of the overall pensions market amongst life insurers (private players account for about 32 per cent of the entire pensions market).7

2.4 Global SRI Funds

In our review, we have not come across any global SRI fund registered for sale in India or with significant holdings in the domestic market.

3.0 SRI RELATED ORGANISATIONS IN INDIA

3.0.1 Global Environment Fund

Global Environment Fund (GEF) is an international investment management firm established in 1989 to invest in, and provide management support to, companies that make positive contributions to environmental quality, human health and the sustainable management of natural resources. Through its private equity investment funds, individually managed accounts and principal investment activities, GEF has completed more than 30 private equity or early stage investments in businesses operating in a broad array of economic sectors and in all major geographical regions of the world. Today, the firm's private equity portfolio includes controlling or major interests in fast-growing, entrepreneurial companies whose aggregate sales are in excess of $2 billion.

GEF’s portfolio companies own and operate critical infrastructure systems that deliver the basic essentials of life, or provide life-enhancing technologies to industries and consumers. Sectors of particular interest include: clean energy; water/wastewater treatment; sustainable forestry and forest products; healthcare; efficient transportation; integrated waste management; technology that promotes improved efficiency and safety in energy use, industrial processing, telecommunications, and healthcare.

In India, GEF has invested in Niko Resources Ltd., the Indian asset of Niko (a Canadian natural gas and oil exploration, production, and distribution company now listed on the Toronto Stock Exchange (NKO)). Its principal Indian asset is the Hazira field, encompassing a 50 square kilometre block that straddles the shore of the Gulf of Cambay, in the State of Gujarat, southwest of the city of Surat. Niko's current activities are focused on developing, placing into production, and delivering natural gas from this one-third owned and Niko operated gas field. The company's production facilities have been constructed in compliance with industry, country, and World Bank environmental standards.

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7 Pension funds: The next boom business, The Indian Express, March 23, 2003
3.0.2 The Calvert Foundation  
www.calvertfoundation.org

Calvert Social Investment Foundation has Investment, Research and Donation products that support community development organizations, across the country and around the world. Through socially responsible investment, the Foundation supports affordable housing, microcredit, minority lending, small business and social enterprise programs.

Calvert Foundation offers several community investment options that can transform capital into economic opportunities for the needy. It ensures that through these different community investment programs below-market investment is safe and effective.

The foundation's loan portfolio is backed by security enhancements of US$8+ million. The foundations maintains that this is effective because it performs rigorous due diligence and monitoring on the organizations in its portfolio to make sure they are financially strong organizations that have real social impact.

Calvert Foundation has invested US$50,000 in CASHPOR Financial and Technical Services Private Limited, India, a micro-credit scheme based in Uttar Pradesh with over 13,000 women borrowers and a 92% repayment rate.

3.0.3 Asian Development Bank (ADB)  
www.adb.org

ADB's cumulative lending to India as of 31 December 2002 was US$11.64 billion. In 2002 it approved seven loans for six projects - five public sectors and one private sector, totalling US$1,183.6 million. The projects aim at developing the East-West Corridor, developing roads in Madhya Pradesh, reforming the state power sector, improving railways, and modernizing government and fiscal reform in Kerala. The private sector loan of US$20 million equivalent in local currency was approved for a medical services network.

Twenty-six technical assistance loans totalling US$13.2 million and three grants - modernising government and fiscal reform in Kerala, rainwater harvesting and slum development in Rajasthan, and sustaining income and basic human needs of the poor in disaster-prone areas of Gujarat - totalling US$55.3 million were approved.

ADB also approved two equity investments totalling US$25 million in an infrastructure fund to help finance private sector infrastructure projects and in a mortgage guarantee company in India.

3.0.4 Global Fund to Fight AIDS, Tuberculosis and Malaria  
www.globalfundatm.org

The Global Fund for ATM attracts, manages and disburses additional resources through a new public-private partnership that makes a sustainable and significant contribution to the reduction of infections, illness and death, thereby mitigating the impact caused by HIV/AIDS, tuberculosis and malaria in countries in need, and contributing to poverty reduction as part of the Millennium Development goals.

In India, the Fund has committed US$140 million for the prevention and control of HIV/AIDS and tuberculosis. The fund supports comprehensive approaches to fight AIDS, TB and malaria, government and NGOs.

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8 www.gfusa.org/replications/india.html#CFTSI  
9 adb.org/INRM
3.0.5 The International Finance Corporation (IFC)  
www.ifc.org  

Since 1956, IFC has invested in 142 companies in India, providing nearly US$ 1.9 billion in financing for its own account and US$ 387 million for the accounts of participants in IFC’s loan syndication program.

With a portfolio of US$ 632.6 million (as of March 2002) India is the third largest country of IFC’s operations after Argentina and Brazil. In India, IFC focuses on supporting the following activities:

- Private sector involvement in infrastructure financing;
- Restructuring and modernization of the manufacturing and services sectors to become internationally competitive;  
- Development of new financial institutions and products.

By working on the frontiers of private investment, IFC helps bring commercial disciplines and entrepreneurial dynamism to new areas of the economy. It also supports private investment in health and education, and innovative applications of information technology.  

3.0.6 The World Bank Group  
www.worldbank.org  

The bank’s India portfolio is its second largest in the world, comprising 69 ongoing projects with a net commitment (as of September 2002) of US$ 12.9 billion.

Transport constituted 41 per cent of new lending, or US$ 2.7 billion, followed by rural development and energy. Structural adjustment loans/credits represented 11 per cent of the total. New lending for health and education was 9 per cent, considerably less than their combined 26 per cent share of the portfolio.

3.0.7 Credit Rating Information Services of India Limited (CRISIL)  
www.crisil.com  

CRISIL states that it offers a comprehensive range of real time news, analysed data, incisive insights and opinion, and expert advice on economy, industry, mutual funds, and infrastructure, to enable investors, issuers, policy makers de-risk their business and financial decision making, take informed investment decisions and develop workable solutions. CRISIL helps to precisely understand, measure and calibrate myriad risks - financial and credit risks, price and market risks, exchange and liquidity risks, operational, strategic and regulatory risks.

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10 www.ifc.org/southasia/India.htm
4.0 NGOS IN INDIA

A number of well-intentioned policy initiatives have been instituted by the Indian Government to try and achieve a balance between economic growth, social development and environmental protection. Yet results continue to be uneven. This is due to a number of factors including: lack of policy and programmatic co-ordination, projects not being brought to effective scale for optimum impact, unevenness of political will in India's vast and diverse states, lack of imaginative resource generation and implementation partnerships, and chronic resource and monetary constraints.

The Government is a signatory to important international agreements on sustainable development and has passed legislation on a range of key environmental protection issues, such as water and air pollution, recycled plastics manufacture, hazardous wastes, wildlife protection, etc. It has also set up co-ordinating bodies to oversee environment and sustainable development issues, including the Ministry of Environment and Forests (envfor.nic.in/). But there is a lack of joined-up coordination with other key ministries to ensure coherent and integrated sustainable development benefits.

In its Country Report\(^{12}\) to the United Nations on sustainable development, the Government notes that: ‘in India there are several ongoing projects which are being implemented through various bilateral programmes with global development agencies. The largest share is for poverty eradication, natural resource protection and capacity building in that order.’ However, in terms of funding, the programs are limited by stringent budgetary constraints. At best, only a modest reallocation of resources is feasible. The report notes that 'the amounts are miniscule compared to the needs of the country.' It also notes that active involvement by the private sector in the funding and implementation of sustainable development is critical.

Realizing the importance of Environmental Information, the Government of India, in December 1982, established an Environmental Information System (ENVIS)\(^{13}\) as a data resource. The focus of ENVIS since inception has been on providing environmental information to decision makers, policy planners, scientists and engineers, research workers, etc. all over the country. The Government has also set up two centres of Excellence, namely the Centre for Environment Education, Ahmedabad and the CPR Environment Education Centre, Chennai, which are intended to provide capacity building support to NGOs.

The Government has instituted a number of donor-aided partnership programmes on the environment with industry, consumer associations and others, to promote sustainable consumption and production patterns. These include an Ecomark Scheme, a Green Rating Scheme, and a scheme to promote the adoption of ISO 14001 certification. Adoption of Cleaner Production Technologies, and formation of Waste Minimization Circles, are also being encouraged to minimize environmental pollution. Under the World Bank-aided Industrial Pollution Control Project, technical and financial assistance is provided for establishing Common Effluent Treatment Plants (CETPs) in clusters of small-scale industrial units.

The Government has also launched awareness campaigns through the print and television media to stress the need to save scarce water, energy, and petroleum resources. Awareness campaign programmes to promote sustainable consumption patterns are carried out through Programmes of Quality Council of India/BIS/MOEF/CPCB/Consumer Protection Councils.


\(^{13}\) [www.envis.nic.in](http://www.envis.nic.in)
For the past decade, India has been committed to an economic liberalization process predicated on the privatization of state-owned industries and the deregulation of several sectors of the economy. These processes are creating ever-increasing opportunities for the involvement of the private sector, and financial markets, not just in economic policy but also in broader sustainable development policies including environmental protection, employment generation, health and education. There is, therefore, increasing scope for the inclusion of SRI criteria into market decision-making as a means of furthering sustainable development objectives.

The Government clearly has an important role to play in supporting the adoption of SRI criteria in financial decision-making. For example, pension funds are just one area where the Government can exert a positive influence. Further research is needed, however, to identify other areas so that the Government can systematically begin to apply its varied powers to promoting sustainable and responsible investment in India.

5.0 NGOS IN INDIA

India is well known in international development circles for the diversity and richness of its civil society organisations, including non-governmental organisations (NGOs). Varying estimates put the number of non-profit organisations in the country at more than several hundred thousand. The limits of state effectiveness, and the colossal need in the country for social services, has meant that the majority of these NGOs have been largely concentrated in the social welfare and relief sector. In terms of size, these organisations range from modest grassroots-based community organisations to vast supertanker NGOs such as the TATA Rural Development Society.

Increasingly, however, NGOs are beginning to diversify in both thematic concentrations and their nature of operations. Now NGOs can be found in every sector from efforts to promote literacy to disability rights, and from women’s empowerment to environmental justice. NGOs are also beginning to shift in function from basic service delivery to research, education, project management, advocacy and consultancy.

5.1 NGOs Active In CSR And SRI

SRI has not been an explicit focus of research or advocacy attention in India as yet with the exception of the work of the Centre for Social Markets (CSM).

5.1.1 The Centre for Social Markets (CSM)

www.csmworld.org

CSM is an India and UK-based non-profit international organisation dedicated to making markets work for the triple bottom line - people, planet and profit. A values-based organisation, CSM is a leading force in India, and internationally, on CSR education, training, research and advocacy. The organisation has an explicit focus on five key market actors business, investors, workers, consumers and legislators, particularly in developing and transition countries, with a view to engaging them in the movement for sustainable development, ethics and accountability. CSM has also pioneered work with ethnic minority and diaspora communities, such as overseas Indians and Chinese in industrialised countries, and focuses on domestic industry, rather than foreign MNCs, in developing countries such as India.
CSM holds an Annual Conference on Corporate Citizenship in India and has also developed the first website portal dedicated to CSR in developing countries. The organisation also administers a regional e-list serve, CSRAsia, to promote information exchange and learning in the region.

Since 2001, CSM, a member of ASrIA, has also pioneered awareness-raising, research and advocacy on SRI issues in India. This began with the first session on the subject in the country at its 1st Annual Conference on Corporate Citizenship in Kolkata in 2001 and more recently with the 1st International Conference on SRI in India in Sept. 2003 in Mumbai with ASrIA, and collaboration with SRI leaders such as the Calvert Group.

Further details on CSR and SRI in countries such as India can be found on CSM's website (www.csmworld.org) and Portal (www.csmworld.org/portal) on the subject. A "Who's Who on CSR in India: A Resource Guide", published by CSM and Ogilvy & Mather India, will be available in December 2003.

In recent years, a number of other NGOs have also emerged in response to the international movement for corporate social and environmental responsibility. Some, such as Partners in Change and Business & Community Foundation have been set up by foreign parent organisations - in this case ActionAid and the Prince of Wales Business Leaders Forum respectively. This type of NGO provides services and promotes partnerships with corporate members.

5.1.2 Partners in Change (PIC)
www.picindia.org

PiC is registered as a Society and its auditors are PriceWaterhouseCoopers. Currently, ActionAid India, The Ford Foundation and some of its corporate partners provide financial and technical support. PiC has come together with ActionAid India, Books for Change, Praxis and Sabala to form a Strategic Alliance of Organisations (SAO).

PiC is a founder member of South Asian Alliance for Responsible Business (SARB), in partnership with the Confederation of Indian Industry (CII). SARB seeks to further the cause of CSR in South Asia. The group comprises participants from Nepal, Pakistan, India, Bangladesh and Sri Lanka. PiC also acts as a Secretariat to the UN Global Compact in Mumbai.

PiC helps businesses at various stages of adoption of CSR by identifying the stakeholders and their relevant issues; development of CSR policy and guidelines; training/sensitising company staff on social developmental issues; benchmarking a company’s social responsibility programme to ensure that it is internally and externally consistent; identifying partners - NGOs, community groups, government departments and managing these relationships; resource allocation for CSR; social performance evaluation and reporting.

5.1.3 Business and Community Foundation (BCF)
www.bcfindia.org

BCF is a not-for-profit business coalition, established in New Delhi by Indian and International Companies, in association with the Prince of Wales International Business Leader’s Forum, (IBLF), UK an international educational charity founded by HRH the Prince of Wales.

The BCF works as an intermediary, mobilising the core competence and resources of its members and other key shareholders and facilitating their working in partnerships on projects benefiting the business and the society. For instance, the foundation organised a consultation for the ABB group to finalise a strategy document on social issues for its interventions in India. The objective of this consultation held on the 6th of August, 2002 was to share its global social policy document with different stakeholders, understand localised approach, local needs and local issues and work toward a need based country policy for India.
5.2 Research And Development NGOs And Voluntary Organisations

These newer NGOs and initiatives complement pre-existing relationships between two other types of NGOs and industry: 1) research and development NGOs such as The Energy and Resources Institute (formerly the Tata Energy Research Institute), Development Alternatives, and the Centre for Science and the Environment which have maintained specific industry-focused programmes and issue-specific campaigns; and 2) voluntary organisations which have worked with business foundations and plants to deliver specific services such as education and health.

5.2.1 The Energy and Resources Institute  
www.teriin.org

TERI activities relate to every aspect of sustainable development. From providing environment-friendly solutions to rural energy problems to helping shape the development of the Indian oil and gas sector; from tackling global climate change issues across many continents to enhancing forest conservation efforts among local communities; from advancing solutions to growing urban transport and air pollution problems to promoting energy efficiency in the Indian industry.

According to TERI, India figures among the world’s top 10 contributors to greenhouse gas emissions, but its relative share is low in terms of per capita emissions (only one-sixth the world average). Because of India’s heavy reliance on coal and a rapidly rising population, however, that figure has nowhere to go but up unless new measures are taken.

More than 40 top Indian companies currently undertake energy auditing every year at TERI, with an additional 150 subject to self-auditing and examination. Sixteen leading corporations are active members of India’s Corporate Network on Environment, which attempts to identify key problem areas and develop strategies in the field of industrial sustainability.

5.2.2 Development Alternatives  
www.devalt.org

The Development Alternatives works towards innovation and dissemination of the means for creating sustainable livelihoods on a large scale, and thus mobilise widespread action to eradicate poverty and regenerate the environment.

Development Alternatives works with partners in all sectors: government, international agencies, public and private sector institutions and grass root voluntary organisations. The responsibility for providing support to such partnerships lies with the respective functional units of the Development Alternatives Group.
5.2.3 Centre for Science and the Environment (CSE)

www.cseindia.org

CSE is an independent, public interest organisation, which aims to increase public awareness on science, technology, environment and development. Since its inception in 1980, CSE has been creating awareness about the environmental challenges facing India. With a problem-solution approach it has been instrumental in policy changes and reforms placing people at the centre.

CSE has launched a number of campaigns in the area of air and water pollution to raise consumer awareness and increase pressure on policymakers. For example CSE’s Right To Clean Air campaign seeks to improve the air quality of Delhi, one of the most polluted cities in the world. The main plank of the six-year-long campaign was to push the government to introduce an alternate fuel policy and mandate the use of clean fuels, such as compressed natural gas (CNG) for public transport. The efforts of the Clean Air campaign were vindicated in a 2002 Supreme Court ruling in April 2002 mandating all public transport to run on CNG.

5.2.4 Consumer Unity & Trust Society (CUTS)

www.cuts.org

CUTS focuses on information dissemination, awareness building and lobbying industry and government on issues of sustainable production and consumption, with a particular focus on environment-friendly technologies. For example, CUTS launched a two-year awareness raising project on the Ecofrig to promote environment-friendly refrigerators for Indian consumers in 1998, and other campaigns on consumer rights in states such as Rajasthan.

Attitudinal surveys to measure the importance of environmental or social issues to Indian consumers are comparatively in their infancy compared to western countries. Many large companies are known to conduct such surveys for market research but this information is seldom in the public domain. Assessing, and influencing, consumer attitudes is set to be a growth industry in the coming years however.

The Tata Energy Research Institute (TERI) has published valuable research based on a poll of Indian public attitudes to corporate responsibility in India, which indicated that the Indian public is concerned about these issues and does expect higher CSR standards from Indian corporates. “Indians feel that the business sector must play a wider and more expansive societal role.” (Altered Images, the 2001 State of Corporate Responsibility in India Poll, TERI Europe, p.20): Full Report linked to this ASrIA India Report on the ASrIA website).
As noted above, the international CSR movement has certainly arrived in India. Many leading foreign MNCs and domestic titans, pre-eminently members of the Tata Group, have been standard-setters on core CSR issues such as labour conditions, health and safety, environmental management, corporate governance and integrity. India also has its own counterparts of 19th century Victorian industrialists and Quaker social reformers such as the Lever Brothers and Cadbury family who established company towns such as Port Sunlight and Bourneville in Britain. The Indian counterparts include the Tata and Godrej families, from India's Parsi community, who continue to have a significant industry presence and reputation for social responsibility. One of the Tata Group of companies, Tata Steel, is the first in the country to produce a corporate sustainability report and administers the only industry town in the world, Jamshedpur, which has received ISO14001 environmental quality certification.

Given the increasing importance given to CSR in corporate circles world-wide, and attendant public pressure for corporate probity, many leading Indian corporates have been keen to broadcast their CSR credentials. Regrettably this is too often more a public relations exercise relying on slick advertising, rather than a true reflection of a well-thought out committed business strategy and corporate culture predicated on CSR values. A handful of Indian companies and MNCs operating in India have begun to produce environmental and social reports. These companies include, Infosys, the Tata Group, Ballarpur Industries Limited, Paharpur Business Park, Ford India, Samsung India Electronics, and Cadbury's India.

In recent years, some large and increasingly image and market-conscious Indian companies have started signing up to voluntary international CSR initiatives. The UN Global Compact (www.unglobalcompact.org) is a good example. There are now some 87 Indian companies which have signed up to the Global Compact's nine principles on human rights, labour and the environment. Leadership by a handful of corporate leaders such as Infosys and Tata, and importantly, persistence by local advocates, have been crucial to this.

As ever, however, the proof of such voluntary commitments will lie in performance being commensurate with promises. Organisations like CSM are involved in the UN Global Compact with the explicit purpose of promoting not only the aims of the Compact, but also meaningful domestic compliance with its objectives. In India, as elsewhere, verification of corporate commitment to voluntary efforts is still a long way off and will require both stakeholder partnership and independent oversight.

The Confederation of Indian Industry (CII) (www.ciionline.org) India's largest industry body has taken a noteworthy lead in promoting CSR amongst its membership. It has adopted a set of Social Principles with UNDP India and has appointed CSR officers in its regional offices. This has set a positive example to other industry bodies in India such as FICCI (Federation of Indian Chambers of Commerce & Industry), which have also held CSR-related events.

There is a need, however, to move beyond one-off events towards the development of a more systematic and inclusive approach by industry bodies in partnership with NGOs, trade unions and other stakeholders. This will be critical to the successful mainstreaming of CSR in Indian business and industry - especially in the absence of a vibrant consumer movement as a key driver.

The profiles below provide an illustration of some of the CSR activities that corporates are beginning to advertise in India. This list is not meant to be comprehensive but only to provide a snapshot from different industrial sectors in the country.
6.0.1 IBM India
www.ibm.com/in

In India, one of IBM's major initiatives in the area of Corporate Community Relations (CCR) has been in the setting up of the Gandhi Institute of Computer Education and Information Technology, in partnership with the Bharatiya Vidya Bhawan. Set up in Mumbai, Delhi, Gopalganj and Hazirabagh, it provides free computer education to students from the economically weaker sections of the society. The company has also partnered with the Victoria Memorial School for the Blind in Mumbai and donated PCs and other equipment to open a computer centre for imparting training to visually-impaired students from the disadvantaged sections.

Kidsmart is another CCR programme being rolled out in India by IBM. It aims to use IT to give pre-school children, from the age of three to seven, from economically weaker sections, a jump start in their education through the use of age-appropriate software developed by the company. While IBM's team of volunteers and experts from Global Crisis Management Team helped during the Gujarat quake, there are other continuous efforts like EXITE (Exploring Interest in Technology and Engineering) camps to generate interest in maths and science among young women; and donations of refurbished computers, etc.

6.0.2 ING Group
www.ingvysyalife.com

ING Group has launched the ING India Foundation for Social Development with an initial seed capital of Euro100,000 (Rs 4,300,000), targeted to benefit a variety of social goals including child poverty alleviation and education for women.

ING Group is one of the world's leading financial institutions and is active in the field of banking, insurance and asset management, employing 100,000 people worldwide in 65 countries. In India, ING has assets of Euro1 billion, and has a presence in insurance, mutual fund, wealth management, and investment banking, corporate finance and other financial products and services to corporates and financial institutions.

6.0.3 Global Sullivan Principles
www.globalsullivanprinciples.org

These business principles were developed by Reverend Leon Sullivan and a small group of U.S. and European companies. Procter & Gamble, General Motors, Colgate-Palmolive, and Sun Oil are the U.S. companies that have thus far endorsed them. Shell and Rio Tinto of the UK, and TATA Industries, and Paharpur Business Centre of India have also done so. Intended as an aspirational statement to which companies can align their internal policies, the Principles cover such things as equal opportunity; freedom of association; safety and health; and ethical business dealings.

6.0.3.1 Tata Steel
www.tatasteel.com/tataorg

Tata Steel's Corporate Sustainability Report 2001-02 marks the first time that an Indian corporation has produced a Sustainability Report. It is an ambitious achievement and noteworthy in its use of the GRI Guidelines on Economic, Environmental and Social Performance. The report has also been independently assured by Pricewaterhouse Coopers which sets it again in a league apart.

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14 www.ingvysyalife.com/press_rel_7.htm, New Delhi, March 11, 2002
15 www.nautilus.org/cap/resources/globalstandards.html
16 www.globalreporting.org/guidelines/rep_country.asp
6.0.3.2 Paharpur Business Centre & Software Technology Incubator Park
www.pbcnet.com

PBC is an SME in the service sector and currently offer a suite of twenty-seven quality services in Delhi in India. These services include Business Centre Facilities, Software Technology Incubator Parks with Plug and Play facilities, Travel Management, Rent-a-Cab, Housekeeping, Catering, Restaurant, Security, Horticulture, Accounting, Office Services and Office Supplies, Property Management, Indoor Air Quality Consulting, Communication Services, Internet, Cable & Internet Telephony, Legal Research, and other services.


6.0.4 Aptech
www.aptech-worldwide.com

IT training major Aptech has also been focusing on literacy initiatives as a part of its CSR initiatives. Apart from contributing to associations involved in humanitarian causes, the company also comes up with special low-priced IT courses. ‘My Vidya’ (My Education) is a basic computer literacy course priced at only Rs 450 (US$9.40).

‘Project Saraswati’ is yet another endeavour towards complete IT literacy to underprivileged students. It has teamed up with leading NGOs in this programme. Some of the other efforts include - donation of a computer lab in a village near Pune; support to NGO Pratham's ‘balwadis’; computer literacy projects with the Rotary International, etc. In the future, the company plans to take Project Saraswati to the global level. It has already initiated literacy programmes for underprivileged women in Bangladesh and is now extending the same to Nigeria.

At Aptech it is the Strategic Business Council team that decides the resource allocation, which is done in sync with the business strategy of the organisation.

6.0.5 Ford India
www.india-ford.com

The Corporate Assessment Report is an examination of the challenges faced by Ford India. It offers a comprehensive assessment of the company’s performance on a wide range of social, economic and business issues. It highlights opportunities for action on the important issues of customer satisfaction, local community participation, employee satisfaction and environmental protection. It also reflects Ford India's successes, areas of concern and opportunities for measurable improvement.

Ford Motor Company issued its first Global Corporate Citizenship Report in the year 2000 and established new ethical standards for corporate reporting on social and environmental activities. Ford India's Corporate Assessment Report follows the same principles. It is the first country-specific assessment by a Ford affiliate.

17 www.socialfunds.com/news/release.cgi?sfArticleId=1069
BG India has been active in India for over ten years during which the company has supported several community development initiatives.

To strengthen this objective further and provide a guiding direction, a framework on future community initiatives was developed based on business links, government guidelines and community needs. Based on this, support to a primary education programme, with a wide impact and direct community benefits have been initiated in areas of the company's operations.

The programme has a two-stage format - a short-term pilot project in New Delhi and Mumbai to ascertain impact followed by a larger sustainable project in Mumbai, now under way. The programme involves bringing children from disenfranchised areas, currently outside the school system, 'into school and learning' towards the objective of achieving 'Universalisation of Education'.

7.0 CORPORATE GOVERNANCE INITIATIVES

7.1 Compelling Reasons For Reforms

India's financial markets were rocked by two huge stock market scams in 1992 and 2001. In the context of the 2001 scam, it was admitted, perhaps for the first time, that the causes were systemic and not conjectural. A recent study by the Reserve Bank of India (RBI) on "Stock returns and volatility in India" says that empirical relationships suggest investors who tend to optimise returns in the short-run dominate the equity market in India. As a result, they not only add avoidable volatility to the stock market and increase the amplitudes of the BSE Sensex, but also give rise to alternating short phases of bull runs and bear hugs.

The gradual induction of the Indian economy into the larger global economy has led to increased volatility of all economic indicators, including corporate profits. Consequently, one finds corporate incomes rising from sources other than primary lines of business, such as returns on investments in real estates, commodities, and a host of equity options, gilt funds, bonds, among others.

7.1.1 A 2001 study on corporate governance and economic reforms in India indicate the following micro-level findings:

- High negative impact of share buy-backs on CG
- Issue of non-voting shares have least negative impact on CG
- No significant demonstration effect of MNCs in India on Indian Companies
- SEBI guidelines/policies:
  - Guidelines for Disclosure Norms and Investment Protection are least effective
  - Prohibition of Investor Trading Regulations of Mutual Funds Most Effective
  - Substantial Acquisition of shares & Take-over Regulations a bit lax

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18 [www.bg-group.com/socenv/cs_comm_sci.htm](http://www.bg-group.com/socenv/cs_comm_sci.htm)
19 The Hindu, Thursday, March 22, 2001
The authors provide the following policy recommendations:

- Overall increased stringency in the application of corporate law
- Significant investment in protection and education of small investors
- Restructuring of the existing system of institutional investing
- Development of feasible and enforceable requirements of accountability and transparency
- Systematic consultation with civil society groups that are engaged in the assessment and evaluation of corporate behaviour
- Support business and civil society initiatives to promote more responsible/ethical corporate culture, in line with local values

7.1.2

A recent study\(^\text{21}\) conducted in the year 2001 across global emerging markets finds large companies with good corporate governance yield better bottom-lines. Entitled “Saints and Sinners - Who's Got Religion?,” the report issued by CLSA (Credit Lyonnais Securities Asia) Emerging Markets analysed survey results of 495 companies in 25 emerging markets around the world.

In examining the 100 largest companies in emerging markets, researchers found a strong correlation between corporate governance and financial performance ratios. For example, the average ROCE (return on capital employed) for the largest 100 firms was 23.5 percent for fiscal year 2000. Companies that were ranked in the top quarter of corporate governance, however, yielded an average ROCE of 33.8 percent. Firms in the bottom half of the corporate governance rankings had an average ROCE of only 16 percent.

Of the 100 largest companies, firms that garnered the top five scores for corporate governance were HSBC (Hong Kong), Infosys (India), Singapore Airlines (Singapore), Li & Fung (Hong Kong) and Richemont (South Africa). The lowest five scores of the largest firms were Lukoil (Russia), TPSA (Poland), Isbank (Turkey), Tenaga (Malaysia) and PCCW (Hong Kong).

7.2 Corporate Governance Reforms

In India, the central and state governments have over the years taken action on legislative and regulatory reform to promote better corporate governance. As in the majority of other countries, however, shareholder activism is largely an under-developed force in India. For shareholders to gain greater influence in the management of their funds, investor education, better organisation of investor groups, and alliances with professional bodies, business organisations and NGOs will be needed.

The Indian Government is now talking about more stringent regulations for compliance with corporate governance norms. The greater challenge is how to ensure that those who manage corporations actually follow these rules. To put this in context, in the USA it was not absence of rules but a lax and wilful culture of non-compliance in some sectors that led to the massive corporate scandals of recent times. The issue, therefore, is how to ensure honesty and integrity in both corporates and their watchdogs\(^\text{22}\).

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\(^{21}\) [www.sri-adviser.com/article.mpl?sfArticleId=592](http://www.sri-adviser.com/article.mpl?sfArticleId=592)

\(^{22}\) Corporate governance ratings can curb frauds, Business Line, MUMBAI, July 11 2003
One positive development in the Indian context is that the Indian rating agency, ICRA (Investment Information and Credit Rating Agency), has now started offering corporate governance ratings (CGR) to listed companies (www.icraindia.com). According to ICRA, its CGR is based on core principles - fairness, transparency, accountability and responsibility - of corporate governance practices laid down by the business sector advisory group of OECD.

While evaluating an organisation on the CGR scale, ICRA considers whether the codes and guidelines have been followed just for statutory compliance or whether the organisation has implemented the concept of corporate governance in spirit as well.

The Indian Government has recently passed the Companies (Amendment) Bill 2003, which promotes transparency in corporate affairs and better corporate governance. In particular, the Bill seeks to define auditor-company relationship and prescribe stiffer penalties for non-compliance. Further, it also provides for the statutory auditor-company relationship to further strengthen the professional nature of this interface, and measures required to ensure that the management and companies actually present "true and fair" statement of the financial affairs of companies. The Bill defines the role of independent directors, and how their independence and effectiveness can be assured.

The Indian Government, and various regulatory bodies such as the Securities and Exchange Board of India (SEBI) and Insurance Regulatory and Development Authority (IRDA), realise that small investors form an integral part of any economy and regulatory bodies must endeavour to ensure that interests of small investors are protected. Over the last decade, SEBI has taken important steps to improve the efficiency and transparency of the capital market through developmental and regulatory measures for investor protection. The objective is to move towards qualitative improvement and transparency in disclosure standards and better trading practices in stock exchanges.

Investor education is as critical as industry regulation. In most cases, an investor does not have the ability to understand and interpret the available information. Investors rely on information provided by brokers that is likely to be biased to favour immediate returns. Herein lies the challenge. SEBI and IRDA have upped their efforts in investor education. The Indian Government set up the Investor Education & Protection Fund in October 2001 with a view to enhancing investor education. Institutions such as the India Invest Economic Foundation, Association of Mutual Funds in India, USAID, stock exchanges such as the Bombay Stock Exchange, CRISIL, are also active in the field of investor education.

Despite various efforts by SEBI, stock exchanges and increasing requirements of corporate governance, a lot admittedly remains to be done to protect the interest of small investors. Regrettably, frauds and scams are a part of any system and cannot be entirely eliminated. Constant vigilance is required, in particular by the regulatory authorities enforcing their own rules and raising investor awareness as an additional force to be reckoned with.

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23 ICRA, India: www.icraindia.com
8.0 MICRO-FINANCE

The micro-finance pioneer, Micro-Credit Ratings International Limited (M-CRIL), which introduced MFI (Micro-finance Institution) rating services in India in 1988, has analysed the performance of 69 MFIs to provide a broad picture of micro-finance in the country.

M-CRIL’s analysis reveals that microfinance in India is characterised by a small number of large MFIs that are relatively strong, and a large number of small and weak organisations. Collectively these MFIs manage to reach some 1.4 million families. The micro finance sector now covers over 0.7 million self help groups (SHGs), which enjoy bank credit of over Rs 2000 crore. MFIs in India have brought the poor, especially poor women, into the formal financial system and enabled them to access credit and fight poverty.

While MFIs are increasingly aware of the need to obtain resources from members, donor funds are still the pre- eminent source of financing and MFIs still prefer to obtain resources from development loan funds on 'soft' terms. Savings services have much potential for improvement and Grameen-type MFIs appear to be the best in portfolio quality. IBPs24 fare better in portfolio management and come closest to achieving full operational self-sufficiency. While Indian MFI operating efficiency compares well with international best practice norms, the portfolio yields remain very low.

Overall, while positive trends are discernible in terms of sustainability and growth, a number of critical institutional and systemic issues in MFIs are holding the sector back from attaining its true potential in a country such as India. These include:

- unprofessional or undertrained staff;
- overlarge scale of operations and geographical spread;
- lack of basic management information systems and poor financial accounting systems; and
- the over welfare orientation of most MFI CEOs.

To their credit, however, it must be noted that the proliferation of MFIs in the country mark arguably the first time in the history of Indian development, that a serious effort is being made to provide accessible financial services in a systematic fashion to low-income families. Largely to this, a new sub-economy of financial intermediation is beginning to emerge. According to Sanjay Sinha, Managing Director of M-CRIL, the concerns outlined above would, in the long run, be seen as no more than the growing pains of a new economy25.

The Reserve Bank of India (RBI) is concerned about the uneven growth of MFIs across India and the diverse rates of interest being charged of their members. It suggests identifying policy measures relating to the micro finance industry, in order to further growth and development of MFIs.

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24 Individual Banking model (also referred to here as IBP) entails the provision by MFIs of financial services to individual clients, though they may sometimes be organised into joint liability groups, cooperatives or even self-help groups.

9.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in India

- Some early domestic SRI funds already present in the market.
- Mutual fund industry and retail investment becoming increasingly well established and sophisticated. Vast consumer class could be strong supporters of SRI in the future.
- Public is showing increasing awareness and interest in fund products as opposed to traditional bank accounts.
- Long traditions of environmental and social awareness and activism in the wider community.
- Vibrant civil society and civil institutions with a number of NGO's increasingly focused on issues such as corporate governance and CSR.
- Centre for Social Markets (CSM) is actively promoting SRI and has organised the first conference on SRI in India, jointly with ASrIA.
- Development and private equity funds are increasingly focused on managing sustainable investment.
- Government recognizes importance of corporate governance, including the protection of small shareholders.
- Corporates reporting and adoption of environmental standards rapidly improving, with some shining stars. CSR has firmly arrived in India.

Conclusion

- Imagination is needed to identify key potential domestic markets and design appropriate financial products;
- Awareness-raising around SRI issues is crucial to create a receptive local culture on both the business benefits AND the social and environmental gains from an SRI approach to investment;
- A credible corporate governance regime must be embedded in India, and sincerely taken-up by domestic corporates, to gain confidence from international investors;
- Education, leadership and mobilisation by key financial institutions, corporates and civil society actors is important to promote SRI in India;
- Supportive economic reforms, and public policy regimes, that emphasise core SRI principles of sustainable development, equity and profitability must be adopted.

SRI is an investment approach that integrates social and environmental considerations into the investment process. For this reason, it is also called 'triple bottom line' investing. This means that social, environmental and financial factors are given comparable weighting in reaching an investment decision.

SRI, as is commonly understood in North America, Europe and East Asia, is still relatively unknown and not well understood in India. While SRI volumes and values have increased globally, the Indian financial markets have not been proactive in attempting to introduce it to India or make it available to domestic investors.
However, the experience of early SRI movers such as JM Asset Management, show that the Indian market is not impenetrable, or growth impossible. A full assessment of the situation must recognise the many untapped assets and positive developments in the country in recent times.

Two of India's key assets are a vibrant civil society and free press that together can help create domestic demand for investment that serves the *triple bottom line* - people, planet and profits. Financial innovations in the past such as micro-credit are not new to India - indeed many forms are indigenous in origin and successfully exported to other parts of the world. One can conclude that the experience of MFIs in India reveals that where the proposed solution meets a pre-existing need, successful take-up is possible.

Another factor is the lure of the Indian market. India's vast consumer class is notoriously price conscious, but there is no reason to think that SRI cannot find favour in a country where some shoppers are believed to include green and ethical criteria into their purchasing and investment decisions. The examples of consumer mobilisation noted in the earlier section are indicative of the potential for more targeted consumer action.

Further research needs to be undertaken on contemporary consumer attitudes, but there is little doubt that attitudes are now more receptive to triple bottom line considerations. A greater challenge will be how to ensure that the vast unorganised sector in India can benefit from the introduction of SRI principles in financial markets and products.

If the Indian financial sector has been less than proactive with regard to SRI, Indian business and industry are perceptibly responding to the CSR agenda. Factors such as increasing participation in international trade, exposure to better practice, and pressure from Western contractors, have all helped raise domestic standards in the social and environmental fields. The successful take-up of ISO certification on quality and environment standards further demonstrates that many Indian firms - large and small - value the 'seal of approval' this gives them in competitive foreign, and increasingly domestic, markets. One can now speak of rising norms in several domestic industries.

India's leading industry associations now routinely hold events on CSR, corporate citizenship and corporate governance. On the corporate governance (CG) side, a handful of business leaders are now pushing the government to speed up its process of CG and necessary amendments in the Companies Act. They have successfully set CG benchmarks for the rest of Indian industry to follow.

The Government is also taking account of the changes in public and private expectations of business. In the 10th Five-Year Plan (2002-07), prepared by the Planning Commission, the Government of India calls for transforming traditional economic development patterns from ones that emphasizes quantity into ones that emphasize quality of development in order to establish a market-driven, energy- and resource-efficient economy.

A cursory reading of the above developments could suggest that indeed the conditions could be ripening for the introduction of SRI into the Indian market. It must be noted, however, that the nature and pattern of SRI progress will necessarily vary in India as it has from country to country. But existing global experiences can provide valuable insights and must be shared.
10.0 RESEARCH PARTNER

Research Director & Editor: Malini Mehra
Research Team: Sachin Joshi (Lead), Paramita Roy, Karabi Basu

The Centre for Social Markets (CSM) is a non-profit organization dedicated to making markets work for the triple bottom line - people, planet and profit. Through our offices in India and the United Kingdom, and an international network of partners and associates, CSM promotes responsible entrepreneurship, ethics and accountability worldwide. We are a values-based organisation committed to sustainable development and human rights.

CSM’s work is divided into five main work streams focussing on business, investors, workers, consumers and governance respectively. Our primary geographical focus is on developing and transition countries, and our key constituencies are ethnic minority communities in industrialised countries, and domestic industry and stakeholders in developing countries.

Our primary activities include the following:

Education & Training (Conferences, workshops, bespoke seminars & training courses);
Consultancy Services;
Programmes (local, regional & international);
Policy Engagement & Advocacy;
Portal & Resource Centre on corporate responsibility in developing countries;
On-line Services: Newsletter ‘Social Markets’, regional e-list serves, e.g. CSR Asia;
Research & Publications: Books, reports & discussion papers.
11.0 GLOSSARY

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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>BCF</td>
<td>Business and Community Foundation</td>
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<td>CCR</td>
<td>Corporate Community Relations</td>
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<td>CG</td>
<td>Corporate Governance</td>
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<td>CGR</td>
<td>Corporate Governance Ratings</td>
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<td>CII</td>
<td>Confederation of Indian Industry</td>
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<td>CRISIL</td>
<td>Credit Rating Information Services of India Limited</td>
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<td>Crore</td>
<td>Rs 10 million</td>
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<td>CSE</td>
<td>Centre for Science and the Environment</td>
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<td>CSM</td>
<td>Centre for Social Markets</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>CUTS</td>
<td>Consumer Unity and Trust Society</td>
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<td>DFID</td>
<td>Department For International Development (UK)</td>
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<td>ENVIS</td>
<td>Environmental Information System</td>
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<td>FDCG</td>
<td>Financial Deepening Challenge Fund</td>
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<td>FICCI</td>
<td>Federation of Indian Chambers of Commerce and Industry</td>
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<td>FMCG</td>
<td>Fast Moving Consumer Goods</td>
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<td>GEF</td>
<td>Global Environment Fund</td>
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<td>GIC</td>
<td>General Insurance Company</td>
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<td>ICRA</td>
<td>Investment information and Credit Rating Agency</td>
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<td>ICT</td>
<td>Information and Communication Technology</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IRDA</td>
<td>Insurance Regulatory and Development Authority</td>
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<td>ISO14000</td>
<td>International Organisation for Standardisation - Environmental Management</td>
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<td>ISO 9000</td>
<td>International Organisation for Standardisation - Quality Management</td>
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<td>Lakh</td>
<td>Rs 100,000</td>
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<td>LIC</td>
<td>Life Insurance Corporation of India</td>
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<td>M-CRIL</td>
<td>Micro-Credit Ratings International Limited</td>
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<td>MFI</td>
<td>Micro-Finance Institution</td>
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<td>MNC</td>
<td>Multi National Corporations</td>
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<td>NGO</td>
<td>Non Governmental Organisation</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>PIC</td>
<td>Partners In Change</td>
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<td>RBI</td>
<td>Reserve Bank of India</td>
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<td>ROCE</td>
<td>Return On Capital Employed</td>
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<td>SARB</td>
<td>South Asian Alliance for Responsible Business</td>
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<td>SEBI</td>
<td>Securities Exchange Board of India</td>
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<td>SHG</td>
<td>Self Help Group</td>
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<td>SME</td>
<td>Small and Medium sized Enterprises</td>
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<td>UTI</td>
<td>Unit Trust in India</td>
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SRI
IN ASIAN EMERGING MARKETS:

INDONESIA

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1.0 EXECUTIVE SUMMARY

Indonesian corporates, having tight family and friendship bonds, have long traditions of serving social objectives. However, the realization of an unsustainable future and the evolution of CSR on a global scale as a means to identify and implement solutions is generating boardroom reflection and operational repercussions worldwide. In spite of natural distinctions in business culture and CSR definitions, leading companies are responding - Indonesia is no exception (see 9.3, 9.5, Appendix 4).

Indonesia continues to operate under the shadow of the economic and subsequent socio-political crisis that erupted in 1997. A major stumbling block to renewed investor confidence in private and public sector business undertakings is a concern for a continuing lack of sound corporate governance practices (see 7.1). Investors want to believe their funds are being used in their interests, and that transparent and full disclosure of company results allows them to confidently monitor the investment performance of the companies in which they invest.

The Jakarta Stock Exchange (JSX), established in a private operational capacity since 1992, has focused on establishing basic modern fundamentals to support a reputable trading environment in a developing country context (see Appendix 1). The economic crisis drained significant momentum from the growing, albeit immature bourse. Recent corporate restructuring, institutional strengthening and policy improvements have combined to help stabilize the currency and improve overall investment scenarios (see 4.1).

SRI as an investment strategy is a relatively unknown phenomenon in the business, financial and social communities of Indonesia. However, there are interesting parallels between SRI and faith-based investment approaches, such as the Islamic (Syariah) principles. Syariah screening criteria (see 2.5), in particular its prohibition of interest/hedging practices, has enabled Islamic financial institutions/instruments to be relative beacons of stability during the economic crisis. Islamic investment strategy has expanded over the years to include a capital market Islamic Index (JII) (see 2.5.1) and a range of Syariah financial instruments. Comparison of recent capital market Indices indicates significant positive trends in JII results during a strengthening bourse and conventional bond market (see Appendix 2).

A continuation of these trends may encourage future SRI investment to take root and accelerate alternative growth in a variety of Islamic financial instruments. Indonesia faces extraordinary challenges as it designs its version of sustainability and perseveres with improvements in related risk areas (i.e. good governance, legal reform/enforcement, taxation, corruption, human/consumer rights, regional autonomy and politicking/power-sharing). As the gaps in imagination, understanding and leadership lessen the diffusion of good governance, business standards and human development increases. Great nations rise to challenges of integrity and long-term viability - Indonesia is no exception.

With a gradual improvement in corporate reporting (9.1), corporate awards (9.5) and corporate governance standards (7.0) there is an increasing pool of information that both global and domestic SRI investors can act upon. That this is beginning to happen, at least with respect to some global funds, is evidenced by the fact that some SRI research has already been conducted into Indonesian corporates, and this trend is likely to continue. Considering all the corporate, government, civil society and religious trends that this report highlights, the adoption of SRI in Indonesia may take time, but its roots should be strong.
2.0 SRI FUNDS

2.1 Domestic SRI Funds

None to date

2.2 Global SRI Funds Registered For Sale In Indonesia

None to date

2.3 Global SRI Funds With Significant Holdings In Domestic Market

Listed-company CFO’s and international securities firms have indicated that SRI funds have been investing in Indonesia. Morley Fund Management (Singapore) Ltd. has limited holdings in Indonesia. Research providers SAM and Socia Center have conducted research on a limited number of Indonesian companies (see 3.02).

The Blue Orchard Dexia Micro Fund has confirmed an investment of approximately US $1 million into the Indonesian micro-credit sector (4% or the current portfolio value of US $25 million). ¹

2.4 Private Equity Investment, Community Funds And International Development Funds

Over the past several years Indonesia has seen dramatic political liberalization, massive decentralization and substantial economic reform with higher levels of citizen participation. However, there remains significant uncertainty in efforts to minimize instability and restore economic growth. The process of transition has been a difficult one, leaving up to 40 million Indonesians living below the poverty line with no guarantee of fair, democratic and accountable mechanisms for governance of natural resources and quality of life at the community level.

Aside from expanding programmes at major international NGO representative offices (i.e. WWF, The Nature Conservancy (TNC), Conservation International (CI), International Business Leaders Forum (IBLF), Ford Foundation, Asia Foundation) an impressive increase in civil society organizations, widely known as NGO’s, has evolved to support community and environmental recovery (see Table 1 on "Major NGO's" below). These organizations, which receive up to 65% of their funds from international funding agencies, focus in five key areas; education and training, community development, micro credit, institution building and environmental conservation.

¹ Confirmed for Blue Orchard by Jean-Philippe de Schrevel, Blue Orchard, 4/8/03
See list of major international lenders and SRI themes (10.2)

A few of the major Indonesian NGO's are highlighted below:

2.4.1 KEMALA (Kelompok Masyarakat Pengelola Sumberdaya Alam)
www.bsp-kemala.or.id

KEMALA (meaning Natural Resource Management Community Group), is a component of the USAID/Indonesia Natural Resource Management programme (NRM) established in 1998. KEMALA is implemented by the Biodiversity Support Programme(BSP), a consortium of the World Wildlife Fund, The Nature Conservancy, and World Resources Institute with additional support from DFID and the Ford Foundation. BSP is managed by USAID’s Global Bureau Environment Center with a mission to promote conservation of the world's biological diversity and to maximize the impact of U.S. Government resources directed towards international biodiversity conservation. KEMALA is a focal point to build strong regional nodes through supporting NGO's and local community organizations. It's overarching focus is environmental protection and community human rights in Java/Sumatra, Maluku, Papua, Kalimantan and Sulawesi. KEMALA has evolved into a proven network of participatory community mappers, public interest lawyers, community organizers, coastal/marine advocates, agrarian and conflict resolution trainers and regional autonomy specialists.

2.4.2 DML (Dana Mitra Lingkungan)
www.dml.or.id

DML or ‘Friends of the Environment Fund’, was founded in 1983 under the initiative of a group of prominent public figures and captains of industry. DML provides a forum for Indonesian corporate leaders to examine environmental effects of their operations and consider alternative solutions to the challenges of eco-friendly development. DML’s centrist approach strives to promote methods that improve company bottom lines while also improving environmental quality and community living standards. DML takes a middle of the road position because its founders are striving to understand the complex world of the global economy along with the challenging opportunities to preserve the environment. Through corporate support, DML’s mission is to increase awareness of the importance in environmental protection and striking a healthy equilibrium between environmental preservation and nation building.

DML addresses environmental problems surrounding industrial and urban development that include issues on industrial pollution, solid and non-toxic waste recycling, public policy, community empowerment and CSR. DML's experts and partners work closely with local authorities, civil society and industry to facilitate development of intelligent and practical proposals through win-win approaches. Viable solutions emphasize the relationship between increased productivity on the one hand, and environmental protection and social improvement on the other.

2.4.3 KEHATI (Keanekaragaman Hayati Indonesia)
www.kehati.or.id

KEHATI, the 'Indonesia Biodiversity Foundation', received initial financial support as a grant(US $21 million) in the form of an endowment fund from USAID under a 10-year Cooperative Agreement. The fund enables KEHATI to conduct training, research/information, empowerment, advocacy, community/institution building, policy formulation, etc. as well as establish long-term commitments to conserve the country’s rich biodiversity. Domestic business enterprises and individuals sharing a concern for biodiversity conservation are crucial partners in KEHATI's engagement with multi-stakeholders to identify and pursue innovative ways to manage and conserve biodiversity resources. Given the significant progress in its conservation programmes and the magnitude of biodiversity destruction across the country, KEHATI cannot continue to rely on its endowment fund as primary financial support for its operations. It therefore endeavors to mobilize resources from a host of international and domestic sources. In joint efforts with
national and international partners, KEHATI has attempted to apply innovative conservation financing mechanisms (i.e. debt swaps) that will support biodiversity programmes in Indonesia in a sustainable manner.

The following is a list of major NGO’s showing funding and funding sources:\footnote{In part to Synergos Institute ‘CSRO Development in Asia: Indonesia Case’ 2001}

### Table 1 Major NGO’S – Funding Sources

<table>
<thead>
<tr>
<th>No.</th>
<th>Organization/ Programme</th>
<th>Type of Fund(s)</th>
<th>Fund Utilization</th>
<th>Grant/Loan Amount (Rp)</th>
<th>Source of Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Friends of the Environment Fund (Dana Mitra Lingkungan)</td>
<td>Corporate Grants</td>
<td>Regular support to WALHI (environmental NGO)</td>
<td>Varies year-to-year</td>
<td>Over 100 Private Companies</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Nature conservation/ education by NGO’s/ students/universities</td>
<td>4 million - 1.5 billion</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Small-scale funding to local NGO’s</td>
<td>8 million/ activity</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Bank Indonesia</td>
<td>Revolving Loan</td>
<td>Conservation - 5000 ha. community forest/critical land</td>
<td>30 billion - 10 years</td>
<td>Bank Indonesia</td>
</tr>
<tr>
<td>3</td>
<td>Strengthening Small Scale Enterprise and Cooperative (PUKK)</td>
<td>Corporate Grants</td>
<td>Managed as venture capital by Permodalan Nasional Mandiri and Bahana Ventura</td>
<td>2.75 billion</td>
<td>2.5% of State-Owned Enterprises (SOE) profit</td>
</tr>
<tr>
<td>4</td>
<td>Natural Resource Management Programme (NRM III)</td>
<td>Various Grants</td>
<td>Administers programmes in sustainable forestry, agriculture/coastal resources and protected areas</td>
<td>&gt; USD $15 million/year</td>
<td>USAID, WWF, TNC, WRI, DFID, FORD FOUNDATION</td>
</tr>
<tr>
<td>5</td>
<td>KEMALA Foundation</td>
<td>Government Grants</td>
<td>Supports 30 NGO’s in environmental/community-based programme implementation</td>
<td>Up to USD $500,000/year</td>
<td>USAID, EU</td>
</tr>
<tr>
<td>6</td>
<td>Indonesian Biodiversity Foundation (KEHATI)</td>
<td>Government &amp; Corporate Grants, Endowments</td>
<td>Support NGO’s/CBO’s in biodiversity/conservation, grants</td>
<td>4 million – 1.5 billion/activity</td>
<td>USAID 88%, ODA + Intl. NGO Grants 12%</td>
</tr>
<tr>
<td>7</td>
<td>Bina Swadaya Foundation</td>
<td>Domestic &amp; International Sources</td>
<td>Research, facilitation, micro-credit loans, consultancy &amp; banks to improve common welfare: self-help concept</td>
<td>100K – 15 million/activity</td>
<td>Domestic sources 90%, International NGO’s 10%</td>
</tr>
<tr>
<td></td>
<td>Organization</td>
<td>Funding Sources</td>
<td>Purpose</td>
<td>Amount/Duration</td>
<td>Notes</td>
</tr>
<tr>
<td>---</td>
<td>------------------------------------------------------------------------------</td>
<td>--------------------------------------</td>
<td>---------------------------------------------------------------------------------------------</td>
<td>-----------------</td>
<td>--------------------------------------------</td>
</tr>
<tr>
<td>8</td>
<td>Credit Union Coordination of Indonesia (Badan Koordinasi Koperasi Kredit Indonesia - BK31)</td>
<td>Bank Loans, Member Savings</td>
<td>Cooperatives development, micro-credit loans, education/training to network members</td>
<td>15 – 500 million/ activity</td>
<td>Domestic sources 60%, International NGO’s 40%</td>
</tr>
<tr>
<td>9</td>
<td>Astra Dharma Bhakti Foundation (YDBA)</td>
<td>Corporate Grant</td>
<td>Community development, education/training, publications</td>
<td>Various</td>
<td>P.T. Astra International, Tbk. ODA 40%, Intl. NGO’s 20%, Income/Fees 40%</td>
</tr>
<tr>
<td>10</td>
<td>Dian Desa Foundation</td>
<td>Domestic &amp; International Sources</td>
<td>Community development, research, micro credit, SME development, grants/loans</td>
<td>1 – 400 million/ activity</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Mitra Mandiri Foundation (United Way International)</td>
<td>Corporate Grants</td>
<td>Social services/health, credit provision, medium loans, education/training, welfare</td>
<td>20 – 150 million/activity</td>
<td>Mobil Oil, Freeport, Aqua, Citibank/Amex, Medco, P&amp;G, Bakrie, etc.</td>
</tr>
<tr>
<td>12</td>
<td>Indonesia Forum for the Environment (Wahana Lingguungan Hidup Indonesia - WALHI)</td>
<td>CSRO Grant, International Sources</td>
<td>Environmental conservation, human rights, small/medium size grants/loans</td>
<td>50 – 200 million/activity</td>
<td>ODA 50%, Intl. NGO’s 50%</td>
</tr>
<tr>
<td>13</td>
<td>Lembaga Penelitian, Pendidikan dan Penerangan Ekonomi &amp; Sosial (LP3SE)</td>
<td>Government Grants, Endowments</td>
<td>Research, publications, education/training, community development, large grants</td>
<td>100+ million/ activity</td>
<td>ODA 60%, Intl. NGO’s 10%, Indo. Gov. 20%</td>
</tr>
<tr>
<td>14</td>
<td>Indonesia Prosperity Foundation (Yayasan Indonesia Sejahtera - YIS)</td>
<td>Corporate Grants, Endowments</td>
<td>Community development, public health, research, credit provision, medium grants/loans</td>
<td>1 – 45 million/ activity</td>
<td>Income/Fees 30%, Endowments 25%, Intl. NGO’s 45%</td>
</tr>
<tr>
<td>15</td>
<td>Yayasan Bina Usaha Lingkungan (YBUL)</td>
<td>Domestic &amp; International Sources</td>
<td>Facilitate environmental care, education/training, technology, micro-credit, grants</td>
<td>70 million – 1.5 billion</td>
<td>World Bank/GEF-SGP, Winrock, USAID</td>
</tr>
<tr>
<td>16</td>
<td>Yayasan Dharma Bhakti Parasahabat (YDBP)</td>
<td>Domestic Sources</td>
<td>Grameen micro-credit replication throughout Indonesia (Java so far)</td>
<td>500K – 2 million/credit</td>
<td>Individual investors, self-financing</td>
</tr>
<tr>
<td>17</td>
<td>Yayasan Dian Mandiri (DIMAN)</td>
<td>International &amp; Domestic Sources</td>
<td>Grameen micro-credit replication throughout Indonesia (Java so far)</td>
<td>500K – 2 million/credit</td>
<td>Opportunity International, local business/government</td>
</tr>
</tbody>
</table>
2.5 Islamic Investment In Indonesia

Islam encourages people to invest for the long-term future. Investment is in accordance with Islamic principles (Syariah) that are realized through deposits/savings in Syariah banks or via Syariah bonds/shares in both public and private listed corporations in the capital market. However, investment utilizing Syariah methods requires an investor awareness of the strict compliance to codes of operational conduct honored by the Syariah-certified companies in receipt of those funds. The Jakarta Islamic Index (JII) therefore aims to provide a basic performance benchmark for investors to profit from investment in Syariah financial instruments in Indonesia.

2.5.1 Jakarta Islamic Index

P.T. Danareksa Investment Management (DIM) and P.T. Jakarta Stock Exchange (JSX) recently launched an Islamic index of shares based on traditional Islamic Principles: the Jakarta Islamic Index (JII). JII is one of the DIM products in cooperation with the JSX based upon an MOU to develop Syariah within the stock exchange. The JII currently includes 30 Syariah corporations. Criteria for selection and certification of the stock in JII companies has been developed by the Dewan Pengawas Syariah (Syariah Supervision Board) at DIM until further notice from Dewan Syariah Nasional and Majelis Ulama Indonesia (National Syariah Board and the Indonesia Ulama Council).

The Objective of JII is to function as a benchmark to measure the performance of investment in Syariah shares. The Goal of the JII is to increase the trust level of investors to develop further equity investments utilizing Islamic Principles.

2.5.2 Syariah Investment Categorization

Out of the total listed companies in the JSX, many do not meet Syariah criteria, automatically excluding those shares from Syariah eligibility. According to the Syariah Supervision Board (SSB), the major business activities that violate Syariah principles include:

- Gambling and related recreation or unethical business transactions in trade
- Conventional financial institutions such as banks and insurance companies which utilize interest and profit orientation as the major means of revenue generation
- Activities that produce, distribute and trade in haram (forbidden) food and beverages
- Activities that produce, distribute or provide products and services which damage moral standards and/or provide no useful natural purpose

Considering various economic factors that influence corporate financial performance, the SSB decided to exclude numerous financial ratios of corporate performance from the Syariah selection criteria until the national economic recovery becomes further stabilized and public firms have established a more significant degree of good governance. Stocks of publicly-listed companies not eligible due to Syariah criteria are excluded from the JII.
2.5.3 Stock Selection Methodology at JII

The determination of stocks for JII index inclusion has been determined via a specific calculation methodology:

- 60 stocks are chosen from a recognized Syariah performance list, based on the highest value of average market capitalization during the past year.
- A subsequent ranking of those stocks is based on average liquidity of regular trading value for the most recent full calendar year in order to determine the top 30 performers in the JII.

A semi-annual review of the JII is performed with index component determination each January and July. Changes in listed company activities are monitored regularly based on available public data.

2.5.4 Syariah Supervision Council

To ensure that all Syariah categorized stocks meet established Islamic Syariah guidelines, the Syariah Supervision Council at DIM has established stock selection criteria. In addition, a compliance audit of the criteria is available which focuses on transaction validity and business structure integrity. An interesting difference in the Indonesia transaction criteria is its emphasis on historical and projected revenue compared to a focus on profit in Malaysia.

2.5.5 Index Calculation

For details on the Index Calculations see Appendix 2

3.0 SRI RESEARCH IN INDONESIA

3.1 Domestic SRI Company Research

No SRI research is presently conducted in Indonesia.
3.2 International SRI Research Groups Covering The Domestic Market

Researchers/analysts on behalf of the major national/international securities houses with a presence in Indonesia have an awareness of SRI but have generally given it little or no priority in terms of significant market analysis or investment potential.

Sam Research Ltd. has conducted limited research into Indonesian companies, including the cigarette manufacturers Gudang Garam and Hanjaya Mandala Sampoerna and also into Telekomunikasi Indonesia (Telkom).

Socia Center, has conducted research into mainly multinationals with a major presence in Indonesia, including P.T. Astra International and P.T. Barito Pacific.

4.0 GOVERNMENT INITIATIVES

Growth, environmental protection and social justice go hand-in-hand in any vision of true sustainable development. Over the years, rapid economic growth in some parts of the country has created an overall rise in per capita income and rich dividends for many Indonesians. However, the disproportionate prosperity, corrupt oversight and subsequent economic crisis resulted in significant income disparity and pollution, for which Indonesians are paying a heavy price in terms of social well-being, human health and natural resource degradation. Many well-intended policy initiatives have survived a consultative process riddled with political self-interest to become reasonable programme frameworks to address these challenges, but beneficial results are scarce and continue to suffer from a lack of adequate inter-ministerial coordination, detailed implementation, resource/budget allocation and effective enforcement.

4.1 Government Policies/Programmes

<table>
<thead>
<tr>
<th>No</th>
<th>Government Policies/Regulations/Programmes</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Law No. 23/1997 on Environmental Management</td>
<td>Defines corporate responsibility, company activity and public role in environmental management</td>
</tr>
<tr>
<td>2</td>
<td>Law No. 10/1998 on Banking</td>
<td>Relevance to bank finance practices (incl. Syariah) – banks must consider EIA in lending</td>
</tr>
<tr>
<td>3</td>
<td>Law No. 8/1995 on Capital Market An obligation to report on corporate governance, including some major environmental aspects</td>
<td>Regular reporting requirements for all JSX companies for BAPEPAM submittal and public scrutiny</td>
</tr>
<tr>
<td>5</td>
<td>Board of Director JSX Decree No. Kep-316/BEJ/06/2000 on Requirements and Procedures for JSX Listing</td>
<td>Listed companies are in environmental compliance by filing EIA. Forestry companies should have eco-labeling certification</td>
</tr>
<tr>
<td>6</td>
<td>Law No. 19/2002 on Intellectual Property/Copyrights</td>
<td>Procedures on comprehensive compliance/enforcement of IP piracy/prevention</td>
</tr>
</tbody>
</table>

3 www.asria.org/sri/asia/research?expand_all=1
4 www.asria.org/sri/asia/research?expand_all=1
<table>
<thead>
<tr>
<th>No.</th>
<th>Law/Regulation Description</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Industrial Performance Rating Programme (PROPER) based on various Laws/Regulations/Decrees between 1995-2001</td>
<td>Voluntary industry-wide initiative to account for environmental regulation compliance via colour rating/public awareness/award scheme</td>
</tr>
<tr>
<td>9</td>
<td>Law No. 5/1999 on Antimonopoly and Unfair Competition</td>
<td>Levelling the field in production and services to control business competition and violation of public interests/consumer rights</td>
</tr>
<tr>
<td>10</td>
<td>Ministerial Decree No. KEP 117/M-MBU/2002 on Corporate Governance (CG) in SOE’s</td>
<td>Requirements for all state owned companies (SOE’s) to adopt &amp; implement CG guidelines</td>
</tr>
<tr>
<td>11</td>
<td>Board of Director JSX Decree No. Kep-315/BEJ/06/2000 on Requirements &amp; Procedures for GCG</td>
<td>Independent Commissioners, Audit Committee &amp; Corporate Secretary become mandatory</td>
</tr>
<tr>
<td>13</td>
<td>MPR Decree No. 9/2001 on Agraian Reform and NRM</td>
<td>Mechanism to settle land disputes and protect natural resources</td>
</tr>
</tbody>
</table>

Sources

5 Law No. 8/1995 on Capital Market
   Law No. 23/1997 on Environmental Management
   Law No. 10/1998 on Banking
   JSX & BAPEPAM websites (regulations)
5.0 SRI ORGANISATIONS

There are currently no organizations in Indonesia actively promoting SRI. However, there are a number of NGO's and firms assisting in the fields of CSR and a range of sustainable development issues.

5.1 Some Leading Organisations Involved In CSR And Sustainable Development

5.1.1 Leadership for Environment & Development (LEAD) lead.or.id
A resource centre for SD training, IT services, and networking.

5.1.2 Forum for Corporate Governance in Indonesia (FCGI) fcgi.or.id
This organization has been active in linking corporate governance with CSR strategy/practices.

5.1.3 Indonesia Rainbow Foundation (Pelangi) pelangi.or.id
Environmental policy research/recommendations, project consultancy

5.1.4 Society for Islamic Society (Masyarakat Ekonomi Syariah - MES) economisyariah.org.id
Policy development, awareness, consultation on Syariah principles, investment & financial instruments.

5.1.5 Institute for Development, Economic and Finance (INDEF)
A research Institute for development, economy and finance

5.1.6 Foundation for Humanitarian Projects in Indonesia (Yayasan Kemanusiaan Indonesia) humanitarianprojectsindonesia.org
Health as a basic human right; medical care, IT, equipment, advice

5.1.7 Forest Watch Indonesia (FWI) fwi.or.id
Public/private sustainable forestry policy, research, practices, monitoring & publications

5.1.8 Telepak Indonesia telepak.org
Natural resource management advocacy, capacity building, research, policies, etc. (forestry, fishery, etc.)

5.1.9 Indonesia Ecolabel Institute (Lembaga Ecolabel Indonesia (LEI) lei.or.id
Insure the sustainability of all environmental resource functions

5.1.10 International NGO Forum on Indonesian Development (INFID) infid.be
Communication facilitation amongst NGO’s on democratic principles and environmental justice to insure human rights and civil society participation

5.1.11 International Association of Students for Commerce, Economics and Science (AIESEC) aiesec.org
A leading global university network of students supporting CSR, cultural understanding, higher education and information-sharing with an active Indonesian chapter.

5.1.12 Indonesia Business Links (IBL) ibl.or.id
National/international companies in Indonesia committed to ethical business practice supporting technology transfe amongst peers and SME’s (affiliated with IBLF - U.K.)
5.2 Other Related Organisations

A list of NGO's managing development funding above: (2.4)
A list of consumer and advocacy organizations (6.1)
A list of organizations active in improving corporate governance (7.0)

6.0 PUBLIC AWARENESS

As government, business and consumer awareness levels evolve to better understand how transparent, accountable institutions, systems and behavior benefit society, the concept and characteristics of SRI gain momentum. Indonesia continues to struggle in its recovery from dramatic economic/financial collapse and emerge as a fledgling democratic republic - the transition in key sectors (such as political, judicial, commercial, fiscal, institutional) naturally takes time.

6.1 Consumer And Public Surveys

Analysis of existing surveys/reports demonstrates a low level of consumer awareness and public opinion on environmental/social issues (i.e. 5%). Consumer solidarity and concern for major issues is weak due to minimal education, historical/cultural interaction and a pricing orientation related to income gaps, survival modes and affluent lifestyles. Approximately 20% of the more than 40 million workers employed in the formal sector have unionized, reflecting a concern for workers' bargaining power. However, a recent survey of capital market participants, academia and the investment community indicates significant awareness and support for additional environmental parameters (88%), including an environmental index and internal costing of external environmental factors to insure more sustainable operational practices and realistic market pricing (For full details on these surveys see Appendix 3).

Quantum leaps in policy development are not understood well by a majority of the general public, who are experiencing continuous infringement on their rights and resources. Media, public relations firms and NGO's have come to play a critical role in communicating on a broad range of environmental and social trespasses during a reformation period that encourages open, accurate dialog. NGO's are likewise gaining support and influence, due to the new paradigm in multi-stakeholder viewpoints and would benefit further from an impartial oversight/certification authority.

6.2 Indonesian Consumer And Advocacy Groups

6.2.1 Indonesian Consumers Organization (Yayasan Lembaga Konsumen Indonesia - YLKI) ylki.org
Consumer protection and consumer awareness; seminars/training, publications, etc.

6.2.2 Indonesian Green Consumers Foundation (Yayasan Lembaga Konsumen Hijau Indonesia - YLKHI)
Promotes green consumerism

6.2.3 Indonesia Forum for the Environment (Wahana Linguungan Hidup Indonesia - WALHI) walhi.or.id
Environmental Advocacy (forestry)

6.2.4 Indonesia Mining Advocacy Network (Jaringan Advokasi Tambang (JATAM) jatam.org
Environmental Advocacy (mining)
7.0 CORPORATE GOVERNANCE INITIATIVES

7.1 Introduction To Corporate Governance (CG) In Indonesia

Implementation of good corporate governance (GCG) practice in Indonesia has shown positive progress since its introduction less than three years ago, despite overall lack of support from the government and general public. A Corporate Governance Code was revised by the capital market authorities in 2000/2001. Pursuant to an IMF recommendation, both the World Bank and ADB have contributed resources to support the establishment of a National Committee for Corporate Governance (NCCG) in 2000 as well as a number of subsequent programmes, workshops and forums on CG. NCCG issued a ‘Code of Best Practice’ in 2001 that has contributed meaningfully to the foundation for capital market and corporate implementation of CG in Indonesia. Both the JSX (7.2.1) and BAPEPAM (7.2.2) have been persistent in efforts urging business adoption and compliance to maximize shareholder value through improved application of principles related to transparency, accountability, trustworthiness, responsibility and equity. The guidelines also encourage a sense of social responsibility, environmental protection, shareholder rights, moral norms and legal compliance.

The most recent regulations issued by BAPEPAM/JSX address audit committees and independent commissioners. Many CG initiatives remain voluntary, yet a number of corporate leaders have recognized the benefits of implementation in terms of improved competitiveness/productivity, access to capital/qualified staff, HRD/industrial relations, Commissioner/Director professionalism, share price/profitability, disclosure/decision-making, etc.

Recent independent CG market analyses (2002/2003) conducted by security houses (CLSA/ACGA/Bahana), accounting institutions (PwC/ACCA/McKinsey) and international organizations (OECD/PERC/TI) highlight a number of common positive trends and serious concerns.

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<table>
<thead>
<tr>
<th>+ Trends +</th>
<th>- Concerns -</th>
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<tbody>
<tr>
<td>New rules/regulations expand compliance scope</td>
<td>Reduction in corruption, collusion &amp; nepotism (KKN)</td>
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<tr>
<td>Accounting standards improvement (IGAAP)</td>
<td>Stronger, consistent enforcement of existing rules, regulations &amp; sanctions</td>
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<tr>
<td>Strengthening of GCG culture/support organizations</td>
<td>Greater disclosure and transparency - financial statements, annual reports and related parties</td>
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<tr>
<td>Improved disclosure</td>
<td>Clearer separation of ownership and management</td>
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<td>More independent boards</td>
<td>Better definition of Directors’ role &amp; responsibilities</td>
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<td>Audit committee introduction</td>
<td>Improved audit committee role</td>
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<td>Independent commissioners requirement</td>
<td>Broader education &amp; socialization of GCG code/rules</td>
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<tr>
<td>Investor premiums between 17-25% for GCG implementation</td>
<td>Improved risk management &amp; compliance processes</td>
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<td>Media awareness</td>
<td>More effective external audits</td>
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<td></td>
<td>Less minority shareholder sufferance/abuse</td>
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<td></td>
<td>Ethical taxation collection methodology</td>
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</table>

The Indonesian Institute for Corporate Governance (IICG) organized the 2nd annual GCG Awards in 2002 based on its GCG Perception Index shared with all JSX member companies. Seven GCG categories were used to rank and evaluate respondents, based on their positive adoption of the following criteria.

- GCG Commitment
- Rights of Shareholders
- Board of Commissioners
- Functional Committees (Audit, Remuneration & Nomination)
- Board of Directors
- Transparency & Accountability
- Shareholder Relations

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<tr>
<th>Corporate Governance Perception Index (CGPI) 2002</th>
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These results compare fractionally to the most recent quartile CG ratings from CLSA/ACGA in which Unilever, Bank Central Asia, Telkom and Aneka Tambang were respective leaders. GCG is not just an Indonesian issue - the compilation of various market analyses likewise evaluates Indonesia CG on both a regional and international basis, casting a comparatively negative light on progress achieved to date. In early 2003 CalPERS divested from several Asian markets, including Indonesia, due to a negative mix of market liquidity/volatility, market regulation, investor protection, capital market openness, settlement proficiency, transaction costs, political stability, financial transparency and labor standards.

Implementing GCG is difficult to separate from the macro-environment in which companies operate. Public institutions need to perform their roles, functions and tasks in accordance with good governance principles. The government lacks proactive political will at all levels to affect the required legislative, regulatory and administrative changes associated with effective good public governance (GPG) and GCG. A 2003 survey conducted by UNDF/World Bank shows that 65% of Indonesian households are victims of corrupt officials. The same survey indicates households spend over 1% of income on bribes while business expends as much as 10%. The general public and supporting organizations need to better realize and assertively to hold authorities and business accountable for corrupt transgressions.

Please also refer to the Astra Reporting Case Study (9.4) for corporate governance trends in Indonesia.

For regulatory initiatives by the Government please also see 4.1
For information on shareholder associations and activism see 8.0

7.2 Organisations Promoting Corporate Governance

7.2.1 Jakarta Stock Exchange (JSX)  jsx.co.id
Stock Exchange

7.2.2 Capital Market Supervisory Agency (Badan Pengawas Pasar Modal - BAPEPAM) bapepam.go.id
Stock Exchange watchdog

7.2.3 Indonesia Institute for Corporate Governance (IICG)  iicg.org
Corporate governance development, awards (see 7.1) & shareholder activism

7.2.4 National Committee for Corporate Governance (NCCG)  nccg-indonesia.org
Policy development, support structures, institutionalization and socialization driver for good corporate governance

7.2.5 Forum for Corporate Governance in Indonesia (FCGI)  f cgi.or.id
Linking corporate governance with CSR strategy/practices

7.2.6 Indonesian Institute of Accountants (IAI)  akuntan-iai.or.id
National body to improve accounting practices

7.2.7 Center for Local Government Innovation (CLGI)  clgi.or.id
Supports excellence in local governance

7.2.8 Partnership for Governance Reform  partnerships.or.id
Governance reform in decision-making and resource allocation, eradicate corruption, supremacy of law

The Government lacks proactive political will to effectively challenge corruption and promote good public and corporate governance.
7.2.9 **Indonesia Corruption Watch (ICW)**  antikorupsi.org
Systematic freedom from corruption based on social justice - awareness, participation, enforcement, monitor/empower, etc.

7.2.10 **Business Watch Indonesia (BWI)**  unisosdem.org
Business accountability and fairness issues researched and converted into action and NGO network support

7.2.11 **Transparency International (TI) / Indonesia Society for Transparency (MTI)**  ti.or.id / transparansi.or.id
Leaders in corruption awareness/monitoring/avoidance and good governance to strengthen accountability

7.2.12 **Indonesia Institute for Corporate Directorship/Commissioners & Directors (IICD)**  nccg.org
Strategic business partners to develop and internalize directorship skills, knowledge and ability to implement GCG. Affiliated with NACD (USA)

7.2.13 **Corporate Leadership Development Institute**  cldi-i.com
An instrument of strategic intervention for all State Owned Enterprises (SOE’s) to develop future corporate leaders, including a healthy dose of CG

7.2.14 **Indonesian Society of Independent Commissioners (ISICOM)**
A leading association supporting the implementation of CG guidelines and practices from professional directorship perspective

7.3 **Corporate Governance Case Studies**

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<tr>
<th>No.</th>
<th>Event</th>
<th>Issues</th>
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<tr>
<td>1</td>
<td>Lippo Bank</td>
<td>Investment Management &amp; Performance Agreement (IMPA) confidentiality/dubious financial reporting/Director accountability/BAPEPAM regulatory enforcement</td>
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<td>2</td>
<td>Kimia Farma</td>
<td>Dubious financial reporting/Director accountability, BAPEPAM regulatory enforcement</td>
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<td>3</td>
<td>Texmaco</td>
<td>Master Settlement Acquisition Agreement (MSSA) manipulation/owner accountability/BAPEPAM regulatory enforcement</td>
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<td>4</td>
<td>Semen Cibinong</td>
<td>Asset (equity) Off-balance sheet manipulation/owner accountability/BAPEPAM regulatory enforcement</td>
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<tr>
<td>5</td>
<td>Indomobil</td>
<td>Credit asset (property) (re)purchase misappropriation/owner accountability/BAPEPAM regulatory enforcement</td>
</tr>
<tr>
<td>6</td>
<td>Bumi Resources</td>
<td>Minority shareholder rights/transparency in asset acquisition/Director accountability/BAPEPAM regulatory enforcement</td>
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</table>
8.0 SHAREHOLDER ACTIVISM

Shareholder activism and investor governance initiatives have grown in concert with the public introduction and gradual development of good corporate governance initiatives begun in earnest since 2000. Leading activists highlight moral hazard and bureaucratic inefficiency repeatedly in the lack of enforcement and unequal application of law - determining factors that motivate non-compliance both inside and beyond the commercial sector. A number of high profile infractions fingered over the past couple years attest to occasional deviation and uneven recourse (see Table below). For example, the recent Lippo Bank mishap not only raises director-owner transparency-accountability issues, it triggers deeper concern from a realization that the majority of bank shares, temporarily in government hands, remain subject to political intervention. (i.e. director appointment, credit distribution, asset settlement/foreign acquisition, debtor release/discharge, etc.)

A representative group of minority shareholders recently established an equity presence in the capital market (LQ 45) as an independent shareholder association - a promising trend to counter the occasional lack of ethics and competency in implementing legal oversight and raise awareness levels. Several NGO's and firms have discovered meaningful purpose in defending the common rights of abused parties and supporting others short on power and influence (See 7.2). Much remains to be done.

9.0 CORPORATE DEVELOPMENT AND RESPONSE

9.1 Corporate Reporting

The presence of a significant number of multinational corporations in Indonesia along with the adoption of ISO14000 standards by many companies has encouraged a movement towards social and environmental reporting in Indonesia. A few companies, such as P.T. Astra International, Tbk., have produced or are producing approximate versions of internationally recognized standards for sustainability reports.

9.2 BAPEDAL Report

In 2001, BAPEDAL (the Environmental Impact Management Agency, which recently merged with the Ministry of Environment), examined the status of environmental reporting in Indonesia. In addition, a recent review of current overall reporting practices in the business community indicates the following results:

- A small percentage of Indonesian companies have produced environmental/social/sustainability reports that exhibit varying degrees of qualitative and quantifiable content (see examples below). Several firms are in the process of increasing quantitative content and engaging 3rd party verification to achieve higher levels of sustainable corporate reporting during 2003. Others consider those goals as realistic objectives in 2004.

- Some companies have clearly associated environmental reporting with ISO 14000 series certification and Environmental Performance Indicators - measurement of enterprise effectiveness/efficiency in the utilization of relevant resources. Although CSR as a value driver is mainly skin-deep, many companies are in the process of developing effective approaches to identify, apply, integrate, quantify and report on sustainability initiatives.
9.3 Leading Company Examples - Corporate Reporting

9.3.1 Freeport-McMoran Copper & Gold (mining)

2002 Sustainability Report ('Real People, Real Commitment') is the company's first annual qualitative/quantifiable attempt to highlight a combination of relevant economic, environmental and social conditions, challenges, programmes and benefits primarily in Eastern Indonesia. The companion document is not yet fully integrated into overall 2002 corporate financial reporting or verified by qualified 3rd parties.

9.3.2 P.T. Astra International, Tbk. (holding company)

2002 Green Report is a 'leading edge' environmental/community development documentation in Indonesia which summarizes the business Group's evolving efforts in qualitative and quantifiable ways related to its diverse range of company operations. The Green Report is not yet fully integrated with relevant 2002 corporate financial reporting or verified by qualified 3rd parties (see Company Reporting Case Study 9.4).

9.3.3 Asia Pacific Resources International Holdings, Ltd. (APRIL) (forestry)

2000-2001 Environmental & Social Review ('Nurture') is the first Group report combining both disciplines with an Indonesia focus on steady progress, multi-stakeholder participation and assertive solicitation for feedback in achieving international standards of excellence in the pulp/paper industry. 3rd party verification and further operational integration of sustainability practices is a commitment in a more comprehensive 2003 Sustainability Report.

9.3.4 P.T. Kaltim Prima Coal (mining)

2002 Social & Environmental Report ('More Than Mining') recounts consistent progress in its commitment to transparent social & economic programmes to increase community welfare in mining areas with a focus on HRD, safety, community (including micro-credit), environment and a dedicated foundation. 3rd party verification and further operational integration/quantification of sustainability practices is a logical next step.

9.3.5 P.T. Newmont Nusa Tenggara (mining)

2002 Sustainability Report ('Now & Beyond') is the result of a global HQ initial effort to support achievements and challenges in individual mining conditions related to economic, safety, employee, environment and community accountability. Newmont is a Global Mining Initiative/Mining, Minerals & Sustainable Development leader utilizing a 5-Star assessment process to enhance disclosure content with a commitment to 3rd party verification in 2003.

9.3.6 Beyond Petroleum - BP (oil & gas)

Utilizing a major greenfield gas development project with 3rd party verification and reputable donors/ multi-stakeholders to demonstrate world renowned sustainability implementation experience while other corporate divisions develop and align ad hoc environmental/community initiatives into an eventual national sustainability framework.

9.3.7 P.T. Unilever Indonesia, Tbk. (consumer goods)

In keeping with its mantra of 'Global challenges-local actions, global policies-local initiatives, global reporting - local performance', major programmes in water stewardship, sustainable fisheries, public health and SME development are strong testimony to its leadership and commitment to environment/social development in country. Further operational integration, quantification and 3rd party verification are under consideration.
9.3.8 Citibank (financial services)

Active involvement (including Citi employees) in community development, education, capacity building and micro-finance programmes as well as a leading domestic proponent of the new Equator Principles re environmental and social guidelines on project finance. Perfect timing to quantify and integrate into operations to maintain a leading MNC role.

9.3.9 P.T. Indocement Tunggal Prakasa, Tbk. (cement)

They are gradually implementing environmental and social programmes including climate change/ emission control. Further progress is anticipated in moves toward more sustainable business practices and reporting in 2003.

9.3.10 P.T. Indofood Sukses Makmur, Tbk. (food/snacks)

The Bogasari Flour Milling Division implements exemplary CSR initiatives in 5 categories; HRD, environment, CG, social cohesion & economic strengthening. Environmental and community programmes emphasize SME development while internalizing sustainable values and work methods. The holding company supports education/awareness initiatives and has designs to begin a broader assessment of sustainability benefits in 2003.

9.3.11 P.T. National Gobel (electronics)

Various 2000/2001 management programmes on solid/hazardous waste, energy reduction, water/gas consumption, HRD, green products and environmental accounting. Programme implementation throughout the (Matushita) production network (9 plants) and reporting are not yet annualized/integrated into group operational/financial performance.

9.3.12 P.T. Nestle Indonesia (food/beverage)

Ad hoc reports (2000/2001) summarize factory and apprentice operations in East Java highlighting HRD and community participation. Also involved in coffee/cocoa/palm oil supply chain QC initiatives and donations to conservation, education, health and gender initiatives. Annual reporting of overall national operations (4 plants) and related environmental/social issues is not available. A CSR Update is planned for 2003.

9.3.13 P.T. Uni Seraya (wood products)

First corporate Chain of Command (CoC) certification in Indonesia confirming sustainable forest management practices (FSC standard) in wood sourcing for moulding, doors and furniture production. Critical aspects related to planning, documentation and field operations (plantations, logging, woodworking) across group related companies were concluded in 2002 to earn SGS/LEI accreditation/certification including WWF attestation. Current financial/sustainability reporting is at an elementary stage.

9.3.14 P.T. Aneka Tambang, Tbk. (mining)

2002 Annual Report (financial) briefly outlines numerous environmental and community initiatives without quantification or operational integration and includes qualitative progress on good governance. Aneka Tambang is also publicly-listed in Australia and a top-level leader in good corporate governance reporting with recent awards from IICG, JSX and the Ministry of State Owned Enterprises (SOE’s).
9.3.15 P.T. Bank Dagang Bali (banking)

A private bank specializing in delivering financial services profitably to the low-income public. Since 1970, the longest serving formal sector financial institution providing micro-finance on a substantial scale in a developing country on a continuous, profitable basis without a subsidy. Sustainability is its lifeblood while sustainable reporting is becoming a priority.

9.3.16 P.T. Kawasan Industri Jababeka, Tbk. (industrial estate)

First integrated sustainable industrial real estate development in Indonesia established in 1989 with over 1000 companies, infrastructure, housing/recreational facilities and elementary - university education. Progressive expansion of estate-wide environmental and community development programmes - the benchmark in eco-industrial estates in Indonesia.

9.4 Company Reporting Case Study


Known throughout the Asian region as a leading, well-managed Indonesian-based automotive conglomerate, a look under the hood at P.T. Astra International, Tbk. reveals its founding roots lay in basic CSR principles and values that bespeak a history of impressive business growth and performance. The journey to modern day financial prominence, corporate governance role model and sustainability aspirant is an inspiring tale likely to motivate other company quests for public recognition, commercial success and long-term shareholder value. Successful completion of restructuring demands and rights issues has enabled a refocus on the basics, including GCG and a deepening sustainability agenda.

Its current preeminent position in Indonesia is no surprise to its senior executives, who have consistently espoused a credo of integrity, best practices, transparency, responsibility and business value creation. These have become essential elements driving processes and performance to higher levels of profitability, social responsibility and environmental conservation. The growing commitment to triple bottom line implementation exemplifies solid progress in good governance development and helps to ensure a sound financial position, strong sense of community and healthy operational environment for the greater Astra family of companies, shareholders and stakeholders.

The summary of the PT Astra 2002 Green Report is in Appendix 5.

9.5 Corporate Rewards And Ceremonies

2001 was the first year in which annual ceremonies have been performed to recognize financial reporting and good governance accomplishments within the business community. These events have been driven by a combination of factors related to improvements in tax compliance, capital market integrity and corporate citizenship. The intention is to demonstrate positive contributions to help recover investor confidence and accelerate the national economic recovery. Based on an evaluation of 83 Annual Reports (financial) from 2001, public and non-public companies, including SOE’s, were ranked according to extensive criteria (see Appendix 4) in August 2002. The top 3 winners were:

- P.T. Asuransi Bintang, Tbk.
- P.T. Aneka Tambang, Tbk.
- P.T. Astra Graphia, Tbk.

Corporate awards for CG and financial reporting were introduced in 2001.
The evaluation was conducted by examining the audited Annual Reports for 2001 under criteria emphasizing the implementation of good corporate governance principles. The Jury Committee selected potential top rated companies and interviewed their management. The Jury Committee did not perform any audit or investigative audit, or any related procedures in this evaluation process.

10.0 COMMUNITY INVESTMENT AND MICRO-FINANCE

Micro-finance is commonly defined as the provision of financial services provided (savings and/or credit) to economically active low-income groups in different occupations (the poor, low-income households and micro-entrepreneurs). These services are often in the form of poverty alleviation projects and important for the economic development of the informal sector and the creation of employment. Consequently, micro-finance contributes to relieving poor target groups (i.e. small farmers/fishermen/entrepreneurs) by serving a clientele that either has no access or insufficient channels to the formal banking system and by offering services in rural areas where the formal banking system is not sufficiently represented. Even as Indonesia’s financial system collapsed during the crisis, the leading micro-finance institutions remained liquid, profitable and stable. Steady progress since on key constraints in the business environment, such as security, inefficient bureaucracy, misguided policy and legal uncertainty, is creating a more prospective climate for micro-finance infrastructure and services to flourish. Bank Indonesia now requires all banks to have a strategy and business plan related to MSME portfolio development. According to the Director of Rural Bank Supervision, over Rp. 170 trillion has been channeled into the MSME sector to date with another Rp. 43 trillion set aside for qualification and disbursement - average annual ROI has hovered around 25%.

10.1 Provision Of Micro-Finance Programmes

Micro-finance is provided to beneficiaries in Indonesia from a variety of formats and programmes summarized:

7 Bapepam Press Release re Annual Report Award, August 2002
### Regulated:
- Commercial banks with micro-finance windows: BRI, BPD
- BPR's (People's Credit Banks)
- Cooperatives
- LDKP - Lembaga Dana dan Kredit Pedesaan (Rural Micro-finance Institution)
- G-G Donor Activities (see Appendix 5)

### Non-regulated:
- Self-help Groups
- NGO's
- Credit Unions
- Baitul Maal wat Tamwil (local financial institution established by Islamic NGO's)
- Dakabalarea (established by private sector/individuals in West Java)

### Bank Indonesia (2002 Report):
- Total active BPR: 2,141 (82 are BPR Syariah)
- Total assets: Rp. 8,393 trillion (September 2002)

### 10.2 Examples Of Micro-Finance Programmes In Indonesia

The following table illustrates a number of SRI categories and micro-finance projects listed according to donors and indicating the amounts of overall investment. A large percentage of the G-G donors strive to channel funds to relevant implementers (NGO’s) for targeted implementation or route funds through ongoing country programmes with major international donors (IMF, World Bank, ADB, EU, etc.). This enhances communication, recipient relationships and technology transfer while insuring host government involvement in a coordination/administration capacity to minimize unnecessary intervention and preempt the tendency for corruption.
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<tr>
<td>1</td>
<td>ADB</td>
<td>Farmer income</td>
<td>Rural Income</td>
<td>Poverty reduction via micro-enterprises</td>
<td>Micro-finance to mobilize savings/access credit to improve livelihoods</td>
<td>762,200,000</td>
<td>79,000,000</td>
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<td>NRM-coastal reefs</td>
<td>Community</td>
<td>Community empowerment in the villages</td>
<td>Community-based savings/loans in Sulawesi</td>
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<td>Financial governance</td>
<td>Empowerment for Rural Development</td>
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<td>SME exports</td>
<td>Micro-Credit</td>
<td>Micro-enterprise development for poor/near poor</td>
<td>Credit/savings support in 5 provinces</td>
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<td>Renewable energy</td>
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<td>Power transmission</td>
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<td>SOE governance &amp; restructuring</td>
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<td>Decentralization</td>
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<td>2</td>
<td>ACIAR</td>
<td>Agriculture extension</td>
<td>Micro-finance research, training &amp; farmer support</td>
<td>Programme structure, development and pilot implementation</td>
<td>Case studies &amp; lending activity to rural farmers in E. Indonesia (Lombok)</td>
<td>3,500,000</td>
<td>300,000</td>
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<td>Fisheries development</td>
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<td>Crop science</td>
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<td>Poverty reduction</td>
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<td>3</td>
<td>GTZ/KfW/DEG</td>
<td>Health/family planning</td>
<td>Small financial institutions</td>
<td>Improve banking capacity of small financial institutions at people credit banks (BPR) and LKPD</td>
<td>Strengthen Perbarindo, establish LDKP, introduce deposit protection scheme, improve financing system, adapt regulations and supervision by BI</td>
<td>35,000,000</td>
<td>500,000</td>
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<td></td>
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<td>Water supply</td>
<td>Bank linkages for credit &amp; savings formation</td>
<td>Improve rural poor access to financial services</td>
<td>Linking self-help groups and banks, minimizing costs/risks by providing banking services</td>
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<td>Pollution control</td>
<td>Provincial Development Bank (BPD) strengthening for rural finance development</td>
<td>Improve rural population access to bank services</td>
<td>Strengthening banking network, establishing BPR in sub-districts, products for rural needs/capacities</td>
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<td>Training/education</td>
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<td>Good governance</td>
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<td>SME development</td>
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<td>Water supply</td>
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<td></td>
<td></td>
<td>Pollution control</td>
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<td>4</td>
<td>CIDA</td>
<td>Good governance</td>
<td>Private Enterprise Participation (PEP)</td>
<td>Credit circles of small loans at low interest MSME’s in Sulawesi, Bali &amp; Java</td>
<td>Pilot partnerships w/women association, rattan, coconut oil, pottery, garments &amp; metalwork clusters</td>
<td>20,000,000</td>
<td>1,250,000</td>
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<td></td>
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<td>Human rights</td>
<td>Canada Fund (small grants)</td>
<td>Support NGO’s with revolving micro-finance fund</td>
<td>Poverty reduction in Kalimantan, Sulawesi, Papua &amp; Sulawesi</td>
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<td></td>
<td>SME development</td>
<td>Governance Reform Support Project</td>
<td>Reform advisory to Ministries of Health, Education, Cooperatives &amp; SME’s, etc.</td>
<td>Technical assist to reform policy, structures, systems, institutions, mechanisms &amp; skills</td>
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<td></td>
<td></td>
<td>NRM</td>
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<td>Capacity building</td>
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<td></td>
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<td></td>
<td>EU</td>
<td>NRM-forestry focus</td>
<td>MSME development</td>
<td>Health/education</td>
<td>Poverty reduction</td>
<td>Trade/investment</td>
<td>Good governance</td>
</tr>
<tr>
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<td>6</td>
<td>World Bank</td>
<td>Energy reform</td>
<td>Community development</td>
<td>Water resources</td>
<td>Corporate governance reform</td>
<td>JSX/BAPEPAM support</td>
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<td>7</td>
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<td>Agriculture expansion</td>
<td>Extractive industry sustainability</td>
<td>SME development</td>
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<td>8</td>
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<td>Governance reform</td>
<td>Forestry stakeholders</td>
<td>Poverty reduction</td>
<td>Conflict prevention</td>
<td>Small grants</td>
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<td>9</td>
<td>UNDP</td>
<td>Poverty reduction</td>
<td>Governance reform</td>
<td>Environmental protection</td>
<td>Conflict recovery</td>
<td>Sustainable HRD</td>
<td>Regional autonomy</td>
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<td>ILO</td>
<td>Labour law</td>
<td>Human rights</td>
<td>Trade unions</td>
<td>Employer organizations</td>
<td>Child labour</td>
<td>Social security</td>
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<tr>
<td>No.</td>
<td>Donor</td>
<td>Programs</td>
<td>Amount</td>
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<td></td>
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<td>-----</td>
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<tr>
<td>11</td>
<td>USAID</td>
<td>Democracy/governance, Decentralization, Environment &amp; Energy, Economic growth, Health/humanitarian aid</td>
<td>104,000,000</td>
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<td>12</td>
<td>AusAID</td>
<td>Democratic reform, Education/elections, Good governance, Financial strengthening, Security/stability, Economic/environmental management</td>
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<td>13</td>
<td>Dutch Aid/INA</td>
<td>Poverty alleviation, Good governance, Community rehabilitation, Water management, Basic education</td>
<td>58,000,000</td>
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<td>14</td>
<td>Korean Aid (KOICA)</td>
<td>HRD/digital divide, Democracy/human rights, Emergency relief, Environment, Gender equality, Poverty reduction</td>
<td>3,000,000</td>
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<tr>
<td>15</td>
<td>JICA/JIBCO/JETRO</td>
<td>Social development, Poverty alleviation, Good governance, Environmental protection, Sustainable growth, Structural reform, Economic recovery</td>
<td>160,000,000</td>
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<tr>
<td>16</td>
<td>NORAD</td>
<td>NRM/Coastal zone mgt, Human rights &amp; Health, Poverty eradication, Governance reform, Education/training, Capacity building</td>
<td>1,250,000</td>
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<tr>
<td></td>
<td>NZAID</td>
<td>Education, NRM, Community development, Conflict Resolution, Governance</td>
<td>700,000</td>
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<td></td>
<td>Sweden Aid (SIDA)</td>
<td>Human Rights, Democratization, Poverty alleviation</td>
<td>600,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources

GTZ, Project Group Microfinance, May 2001
Miscellaneous contact with Jakarta-based donor offices
Indonesia Foreign Assistance Database (www.undp.or.id/infoad/profilesdetail)
10.3  Micro-Finance Case Studies

10.3.1 Bank Rakyat Indonesia (BRI)

Known as Indonesia's oldest Bank (1895), an offshoot from the German Raiffeisen cooperative bank model, BRI is regarded as the beginning of Indonesian rural banking. A series of hard lessons learned over the years enabled policy leaders and bank management to launch the BRI micro-banking division, the world's largest fully self-sufficient and sustainable micro-finance system, which has operated profitably on a nationwide scale without subsidy since 1987.

10.3.2 Yayasan Dharma Bhakti Parasahabat (YDBP)

YDBP began in 1999 with initial funding from experienced businessmen and bankers, as a pilot project providing small loans of USD $40 - $225 to farmers and petty traders, primarily women, in the villages of West Java. From the outset, YDBP has followed closely the Grameen approach, providing one year loans without collateral in an effort to deliver a means of self-sufficiency and compliment inadequate government safety net initiatives for the underprivileged. Today YDBP has over 42,000 members and is Grameen's first large-scale replicator poised to become an important player in the field of micro-credit for the poor in Indonesia.

11.0  ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in Indonesia

- Islamic values based investment industry already well established
- Global SRI funds showing some interest in Indonesia already
- Some SRI research has already been conducted
- Wide range of civil society institutions active
- Significant private equity and development financing programmes under way
- Micro-finance sector active with many schemes and gaining valuable experience of grass-roots investment needs
- JSX & BAPEPAM actively promote corporate governance and sustainable development agenda
- Corporates reporting and adoption of environmental standards improving, with some shining stars

Conclusion

- Potential for some cross-over between Islamic and SRI investment
- Increasing information to encourage global SRI funds to enter the market
- SRI may be slow to establish, but the potential is there for a solid future
The current era of more open politics, regional autonomy, trade liberalization and citizen participation is creating an environment of rapidly changing needs in a country faced with many new challenges. The IMF post-programme monitoring role helps to reinsure reforms stay on track and cost of capital remains relatively low through an upcoming election year.

The combination of low corporate governance ratings and an insecure investment climate is presently discouraging many funds from considering Indonesia. The slow pace of reform in legal/judicial, banking/financial and political/institutional areas may dampen investor confidence, but macro-environment restoration from strong policy reform has enabled falling public debt, interest and inflation while currency value, new lending and corporate earnings rise. Robust performance in the MSME sector has converted funds into livelihoods, products and services with growing NGO support and remains a key factor in the future stability and commercial success of the country - its world class role in micro-finance underscores further progress in poverty alleviation (see 10.3).

'The increase in external pressure from minority shareholder activism (see 8.0) enhances investor understanding, improves transparency in disclosure/operational accountability and gradually develops a long-term market mindset with the ability to negotiate and resist unethical practices. Recent and upcoming regulations (see 4.1) provide further scope to strengthen enforcement and raise awareness levels. The financial community should be encouraged to exercise prudential oversight in channeling its influence towards capital allocation, ownership prerogatives, new funding and risk management by integrating sustainability into their decisions.

While government and big business struggle with the reform paradigm, there is a growing trend amongst some multinational and domestic companies on the Jakarta Stock Exchange to produce varying degrees of social and environmental reports (see 9.1). This has been driven by a combination of factors related to good governance, ISO14000 standards, Islamic (syariah) compliance (see 2.5.2), corporate HQ direction and investor/public expectation. A few companies have also made early attempts to produce sustainability reports (see 9.3). As corporates act more on their own initiative and out of enlightened self-interest versus increased government regulation and tightened supervision, the promise of real progress becomes profound. Growing awareness of the common investment criteria shared between basic 'syariah' and SRI guidelines may be a precursor to significant growth in Islamic financial instruments and SRI fund opportunities in a range of companies in the foreseeable future.'
12.0 APPENDICES

12.1 Appendix 1: The History Of JSX

The Jakarta Stock Exchange (JSX) came into being as a privately owned company and operated stock exchange on July 13, 1992. The roots of its establishment can be traced back to the early part of this century. In 1912, under the auspices of the Dutch colonial government, Indonesia's first stock exchange was set up in Batavia, the colony's administrative centre which later became known as the future city of "Jakarta".

Closed during the First World War and then reopened in 1925, the Batavia exchange operated alongside parallel bourses in Semarang and Surabaya until 1942, when the archipelago's occupation by Japanese Imperial Forces curtailed further trading. In 1952, seven years after Indonesia declared its independence, the exchange was reopened in Jakarta, trading stocks and bonds issued before the war by Dutch enterprises. A nationalization programme launched in 1956, however, brought trading to a halt yet again.

Not until 1977 was the exchange reopened, this time under the management of the newly created Capital Market Executive Agency (Badan Pelaksana Pasar Modal - BAPEPAM), an institution reporting to the Ministry of Finance.

While trading activity and market capitalization grew over the years alongside the development of Indonesia's financial markets and private sector - highlighted by a major bull run in 1990 - it was not until the exchange privatisation and liberalization in 1992 under the ownership of Jakarta Stock Exchange, Inc. that the JSX emerged as one of Asia's more dynamic securities markets. As the result of the privatization of JSX, BAPEPAM's function has changed to become the Capital Market Supervisory Agency (Badan Pengawas Pasar Modal).

The year of 1995 marked a new beginning for JSX. As of May 22, JSX launched the Jakarta Automated Trading System (JATS) to replace the manual trading system. The newly installed automated trading system facilitates greater frequency of shares trading and ensures fairer and more transparent market practices as opposed to the manual trading system.

In July 2000, JSX launched scripless trading aiming to enhance market liquidity and to eliminate the occurrence of lost and forged instruments, and to speed up the process of transaction settlement.

In 2002, JSX also initiated the implementation of remote trading in order to increase market access, market efficiency, speed and frequency of trading.
12.2 Appendix 2: Islamic Investment And Index Calculation

The JII calculation is done by the JSE based on available data with a market-cap weighted methodology. This calculation also covers adjustments due to changes in public company data and performance.

Sources:  Bank Muamalat (www.muamalatbank.com)  
Karim Consulting (www.karimconsulting.com)  
Danareksa Investment Management (www.danareksa.com)

Syariah Relationship: Religion Based (Islam/Syariah)  
Type of investment: Islamic Banking/Funds/Bonds  
Criteria: based on strict Code of Conduct for Syariah compliance

- Halal: meets Islamic(Syariah) principles  
- Subhat: core activity is halal but revenue source is haram (non-compliant) (i.e. hotel with alcohol sales)  
- Makruh: potential to cause sickness/death (i.e. tobacco/arms)  
- Haram: does not comply with Syariah principles (i.e. alcoholic products at cafés/restaurants/pubs)  
- Debt:Equity: 45%

Islamic Bond and Mutual Funds

Short-term market potential: from present Rp. 500 billion to Rp. 4 trillion (US $55.6 million - US $470 million)

Bond Issuers (mudharabah bonds - profit sharing)

- P.T. Indosat, Tbk. - Rp. 175 billion  
- P.T. Berlian Laju Tanker, Tbk. - Rp. 60 billion  
- P.T. Bukopin Rp. 50 billion  
- P.T. Bank Muamalat Indonesia - Rp. 200 billion  
- P.T. Indofood Sukses Makmur, Tbk. (in process of market development)

<table>
<thead>
<tr>
<th>INDEX DESCRIPTION</th>
<th>Jakarta Composite Index</th>
<th>Liquid Top 45</th>
<th>Jakarta Islamic Index</th>
<th>Main Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-02 2002 Close</td>
<td>451,636</td>
<td>96,952</td>
<td>70,459</td>
<td>121,117</td>
</tr>
<tr>
<td>Dec-02 2002 Close</td>
<td>424,945</td>
<td>91,978</td>
<td>67,318</td>
<td>112,582</td>
</tr>
<tr>
<td>Variance</td>
<td>(26,691)</td>
<td>(4,974)</td>
<td>(3,141)</td>
<td>(8,535)</td>
</tr>
<tr>
<td>Percent</td>
<td>-6%</td>
<td>-5%</td>
<td>-4%</td>
<td>-7%</td>
</tr>
<tr>
<td>1-May 2003 Close</td>
<td>452,198</td>
<td>99,139</td>
<td>72,862</td>
<td>117,441</td>
</tr>
<tr>
<td>29-May 2003 Close</td>
<td>494,776</td>
<td>110,059</td>
<td>81,065</td>
<td>130,488</td>
</tr>
<tr>
<td>Variance</td>
<td>42,578</td>
<td>10,920</td>
<td>8,203</td>
<td>13,047</td>
</tr>
<tr>
<td>Percent</td>
<td>9%</td>
<td>11%</td>
<td>11%</td>
<td>11%</td>
</tr>
</tbody>
</table>
Islamic Banking

**Legal basis:** Law No. 10/1998 on banking
Law No. 23/1999 - Bank Indonesia

**Potential market:**

- Mid-term growth potential (2011) : 54%
- 0.26% of total asset banking sector by 2011: Rp. 204 trillion

**Islamic Banks:**
- Bank Muamalat
- Bank Syariah Mandiri
- Micro-finance/Bank Perkreditan Rakyat Syariah (BPRS): 89 institutions

**Islamic Business Units:**
- Bank Bukopin, Bank Danamon, Bank BNI, Bank BRI, Bank IFI, Bank BII, BPD East Java

**Total Islamic Assets and Financing**

<table>
<thead>
<tr>
<th>No</th>
<th>Description</th>
<th>Commercial Banks (January 2003)</th>
<th>Microfinance (BPRS) (December 2002)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total Asset</td>
<td>Rp. 4.403 trillion</td>
<td>Rp. 165 billion</td>
</tr>
<tr>
<td>2</td>
<td>Third party fund</td>
<td>Rp. 3.112 trillion</td>
<td>Rp. 100 billion</td>
</tr>
<tr>
<td>3</td>
<td>Total financing</td>
<td>Rp. 3.379 trillion</td>
<td></td>
</tr>
</tbody>
</table>

Source: Kompas, 30 April 2003 & ASBISINDO

12.3 Appendix 3: Data On Consumer And Investor Awareness

**Survey on Consumer Awareness of Environmental/Social Issues**

Survey on Internalization of Environmental Aspects into Investment Activity under the auspices of the Ministry of Environment and the University of Indonesia (Laporan Akhir Kajian Internalisasi Aspek Lingkungan Hidup dalam Kegiatan Investasi. Kementerian Lingkungan Hidup dan Universitas Indonesia)

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9 Kompas 22 April 2003: Investasi Obligasi Syariah Bisa Capai Rp. 700 Milyar
Kompas 30 April 2003: Perbankan Syariah yang Semakin Memikat
<table>
<thead>
<tr>
<th>No.</th>
<th>Level of Importance</th>
<th>Results by Rank</th>
</tr>
</thead>
</table>
| 1   | Level of importance - internalization in investment activity | 87.5% agree (87% agree to apply it in planning and feasibility study stages; 13% agree to apply it in IPO and listing process)  
Requirements for listing: 
EIA (0.786), EMS (0.710), environmental programmes and environmental certification (0.429), environmental audit (0.286) (Peraturan Pencatatan Efek Nomor 1-B)  
12.5% do not agree |
| 2   | Level of importance – driving forces for internalization in investment activity | To protect the environment (0.430), to comply with regulations (0.290), public image/reputation (0.140), to apply with international standards/ buyer requirements (0.700), to support the government (0.700)  
Budget constraints: 
Budget is limited (8,000), high investment cost (7.786), instant benefit is not clear (7,000) |
| 3   | Corporate policy for internalization                  | To protect the environment if relevant with its economic benefit/profit (0.430), to protect the environment although profit reduction (0.360), Priority on economic and production aspects (0.210)  
Budget allocation: 
Investments in: raw material savings (energy, water) (0.430), compliance (0.290), pollution prevention (0.210), environmental performance (0.070) |
| 4   | Implementation Strategy                               | To prevent pollution at source (0.690), minimize utilization of water and energy (0.310)  
Policy priorities: 
To protect the environment (0.238), to comply with regulations (0.232), to prevent pollution (0.156) and to reduce complaints (0.113) |
| 5   | Benefits                                              | Protection of the environment (0.430), compliance and law enforcement (0.290), support to government programmes, good image of company, reduction of public complaint and increase sales/demand (0.070)  
Economic benefit: 
Not clear (0.500), tangible economic benefit (0.290), no proof of economic benefit (0.210) |
|   | Influence of environmental problems on corporate financial performance | Pollution having direct impact on financial performance (0.710): (analysis and risk evaluation of company to the environment to be included in company report (0.750), in social conflict case of environmental problems (0.125) and in social conflict due to workforce problems (0.125) 
Pollution not having direct impact to financial performance of company (0.29) (public company to implement EMS (0.67 and environmental audit 0.33) 
Reporting 
Public company report to include incidence of environmental pollution and social conflict (0.86) and not to include same (0.14) 
Rating 
Public company to include performance of: EMS (0.55), safety and health (0.18), nature conservation (0.18), labour (0.09). 
Annual And Semi Annual Reports 
Public company to include environmental performance report (0.670), to submit report on business operation regarding natural resources material (0.170), to submit a report on labor and performance of safety and health (0.080) 
Sanctions 
To lower the level of rating in stock exchange (0.610), administration sanction (0.330), delisting (0.060) 
Administrative sanctions: cancellation of: permits, registration, operational approval and limitation of activity 
Type of public company to implement internalization | Manufacturers (0.100), Natural Resource-based Production (water, mineral, forestry, oil and gas)0.930), Poultry (0.790), Transportation (0.570), Property and Hotel (0.500), Restaurant (0.500), Construction (0.360), Repair Services (0.290) |

Source: 

Notes: 
- Secondary data: books, regulations, library, seminar/research paper, relevant institutions and companies under IPO process 
- Primary data: observation in JSX, interview with questioner, in depth interview with investors and issuers and discussions with stakeholders 
- Respondents: experts and professionals in issuers, JSX, brokers, environmental specialists and capital market experts
Other results from the Survey:

<table>
<thead>
<tr>
<th>No.</th>
<th>Issues</th>
<th>Description</th>
</tr>
</thead>
</table>
| 1   | Requirements for Green Public Company    | a. EIA for those companies on a compulsory list (please refer to the EIA regulation – all types of large business & major polluters from the beginning of JSX registration)  
    |                                           | b. Implementation of Env. Mgt. System (EMS)                               |
|     |                                          | c. Detailed Programme Plan and Environmental Policy for short-term and long-term period |
|     |                                          | d. Certification (Eco-labeling, ISO 14000 series)                          |
|     |                                          | e. Environmental audit                                                     |
|     |                                          | f. Evaluation of regular report by relevant institutions, independent consultant, etc. |
|     |                                          | g. Risk analysis report on environmental problems                           |
|     |                                          | h. Reward has be achieved in environmental management                      |
| 2   | Green Stock Group                        | a. Minimum requirements to be determined                                   |
|     |                                          | b. Assessment can be done by existing appraisal institutions with experience in environmental aspects |
| 3   | Environmental Index                      | a. Use existing mechanism for Index setting (depends on nominal value of the stock, volume of sales). |
|     |                                          | b. Please refer to establishment mechanisms in setting-up LQ-45, Composite Index or Islamic Index |

12.4 Appendix 4: Annual Report Award 2002

A Jury Committee was provided with detailed assessment criteria for each audited 2001 Annual Report consisting of:

- All information and presentations about the profile of those companies which are not limited for such as the brief descriptions of the companies, brief descriptions about their business, products and their core strengths, lists of subsidiaries and affiliation parties, the composition of their commissioners and directors, including independent commissioners, audit committees, shareholder composition, organization structures, number of employees and human resources development programmes;

- All information and presentations about their reports in connection with their implementation of good corporate governance principles which are not limited for such as the descriptions of mission and vision of their companies in the implementation of good corporate governance, the duties of their Board of Directors, Board of Commissioners, Audit Committees and Remuneration Committees, activities in connection with their supports for social and environment equilibrium, transaction with affiliated parties and their explanations with regard to business ethics implementation;
• All information and presentations about analysis and management discussions of their companies implementation, which are not limited for such as their operational and financial performance, their dividend policies and payments, business prospects and strategies and their implementation with regard to business policies;

• All information and financial report presentations with regard to the current general accepted accounting principles and related capital market regulations;

• All information and other relevant report presentations that can be presented fairly according to the needs of their stakeholders such as their shareholders, suppliers, employees and others.

The evaluation was conducted examining audited Annual Reports 2001 under this criteria emphasizing the implementation of good corporate governance principles. Once the Jury Committee selected the potential top rated companies, the Committee interviewed the management of those potential top rated companies on August 5th and 6th 2002. The Jury Committee did not perform any audit or investigative audit, or any related procedures in this evaluation process.

Source

12.5 Appendix 5: A Summary Of The 2002 Green Report Of P.T. Astra International Tbk

The full published Report is available on the Indonesia Country Page of www.asria.org

From its inception in 1957, P.T. Astra International, Tbk. (Astra) founders created milestones for excellence and chose to engage in business that created added value for the nation and society while utilizing available resources to grow and prosper together with the surrounding environment. Today, Astra is a public Company with six business divisions: Automotive, Financial Services, Heavy Equipment, Agribusiness, Information Technology, and Infrastructure. Over the course of its development, the Company has formed strategic alliances with many reputable international corporations in its effort to expand business opportunities.

The clairvoyance of Astra founders in strong business principles and values provided the basis for a 1980's policy entitled 'Guidelines on Business and Work Ethics'. This early focus on good corporate governance was revised in 2001 to insure professionalism, continuous performance improvement and to maximize corporate value in compliance with current standards and regulations. To support Astra’s commitment to maintaining standards of transparency, accountability, responsibility and fairness in accordance with good corporate governance principles, an Audit Committee, Executive Committee, and Remuneration/Nomination Committee as well as a Risk Management Group and an Internal Audit Department were established over the past couple years.

The early 1980’s also marked the formation of the first Environment, Health & Safety (EHS) Committees focused on awareness of fire safety, loss prevention and environmental regulations related to waste, water and air usage. World trends toward cleaner production and zero waste influenced programmes introduced as pro-active and comprehensive ways of dealing with pollution and determining more efficient processes and materials less hazardous to human health and the environment. EHS initiatives have been translated into a 4C approach: Commitment, Compliance, Competence and Cleaner Production, which provides a foundation for Astra Green Company assessment criteria. EHS Corporate Policy in 2000 signified
the creation of the Astra Green Company (see Illustration 3) and involved four distinct pillars: Green Strategy, Green Processes, Green Products and Green Employees (see Illustration 1). Astra management recognized business as a Green Company ultimately generates solutions to EHS challenges, as well as being a friendly interface with the environment and community. Astra continues to implement this Triple Bottom Line (TBL) approach as the foundation for 'sustainable business' in an effort to integrate the achievement of economic, social and environmental, health & safety performance in its 2003 EHS Corporate Policy (see Illustration 2).

The creation and application of various TBL management 'tools' has its roots within the individual behavior of Astra employees. Training and competence development programmes are implemented based on an HRD system (AHRM) that supports the establishment of a corporate culture involving all workers (see Illustration 2). An Astra Management System (AMS) was also developed from its Total Quality Control network as a framework and process guide in creating "operational excellence".
The strategy towards achieving TBL performance is reflected in real action programmes which the Astra Group have emphasized in two major programme areas: EHS and Social Development. A number of eco-efficiency and health & safety programmes have been initiated in affiliated companies, producing a number of tangible and intangible benefits. The tangible results are important for management to quantify the benefits of EHS implementation. EHS practices enforce key EHS principles: Refine, Reduce, Re-use, Recycle, Recover and Retrieve-to-Energy. Best performance in accordance with Astra Green Company criteria is labeled 'GOLD' level, while low results receive a 'BLACK' level endorsement. The achievement of Astra Green Company performance is used as input for subsequent EHS Corporate Policy refinement, as well as reference material in executive reviews to monitor the extent of sustainability in each business sector.

In line with its vision of 'Prospering Together with the Nation', the Astra Group has initiated a number of community development programmes, serving local communities near its Head Office and local communities surrounding subsidiary companies throughout Indonesia. The Dharma Bakti Astra Foundation (YDBA) focuses on assistance in the development of SME's in Indonesia (see Illustration 1).

In 2002, the Foundation sponsored 70 training programmes with like-minded corporate partners for over 1,500 SME's. An Astra venture capital company, P.T. Astra Mitra Ventura (AMV), invested almost Rp. 15 billion in 45 partner companies in 2002. These partners have shown positive growth and adopted relevant investment criteria that embody CSR principles and reflect the overall strategy, principles and values of the Astra Group. There is an Astra Manufacturing Polytechnic that serves as a technical institute providing education and job opportunities for an average 200 students per year with 60% of the graduates employed in Astra Group companies. Lastly, the Toyota Astra Foundation likewise supports a scholarship programme and enabling funds for a host of university research, symposiums, expositions, etc.

The Community Development programmes are also conducted in subsidiaries located throughout Indonesia. These companies work closely with local communities and leaders to develop neighborhood contests that contribute to overall cleanliness of local neighborhoods and a sense of pride and community spirit.
13.0 RESEARCH PARTNER

**David Finneren**

David Finneren is the President Director of P.T. Minaca Selaras, an Indonesia-based enterprise supporting corporations in their approach, identification, implementation, integration, quantification and reporting on sustainability initiatives. The company also facilitates investment in specific sustainable development projects related to clean production/climate change, water resource utilization, ecotourism and renewable energy as well as sustainable ventures in agriculture, forestry, plantations, fisheries and resource extraction. Since 1998, he has been a Regional Vice President in S.E. Asia and Advisor to Integrated Control Systems, Inc. (USA), a leading global specialist in productivity and efficiency solutions incorporating guaranteed performance and sound investment returns.

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**Emma Rachmawaty**

Emma Rachmawaty is Head of Economic Resources Division, Ministry of Environment, Republic of Indonesia. She has been working for MOE for 11 years and since 1993 she has been in charged of involving financial institutions in Indonesia in incorporating environmental aspect into their business practice. She manages environmental credit-lines channelled by banking sector for investment. Recently she has been tasked with identifying possible involvement of non banking financial institutions in environmental management and to create other alternatives of financing for environment. She also responsible for setting up policy on changing unsustainable production and consumption patterns, setting up policy on economic instruments implementation and actively involved in Trade and Environment Committee of WTO.
## 14.0 GLOSSARY

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>BAPEPAM</td>
<td>Badan Pengawas Pasar Modal</td>
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<td>Danareksa Investment Management</td>
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<td>Return On Investment</td>
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<td>Small and Medium Sized Enterprises</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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SRI
IN ASIAN EMERGING MARKETS:
MALAYSIA

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1.0 EXECUTIVE SUMMARY

Socially responsible investment has not yet been a widespread trend in Malaysia. The first socially responsible investment fund in Malaysia - the Mayban Ethical Trust Fund managed by Mayban Management Bhd - was launched on 7 January 2003.1,2

Although a socially responsible investment fund is a relatively new financial product to the Malaysians, the concept of socially responsible investment is not new to them. Socially responsible investment funds have appeared in the form of "Islamic Investment Funds" since 1968, with the introduction of the Islamic funds Dana Al-Aiman.3 The term "Islamic Investment Fund" commonly refers to a joint pool wherein the investors contribute their surplus money for the purpose of its investment to earn "halal" (lawful under Islamic Law) profits in strict conformity with the precepts of Islamic Shariah.4 As with negative screened socially responsible investing, Islamic Funds are constructed using screens that weed out companies whose activities are considered immoral by Islam and forbidden to Muslims.5 According to the CEO of Asia Unit Trusts Bhd Mush-thaq, Islamic Funds are similar to socially responsible funds but the difference lies in the fact that Islamic Funds follow a particular religious guidance rather than the general perception of what is socially responsible.6 Also, Islamic funds focus primarily on screening. Socially responsible funds increasingly focus on selecting companies according to positive criteria or adopting strategies of active engagement with companies to encourage the adoption of improved social and environmental standards.

As an educated and increasingly financially sophisticated society, there is therefore potential for both the further development of SRI, and also the potential for Islamic and SRI funds to draw on each others strengths and develop new SRI products which are also sensitive to Islamic investment precepts.

1 "Mayban Management launches Malaysia's first Ethical Fund," The Edge Malaysia, 7 January 2003.
3 List of All Known Islamic Bond and Equity Funds, Failaka International Inc. (www.failaka.com).
6 "Unit trust companies - Not right time yet to launch social funds," The Star (Malaysia), 16 December 2002.
2.0 SRI FUNDS

There are now two SRI funds in Malaysia, as well as a number of Islamic funds.

2.1 Domestic SRI Funds

**Mayban Ethical Trust Fund**  [www.maybank2u.com.my](http://www.maybank2u.com.my)

Managed by Mayban Unit Trust Berhad (formerly known as Mayban Management Berhad), the fund was launched on 7 January 2003. To cope with the problem of the lack of ethical research services in Malaysia, Mayban Ethical Trust Fund has partnered with NGOs, which provide the fund with necessary advice over ethical issues. Internally, the Mayban Ethical Trust Fund has established a Special Advisory Panel which covers topics including corporate governance, social responsibility and environmental protection. The managers of the fund report the nature of the corporations’ business to the panel. The members of the panel, drawing on their knowledge over their respective areas, will then enquire about areas which they want to know more. The fund managers will in turn convey the panel’s queries to the management of those corporations. The answers will then be made known to the panel, and the penal will advise on the areas that they would like the corporations to look into.

**Phillip First Ethical Fund**

Managed by Phillip Mutual, the fund was launched on 3rd June 2003. Phillip Mutual also launched the Phillip Ethical Index, a capitalisation weighted index derived from the KLSE CI. Components of this index are stocks that are eligible for the Ethical Fund. Phillip Mutual is an associate of the Phillip Capital Group, a financial conglomerate with operations in 10 countries.

2.2 Islamic Funds

Islamic funds would not invest in companies which involve any of the prohibited practices, namely riba or interest (e.g., the business of lending money in return for an interest), gharar or uncertainty or doubt, and production or trading of prohibited products. The portfolio of Islamic Investment Funds must comprise Islamically acceptable companies whose primary business is halal. Examples of companies which are not halal include companies engaging in production, packaging, marketing, wholesaling, retailing, designing, or otherwise dealing in alcohol, liquor and gambling. Though there is no universal consensus among contemporary Shariah scholars, Islamic funds generally avoid companies in the tobacco and defense industries.

Islamic funds have not been the mainstream in the Malaysian financial market yet, but their potential is apparent. The financial modules offered based on Syariah principles have seen a

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8 "Mayban Management launches Malaysia’s first Ethical Fund," The Edge Malaysia, 7 January 2003.
10 "Mayban Management launches Malaysia’s first Ethical Fund," The Edge Malaysia, 7 January 2003.
11 [www.sdara.net/story/143](http://www.sdara.net/story/143)
12 "Islamic Fund in Malaysia," Datuk Dr. Syed Othman Alhabshi of Asia Unit Trust Berhad, February 1995.
13 Website of Al Rajhi Banking and Investment Corporation ([www.alrajhibank.com.sa](http://www.alrajhibank.com.sa)).
14 Website of Al Rajhi Banking and Investment Corporation ([www.alrajhibank.com.sa](http://www.alrajhibank.com.sa)).
The development of Islamic funds has the blessing of the Malaysian Government. Malaysia has indicated its ambition to become an international Islamic capital center in the Capital Market Masterplan, the country's comprehensive plan for charting the strategic positioning and future direction of the Malaysian capital market for the next 10 years. As a result, the Malaysian Government has tried to create a favorable environment for the development of Islamic Funds. To encourage the development of Islamic funds, the Securities Commission has maintained a list of companies that are Syariah compliant for securities trading on the Kuala Lumpur Stock Exchange. The Securities Commission's efforts have given confidence and guidance to Malaysian investors. As at October 2002, there were 652 shares that were listed as Syariah based on the Kuala Lumpur Stock Exchange, covering 76 percent of all shares traded on the exchange.

17 "MBfUT poised to close deal with Islamic financial portal," The Star (Malaysia), 25 January 2002.
2.3 Global SRI Funds Registered For Sale

As of 2002 year end, there were no foreign SRI funds registered for sale in Malaysia.

2.4 Global SRI Funds With Significant Holdings In The Domestic Market

Despite the fact that Malaysia has made great efforts to make good progress in the areas of corporate governance, transparency, and in further strengthening the banking and financial sector, global SRI Funds have not maintained a significant position in the Malaysian stock market. However, certain global SRI Funds have some limited interest in Malaysian companies. For example, it is known that Henderson TR Pacific Investment Trust PLC, a UK SRI Fund, has Malaysian investments.

Not only global SRI Funds, but global Islamic Funds have not shown particular interest in Malaysian securities. A report stated that there are 105 Islamic funds operating in several financial centers worldwide (including Malaysia) with a net asset value of RM 11.4 billion/US$3.0 billion. Among the 71 funds not in Malaysia, only a few hold a limited portfolio of Malaysian securities.\(^\text{22}\)

3.0 SRI RESEARCH

3.1 Domestic Research

There are presently no SRI research organizations within Malaysia. Mayban Ethical Trust Fund conducts its own in-house research.

3.1.1 Institute of Islamic Understanding Malaysia ikim.gov.my

However, regarding Islamic funds, Sirim Bhd and the Institute of Islamic Understanding Malaysia (ikim.gov.my), a Malaysian think-tank, are actively pursuing initiatives to establish standards for halal certification, with the aim of turning them into the de facto global standard for other countries to adopt.\(^\text{23}\)

3.2 International SRI Research Groups Covering the Domestic Market

The following international SRI research groups have limited coverage on Malaysian companies:

3.2.1 SAM Research sam-group.com

SAM Research is a subsidiary of SAM Group Holding forming the research base for SAM’s investment process and the Dow Jones Sustainability Indices (DJSI). SAM Research covers 23 Malaysian companies.


\(^{23}\) "Malaysian Newspaper Highlights," Asia Pulse, 26 August 2002.
3.2.2 Innovest  www.innovest.org

The organization currently covers a very limited number of companies in Malaysia.

4.0 SRI RELATED ORGANISATIONS, INCLUDING NGO’S

Collaboration among NGOs, private sectors and government agencies for the betterment of the environment is illustrated by Prime Minister’s Hibiscus Award for achievement in environmental protection, and the Tree Planting Group which was initiated by a group of NGOs. This is an initiative to inspire people and companies to plant trees. The corporate sector in Malaysia supports educational and awareness raising goals by making contributions to the Environmental Education and Awareness Trust Fund. The private sectors support successfully a number of environmental awareness activities for example in the organization of Environmental Journalism Award and the Beautification of Schools program. All major newspapers in Malaysia have introduced a special column on the environment.24

The following environmental groups are active in Malaysia:

4.0.1 WWF-Malaysia  www.wwfmalaysia.org

WWF is a national, non-profit organization that promotes and implements initiatives for the conservation of nature and the protection of the environment.

4.0.2 Environmental Protection Society of Malaysia (EPSM)  www.pjnet.com.my

EPSM was established in 1997. It organizes seminars and capacity building seminars with the particular objectives of raising awareness for action for sustainable development worldwide.

4.0.3 ENSEARCH  www.ensearch.org

ENSEARCH is a non-profit, membership organisation comprising people interested in promoting the practice and research in environmental management. It was formed in 1984 by a group of professionals and academicians, from various disciplines. Today, ENSEARCH is an established and reputable, local NGO with about 500 individual and 75 institutional members.

4.0.4 Malaysian Nature Society  www.mns.org.my

Established in 1940, the Malaysia Nature Society is the oldest scientific and non-government organisation in Malaysia dedicated to nature conservation and appreciation. It’s mission is to promote the study, appreciation, conservation and protection of Malaysia’s Natural Heritage, focusing on biological diversity and sustainable development.

5.0 CORPORATE GOVERNANCE INITIATIVES

The Malaysian Government has been the main catalyst for corporate governance reform and has taken progressive steps to establish a strong foundation for corporate social responsibility (CSR) strategy and implementation with its Code on Corporate Governance.25 Malaysia began incorporating modern governance principles into its securities and companies legislation relatively early. But as in the rest of Asia, the financial crisis caused a resurgence of interest in the subject among government and business circles. In March 1998, the authorities established a committee - the High Level Finance Committee on Corporate Governance - to review the situation and make recommendations for raising governance standards and strengthening investor confidence in local capital markets. The committee's recommendations were finalized in February 1999 and remain under review by the authorities. Some have been implemented.26

The High Level Finance Committee on Corporate Governance, which comprised members from both government and business including the Governor of the Central Bank, the Chairman of the Securities Commission, the Chairman of the KLSE, the Chairman of the Financial Reporting Foundation and representatives of various industry organizations,27 made an extensive study of the corporate environment in Malaysia and produced a detailed report. This culminated in the submission of the Malaysian Code on Corporate Governance to the Minister of Finance in February 1999, and its eventual introduction to the public in October 2000. Improving effective enforcement of the code and other CG initiatives is now the primary challenge facing the authorities.

5.1 The Code On Corporate Governance

The "Proposed Malaysian Code on Corporate Governance" is aimed primarily at boards of listed companies. The approach adopted for the Malaysian Code on Corporate Governance represents a hybrid between the prescriptive and non-prescriptive approach. The former sets standards for desirable practices for disclosure of compliance, whilst the latter requires actual disclosure of corporate governance practices. The approach in Malaysia is designed to allow for a more "constructive and flexible response to raise standards in corporate governance as opposed to the more black and white response engendered by statute or regulation."28 It includes a role for investors and auditors to enhance their role in corporate governance. These are purely voluntary.29

The committee has made a long list of recommendations. One of the key issues addressed was clarification of the responsibilities and obligations of major shareholders (especially in grey areas such as related-party transactions). The committee concluded that there was also a need to improve the accuracy and timeliness of disclosure, to increase the value of general meetings, and to raise the efficiency of shareholder-redress mechanisms. The primary objective of the code is to encourage disclosure by providing investors with timely and relevant information upon which investment decisions may be made and the performance of companies evaluated. The code also aspires to serve as a guide to boards of directors by clarifying their responsibilities and providing prescriptions to strengthen the control which they exercise.30

27 Kuala Lumpur Stock Exchange (KLSE) and Securities Commission (SC).
28 Kuala Lumpur Stock Exchange (KLSE) and Securities Commission (SC).
29 Kuala Lumpur Stock Exchange (KLSE) and Securities Commission (SC).
30 Kuala Lumpur Stock Exchange (KLSE) and Securities Commission (SC).
The code also advocates the training and education of directors, potential directors and officers of listed companies and other market participants focusing on the respective rights, duties, obligations, responsibilities and liabilities under law (both common law and under statute, rules, regulations and guidelines), application of the code, and industry and company specific information (where necessary). More recently, the Government has amended various laws to improve standards of governance. In line with the recommendations of the High Level Finance Committee, the Securities Commission and the Kuala Lumpur Stock Exchange introduced expanded disclosure requirements during 1998-99. In addition, the Finance Committee also made several recommendations for reform of laws, regulations and rules with the aim of strengthening the overall regulatory framework for public listed companies. The recommendations embraced key aspects of corporate regulation which include:

- Duties, obligations, rights and liabilities of directors, company officers and controlling shareholders;
- Adequacy of disclosures and conflict of interests with respect to transactions that involve the waste of corporate assets;
- Enhancing the quality of general meetings;
- Shareholders’ rights and remedies;
- Developing effective governance and enforcement mechanisms within the regulatory framework.
- The recommendations of the Finance Committee are in various stages of implementation. An implementation project team has been established to monitor and manage the implementation programme for the various recommendations of the Finance Committee.

5.2 Listing Rule Requirements

The Listing Requirements of the Kuala Lumpur Stock Exchange (KLSE) stipulates that a listed company must ensure that the board of directors makes, in its annual report, a statement of how the listed company has applied the relevant principles set out in Part 1 of the Malaysian Code on Corporate Governance to its particular circumstances and a statement on the extent of compliance with the Best Practices in Corporate Governance set out in Part 2 of the said code which statement shall specifically identify and give reasons for any areas of non-compliance with Part 2 and the alternatives to the best practices adopted by the listed company, if any.

5.3 Code Of Business Ethics

The Domestic Trade and Consumer Affairs Minister of Malaysia proposed a non-compulsory code of business ethics, which was enacted in 2002. The code identifies six business practices that businesses are expected to follow - honesty, responsibility to customers, the community and the environment, and the practice of humanity, moderation, fairness, and seriousness.31

5.4 Legal Framework For Shareholder Protection

In Malaysia, shareholders are protected by a number of laws and regulations and non-legal requirements and codes of conduct which guide company directors in the performance of their duties and responsibilities. Principle among them is the Companies Act 1965, a law regulating companies which based originally on the U.K. Companies Act 1948 and the Australian Uniformed Companies Act 1961. The said act had been amended twenty-six times since it was first implemented on 15 April 1966. In addition to the Companies Act 1965, directors of public listed companies must also observe and comply with the Securities Commission Act 1993, the Securities Industry Act 1983, the Policies and Guidelines On Issue/Offer of Securities Commission and the Listing Requirements of the Kuala Lumpur Stock Exchange.32 Notably, the Company Act requires disclosure of interests in contracts with the company by directors, disclosure of interest in shares by directors and substantial shareholders, substantial property transactions by companies with their directors and insider trading. Also, the Company Act prohibits the giving of loans to directors and persons (including corporations) who are connected to the directors.

5.5 Corporate Governance Summary

With a World Bank 2001 report rating Malaysia near the bottom of corporate governance standings for Asian countries, the country's image received another battering in the eyes of both foreign and domestic investors.33 However, Malaysia has shown great improvement in the area of corporate governance since then. According to a report published by CLSA in 2003, Malaysia has seen the biggest improvements in corporate governance in the previous 12 months.34 PriceWaterhouseCoopers chairman (Asia region) Ian Rickword, many countries in Asia, notably Malaysia, have taken great strides in improving the levels of corporate governance since the Asian financial crisis.35

6.0 SHAREHOLDER ACTIVISM

To the Malaysians, who are mainly Muslims, shareholder activism is not an option but a requirement of their religion. A majority of Shariah scholars recognized that the Muslim investor will be morally bound to inform management (perhaps in the annual general meeting of the company) in which he or she has interest that he or she does not approve of such transactions which are not halal. Some Shariah scholars even argue that the ownership of shares in a company is a form of partnership. As a partner in the business, then, the Muslim investor authorizes management to run the business as they see fit. If management of the company does something not halal, the investor becomes responsible for consenting to such actions and, to make matters worse, is considered to have participated in that action, because he or she is a partner in the company.36 Note that in SRI there is also an emphasis on the shareholder as an 'owner' of the company and, in this respect, the concept of 'positive engagement' has been developed as a process by which the SRI fund takes a long-term approach to its investment and engages with the company as a partner in working towards sustainability goals.

34 CG Watch: Corporate Governance in Asia, CLSA Emerging Markets, April 2003.
A recent survey in Malaysia asked institutional investors and equity analysts to identify the factors that were most important in assessing corporate governance and deciding to invest in publicly listed corporations (Low, Seetharaman, and Poon 2002). The analysts thought that the frequency and nature of public and press comments about the company were more important than a host of other factors that receive more attention in academic debate, such as the company's relationship with the regulatory authorities, the number of independent non-executive directors and their qualifications, the existence of remuneration and audit committees, and the identity of company auditors. This study shows that the media is playing an important role in investor governance in Malaysia.

6.1 Media Attention To Shareholder Role

At present, there are two minority shareholder groups in Malaysia:

6.2 Emergence Of Minority Shareholder Groups

6.2.1 Minority Shareholder Watchdog Group (MSWG) watchdog@mswg.org.my

This organization was established in August 2002 as a non-profit company limited by guarantee with founding members comprising government-linked institutional investors. This outfit, which promotes shareholder activism, is encouraging minority shareholders to exercise and enforce their rights as provided for in relevant statutes of Securities Law as well as Companies Act 1965 against listed company managements.

6.2.2 Malaysian Institute of Corporate Governance (MICG) www.micg.net

This academic institution comprises five professional groups including Federation of Public Listed Companies, Malaysian Institute of Accountants, Malaysian Association of the Institute of Chartered Secretaries and Administrators, Malaysian Association of Certified Public Accountants, and the Malaysian Institute of Directors.

7.0 GOVERNMENT INITIATIVES

In its National Report on Agenda 21, the Malaysian Government recognised the importance of sustainable development, however it is wary of being pressured by the West on this issue. The Government sees a strong priority in increasing trade and economic development as the route to both reducing poverty and, shifting the Malaysian economy from a reliance on extractive raw material industries, such as the timber industry, to higher value added manufacturing.

The Government also noted in the report that, as a member of ASEAN, Malaysia favors liberal trade policies and is working towards the greater liberalization of international trade. National priorities for Malaysia in this area include:

1. increased foreign investments and shifting the economy to manufacturing and export-oriented trade
2. The increase in trade and investment has contributed towards the decline in the incidence of poverty in Malaysia
3. Per-capita income has grown over the years corresponding to the increase in manufacturing sector's contribution to GDP and the increasing importance of trade to the national economy.

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37 The Sustainability of Business Corporate Governance: Evidence from Publicly Listed Companies in Malaysia, Low, Kevin, Arumugan Seetharaman, and Wai Ching Poon of Multimedia University, Faculty of Management, Cyberjaya, Malaysia, 2002.
38 Kuala Lumpur Stock Exchange (KLSE) and Securities Commission (SC).
40 Asian Institute of Management Center for Corporate Responsibility Country Report - Malaysia
The incidence of poverty and hard-core poverty has also declined over the years as a result of the increase in job opportunities arising from the influx of foreign direct investment.

The Malaysian Government primarily recognized four major environmental NGO’s, which are The World Wide Fund for Nature Malaysia, Malaysian Nature Society, Environmental Protection Society of Malaysia and ENSEARCH.

Foreign investment in Malaysia is encouraged, particularly in the area of high-end technology; non-labour intensive and non-polluting industry and foreign investment conditions aims have been liberalized to this end. Several fiscal and financial incentives have been announced to facilitate increased foreign investment.

In particular several fiscal incentives have been announced to facilitate the purchase of new, more efficient and cleaner technology in manufacturing, waste management and air pollution control. These include the granting of pioneer status to certain types of companies and exemption of import duty, sales tax and excise duty from pollution control technology.

Public awareness campaigns are carried out by NGOs and government agencies and consumer groups are active partners in controlling consumption. Efforts are under way to integrate consumer education into the formal education system.

The Malaysian Government has initiated a RM 20 million project in July 2003 to promote the conservation and sustainable use of peat swamp forests, aiming at changing public perception of peat swamp forests, promoting awareness of their importance, and collecting data to promote the most sustainable management and conservation practices for peat swamp forests. The project will be funded by the United Nations Development Programme/Global Environment Facility (UNDP/GEF) in collaboration with the Danish International Development Agency (Danida), executed by the Primary Industries Ministry, and implemented by Forest Research Institute Malaysia.

### 8.0 CORPORATE DEVELOPMENTS AND RESPONSE

#### 8.1 Environmental/ Social/ Sustainability Reporting

There is no statutory requirement in Malaysia requiring public listed companies to disclose environmental information to the public, although the Government is considering making environmental reporting mandatory. The Malaysia Accounting Standard Board (MASB) has incorporated a new standard to encourage greater disclosure of environment-related financial information including:

- Paragraph 10 of MASB 1, which makes explicit reference to 'environmental reports and value added statements' encouraging companies 'to present additional information if management believes they will assist users in making economic decisions';

- MASB 20, which sets out accounting and disclosure requirements for the recognition of contingent liabilities and assets, although MASB 20 does not provide specific detail of the types of liability that companies are required to disclose. It is foreseeable that environmental liabilities could potentially be included within a company's financial statement.\(^{42}\)

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\(^{42}\) The State of Corporate Environmental Reporting in Malaysia, Environmental Resources Management Malaysia (sponsored by ACCA), 2003.
8.1.1 Environmental Reporting

According to an ACCA-sponsored survey published in 2003, there are an increasing number of KLSE mainboard listed companies engaging in some form of environmental reporting. The number of reporting companies grew from 25 in 1999, to 35 in 2000, reaching 40 companies by 2001. This represented 5.3%, 7.0% and 7.7% of the KLSE mainboard listed companies in 1999, 2000 and 2001 respectively. Half the reporting companies were in the list of the top 100 companies in Malaysia, representing 20% of the top 100 Malaysian companies who engage in some form of environmental reporting. In addition, ACCA’s report found that the Industrial Products sector (IP) (which includes oil and gas, metals manufacturing, cement manufacturing, chemicals, etc.) is the largest sector engaged in environmental reporting.

In terms of the form of reporting, ACCA’s survey noticed that there was a general increase in terms of the number of pages companies allocated within their annual reports for communicating environmental information. Also, there has been an increase in the number of companies allocating individual sections specifically for environmental information. All reporting companies used their published annual report for communicating environmental information to their stakeholders apart from Shell Refining Company Berhad, which also publishes a stand-alone Sustainable Development Report.

In terms of the content of reporting, ACCA’s survey found that resource-based companies (such as plantation, forestry, power generation, oil and gas extraction, and water treatment and supply) tended to focus on environmental issues. Manufacturing-based industries were more likely to combine environment with Occupational Safety and Health (OSH) issues, while the construction sector tended to focus on OSH issues. Also, ACCA’s survey found that few companies have started to include environmental performance data to provide an indication of their environmental impacts and progress year on year, or to include quantifiable environmental objectives and targets, and the most commonly focused areas are the Environmental Management and Achievements areas.

List of environmental reporting companies in Malaysia for 2002

| Aluminium Company Malaysia Berhad (Alcom) | Negara Properties (Malaysia) Berhad |
| Cement Industries of Malaysia Berhad (CIMA) | Perusahaan Otomobil Nasional Berhad (PROTON) |
| Chemical Company of Malaysia Berhad | Petronas Dagangan Berhad |
| DRB-Hicom Berhad | Petronas Gas Berhad |
| Fraser & Neave Holdings Berhad | Powertek Berhad |
| Golden Hope Plantations Berhad | Project Penyelengaraan Lebuhraya Bhd (PROPEL) |
| Golden Pharos Berhad | Public Bank Berhad |
| Guiness Anchor Berhad | Public Finance Berhad |
| Guthrie Ropel Berhad | Puncak Niaga Holdings Berhad |
| Highlands & Lowlands Berhad | Road Builders (M) Holdings Berhad |
| IOI Corporation Berhad | Shell Refining Company (Federation of Malaya) Berhad |
| UIM Corporation Berhad | Star Publications (Malaysia) Berhad |
| Intan Utilities Berhad | Ta Ann Holdings Berhad |
| Kim Hin Industry Berhad | Tenaga Nasional Berhad |
| Kulim (Malaysia) Berhad | TH Group Berhad |
| Kumpulan Guthrie Berhad | Tractors Malaysia Holdings Berhad |
| Lingui Developments Berhad | Tradewinds (Malaysia) Berhad |
| Malayai Cement Berhad | UMW Holdings Berhad |
| Malaysia International Shipping Corporation Berhad | United Engineers (Malaysia) Berhad |
| Matsushita Electric Company (Malaysia) Berhad | Worldwide Holdings Berhad |


Shell is presently the only company which publishes a stand-alone sustainability report.
While there are an increasing number of companies engaging in some form of environmental reporting, ACCA's report found that a considerable number of Malaysian multinational companies have not yet made environmental information available in their annual reports. Few companies included information on Context and Commitment and Stakeholder Engagement, environmental financial information, and negative information. Lastly, none of the reporting companies had had their environmental information verified by a third party.  

The low growth in the uptake of environmental reporting as well as the lack of breadth and depth of information provided by the reporting companies, indicates that there is a general low level of willingness to disclose environmental information (although it is not low compared to many other Asian countries). Considering that this is a new trend, even for the developed countries, companies in Malaysia are still uncertain about the benefits of environmental reporting. The use of environmental information for performance benchmarking and business decision making has not been widely recognized by companies or by the financial community.

Last, per the survey, it is difficult to qualify and prioritize drivers in order of significance and to predict the pace at which environmental reporting will be taken up by Malaysian companies owing to the recent emergence of environmental reporting in Malaysia.  

8.1.2 Social Reporting

Jeremy Moon, the director of Nottingham University International Center for Corporate Social Responsibility (CSR), conducted research on social reporting in the top fifty companies in seven Asian countries - Malaysia, India, Indonesia, the Philippines, Singapore, South Korea and Thailand. The research shows that Malaysia ranked fourth in terms of penetration of CSR reporting with 32% (of the country's Top 50 companies), after India (72%), South Korea (52%) and Singapore (38%). The findings showed that CSR in Malaysia is dominant in health and disability; environment and conservation; and education and training.  

**Conclusion:** Sustainability reporting which incorporates social and environmental reporting together to reflect their combined importance/impact is still a very new concept to Malaysian companies.
8.2 Popularity Of Environmental And Social Certifications

Though the overall number of certifications awarded to Malaysian companies is still relatively small, compared for instance to Thailand, the corporate sector is continuing to show more awareness of the value of certification.

8.2.1 ISO 14001

A recent study surveyed the impact of ISO 14001 certification on company environmental and economic performance in Malaysia. It noted that currently the number of certified sites in Malaysia is low, with only 137 sites as of 30 June 2001. The following results are presented by this study:

- The report shows that few listed companies are in fact ISO 14001 certified.
- According to this study, most respondents to the survey reported that the ISO 14001 certifications has helped enhance reputation of their companies, significantly reduced waste within the production process and significantly improved the company’s position in the market place.
- To a significant extent, the respondents surveyed felt that the benefits of certification actually far out weighed its costs.
- When asked about what are the factors influencing their company’s decision to gain certification, improved corporate image and market opportunities are rated very highly by respondents. This supports the contention that market factors are the drivers behind companies seeking certification in Malaysia.
- Surprisingly, pressure from environmental groups and financial institution is ranked last. The author of this study suggests that this is perhaps due to the fact that environmental groups in Malaysia are not actively pursuing businesses to be environmentally responsible or alternatively, respondents surveyed do not think much about environmental groups.
- 10 out of 58 respondents (17% of total respondents) indicated that it was because of direction from their headquarters that they are ISO 14001 certified (indicating in this case that they are foreign owned multi-nationals). Of these 10 respondents, 9 are Japanese affiliates.

The above survey appears to suggest that the reasons behind companies seeking ISO 14001 have more to do with corporate interest (i.e."improves corporate image" and "market opportunities") as opposed to meeting the needs of various stakeholders (such as employees, government, financial institutions and suppliers).

8.2.2 Other Certifications

Apart from ISO 14001, some Malaysian companies have expressed interest to qualify their operations for international certification as the providers of sustainable travel and tourism services. This qualification is granted by Green Globe Asia Pacific Pty Ltd. Green Globe places special emphasis on three areas of compliance namely environmental, social and economic responsibility.

---

8.3 Award Schemes

8.3.1 Association of Chartered Certified Accountants (ACCA) Malaysia
malaysia.accaglobal.com

An environmental reporting award was introduced by the Association of Chartered Certified Accountants in 2002. In addition to this award, ACCA published "Environmental Reporting Guidelines for Malaysian Companies" which is distributed free upon request.

8.3.2 NACRA Environmental Reporting Award

NACRA is Malaysia's most prestigious award in recognition of excellence in annual corporate reporting. NACRA was launched in 1990 to promote the highest standards in the presentation and reporting of financial and business information. It is jointly sponsored by the Kuala Lumpur Stock Exchange, the Malaysian Institute of Management (MIM), the Malaysian Institute of Accountants (MIA) and the Malaysian Association of Certified Public Accountants (MACPA). The NACRA Environmental Reporting Award was introduced by the Organizing Committee of NACRA in the year 2000. The purpose of this is to enhance awareness in regard to the environment and to address and recognize efforts towards its preservation.

9.0 ASSESSMENT OF MICRO-FINANCE ACTIVITY IN MALAYSIA

9.1 Overview

Essentially the only institutions engaging in micro-finance in Malaysia are drawn from the NGO community, where there is one dominant micro-finance institution - Amanah Ikhtiar Malaysia ("AIM") and a handful of minor operators. AIM, which adopted the Grameen Bank model and is intent on targeting the poorest among the poor, is primarily financed by the Malaysian Government.

By August 1994, AIM had some 6,100 Grameen groups in operation with a total membership approaching 30,000 borrowers (the indigenous Malay community was disproportionately represented among these poor borrowers). Assuming that AIM's procedures to identify the poor were both effective and consistently applied, this is quite an impressive coverage of the target population, to be achieved in seven years. As discussed below, outreach might have been higher, but for political interference. Total loans disbursed up to that time amounted to RM 37.9 million (US$ 14.8 million) and, reflecting the relative priorities accorded savings and credit, total savings were US$ 1.8 million. Some 28 per cent of lending was for agriculture, 46 per cent for trade, 15 per cent for animal husbandry and 10 per cent for other activities (Conroy, Taylor and Thapa, 1995, 20). Some 80 per cent or more of all funds loaned were for economic purposes, the remainder for 'social' purposes.

Historically, AIM levied 'service charges' on loans rather than interest expressed in percentage terms. If calculated as interest on the principal involved, however, these charges were well below rates in the Malaysian commercial banking sector. As a result, for all classes of loans, service charges covered only a portion of AIM's lending costs (Conroy, Taylor and Thapa, 1995, 21). To improve the overall sustainability, AIM has increasingly focused on providing

50 Ibid.
larger-sized and higher-interest loans and serving non-hard core poor. AIM's expansion from 1994, at which time it had reached some 50 per cent of its target group in Peninsular Malaysia (Sukor Kasim 2000, xii) appears to have been more in terms of value of loans outstanding than increased outreach to the hardcore poor. An increase in numbers of 'dropouts' from the program, especially among poorer members, was noted from 1994 as loan sizes increased, a trend which accelerated from 1997. In 1997 AIM even decided to break with its early practice by raising the interest rate on loans to a uniform 19 per cent. Not only was this a substantial increase, it also expressed borrowing cost as a percentage of principle for the first time. The evaluation suggests this accelerated the loss of poorer clients from the program, not just because an increase in costs would depress demand but because many of the poorest are devout and would find the interest charge unacceptable.

In December 2001, following a Central Bank audit, senior staff of AIM were suspended and a Government line of credit for lending was frozen. AIM's management information system is reported as having broken down, and while arrears were said to be still at 10 per cent of portfolio at end-2001, Credit for the Poor speculates that PAR may prove to be double this proportion. It remains to be seen whether the recent management shakeout will be succeeded by a period of stabilisation and recovery. AIM's Board is reported to be negotiating the return of experienced senior staff and management.51

9.2 Assessment Of Fund Flows (Including From The Private Sector)

In Malaysia, interest rate controls may have played some part in keeping commercial banks out of microfinance. McGuire, Conroy and Thapa (1998, 185) noted that Bank Negara, the central bank, restricted the spread between base and maximum lending rates in the commercial banking system to 4 percent, less than would be required to cover the extra costs associated with microfinance lending. In the case of some loans guaranteed by CGC the permissible spread was only 2 per cent, reinforcing this effect.52

9.3 Case Studies

As mentioned above, AIM has increasingly focused on providing larger-sized and higher-interest loans and serving non-'hard core poor'. Two loan programs introduced after 1997 illustrated this point. The first was given the name 'SPIN'. The SPIN program targeted men in the fishing industry. The second was titled SP-IT, for 'Single Mothers' (female heads of households). Participants were offered an unprecedentedly high first loan of RM10,000 (US$ 2,650). With the diversion of AIM's attention to larger loans and better-off borrowers, the evaluator was also concerned about the implications of this development for credit discipline and portfolio quality with SPIN at 60 per cent PAR and SP-IT at 36 per cent (Sukor Kasim, pers comm 10/01). These are levels which indicate grave problems for the AIM program.53

52 Ibid.
53 Ibid.
10.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in Malaysia

- First domestic SRI fund already established
- Islamic values based investment industry well established with very strong Government support
- Global SRI funds showing some interest in Malaysia
- Limited SRI research has already been conducted
- Civil society and civil institutions becoming more active
- Mutual fund industry and retail investment becoming increasingly well established and sophisticated. Wealthy and educated middle class could be strong supporters of SRI in the future.
- Government strongly supports corporate governance and has a particular focus on social issues such as poverty, education and health
- Corporates reporting and adoption of environmental standards still weak but improving

Conclusion

- Potential for some cross-over between Islamic and SRI investment
- Increasing information to encourage global SRI funds to enter the market
- SRI already has a foothold and significant potential to develop in the future

Several Malaysian unit trust management companies, including TA Unit Trust Management Bhd, Asia Unit Trusts Bhd and Pacific Mutual Fund Bhd have expressed doubts over the introduction of SRI funds in Malaysia, citing the following barriers:

- The lack of demand due to lack of education and awareness of social issues; (However, educate on these issues increasing through Government, international and local NGOs.)
- Local trust funds are only allowed to invest not more than 10% of assets in overseas markets. (However, experience points to a likelihood that capital restrictions will gradually open up as market develops, plus there should be a growing number of SRI investments available in Malaysia going forward.)
- The bulk of traditional Malaysian unit trust investors is over 40 and male. SRI funds launched in Asia have been attracting a younger group of investors aged between 30 and 40 and a large proportion tends to be female. (However, if we look at this from another perspective, this unexploited investor group represents a huge potential market for SRI funds.)
- SRI funds require additional research to screen out companies based on social and environmental issues. Traditional stock brokerage research firms do not do such screening, therefore the onus falls on the fund management department to do the screening. This additional and potentially high cost would inevitably be reflected in the cost of the SRI funds to unit holders and may make the fund a poor investment choice. (However, use of NGOs and existing internal expertise brings cost down. SRI has thrived in other markets despite this extra work because of belief that extra analysis provides better performance.)

54 “Unit trust companies - Not right time yet to launch social funds,” The Star (Malaysia), 16 December 2002.
On the other hand, Islamic Funds enjoy strong prospects for growth, thanks to the following stimulants:

- Firstly, Islamic Funds are growing at a rapid rate since the establishment of the Islamic Bank.\(^55\) In Malaysia, about five per cent of all banking transactions are conducted by Islamic Financial Institutions. This is set to rise to 10 per cent by 2005.\(^56\) Deposits held by the Islamic Bank and the other conventional banks which operate Islamic windows alone have to date accumulated around RM 5 billion. Other institutions like the Pilgrims Management and Fund Board, Bank Rakyat which is actively turning itself to an Islamic Bank, the Baitul Mal of every state, YPEIM, the Islamic Unit Trusts, the Syarikat Takaful and MNI-Takaful, which are all holding Islamic Funds.\(^57\) Further, Malaysia has stepped closer to its aim of becoming a regional Islamic financial hub since the launch of The Islamic Financial Services Board (IFSB) in the Malaysian capital Kuala Lumpur in November 2002. IFSB is entrusted with setting standards for Islamic institutions and ensuring they conform with principles of Islamic Shariah laws.\(^58\)

- Secondly, there are a number of Muslim-owned companies which have shown clear interest and commitment in undertaking their financial transactions in the Islamic way, since their main activities are already in line with the Shariah. This creates a group of potential investee companies for the Islamic Funds.

- Thirdly, the move to set up Islamic banking and insurance in Malaysia and Brunei is yet another move towards expanding the size of Islamic Fund in the region, thereby providing greater potential for Islamically oriented investments in the future. There is an increasing interest by some other financial houses such as RHB to provide Islamic financial instruments.\(^59\)

- Fourthly, after the September 11 attack, a lot of Middle East funds are not going to the U.S. but are coming to South East Asian countries such as Malaysia. This provides a fertile demand for Shariah-compliant investment products.

It is early days for SRI funds, but the development of Islamic Funds has provided a favorable grounding for the development of SRI funds. Most Islamic Funds are essentially negatively screened ethical funds. It would be a relatively straightforward next step for companies offering Islamic funds to install some SRI positive screening on top of their existing selection mechanisms.

The fact that shareholder activism is not an option but seems a requirement for Islamic investors, is another strength on which SRI can be introduced.

Though there are potential barriers to the wider adoption of SRI, as mentioned above, as a relatively socially aware society (compared to other Asian countries), overall Malaysia should be a strong potential market for SRI funds.

\(^{55}\) "Good company: what have Islamic economics, animal rights protesters, social justice activists and ethical investors got in common?", M Iqbal Asaria, New Internationalist, 1 May 2002.

\(^{56}\) "Good company: what have Islamic economics, animal rights protesters, social justice activists and ethical investors got in common?", M Iqbal Asaria, New Internationalist, 1 May 2002.

\(^{57}\) "Islamic Fund in Malaysia," Datuk Dr. Syed Othman Alhabshi of Asia Unit Trust Berhad, February 1995.

\(^{58}\) Muslim banks create agency for standards, Reuter News Agency, 4 November 2002. JALIL HAMID.

\(^{59}\) Islamic Fund in Malaysia, Datuk Dr. Syed Othman Alhabshi of Asia Unit Trust Berhad, February 1995.
11.0 RESEARCH PARTNER

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## 12.0 GLOSSARY

<table>
<thead>
<tr>
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<th>Full Form</th>
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<tbody>
<tr>
<td>ACCA</td>
<td>Association Of Chartered Certified Accountants</td>
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<td>AIM</td>
<td>Amanah Ikhtiar Malaysia - Micro-Finance Institution</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association Of South East Asian Nations</td>
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<tr>
<td>CG</td>
<td>Corporate Governance</td>
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<tr>
<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>DJSI</td>
<td>Dow Jones Sustainability Index</td>
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<tr>
<td>KLSE</td>
<td>Kuala Lumpur Stock Exchange</td>
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<tr>
<td>MASB</td>
<td>Malaysia Accounting Standard Board</td>
</tr>
<tr>
<td>MICG</td>
<td>Malaysian Institute Of Corporate Governance</td>
</tr>
<tr>
<td>MSWG</td>
<td>Minority Shareholder Watchdog Group</td>
</tr>
<tr>
<td>NACRA</td>
<td>National Annual Corporate Report Award</td>
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<td>NGO</td>
<td>Non Governmental Organisation</td>
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SRI IN ASIAN EMERGING MARKETS:

PHILIPPINES

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(Note: The appendices are published separately on the ASrIA website, see: www.asria.org/publications)
1.0 EXECUTIVE SUMMARY

The Philippines benefits from a long philanthropic tradition of personal and corporate giving; there are now very well developed mechanisms, foundations and organizations for managing corporate philanthropy. There is also a very active civil society sector in the Philippines. However, concepts such as corporate social responsibility (CSR) and socially responsible investment (SRI) are relatively new concepts that are only recently starting to appear in the corporate and finance sector. The tradition of corporate philanthropy and patronage can also be linked to the fact that many corporations in the Philippines are family owned and controlled. However, this highlights the importance of improving corporate governance and transparency, which is presently quite weak in the Philippines relative to other Asian markets.

Given the uneven distribution of local wealth and the low levels of retail domestic investment in funds, it might take a long period of time before the Philippines possesses a domestic financial environment that can support significant domestic investment similar to the western SRI fund investment model. However, the year 2002 did usher in two innovative projects that sought to employ financial instruments towards attaining socially responsible goals.

The first is the PEACe Bond float, a ten-year term debt issue that was designed to help fund the long-term activities of Caucus of Development NGO Networks (CODE-NGO), a consortium of Philippine NGOs. The initial underwriting and management of the float was undertaken by the Rizal Commercial Banking Corporation, one of the Philippine's universal banks. This funding strategy is similar to the approach used in South Africa post-apartheid, when local NGOs became concerned about medium- to long-term funding. Currently, the PEACe Foundation is managing the proceeds of the float (see 2.4.2).

More akin to the traditional SRI concept, the Asian Conservation Company (ACC) employs sustainable development and financial standards in their investment strategy. The company’s primary partners, the World Wildlife Fund and New Century Partners, Inc. combine their financial and environmental expertise when conducting due diligence on the investments. New Century Partners invest primarily on behalf of the Soros Group of Companies, which supports open trade arrangements and liberal policy and emphasizes the importance of long-term investments and active investor relationships with the invested companies. Current investments of the ACC are in eco-tourism and marine enterprises. It is also noteworthy to mention that most of the ACC’s funds are derived from non-Philippine sources. (see 2.4)

In light of the collapse of Enron and the growth of CSR awareness in the Philippines, a number of groups are working to push corporate governance as a major agenda for voluntary private sector action. It is still unclear how much the Philippine Government sees corporate governance, let alone SRI, as an issue.

The leading domestic institutional investors in the Philippines are the pension funds of private sector employees (Social Security System or SSS), government employees (Government Service Insurance System or GSIS), and the armed forces (Armed Forces of the Philippines Retirement Service and Benefit System or AFPRSB). The two largest institutional investors (SSS and GSIS) have combined assets of PhP 340 billion (US$ 6.7 billion) of which PhP 264 billion (US$ 5.2 billion) are investments in securities, including equities.

Prior to 1998, investments in equities were small, in the case of GSIS totaling less than 2% of its portfolio. While there has been a very substantial growth in investments for both pension funds, their respective charters limit investments in equities. Foreign equity has not played an important role, in part because board membership of investment companies and funds is restricted to Philippine nationals.¹

There are musings that the Philippine Social Security Service (SSS) and its public sector counterpart, the GSIS, could act like the CalPERS fund by including good corporate governance as a parameter in their investment decisions. SSS's Charter is the only one presently setting limitations on investments in SRI-related instruments (mutual funds, corporate stock, etc.), so between the two GSIS has more leeway.

2.0 SRI FUNDS

2.1 Domestic SRI Funds

None at present.

2.2 Global SRI Funds Registered For Sale

None at present.

2.3 Global SRI Funds With Significant Holdings In The Domestic Market

We found no evidence that any of the global SRI funds have invested in the Philippines market. None of the Global or Asian SRI research providers have covered Philippine companies to date according to available data.²

2.4 Private Equity Investment In Development

Though investment in the community by Philippine corporates and investors have been primarily focused on philanthropy there is a trend towards investment in projects that would have an investment return component. Two primary examples are below. Further examples of international development funding can be found in the section on Corporate Response (9.0) and on Micro-finance (10.0).

2.4.1 Asian Conservation Company

www.asianconserve.com

A venture capital initiative with a policy of investing in environmentally sensitive companies that can not only provide an acceptable financial return to the investors, but can also provide gainful employment and education that will create a willingness among the local community to protect the natural resources in the area. It is also the intention to channel some of the returns back into actively funding conservation programs in the areas in which the portfolio companies operate. Two key partners include Next Century Partners: www.nextpartners.com and the World Wide Fund (Philippines).

Current projects:

**Ten Knots Group** who own and operate the El Nido Resorts in Palawan, South Philippines - The ACC partnership will ensure that the resort development enhances the environment and supports biodiversity conservation.

² For comprehensive data on SRI research providers see: www.asria.org/sri/asia/research?expand_all=1
Stellar Fisheries - 2nd largest producer of canned blue crabmeat - is currently working for ISO certification and Marine Stewardship Council. (MSC)

2.4.2 CODE-NGO Network, PEACE Bonds
www.codengo.org

CODE-NGO is a coalition of seven national networks and five regional networks, representing more than 2,500 NGOs, POs and cooperatives all over the country. After the People Power 1 there was abundant donor funds for development, however this has progressively dwindled. By early 2002, CODE-NGO sought advice from Seed Venture Capital, Inc. on how to raise a huge trust fund to sustain development work for member organisations. PEACE Bonds, are Poverty Eradication and Alleviation Certificates. They are 10 year, zero coupon Treasury Notes serving as government certificates of indebtedness.

Through underwriter Rizal Commerical Banking Corporaton (RCBC), CODE-NGO submitted the winning bid for PhP 35billion (US $637million) worth of these Treasury notes at a Dutch auction by the Treasury Bureau. RCBC promptly sold these in the secondary market for PhP 11.996 billion (218 million) for a net gain of PhP 1.827billion (US $33million) to CODE-NGO. After the investment bankers deducting a PhP 100million (US $1.8million) advisory fee and a PhP240 million (US $4.37million) underwriting fee, PhP 148 million (US $2.69million) was placed in a trust for strengthening the CODE-NGO network. The remaining PhP 1.34 billion (US$ 26.8million) was placed in the Trust fund for Anti-poverty projects of the Peace and Equity Foundation. The income of approximately PhP 70-100million (US $1.3-1.8million) a year is used to support the NGO's development projects. Projects need to show that they respond to the problems of poverty and marginalization and show measurable impact within 3 to 6 months.

The sale of the PEACE Bonds was not without controversy, due to the speed of the resale and the size of the investment return. For full details of this controversy see Appendix 4 to this report, published separately on the ASrIA website, www.asria.org/publications

2.4.3 Asian Development Bank
www.adb.org

The Philippines portfolio is the fourth largest that the ADB has under administration. As of December 2001, 45 projects were ongoing, accounting for a net loan value of US $2.6 billion. Most of the ongoing loans support the energy, agricultural and natural resources, transportation and communication, and social infrastructure sectors. The ADB also has an ongoing project to improve good governance and financial market development.

STEP-UP is a current ADB pilot public-private sector partnership to upgrade slums in Metro Manila, Philippines, which ADB is supporting with a US$3.6 million grant from its Japan Fund for Poverty Reduction, financed by the Government of Japan. STEP-UP aims to change the way in which the corporate sector interacts with, and provides support, to local communities. The project links the poor to economic opportunities by providing them with the wherewithal to help themselves as well as with contacts and role models in enterprise. The project provides improved environmental and community facilities to cater to health and educational needs. It aims to reduce their vulnerability to calamities through better risk management. In the six months since the project was launched, 19 homeowners associations, or some 4,429 households from six cities and a municipality, have signed up for the project, reaching 82.6% of the target.

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4 Ibid.
The STEP-UP Program leverages corporate outreach and assistance from leading companies to provide grants for:

- Community infrastructure and basic services
- Revolving funds for housing improvements
- Micro-enterprises to promote livelihood opportunities
- A program to prevent, and prepare for, fires, floods, and typhoons.

Some 35,000 poor people in 23 communities throughout Metro Manila will benefit. In an innovative approach, ADB is partnering PBSP (4.02), a corporate-led non-governmental organisation (NGO) promoting social development, and well as local government units (LGUs). PBSP’s membership comprises over 160 corporations.6

2.4.4 International Finance Corporation (IFC)  
www.ifc.org

The Philippines is the IFC’s eleventh largest country portfolio. Since 1998 the IFC has approved 14 projects with a total investment of US $280 million. In 2000, the value of IFC projects was doubled compared to the previous year. Through stepping up its involvement and undertaking cutting edge projects, the IFC aims to create an important demonstration effect that will help bring additional investments to the country. In addition, the IFC, together with the World Bank, participates in the development of a national corporate governance action program, aimed at improving governance in the corporate, banking and securities markets sectors.7

3.0 SRI RESEARCH

3.1 Domestic SRI Research

None at present.

3.2 International SRI Research Groups Covering the Domestic Market

None at present.

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7 www.ifc.org/factsheets/Factsheets/Philippines-jan01.pdf
4.0 SRI RELATED ORGANISATIONS, INCLUDING NGO'S

4.0.1 Ramon V. del Rosario, Sr. Centre for Corporate Responsibility (RVR Centre)
www.rvr.aim.edu.ph

The RVR Centre is a research and program centre housed in the Asian Institute of Management (AIM). The Centre's main task is the management of corporate citizenship relative to the competitiveness of firms and their impact on society. The Centre is engaged in case writing and research, program development, and executive education and training. A lecture series and an annual conference on Corporate Responsibility are programmed each year. For details on this year's annual conference, see: www.asianforumcsr.com

4.0.2 Philippine Business for Social Progress (PBSP)
www.pbsp.org.ph/index.html

PBSP is a private and non-profit foundation dedicated to promoting business sector commitment to social development, mainly via a philanthropic model. It was organized in December 1970 by 50 of the country's prominent business leaders, and has since grown to become the nation's largest and most influential business-led social development foundation. From an initial membership of 50 business companies, it has grown to more than 160 members, worked with some 2,500 partner organizations, provided over PhP 4.6 billion in financial assistance which supported over 5,000 projects, and benefited close to 2.5 million poor households.

4.0.3 Philippine Business for the Environment (PBE)
www.pbe.org.ph

PBE is a non-stock, non-profit organization incorporated in January 1992 to assist Philippine business address environmental issues and concerns. Specifically, PBE is involved in environmental enhancement projects; education and awareness; promotion of clean technology and sound environmental management; and intermediation between communities, business and government in environmental issues. PBE manages an Industrial Waste Exchange Programme and also produces a regular Business and Environment Magazine.

4.0.4 League of Corporate Foundations (LCF)
www.wingsweb.org/network/profiles/LCF.html

A network of corporate foundations and corporations that advocates greater commitment of the business sector to social development of the country. At present, LCF has 55 member companies nationwide and organizes a yearly event, the Corporate Social Responsibility Week (CSR Week).

The consolidated contribution of the League of Corporate Foundations and 6 other industry associations towards poverty reduction from 1997 - 2002 was PhP 7,637,747,891.00 (US$ 152.75 million). Examples of activities include building schools, upgrading libraries, nutrition and health programs, as well as craft and entrepreneurial skills training.

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\(^8\) Ibid.
4.0.5 Caucus of Development NGO Networks (CODE-NGO)
www.codengo.org

CODE-NGO was organized in 1991 by 10 of the largest networks in the country. Close to a
thousand non-government organizations (NGOs) and peoples' organizations (POs) assembled
for the organization's first national congress. Its formation marked the development community's
desire to promote professionalism, expand the reach, and increase the effectiveness of NGO/
PO work in the Philippines.

Today, CODE-NGO counts as its members seven national networks and five regional networks,
representing more than 2,500 NGOs, POs and cooperatives all over the country.

As an organization of scale, CODE-NGO has the greatest scope of NGO/PO issues and
concerns. It has been an effective forum for discussion and consensus building of issues
among its members. CODE-NGO represents its members with government and donor agencies
to advocate for the concerns of NGOs, POs, and the sectors and communities they assist. It is
also recognized as a principal clearing house of information on NGOs and POs in the Philippines.
See 2.4.2 above for data on the PEACe Bond.

4.0.6 Philippine Rural Reconstruction Movement (PPRM)
www.prrm.org

PPRM is a non-governmental organization engaged in the design and implementation of
community and habitat development programs across the country. PPRM is worth mentioning
because it is the only civil society group in the country with over 300 full-time staff and
multidisciplinary workers. It runs a continuing program for staff and career development
appropriate to its basic strategy.

4.0.7 Philippine Development Assistance Program (PDAP)
www.pdap.net

PDAP is a non-stock, non-profit consortium of NGOs that contributes to social change by
creating a favorable development environment. For the past 14 years, it has worked to reduce
the causes of poverty and inequity in the Philippines.

Canada has disbursed more than US $400 million in development assistance to the Philippines
from 1986 to 1999, primarily through the bilateral (government to government) programs of
the Canadian International Development Agency (www.acdi-cida.gc.ca/). In 1986, five Philippine
NGO networks decided to band together and establish themselves as a unified entity. This
was done to channel much-needed Canadian funds to grassroots-based development projects
in the country. Hence, PDAP was born.
5.0 GOVERNMENT INITIATIVES

Prior to 1990, foreign equity did not play an important role in the Philippine market, in part because board membership of investment companies and funds was restricted to Philippine nationals. The situation changed drastically with the implementation of an economic stabilization program spurred primarily by a stand-by credit facility from the International Monetary Fund. This paved the way for reforms in trade and investment that were started under Aquino and subsequently expanded on in the Ramos administration.

The most important of these was the passage of the Foreign Investment Act of 1991 that liberalized investment by allowing 100 percent foreign equity in a domestic or export enterprise as long as its activity did not fall under a negative list. Furthermore, this law simplified the procedure for the entry of foreign investments by requiring foreign investors to register only with the Securities and Exchange Commission (SEC), unless incentives from the Board of Investments (BOI) are sought.

Since 1992, a more comprehensive market-oriented approach to economic structural reform has been followed. Under this approach, many key sectors, including the oil, shipping, aviation, telecommunications, infrastructure and mining industries have been opened to the private sector, as well as to foreign investors. Ten foreign banks were initially allowed to open branches.

Prior to entry into the Philippines domestic market, foreign companies usually have to comply with labor, environmental and economic criteria as set forth by the Philippine Government. The basis for these criteria can be found in the Philippine Omnibus Investments Code, the application of which is revised annually and is released as the "Investments Priorities Plan" (IPP). Specific applications of the criteria are not usually fully disclosed as this is tied into the granting of fiscal incentives to firms on a case-by-case basis.

See section 7.3 and 7.4 on government legislation and other initiatives with respect to the Stock market and corporate governance.

6.0 PUBLIC AWARENESS

According to the 1999 UN Human Development Report, the Philippines ranked 77th out of 174 countries in terms of human development, as measured by the Human Development Index (HDI), a significant improvement from 82nd in 1998. By comparison, however, regionally, the Philippines lags in terms of human development. Environmental degradation, with its impact on health and economic growth also continues to be a major challenge. All major environmental concerns (e.g., urban water and air pollution, degradation of forests and watersheds, and deterioration of marine and coastal resources) are exacerbated by the high population growth rate.

Schemes to raise awareness with consumers include a voluntary eco-labeling scheme, based on ISO14024 guidelines, which will be promoted by the Clean and Green Foundation. Schemes like this almost certainly help to raise environmental and community awareness among consumers.

The Philippines does benefit from a huge 'third sector' of NGO's, people's organizations (PO's) and co-operatives, who work to raise awareness and conduct projects to tackle these issues.
POs are membership-based organizations which function as community-, sector-, or issue-based primary groups at the grassroots level (e.g., trade unions, environmental advocacy groups, peasant groups, etc.), these groups come together largely on a voluntary basis (although full-time secretariats tend to emerge as the POs expand their size or scope). NGOs, on the other hand, are intermediate agencies and institutions that tend to operate with a full-time staff complement and provide a wide-range of services for primary organisations.

Cooperatives here have a dual nature. Primary cooperatives are also membership-based and are characterized more as POs, while secondary and tertiary cooperatives (regional or national federations providing support services to their primary members) are considered NGOs.

Estimates of the entire non-profit sector vary from 60,000 to almost 96,000 registered non-profit, non-stock corporations. Aside from these there are 35,000 cooperatives registered with the Cooperative Development Authority (CDA). These figures do not include, as yet, an undetermined number of unregistered organizations. Figures for registered organisations also encompass a whole range of civic organisations, business/professional and labour associations, and religious organisations, most of which are not, strictly speaking, development oriented.

Recent estimates suggest that whilst many civil society organisations operate on relatively small annual budgets of less than PhP 2 Million (US$ 58,000), there are also a few big NGOs and foundations with annual budgets of PhP 30 Million (US$ 870,000) and above. Though the data is not comprehensive, estimates based on limited surveys indicate that the majority of NGOs are probably small (i.e. staff numbers, 10 or less). There are also very large ones NGOs correspondingly well resourced with staff complements of 30 and above. These are sometimes referred to as BINGOs, or big NGOs. One example is the PRRM (4.6) which has more than 300 employees. PBSP (4.2) has probably a slightly smaller number of staff.9

For more details on civic society in the Philippines and on environmental issues in the Philippines, see Appendix 1 and 2 to this report, on the ASrIA web-site: www.asria.org/publications

7.0 CORPORATE GOVERNANCE INITIATIVES

7.1 Present Status Of Corporate Governance

Last May, the Philippines ranked last among other Asian countries in CLSA’s fourth annual survey of corporate governance in Asia.10 Although the scores of the survey reveal only the performance of companies in seven areas: discipline, transparency, independence, accountability, responsibility, fairness, and social responsibility, it reflects the sad state of corporate governance in the Philippines.

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In 2002, a World Bank study\textsuperscript{11} revealed that although the statutory codes and standards are reasonably well elaborated, the Philippines showed problems of weak compliance starting with poor levels of implementation and enforcement by regulators of the minimum requirements of governance, relatively weak institutions to enforce regulations, and feeble judicial processes where mistreated parties can seek compensation. The final assumption is that there is low level of governance in practice.

A similar study showed the same results. The study, conducted by the RVR Center indicates that corporate governance in the Philippines is considered weak in practice in spite of assessments that formal requirements are more than sufficient. Further, the regulatory system; both the government regulation of the corporate sector and the stock exchange, has relatively poor enforcement mechanisms in identifying and punishing poorly governed and errant firms until an actual crisis has occurred. As a result, the country has suffered from an image of poor governance and continuing corruption.\textsuperscript{12}

Several reasons point out to why the country is in its current state and, according to a study by the Asian Development Bank (ADB), ownership is a key element in corporate control and governance.\textsuperscript{13}

### 7.2 Ownership Concentration

In the 1950's and 1960's, sentiments of nationalism led to politics that favored import substitution and heavy government involvement in business. To implement these policies, the local currency was devalued and high import tariffs were imposed. Protection from foreign competition led to profitability but also gave rise to an expensive labour market, and thus companies were as a necessity large and capital-expensive. An industrial elite, composed of families in the trading business emerged. These families built and preserved their businesses over several generations and most of them became controlling shareholders of the family-based corporations in the present day corporate sector.

The corporate sector can be categorized into four groups based on ownership: publicly listed, foreign-owned, government-owned, and privately owned. The average free float of all publicly

\begin{table}[h]
\centering
\begin{tabular}{|l|c|}
\hline
Country & Ave. Company Scores (Out of 100) \\
\hline
South Korea & 70.8 \\
Singapore & 69.5 \\
Hong Kong & 65.9 \\
Malaysia & 65.0 \\
India & 64.8 \\
Thailand & 60.2 \\
Taiwan & 58.7 \\
China & 57.4 \\
Indonesia & 43.0 \\
Philippines & 39.8 \\
\hline
\end{tabular}
\caption{Ratings Around Asia on Corporate Governance Issues}
\end{table}


listed companies in the Philippine Stock Exchange (PSE) is set at only 38%. Controlling shareholders, defined as the largest five shareholders, own up to 80% of the voting shares in seven out of the 29 companies that compose the PSE, the only stock market in the Philippines.

The publicly listed companies sector overall shows a similar degree of ownership concentration. On average, the largest single shareholder owns 41% of outstanding shares; the largest five shareholders own 65% and the top 20 shareholders own 76% of outstanding shares. The presence of pyramid structures is common in family holding companies. Usually at the apex of the structure is a pure holding company. These form the largest sector in PSE, accounting for 20% of the market capitalization at year-end 2000.14

With such high levels of ownership concentration, minority shareholders are unlikely to be able to influence the strategic and operating decisions of a company without the support of one or more large shareholders. In fact, the quality of participation in annual general meetings and the manner by which most of the meetings are treated as scripted affairs further demonstrates the relative powerlessness of minority shareholders. With large shareholders in control, minority shareholders need to be protected by external control mechanisms.

7.3 Legal And Regulatory Framework

The Philippine legal and regulatory environment is characterized by a comprehensive set of law and capital market regulations. Two pieces of legislation principally govern corporate activities - the Corporation Code, the general law on private corporations; and the Securities Regulations Code, the principal law on securities and governs the rules and regulations of the PSE. The SEC administers both laws and has supervisory responsibilities for all corporations.

The PSE in turn, supervises and regulates the stock market and all listed firms are required to comply with the listing requirements. It is a self-regulatory corporate organization that independently finances its operations through capital from members and fees collected for listing and membership.

Financial institutions are governed by three laws: the General Banking Law, the Banko Sentral ng Pilipinas (Central Bank, BSP) Law, and the charter of the Philippine Deposit Insurance Corporation, which provides protection to depositors in case of bank insolvency. The BSP has the supervisory responsibilities for banks and quasi banks.

7.4 Government's Initiative

The change in government in early 2001 signaled a change in resolve to address the country’s weaknesses in corporate governance. The administration of President Gloria Macapagal-Arroyo came to power with an anti-corruption platform and stresses good governance as one of its highest priorities. In late September 2001, the Philippine Congress and the Administration of President Arroyo just managed to pass an Anti-Money Laundering Act in order to comply with international standards. The Philippine Government has already asked the ADB for a US $120-million loan where part of it will be used for the implementation of the Anti-Money Laundering Act.15

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The appointment of President Arroyo of a straightforward new chair to the Securities Exchange Commission led to the enactment of a Code of Corporate Governance prepared by the private sector and upon the recommendation of the Governance Advisory Council. In addition, a Circular issued 2002 by the SEC chair has mandated companies to participate in a Corporate Governance Training Program for their Board of Directors. The BSP also issued a similar directive to all banks and quasi-banks.

The Code of Corporate Governance upholds the elements of fairness accountability, and transparency (FAT) that the U.S. and U.K. models contain although the ownership structure in the Philippines puts a natural barrier to the full elements associated with corporate governance. Table 2 compares several attributes of the Asian model, more or less a replica of the Philippine model, with that of Western Models of Corporate Governance.

<table>
<thead>
<tr>
<th>Attributes</th>
<th>Predominant Asian Model</th>
<th>U.S. and U.K. Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership structure</td>
<td>Few owners</td>
<td>Widely dispersed to the public and institutional investors</td>
</tr>
<tr>
<td>Protection of minority shareholders</td>
<td>Needs improvement</td>
<td>A high level of awareness</td>
</tr>
<tr>
<td>Disclosure</td>
<td>Limited</td>
<td>More detailed</td>
</tr>
<tr>
<td>Board composition</td>
<td>Members of management</td>
<td>Non-executive majority board</td>
</tr>
<tr>
<td>Sources of funds</td>
<td>Family, bank or public management</td>
<td>Institutional investment</td>
</tr>
<tr>
<td>Amount of shares in market</td>
<td>Limited</td>
<td>High</td>
</tr>
</tbody>
</table>

*Source: The SGV Review, Volume 1 Number 1, March 2003.*

Since the imposition of the Code, a flurry of activity by Filipino Corporations has been witnessed. These have included the preparation of company manuals in corporate governance, the appointment of independent directors, and the setting up of board committees (audit, nomination, and compensation).

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16 In June 2001, the President appointed a five-member Council from among leaders in the private sector that would prepare a governance reform agenda for the country to be reviewed and adopted by the government. The Council submitted its reform agenda to the President on 18 January 2002. One of the members of the Council was recently appointed as Undersecretary to the Department of Education.
7.5 Shareholder Rights

In essence, the Corporation Code guarantees a number of shareholder rights and protection. Among these are to elect, remove and replace directors; vote on certain corporate acts; subscribe to the capital stock of the corporation; obtain information about the company; receive returns on its investments; appoint auditors; and dissent on certain decisions of the board.

Removal of directors requires an affirmative vote of two-thirds of the outstanding capital but the code prohibits the removal of a director without cause if it will deny minority shareholders representation to the board. The code also, mandates the company to allow shareholders to inspect corporate books including minutes of board meetings and provides shareholders with an annual report including financial statements without cost or restrictions.

Shareholders have the right to receive dividends only upon the approval of the board although the SEC may direct the corporation to declare dividends when its retained earnings exceed shareholder equity. Finally, the Code requires corporations to hold annual meetings of shareholders.

Interestingly, a study on investor rights by La Porta, et. al. (1998) gave shareholder rights in the Philippines a rating of 3 of the possible 7, scoring it higher than Thailand and Korea in the region. An ADB survey provides further evidence on shareholder rights and protection and their activism in the corporate sector. The responding companies had an average of 43,522 shareholders each. An average of 327 shareholders per company attended the last annual meeting and they represented about 63 percent of total shares. About 333 shareholders per company voted by proxy, representing 3.4 percent of shareholders but 58 percent of outstanding shares.

The brokers or securities companies were the most important proxy voters, followed by management and banks. An average of about 4,900 shareholders per company did not vote during the last annual general meeting, representing about 24 percent of outstanding shares. Table 3 summarizes the rights that shareholders of responding companies enjoyed.

<table>
<thead>
<tr>
<th>Shareholder Rights</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>One share one vote</td>
<td>100.0</td>
</tr>
<tr>
<td>Proxy voting by mail</td>
<td>51.4</td>
</tr>
<tr>
<td>Preemptive rights on new share issues</td>
<td>70.0</td>
</tr>
<tr>
<td>Prohibition of loans to directors</td>
<td>36.8</td>
</tr>
<tr>
<td>Mechanisms to Resolve Disputes with Company</td>
<td>56.8</td>
</tr>
<tr>
<td>Independent Audit</td>
<td>92.7</td>
</tr>
<tr>
<td>Mandatory Independent Board Committees</td>
<td>43.2</td>
</tr>
<tr>
<td>Severe Penalty for Insider Dealings</td>
<td>69.4</td>
</tr>
</tbody>
</table>

Source: Asian Development Bank Survey of Philippines Listed Companies, 1999
8.0 SHAREHOLDER ACTIVISM

As shown in 7.5 above, shareholders in the Philippines have been quite active in attending and voting at AGM’s. However more active shareholder advocacy is still relatively undeveloped in the Philippines. Two problems cause the deficiency of shareholder activism in the country. Firstly, there is a lack of transparency and disclosure on specific matters that possibly entail the misappropriation of the assets of minority shareholders. SEC should strengthen disclosure requirements by issuing disclosure requirements by issuing specific guidelines on minimum disclosures required for related party transactions.

Second, there is a lack of provisions in the Corporation Code to facilitate class action suits against corporate directors, management, and external auditors. Legal provisions for class action suits should cover self-dealing by directors, compensation contracts, information disclosures, and dividend decisions.

9.0 CORPORATE RESPONSE

The degree of awareness of Corporate Social Responsibility (CSR) in the Philippines is still in an early stage. There has not been much research on the topic of CSR in the Philippines, unlike with corporate governance where organizations such as the ADB have carried out studies. However, there are a number of corporates practicing CSR or carrying out practical projects either within the workplace or among the community. In particular note first five examples of section 9.4.

What is not new in the Philippines is the idea of Philippine corporations helping society solve its problems. History will show how Philippine Business has reached out to assist society cope with difficult situations. The first transpired in 1970 when 50 leading corporations came together to establish PBSP in the period leading to martial law. The second was in 1984-95 when Philippine Corporations launched Community Relations projects to help displaced workers and communities. This was a time when the Philippine economy had literally collapsed, a period where massive lay-offs was experienced in all sectors of society. By the end of 1987, at least 80 major Philippine companies were involved in Community Relations projects of varying scope and value.  

9.1 Corporate Philanthropy

Filipinos are by nature a generous people, giving what they can to be helpful to others. In olden times, the concept of "bayanihan" best exemplifies Philippine generosity where the community acts as one to help its members, whether to move a house or till the soil. Catholicism, the most predominant religion in the country has ingrained the attitude of fulfilling one's obligations to give to the Church and to the less fortunate. The most recently published study on individual gift-giving habits of Filipinos has been provided by the organization, Venture for Fund Raising. In its survey covering seven cities and provinces, findings affirm that the Filipinos have a strong "culture of giving," even in times of difficulty and poverty.  

The practice of giving, or philanthropy, was institutionalized in the 1950's. Leaders of welfare agencies that had supported post-war relief operations expanded their social work through "umbrella" organizations. The Philippine National Committee of the International Council on  

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17 Ramon del Rosario, Sr. in a paper entitled "Corporate Responsibility: Community Relations as good business," delivered on the occasion of the formal launching of the RVR-AIM Center for Corporate Responsibility, 18 July 2000.
19 Coined from two Greek words meaning "love for man."
Social Welfare (known today as the National Council of Social Development Foundations of the Philippines) was formed in 1952. The Church set up the National Secretariat for Social Action in 1967 to address underdevelopment in the countryside. It was also in the 1960s when different sectors of society were drawn to action, channeling resources to address poverty and other societal issues. This continued up to the 1970s when along with PBSP, several other organizations were formed. The Bishop Businessmen’s Conference for Human Development was formed in 1971 and ten private organizations created the Association of Foundations (known today as the League of Corporate Foundations) in 1972.  

Corporate philanthropy has become a significant aspect of corporate CSR in the Philippines. It is also a useful tool in evaluating the performance of companies in the field of CSR. Based on data on Corporate Giving, conducted by the Ramon V. del Rosario, Sr. AIM Center for Corporate Responsibility (RVR) covering fiscal year 1999, cash donations comprise the bulk of the contributions. The Financing, Insurance, and Real Estate Sector had the highest percentage in the share of monetary donations.

Among the areas of concern, education remained the highest priority of assistance, which holds true in a previous survey conducted by the PBSP for fiscal year 1993. The management of corporate giving within the different companies and foundations are approved and evaluated by the Office of the President. Also, the PBSP and the RVR survey showed similar results in which the majority of the companies surveyed reported to having existing policies on Corporate Giving, whether formal or informal.

But unlike the 1993 PBSP survey where most of the companies channeled their donations through specific institutions and civic organizations, specifically, trade/civic/professional associations and church organizations; the 1999 RVR survey showed that schools and educational institutions were the main targets of Corporate Giving and the major channels for assistance and distribution of resources. It seems that the overall focus of many corporations lie on sectors that have a greater general scope and reach and are deemed as the basic needs of Philippine society today.

In terms of regional distribution of funds and resources, most of the donor companies gave within the National Capital Region, which is a significant indicator of the number of businesses within the area that contributed. Regions III and IV also had relatively higher levels of corporate funding. Considering that these richer regions are getting more than the poorer ones signify a resource misdistribution.

Through the years, the level and frequency of corporate giving has continuously increased. This trend is highly dependent on the increasingly humanistic vision of many top-level executives as well as the emergence of many natural disasters and in building up of the company’s image. However, the response to national issues was the most influential factor motivating companies to pursue giving programs. This is perhaps brought about by the political and economic situation in the Philippines.

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20 Ibid.  
21 The 1999 RVR-AIM Annual Report on Corporate Giving is a survey of the philanthropy practices of Top 1500 Philippine and Philippine-based firms designed to be used as baseline data to help individuals and institutions plan their giving programs.
9.2 CSR Movement

As with the global community, the movement of CSR has spread around the local business community in the last decade. In recent times, many privately owned companies have responded to the need for development of Philippine society, not only in the economic sphere, but also in social, cultural, and environmental aspects as well. Most of these companies have entered into tie-ups with different non-profit organisations. Others have built foundations, which are almost autonomous entities, to exclusively handle the socially oriented projects that carry the name or the image of the company.

In 1996, the League of Corporate Foundations (LCF) was formed. The LCF is a network of corporate foundations and corporations that advocate greater commitment of the business sector to the social development of the country. At present, LCF has 55 member companies nationwide and organizes a yearly event, the Corporate Social Responsibility Week (CSR Week). Several Philippine foundations, well-known multinational companies and corporations are featured in Section 9.4, each with a synthesis of their response to certain pressing concerns that the country faces. These corporations were chosen because of the relative accessibility to their annual reports and financial statements owing mainly to their exposure in the public eye and their membership with PBSP.

Business and Peace Initiative - Mindanao

Another leading example of CSR in action is the Business and Peace Initiative - Mindanao (Southern Philippines). This project is particularly significant because it illustrates the involvement of business with development agencies and local NGO's in a constructive partnership. It is also a pioneering project in an area that due to political unrest would otherwise find it difficult to attract investment.

Launched in September 2001, the Business and Peace Initiative - Mindanao is a three year programme to co-ordinate a collective business contribution to conflict resolution and development in the war-torn areas of Muslim Mindanao. The programme is being managed by Philippine Business for Social Progress, with on-going advice and input from the International Business Leaders Forum (IBLF), and funding from DFID via the British Embassy Manila. International Alert, Control Risks Group, AFFRIM (a local peace institute) and UNIDO are also project partners.

The programme focuses on diversity and tolerance in the workplace as well as enterprise development in the Muslim areas through 3 programme activities:

- Encouraging companies to promote equal opportunities and religious tolerance through internal management policies and practices.
- Developing a business links model through which the companies can contribute directly to local enterprise development in the Muslim communities, addressing economic exclusion as one of the major causes of the conflict. Larger companies can transfer valuable business skills and know-how to build the capacity of small and medium-sized enterprises in the Muslim areas.
- Facilitating an on-going dialogue between business leaders and government policy makers to explore ways to improve the general investment environment and economic potential, of Muslim Mindanao.

22 IBLF, www.iblf.org/csr/csrwebassist.nsf/content/f1c2a3c4a5a6.html
9.3 CSR Week

Corporate Social Responsibility Week is a yearly gathering of private companies, corporate foundations, government agencies and the civil society united in the task of social development in the Philippines. Usually held in the month of July, this year’s CSR Week was celebrated through a CSR Expo and at least 100 organizations attended. The CSR Expo showcased both individual and co-sponsored initiatives in the areas of education, arts and culture, environmental conservation, delivery of basic health and social services, livelihood generation, and enterprise development.

9.4 Examples Of CSR In The Philippines

The first five examples in particular are notable as examples of the adoption of aspects of CSR in the Philippines, as apposed to simply a focus on philanthropic giving.

9.4.1 The PHINMA Group Of Companies

Established by a group of Filipino industrialists in 1956, Philippine Investment-Management Consultants (PHINMA), Inc. has become the management and holding company of some 30 corporations that have played a key role in the Philippines’ basic industries. These include, amongst others, the manufacture of cement, steel, and other construction materials, paper and packaging, energy, trading, and property development. PHINMA’s mission is to create and manage enterprises in development-oriented industries in order to foster economic development whilst guided by a commitment to care for the community and for the environment.

PHINMA administers a full-scale integrated programme of assistance that strives to empower its communities to become self-reliant - providing basic services such as the construction and maintenance of potable water systems and day-care centers, to skills training and job placement, and credit programs for farmers, market vendors and other micro-entrepreneurs.

The company started an Educational Assistance Project that aims to support the educational needs of company employees as well as established on-the-job training programs tied up with local technical/vocational schools in Laguna.

In all its manufacturing facilities, the PHINMA Group goes beyond compliance with government standards in preserving the environment, i.e., its companies have invested substantial amounts to upgrade their technology to produce maximum efficiency and ensure that environmental standards are adequately met.

Companies under the PHINMA Group provide funding and material support for educational and Cultural activities, environmental projects, and basic social services. An endowment fund has been established to finance studies on entrepreneurship.

9.4.2 Nestle Philippines, Inc.

Nestle Philippines, Inc. (NPI) has contributed to good corporate citizenship initiatives in the areas of agriculture, education and manpower development, community development, health and nutrition, and environmental protection and preservation. Of these community programs, Nestle has made a mark of excellence for efforts in promoting environmental stewardship in its facilities and areas of operations.
Nestle's commitment to sound environmental practices is reflected in its policy that calls for
the integration of all environmental initiatives in the various aspects of business operation,
embodied in a framework called the Nestle Environmental Management System, committed
to not only comply with, but exceed, government's environmental standards. To promote
environmental consciousness among its employees, the company regularly conducts
environmental awareness training programs which include discussions on the effects of air
and water pollution on health and on the environment, government programs implemented to
address the issue, and Nestle's efforts to help protect and preserve the environment.

9.4.3 The Shell Companies in the Philippines

The Shell Companies in the Philippines are among the fifty business companies who founded
responsibility finds its basis in Shell's "Statement of Business Principles," in particular: Principle
2: Responsibility to Employees; Principle 6: Health, Safety & Environment; and Principle 7:
The Community. It currently co-chairs PBSP's Center for Corporate Citizenship.

Aside from the various community relations projects undertaken, the Shell companies in the
Philippines implement their social development projects through a corporate foundation - the
Pilipinas Shell Foundation, Inc. (PSFI) which serves as the Shell Group's vehicle for long-
term, sustainable development and self-help programmes such as the Sanayan sa Kakayahang
Industriyal (SKIL) Program, an industrial skills training program for out-of-school youth; Sanayan
sa Kakayahang Pangangalakal (SKP) Program which offers entrepreneurship training for families
in Shell's surrounding communities; and Sanayan sa Kakayahang Agrikultural (SAKA) Program,
an agricultural skills training program designed to improve farm productivity and management.

The PSFI also undertakes projects designed to enrich lives through other sustainable
development initiatives, among them, waste management, lake seedling, coral reforestation,
solar energy generation and the preservation of endangered wildlife - in particular, the rare
Philippine monkey-eating eagle. Over the years, Pilipinas Shell Foundation, Inc. has assisted
more than 16,000 beneficiaries, their families neighborhood and communities, to become
better equipped for the future and to work together towards a better life. It currently co-chairs
PBSP's Center for Corporate Citizenship.

9.4.4 Andres Soriano Foundation

*Profit With Honor,* or matching financial stability with a remarkable program of public service,
has been the underlying philosophy that has steered Anscor's businesses through generations.
First articulated in the 1940s by the Soriano patriarch, Don Andres, the philosophy is now
echoed in every mission statement of all Anscor companies, and is translated into a coordinated
program of community relations implemented by the Andres Soriano Foundation (ASF). ASF's
current direction includes major programs such as: Small Island Sustainable Development
Program (SISDEP), Cancer Abatement and Rehabilitation Effort (CARE), Program Development
and Management Assistance (PDMA) and Corporate Development Initiatives (CDI).

Under SISDEP, ASF works directly with assisted communities in the implementation of holistic
community development programs that include community organizing and capability building,
local governance, economic enhancement, resource management and the delivery of basic
social services (health, water and pre-school education) and disaster response. Under its CARE
program, ASF works directly with institutions either through provision of funding support,
technical assistance on organizational and program development and advocacy concerning
national issues on health, primarily in the fight against the "Big C" (cancer prevention). As in
the past, ASF's PDMA will continue to assist technically new foundations/institutions or
individuals with plans to set-up their own social development programs.
9.4.5 Ayala Foundation

The Ayala Corporation is one of the biggest and most diversified business entities in the Philippines. Its business ventures include banking (Bank of the Philippine Islands, the second largest commercial bank in the country next to Metrobank), real estate (Ayala Land, Incorporated; the country's largest and only full-line property developer), and telecommunications (Globe Telecom, one of two leading providers in digital wireless telecom service).

The Ayala Foundation's main thrusts are Education (the Filipinas Heritage Library) and Culture (the Ayala Museum). The foundation also caters to the delivery of technology to those who have been left behind by the quick pace of technology and scientific advancement. An example is their program to establish a Networking Academy at the Laguna College of Arts and Trade. The project aims to teach students about the establishment, maintenance, and repair of local area network (LAN). This is in response to the high demand for LAN technicians amongst many firms.

In training and skills acquisition, the Ayala Foundation has taken part in empowering the Samahan ng Magasasakang Katutubong Iraya sa Talipan (SAMAKAITA) Mangyans23 through training in policy formulation as well as administrative and financial procedures. This project demonstrates the Ayala Foundation's active role in community development.

The foundation also acts as a consultant to several cooperatives. They have assisted in the various concerns of 11 Makati-based24 cooperatives, helping them address their organizational, financial, operational, and networking concerns with the hope that one day, these cooperatives will be independent and be able to stand on their own feet. In these examples, the Ayala Foundation has acted as a catalyst for transforming communities that are closely related to their operations and also those which are simply in need of their skills and resources.

9.4.6 Citibank, N.A.

Citibank Manila has been involved in various corporate giving activities since the 1970s, mostly along the fields of education, community development, microcredit, culture & arts, health, livelihood and social services. In 1999, at the recommendation of Citibank, Citigroup awarded the PBSP with a US$ 100,000 grant for the establishment of five computer laboratories for public high school students, four of which are in Metro Manila, and one in Cebu City. In 2000, a further US$ 54,000 grant was approved for the development of an additional computer laboratory and the expansion of an existing computer laboratory into an IT laboratory.

9.4.7 DOLE Philippines, Inc.

Davao City-based multinational DOLE Philippines, Inc. is probably the country's biggest producer of export bananas, and other food and beverage products. Being involved, to a great extent, in the agricultural sector, which is the pipeline of the Philippine economy and the lifeblood of its people, DOLE's mission statement for Asia puts weight on social responsibility and environmental protection in its areas of operation.

Probably the Company's most significant contribution to social development was the Libuganon River Watershed Reforestation and Soil Conservation Project in Kapalong, Davao Province which targeted some 500 hectares for reforestation and included community development.

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23 Mangyan is a generic term that comprises the indigenous peoples of Mindoro Island, in this case the Northwest part of the Mindoro Island, Southern Philippines.

24 Makati is the premier commercial business district in Metro Manila.
components such as: training and education, backyard food production, income generating projects, health and child care, and potable drinking water facilities. DOLE has also implemented the Small Independent Growers Program, which promoted the spirit of entrepreneurship among the Company's 2,000 plus farmer-growers who now employ the latest banana-growing technologies. DOLE established the Mahintana Foundation in 1977 to assist the Company in its practice of social responsibility to address major areas of concern such as health, education, environment, livelihood and community credit.

9.4.8 IBM Philippines, Inc.

IBM Philippines, Inc. is a wholly Filipino-owned subsidiary of IBM Corporation, the world's leading information technology and services-company. IBM's policy on corporate social responsibility pushes it to be an active contributor to community development through participation in various projects aimed at the economic and social development of the Filipino people.

One of 50 founding members of the Philippine Business for Social Progress, IBM focuses its efforts in social development to support key intervention areas, particularly education, culture and the arts, as well as employee volunteerism. IBM has also donated computer and computer accessories to different schools and organizations, and has helped facilitate the setting-up of rooms and facilities for computer training in selected communities.

9.4.9 Metrobank Foundation

Metropolitan Bank and Trust Company (Metrobank) is currently the number one private commercial bank in the Philippines in terms of assets, loans, and deposits. To George S.K. Ty, the Company’s founder, it was clear that every private corporation had social responsibilities and the more successful the corporation; the greater were its responsibilities to society. Thus, the Metrobank Foundation was formed on 8 January 1979.

The foundation implements their development programmes and projects through the donation of resources. Examples abound in the field of the arts, education and the health sector. Their commitment to education development can be seen in their grant donations to the top universities in the country as well as their awarding events for recognition of excellence in education. In the field of health they have generously given support to the Manila Doctors Hospital and College for improvement of facilities and infrastructure as well as in training seminars.

Metrobank Foundation is more focused and streamlined for promoting culture and the arts, as well as education and healthcare. Because of this, they have limited access as well as motivation to develop other sectors of society such as labor, employment, or livelihood programs. The focus is limited to the vision of their Founder, who envisions a culture of excellence through the arts, education, and healthcare.

10.0 COMMUNITY INVESTMENT AND MICRO-FINANCE

10.1 Historical Background

Philippine micro-finance or microcredit as it was called in the past, began as a social development initiative to alleviate poverty, and has moved from the marginal to the mainstream, towards commercialization and micro banking. The sector consists of both regulated and non-regulated institutional players such as banks, cooperatives, non-government and people’s organisations, which use both formal and informal standards to provide financial services and banking facilities for the poor.\(^{26}\)

The roots of micro-finance date back to 1952, when a law was passed that allowed for the creation of small-regulated banks suitable for providing microfinance on a commercial basis. The Rural Bank Act of 1952 allowed duly established cooperatives to organize rural banks or subscribe to the shares or stock of any rural bank. The cooperative movement was initially sponsored by civic and regional groups that registered the earliest cooperatives under the first Corporation Law enacted in 1906, followed by the Agricultural Credit Associations Act of 1915, and the Cooperative Marketing Law enacted in 1927.\(^{27}\)

A few NGOs began micro-finance activities in the 1980s and hundreds more have incorporated micro-finance as part of their service menu since the early 1990s due to substantial government, donor, and international NGO financial and non-financial support. The influence of the Grameen model of service delivery has been very strong among microfinance NGOs due in large part to various forms of support available to Grameen replicators.\(^{28}\)

In 1985, poverty alleviation began to play a central role in the Philippine Government’s development strategy. It was also during this period when the country went through a process of liberalization of its financial system, implementing a set of policies that was aimed at reducing government intervention and private sector participation in the economy. Although these poverty-alleviation policies were not consistent with market-oriented financial policies, together they led to the proliferation of financial institutions, regulated and non-regulated, providing micro-finance services.

The growth of Philippine micro-finance from 1992 to 2002 has been described as vibrant, yet institutionally complex. It was in 1993 when Dr Mohammed Yunus, founder of Grameen Bank, visited the country at the invitation of the Presidential Commission to Fight Poverty. The Yunus visit which included a meeting with then President Fidel Ramos culminated in the Grameen replication project of the Agricultural Credit Policy Council, an attached agency of the Department of Agriculture. What followed was the formation of a Presidential Task Force on Credit for the Poor and consultative meetings to draw a Master Plan for Credit for the Poor.

The Master Plan identified three strategies to alleviate poverty through micro-finance. The first strategy to raise financial resources, was embodied in the organization of the People’s Credit and Finance Corporation in 1996. The second strategy was in the area of policy and it included lobbying for the passage of Republic Act 8425 or the Social Reform and Poverty Alleviation Act of 1997. With the ratification of R.A. 8425 came the establishment of a government agency, the National Anti-Poverty Commission. The third strategy was to build institutional microfinance capacity, primarily through a government fund called the Peoples


\(^{28}\) Ibid.
Development Trust Fund. Table 4 elaborates several other important events in microfinance in the country covering the period 1990-2002.

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<tbody>
<tr>
<td>Gov. agency - ACPC starts Grameen Bank Replication Project</td>
<td>Presidential Task Force on Credit for the Poor</td>
<td>MO 261 forms Peoples Credit and Finance Corporation with P100 million</td>
<td>PCFC starts operations in June</td>
<td>ADB/IFAD $34.7M loan to PCFC for Grameen Bank replication</td>
<td>RA 6425 sets policy framework for Philippine microfinance</td>
<td>Additional P600 million equity in PCFC</td>
<td>UNDP-MSP introduces ASA method through PCFC</td>
<td>BSP General Banking Law of 2000, Circular 272 boosts Microfinance among rural banks</td>
<td>Micro finance banks are set up: First Opportunity (of Append network)</td>
</tr>
<tr>
<td>APPEND network of credit NGOs</td>
<td>USAID project to develop standards among NGOs in microfinance</td>
<td>NGO standards project funded by USAID</td>
<td>EO 138 signed by President Estrada</td>
<td>- CIDA SEDCOP helps NATCCO network build F1 capacity among 31 cooperatives (CdH: US$ 7.3M)</td>
<td>- USAID US$ 4M MABS project helps rural banks in Mindanao</td>
<td>DBP launches Financing Program for Micro Enterprises, P400 million allocated.</td>
<td>BSP goes on countryside road show to promote microfinance</td>
<td>TLRC exempted from EO 138</td>
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<tr>
<td>CARD Bank established from CARD NGO</td>
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</tbody>
</table>

Table 4: 1990-2002 Philippine Microfinance Milestones


10.2 The Delivery Of Micro-Finance

Table 5 shows the process by which micro-finance is delivered to the borrowers/clients. It also shows the different institutions involved in the delivery of microfinance. Funds usually come from three sources:

- Government-Sponsored Rural Credit - these are government agencies involved in microfinance building and credit delivery.
- Donor-funded Second-tier Loan Funds - these are second-tier loan funds funded by international NGOs.
- Private Bank Loans to MFIs - these are loans from private commercial banks in Asia and the Pacific.

MFIs are classified into formal and informal institutions. Formal institutions can be sub-classified into thrift banks, rural banks, pawnshops, and lending investors while informal institutions are cooperatives and NGOs. The succeeding discussions will elaborate the process further.

Table 5: How is Microfinance Delivered?

<table>
<thead>
<tr>
<th>Wholesale</th>
<th>Retail</th>
<th>Borrowers/Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Government-Sponsored Rural Credit</td>
<td>I. Formal Institutions</td>
<td></td>
</tr>
<tr>
<td>II. Donor-funded Second-tier Loan Funds</td>
<td>a) Thrift Banks</td>
<td>“Entrepreneurial Poor” or a client that has experience in running a microenterprise</td>
</tr>
<tr>
<td>III. Private Bank Loans to MFIs</td>
<td>b) Rural Banks</td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Pawnshops</td>
<td></td>
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<tr>
<td></td>
<td>d) Lending Investors</td>
<td></td>
</tr>
<tr>
<td></td>
<td>II. Semiformal Institutions</td>
<td></td>
</tr>
<tr>
<td></td>
<td>a) Cooperatives</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NGOs</td>
<td></td>
</tr>
</tbody>
</table>

10.3 Sources Of Funds

10.3.1 Government-Sponsored Rural Credit

The biggest operators of funds for rural credit are the Development Bank of the Philippines (DBP), the People’s Credit and Finance Corporation (PCFC), Land Bank of the Philippines (LBP) the National Livelihood Support Fund (NLSF) and the Small Business Guarantee Corporation (SBGCF). In 2002, NAPC met with government agencies involved in microfinance to map out the roles in ensuring the success of microfinance. Discussions between government agencies resulted in the differentiation of roles:

PCFC - shall be a wholesaler of loans up to PhP 25,000.00 per client and whose focus shall be on poor household as specified by the National Economic Development Authority poverty threshold indicator. PCFC was created to be the lead financial institution in the wholesale delivery of funds to NGO’s, people's organizations and rural banks for relending to the poor and marginalized sectors of economy. It is the designated channel of government support for microfinance activities with total resources of P350 million as of March 1998.

DBP - offers rediscounting of microfinance loans and is a primary wholesaler of small and medium enterprise loans above 150,000 per client.

LBP - a wholesaler for farmers and fisherfolk. It supervises the PCFC and NLSF funds. It recently approved a microfinance-lending program.

NLSF- provides loans to agrarian reform beneficiaries through accredited conduits. NLSF extends credit to eligible NGOs, financial institutions, and people's organizations for relending to borrowers with incomes below the poverty line (for example, small farmers, fisherfolk, landless farm workers, and unemployed women). It is supervised by LBP.

SBGFC - supports development of small and medium-sized enterprises through the provision of credit and guarantees. It operates a guarantee program and two lending programs, the Small Enterprise Financing Facility and the Rediscounting Facility for Small Enterprises.

10.3.2 Donor-Funded Second-Tier Loan Funds

Two second-tier loan funds funded by international NGOs also deserve mention - the Responsible Investments for Solidarity and Empowerment (RISE) program of Catholic Relief Services and the Small Economic Activity Development (SEAD) program.

RISE Program - a financial company established for the purpose of lending to Grameen Bank replicators in the country.

SEAD Program - assists poor entrepreneurs, mostly women, to increase income and savings for household livelihood security by providing continuous access to savings.

10.3.3 Private Bank Loans to MFI's

Although MFI's are generally not able to meet the stringent borrowing criteria required for commercial loans in the Philippines, there are some cases where private commercial banks have made lines of credit available to particular MFI's. Good performance by certain NGOs encouraged some banks to risk lending to them but the crisis in 1997 cut short this experiment. Most loans that microfinance NGOs have recently accessed from private commercial banks are at interest rates above prime and could, therefore, be considered commercial or market based.
10.4 Micro-Finance Institutions

Three main types of retail MFIs currently serve the market at present:

1. A large proportion of the 2,865 cooperatives registered with the Cooperative Development Authority (CDA), the governing body that registers and regulates cooperatives;

2. 500 of the approximately 900 microfinance NGOs; and

3. At least 100 of 786 rural banks. Table 6 presents an overview of the major providers of micro-finance in the Philippines:

<table>
<thead>
<tr>
<th>Type</th>
<th>Ownership</th>
<th>Major Funding Sources</th>
<th>Authorized Activities</th>
<th>Target Market</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formal Institutions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thrift banks</td>
<td>Private investors</td>
<td>Equity, commercial loans, deposits</td>
<td>Savings deposits and loans</td>
<td>General public</td>
</tr>
<tr>
<td>Rural banks</td>
<td>Private investors</td>
<td>Equity, commercial loans, deposits</td>
<td>Savings deposits and loans</td>
<td>General public</td>
</tr>
<tr>
<td>Pawnshops</td>
<td>Private investors</td>
<td>Equity, commercial loans</td>
<td>Pawn loans</td>
<td>General public</td>
</tr>
<tr>
<td>Lending investors</td>
<td>Private investors</td>
<td>Equity, commercial loans</td>
<td>Loans</td>
<td>General public</td>
</tr>
<tr>
<td><strong>Semi-formal Institutions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cooperative</td>
<td>Individual members</td>
<td>Capital plus member deposits</td>
<td>Savings deposits and loans</td>
<td>Members</td>
</tr>
<tr>
<td>Rural banks</td>
<td>Private investors</td>
<td>Grants, donations, commercial loans</td>
<td>Loans to individuals and groups</td>
<td>General public</td>
</tr>
</tbody>
</table>


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10.4.1 Rural Banks

Republic Act No. 7353, or the Rural Bank Act of 1992, defines the target clientele of rural banks as "farmers, fisherman and merchants with small cash requirements." As a result of this mandate, since their inception in 1952, rural banks have been viewed as agents of microfinance, the driving force and instrument of rural development providing not just the farmers, fisherman, and merchants but also the rural enterprises and cooperative with credit to finance their productive activities. This sense of mission also provides the basis for fiscal, financial and other activities that over the years have been granted by law to rural banks.

At present, rural banks are predominantly small and family owned. Although rural banks represent 82 percent of all banking institutions, their consolidated assets represented only 2.3 percent as of December 1997. In terms of clientele, BSP statistics show that loans of PhP 10,000.00 (US $200.00) and smaller comprised 60 to 80 percent of the total loans of rural banks. Rural banks are predominantly small in scope with an average of 4,200 borrowers per bank, as of December 1999.

10.4.2 Cooperative Rural Banks

Cooperative rural banks (CRBs) are rural banks owned by cooperative organizations. They share many of the features and have the authority to perform the same banking functions as rural banks. Because they are owned by cooperatives and their federations, CRBs have a mandate to provide their banking services primarily to their constituents in the cooperative movement.

Because CRBs provide services to cooperatives, most of which serve low-income groups, their portfolios largely comprise small loans. Alongside the rural banks, CRBs have been traditionally regarded as the providers of financial services to low-income segments of the population.

The first CRBs were established in 1973-74 during the heyday of government credit subsidies. They were organized by agriculture-based village associations composed of small-scale rice and corn farmers. Just like family-owned rural banks that mushroomed in the mid-1970s, the CRBs benefited from government subsidies in the form of matching capital, cheap funds through the Central Bank rediscount window, and various tax exemptions.

Despite the agricultural focus of their original constituency, BSP-required increases in rural bank minimum capital opened the ownership of CRBs to non-agricultural cooperatives, thus broadening the ownership base and diversifying the portfolios of cooperative rural banks. In addition, most government subsidies and poverty alleviation strategies shifted to micro and small enterprises. Consequently, cooperative rural banks have increasingly focused on non-farm, off-farm, and farm-related rural enterprises. Many have expanded their borrower clientele beyond member cooperatives as well.

10.4.3 Microfinance NGO

The Microfinance Council, the largest domestic microfinance network reports that only 19 NGOs can be considered serious MFI players accounting for 85 percent of the total microfinance portfolio of the microfinance NGOs. Within these 19, only three - Center for Agriculture and Rural Development (CARD), Tulay sa Pag-unlad, and Negros for Women, accounted for 63 percent of the total portfolio. The ADB sub-sector review says that it is unlikely that the importance of NGOs/MFIs will grow; in fact, it will shrink as some NGOs are now seriously

thinking of converting themselves into banks. However this can also be seen as a sign of economic progress in operation.

10.5 Present Status And Future Of Micro-Finance

In her first State of the Nation (SONA) address last July 2001, President Gloria Macapagal Arroyo declared microfinance should be a cornerstone in fighting against poverty. The President committed to reach out to and help 1 million women through micro-finance which has been broken down into an annual outreach of 300,000 new women members each year.

In the Second Semester 2002 Status Report on the Financial System submitted by the Bangko Sentral ng Pilipinas, the Central Bank of the Philippines (BSP) to the President last 9 May 2003, microfinance was seen as making progress towards the mainstream through various joint initiatives by non-government organizations, banks, and cooperatives. Since 2000, 49 additional banks have joined the 71 participating banks in microfinance. The total microfinance portfolio amounted to PhP 2.1 billion (US $38.1 million) reaching 386,431 borrowers as of year-end 2002.

A month after, in a 6 June 2003 report on the progress of microfinance in the country, the Bangko Sentral ng Pilipinas (BSP) has announced that out of the 49 additional banks, 11 banks with 22 branches started operations in 11 provinces not previously covered by any bank with microfinance capabilities. BSP had also granted rediscounting facilities to 10 banks, meaning increasing their lending capability, with total loans outstanding amounting to PhP 21,740,663.61 (US $394,480) involving 9,623 micro-borrowers.

The operating environment for microfinance has been viewed as supportive and positive for growth of the private sector. Commercialization of microfinance in the country holds the promise of capitalizing on the achievements in outreach that Micro-Finance Initiatives (MFIs) have made to date. General improvements in MFIs' financial self-sufficiency are promising, but the industry is far from reaching its full potential.

Two micro-finance case studies are published in Appendix 3 to this Report, on the Philippines country page of the ASrIA web-site: www.asria.org/ref/countries/philippines

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11.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in Philippines

- Strongly rooted and institutionalized corporate philanthropy
- CSR being introduced and adopted by some corporates
- Corporate reporting and adoption of environmental standards still weak but improving
- Vibrant civil society, wide NGO sector and experienced development organisations
- Several NGO’s working with business sector on corporate governance, environmental and social issues
- Mutual fund industry and retail investment industries small but increasingly sophisticated
- Government promoting corporate governance, notably the corporate governance code. The government is encouraging foreign investment that also meets certain labour and environmental criteria
- Pension funds limited in stock market investment but not constrained from adopting SRI criteria
- Micro-finance sector well established with several successful case-studies

Conclusion

- Potential for investor support for SRI particularly if it appeals to traditional and ethical values and also presents SRI as a fresh, differentiated product
- SRI could also gain support of NGO sector if shown to provide fresh perspectives on, as well as to promote and reinforce, broad development goals of equity, poverty alleviation and environmental protection
- Corporates with improving CSR standards can be identified
- Global SRI funds investing in the Philippines would provide an invaluable model to spark a domestic SRI industry

11.1 Does The Concept Belong In The Philippines?

Given the developments in the field of corporate social responsibility (CSR) especially in the context of developing countries like the Philippines, the potentials of SRI cannot be discussed without taking into consideration Foreign Direct Investment (FDI) and related community investments by foreign and domestic corporations. The US and European SRI model that is dependent on domestic shareholders is limited at present in the Philippines economy, as the base of domestic investors is quite limited. Though there are a number of mutual funds, the industry itself is underdeveloped. Also, only a handful of Philippine companies have publicly traded debt issues.

It is most likely that foreign investors initially drive the demand for SRI in the country as foreign investment funds have experience and expertise with SRI investment. However, foreign institutional investors still need relevant social, environmental and ethical data and research on Philippine corporations in order to make informed decisions, and this research can best be produced domestically. Even so, the potential for domestic investors to adopt SRI criteria into their investment decisions should not be totally dismissed, and this could be driven by domestic pension funds.

Even though CSR is still largely underdeveloped by the corporate sector, there are very long traditions of corporate philanthropy which have strong ethical roots in the community. In addition the vibrant and active NGO sector and the active media also reflect the high civil and
environmental awareness within the community. Furthermore, the investing public, though relatively small, is also well educated and fairly sophisticated. There is therefore a strong platform in the community on which SRI could find a foundation of support.

11.2 On Physical Ethical Investments

The Philippines has a foreign investments-attraction policy that is tied into the economic development of the country. Like most other developing nations, the policy of industrialization brought in transnational corporate activity as well as encouraged the growth of domestic industries. The majority of FDI over the years has come from the US, Europe and Japan, while recently some investments have also come from the other ASEAN countries. The majority of these multi-national companies are listed on the capital exchanges of their respective home countries. Prior to entry into the domestic market, these foreign companies usually have to comply with labor, environmental and economic criteria as set forth by the Philippine Government. The basis for these criteria can be found in the Philippine Omnibus Investments Code, however annually the application of this Code is revised and is released as the Investments Priorities Plan (IPP). Specific applications of the criteria are usually not fully disclosed as this is tied into the granting of fiscal incentives to the firm.

Aside from the infusion of technology and capital into particular industry sectors and geographic areas, many of these companies conduct some form of charity work locally in attempts to transplant CSR practices they may have in their home countries. In terms of CSR, the most common mode is through direct infusion of monies to charities, communities and organizations by corporations. As these foreign companies engage in longer-term business in the country, usually more comprehensive community development work is conducted either on its own or through partnership with local groups (note examples in Section 9.0 above).

Domestic companies, especially those that are in the agri-industrial sector, often carry over patronage arrangements with communities and workers that have been established over long periods of time. These quasi-family arrangements can also be seen in their capitalization, as most shareholders are family members or (presuming a certain degree of progressiveness) there is in some cases a profit-sharing arrangement with workers. Manufacturing companies also often have this form of financial structure, thus highlighting that one of the major challenges facing domestic Philippine corporations is corporate governance.

11.3 Politico-Economic Context

Regarding the development of SRI, overall policy does not only look at financial investments but also the presence, process and regulations related to physical investments. This is again juxtaposed on the assumption that it is multinational or transnational companies that are more aware of the concept of CSR and SRI as opposed to Filipino companies. Thus these types of companies would be more sensitive to the CSR-stock/issues relationship. The other message is that as far as international pressure of SRI for Philippine application is concerned, there is a need to look not only at consumer impressions but also there is a need for government and corporates to be able to communicate to financial and hard capital investors the already existing CSR related policies as a measure of sustainable performance.

The need to develop the local financial market goes without saying, but this again is hinged on overall economic development. Given the gamut of issues that this topic could cover, it might be valuable to package or present the Global Compact (GC)33 principles on environment, labor and human rights and the Global Reporting Initiative34 as areas that the Philippine Government and business sector can reference their SRI rating to. However for SRI to have relevance in the Philippines context, it must be shown to contribute in a practical way to the general development goals of the country.

33 Global Compact, www.unglobalcompact.org/Portal
34 Global Reporting Initiative, www.globalreporting.org
12.0 RESEARCH PARTNER

Anthony Bryan J. Rebolledo

Tony is currently the Information Officer for the Ramon V. del Rosario, Sr. Center for Corporate Responsibility housed in the Asian Institute of Management. He has several years of experience in the field of information technology, corporate governance, and corporate social responsibility and has been involved in IT education for the past three years. Prior to working with the Institute, Tony was Information Resource Development Officer for the Philippines Council for Health Research and Development and a consultant for several organizations related to Information Technology. He received his Bachelor's degree from the University of the Philippines and is currently finishing his Masters Degree in Information Management at the Ateneo Information Technology Institute.

Contributory Research

Charmaine M. Nuguid-Anden

Charmaine Nuguid-Anden's interests include development economics, corporate citizenship and governance. She has several years of experience in research, investment and industry policy monitoring and public-private sector networking. Charmaine holds a BSc in Economics from the University of the Philippines and has worked in a range of organizations including the Philippines Board of Investments, Department of Health, and a website company. She was Philippines UNV Specialist in Business-Community Relations based at Philippine Business for Social Progress. Before joining the UNV project, Charmaine was a freelance researcher and writer including a recent assignment for the World Health Organization (WHO) on tobacco control. She is currently finishing her Masters in Development Management in the Asian Institute of Management.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>ACC</td>
<td>Asian Conservation Company</td>
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<td>ADB</td>
<td>Asian Development Bank</td>
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<td>AFPRSB</td>
<td>Armed Forces of the Philippines Retirement Service and Benefit System</td>
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<td>ASEAN</td>
<td>Association of South East Asian Nations</td>
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<td>ASF</td>
<td>Andres Soriano Foundation</td>
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<td>BOI</td>
<td>Board of Investments</td>
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<td>BSP</td>
<td>Banko Sentral ng Pilipinas</td>
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<td>CalPERs</td>
<td>California Public Employees Retirement System</td>
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<td>CARE</td>
<td>Cancer Abatement and Rehabilitation Effort</td>
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<td>CDA</td>
<td>Co-operative Development Authority</td>
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<td>CODE-NGO</td>
<td>Caucus of Development NGO Networks</td>
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<td>CRB</td>
<td>Co-operative Rural Bank</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>DBP</td>
<td>Development Bank of the Philippines</td>
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<tr>
<td>DFID</td>
<td>Department of International Development (UK)</td>
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<td>FAT</td>
<td>Fairness, Accountability and Transparency</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>Global Compact</td>
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<td>Government Service Insurance System</td>
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<td>Human Development Index</td>
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<td>International Finance Corporation</td>
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<td>Investments Priorities Plan</td>
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<td>International Organisation For Standardisation</td>
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<td>LAN</td>
<td>Local Area Network</td>
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<td>LBP</td>
<td>Land Bank of the Philippines</td>
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<td>LCF</td>
<td>League of Corporate Foundations</td>
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<td>LGU</td>
<td>Local Government Unit</td>
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<td>MFI</td>
<td>Micro-Finance Initiative</td>
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<td>PBE</td>
<td>Philippine Business for the Environment</td>
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<td>PBSP</td>
<td>Philippine Business For Social Progress</td>
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<td>PCFC</td>
<td>National Livelihood Support Fund</td>
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<td>PDAP</td>
<td>Philippine Development Assistance Program</td>
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<td>PDMA</td>
<td>Program Development and Management</td>
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<td>PEACe</td>
<td>Poverty Eradication and Alleviation Certificates</td>
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<td>PHINMA</td>
<td>Philippine Investment-Management Consultants</td>
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<td>Philippine Peso</td>
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<td>PPRM</td>
<td>Philippine Rural Reconstruction Movement</td>
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<td>PSFI</td>
<td>Pilipinas Shell Foundation, Inc.</td>
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<td>RISE</td>
<td>Responsible Investments for Solidarity and Empowerment</td>
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<td>Small Business Guarantee Corporation</td>
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<td>SEAD</td>
<td>Small Economic Activity Development</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
</tr>
<tr>
<td>SISDEP</td>
<td>Small Island Sustainable Development Program</td>
</tr>
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<td>SSS</td>
<td>Social Security System</td>
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REPORT
October 2003

SRI
IN ASIAN EMERGING MARKETS:

SOUTH KOREA

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South Korea

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SRI in Korea is still in its infancy. Encouragingly, however, one investment trust management company has formed and started marketing a Socially Responsible Investment (SRI) Fund as of June, 2003.

This report focuses on the specific details of Korea’s movement forward and the potential for SRI. Furthermore, it examines how this is likely to develop in practice. As Korea is one of the more developed emerging markets with an increasingly sophisticated investment sector, more emphasis in this report has been placed on how SRI would apply to mutual funds and the relationship between SRI and listed companies, rather than on development funding, private equity and micro-finance.

This report concludes that SRI has very significant potential to flourish in Korea despite the present lack of SRI products in the Korean market.

Although public recognition of SRI is still low, results of a recent survey concluded that interest and receptivity to the concept of SRI was very positive. The survey, by Economy 21, published in the Economy 21 weekly magazine, showed that, whilst only 3% had heard of SRI, 56.1% of those surveyed responded that SRI is an investment principle suited for the new economic environment. Investment professionals also responded positively, and whilst many had skeptical opinions about market acceptance of SRI, 33.3% of investment experts responded that they would not hesitate to take Social Responsibility Evaluation into account in their investment decisions as soon as reliable SRI data evaluating domestic corporates was available.

Above all, it is very encouraging that both the government and NGOs, as well as other leading public opinion makers, are starting to pay attention to SRI. At the 1st International SRI-Conference held in Korea, on 17th. June 2003, Kim Jin-Pyo, Deputy Prime Minister and minister of Finance and Economy, stated that the “Government will support the market’s effort to adopt SRI positively, such as the development of an SRI Index”. He also pledged that “from now on the Government will strive to promote the necessary conditions for corporations to put social responsibility into practice.” This active support for the concept of SRI by a senior government representative is very notable.

Finally, though environmental reporting has become established in Korea with approximately 40 companies issuing environmental reports (see 9.0), no companies have yet issued a social or sustainability report. However, some social organizations including the Citizens’ Action Network (CAN) have begun to call for the introduction of corporate social reporting. Furthermore, Samsung Electronics Co. has become the first corporate to announce that it is preparing a sustainability report.

In conclusion therefore, though it is early days for SRI in Korea, the potential future for SRI in Korea looks very promising because overall the concept has met with favour from the public, the financial community, and senior government representatives.

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1 Domestic Market Potential Survey on SRI; Economy 21, No. 153; 17/6/2003. The survey was conducted during the period from 30/05/2003 to 5/06/2003. Sample 500 Koreans residing in 7 metropolitan cities in Korea, over the age of 20. For a presentation on the Survey results see: www.asria.org/events/korea/june03/index_html/lib/WonjaeLee.pdf or Section 6.
2 1st International SRI Conference in Korea, 17 June 2003, Seoul
2.0 SRI FUNDS

2.1 Domestic SRI Funds

There is presently one SRI fund marketed in Korea - 'the Samsung Eco-Fund.'

Samsung Eco-Fund

The Samsung Eco-Fund, managed by Samsung Investment Trust Management is currently operated as an SRI Fund. The fund was launched in August, 2001, with an asset size of 8.6 billion KRW (Korean Won) (US$ 7.28 million) in stocks, and 17.7 billion KRW (US$ 15 million) in stocks/bonds. Research for the fund is conducted by the Samsung Global Environment Research Centre, founded in 1993 (See 3.01.03).

The Samsung Eco-Fund consists of two sub-funds:

Samsung Eco-Fund: Stock (over 60% of the asset is stocks) earnings rate was 39.25% from 16 August 2001 to 16 July 2003. For the recent 6 months, it has achieved an earnings rate of 14.61%. It holds assets of approximately 8.26 billion KRW (US$7 million).

Samsung Eco-Fund: Mixed (over 70% bonds) earnings rate was 14.87% from 16 August 2001 to 16 July 2003. For the recent 6 months, it has achieved an earnings rate of 3.92%. Its asset are about 14.16 billion KRW (US$12 million).

The Samsung Eco-Fund is the first and only SRI Fund which invests according to comprehensive SRI criteria.

However, at the end of last year, KYOBO Investment Trust Management Co., Ltd floated the concept of a 'Womens Employment Equality Fund', though this has yet to be launched.

There are also number of retail funds which make social contributions from their management profits. The 'Aid Fund for Children' and the 'World Cup Dream Tree Nurturing Fund' are representative examples of this. Investors have reacted very favourably to the fact that these funds make donations to social causes.

Meanwhile, there is also an initiative underway to register the first Korean corporate governance fund. Deutsch Investment Trust Management Corporation in partnership with the International Finance Corporation (IFC), are to introduce the corporate governance fund, which will specifically aim to invest in companies which are underdeveloped in terms of governance. The intention is to actively influence companies to improve their corporate governance and thereby raise their stock price. Although this is not an SRI fund, but a corporate governance fund, the initiative is worthy of attention.

It is also notable that SEI Asset Management Korea, a property management corporation funded by the IFC, have inserted a clause related to SRI in their fund contracts, which specify that it will not invest in corporations which are involved in the production or marketing of cigarettes, drugs and arms production or contribute to environment destruction. However, as of June, 2003, no fund operated by this policy had yet been launched.

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5 www.samsunginv.com
6 Aid fund for Children: www.samsung.co.kr/community/about_community/community_volunteer02.html(Korean)
7 World Cup Dream Tree Nurturing Fund: www.medifund.co.kr/guide7.asp
2.2 Global SRI Funds Registered For Sale

None at present

2.3 Global SRI Funds With Significant Holdings In The Domestic Market

Innovest has conducted SRI research into Korean companies (see 3.02) so it is likely that some global SRI funds have limited holdings in Korean corporations. There is also a small dedicated Korean sub-fund managed by Kingsway Fund Management, in Hong Kong.

**Kingsway Korea Fund**

www.kingswayfm.com

Kingsway commits to screen all its funds against SRI criteria. The Kingsway Korea Fund is a sub-fund in their Mandatory Provident Fund (MPF) Master Trust Scheme. The evaluation process follows their 'SRI Values Screen' approach which provides a form of investment screening acceptable to a broad cross-section of the socially conscious investing community.

2.4 Private Equity Investment And International Development Funds

There is a growing interest in private equity investment in Korea due to the restructuring and reform of the corporate and finance sectors, the opening up of Korea to foreign investment and the pragmatic attitude of Korean corporates in Korea. For instance, a director of a major private equity fund focused on Korea noted that in their view "Korea, relative to the rest of Asia, has probably made the most progress in terms of restructuring and reforming. Secondly there has been a fundamental shift in the attitude of Korean corporates in general compared to prior to the crisis when it was one of the most closed markets to foreign investment."8

Much of Korea’s past economic growth was based on its low cost base and emphasis on exports. This growth was stalled by the Asian economic crash in 1997. Since then Korea has made significant efforts to rectify weaknesses exposed by the crash. The results of these efforts are starting to become evident. For instance, CSLA, a leading investment bank specializing in emerging markets, in its annual report on corporate governance9 gave Korea a low score relative to other Asian countries in 2001 and 2002, but significantly upgraded its report in 2003 as a result of evidence of improved corporate governance awareness. These reforms have allowed Korea to emerge stronger and more focused than many of its competitors.10 However, there is little apparent evidence as yet that CSR or Sustainable investment policies are being emphasized by the Korean Government as important investment criteria.

With respect to international development agencies, as a relatively developed Asian country, Korea has not attracted the attention and investment of international development agency projects to the same extent as other Asian countries.

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8 Finance Asia.com, "Private Equity Eyes Opportunities in Korea"; 28 July 2003; quoting JPMorgan Partners Asia managing director Eugene Suh; wwwfinanceasia.com/articles/4CA3282F-6C1B-11D5-81CE090277E174B.cfm
9 CSLA Report, Corporate Governance in Asia; Summary: www.acga-asia.org/loadfile.cfm?SITE_FILE_ID=140
10 For more background data on Korea see korea.net/ & www.kisc.org/
3.0 SRI RESEARCH

3.1 Domestic SRI Research

Research on Corporate Social Responsibility (CSR) for SRI is not yet widespread in the Korean corporate and finance sectors. However, several organizations are making efforts to broaden conventional financial reporting to include the evaluation of SRI criteria, in particular through the adoption of environmental management evaluations. Below are listed some Korean organisations which are involved in SRI/CSR evaluation and research activities.

3.1.1 Hankyoreh Corporate Evaluation Centre
www.economy21.co.kr

The centre has been engaged in corporate evaluation since 2000, and since 2002 began to take an interest in SRI after 'Economy 21', reported on Socially Responsible Investment. Accordingly, the Centre co-hosted the 1st International SRI-Conference in Korea with 'Economy 21' and Eco-Frontier Co. in June 2003, in Seoul. Prior to this conference, the Centre carried out SRI related market research for the first time in Korea. The Centre has had financial experts evaluate the corporate transparency of almost all of the major companies listed on the Korean Stock Exchange and Kosdaq, on a half yearly basis since 2001. The center has also held 'Digital Awards' through evaluating the digital management level of Korean Companies belonging to the IT industry since 2000.

3.1.2 Eco-Frontier Co.
www.ecofrontier.co.kr

Eco-Frontier, founded in 1995, is an environment knowledge service corporation which is active in the environment policy and management strategy areas. The organisation performs studies related to government environment policies, such as an environment grade marking system and also environment reliability evaluation, etc. Recently the organization, formed a partnership with Innovest, an American environment credit rating organization, to carry out environmental evaluation, targeting leading Korean companies. Based on this evaluation it awards a credit rating, with the long-term aim of marketing its environment evaluation results to institutional investors. The organization is also aiming to widen its research criteria to evaluating wider and more intangible aspects of corporate value, in addition to environmental criteria. It also co-hosted the 1st International SRI-Conference in Korea in June, 2003.

3.1.3 Samsung Global Environment Research Centre
www.greensamsung.com (Korean)

This research centre, founded in 1993, studies not only environment, security, and health related workplace control within Samsung, the biggest Korean conglomerate, but also domestic and foreign environmental policies.

It formed a contract with the Ministry of Commerce, Industry and Energy to design a 'Korean Environment Credit Rating Model' in Oct. 2001. It also took responsibility for facilitating the 'Samsung Eco-Fund's Superior Environment Management Award' in May, 2003.

In 30 June 2003, Samsung Securities, the exclusive sales agent of Samsung Eco-Fund, awarded $20,000 to two environment-friendly small companies (Hanbo Nisco & Wondai Chemical) and one environment-friendly organization (the Environmental Foundation). The financial source of this award was from a 1.5% sales agency fee of the Samsung Eco-Fund aggregate asset.
3.2 International SRI Research Groups Covering The Domestic Market

Innovest, in co-operation with eco-frontier (see above 3.1.2). Innovest has conducted research on several Korean companies, including:

- Pohang Iron and Steel Co. Ltd
- Samsung Electronics Co. Ltd

4.0 SRI RELATED ORGANISATIONS, INCLUDING NGO’S’ S

4.1 Korean NGOs On CSR

The 'Center for Corporate Social Responsibility' (CCSR) which was founded only a year ago, is the only Korean NGO focused on CSR and SRI. However, there are a few organizations with relatively deep interests in corporate social responsibility among traditional Korean NGOs.

4.1.1 Citizens’ Coalition for Economic Justice (CCEJ) www.ccej.or.kr

CCEJ is a citizens organization established in 1989, with the goal of accomplishing economic justice based on the fair distribution of profit. Since 1991, the 'Korean Economic Justice Institute', a subsidiary of CCEJ, has contributed to raising corporate social responsibility, awarding an "Economic Justice Corporate Award"11 jointly with the national newspaper Hankyoreh Shinmun (www.hani.co.kr). The award is given to listed manufacturing companies according to its own Economic Justice Index Model.

4.1.2 Citizens’ Action Network (CAN) www.ww.or.kr

This organization, which was founded in 1999, conducts citizens’ action on the basis of citizens’ participation through new digital media such as the 'Internet', CAN has launched the 'Good Corporate Making Movement' campaign, as one of its five primary projects. The movement is aimed at spreading Corporate Social Responsibility as a new value standard of corporate management. CAN has reported the results of its Corporate Social Responsibility Evaluation under the name 'Pole to Pole of Corporate Social Responsibility', since 2001.

4.1.3 The Center for Corporate Social Responsibility www.socialinvest.or.kr

The organization has taken a leading part in a great deal of activities for Corporate Social Responsibility since it was founded in 2002. Recently, it made an effort to gather public opinions about corporate social report submissions. CCSR's main interest is social reporting (as yet not sustainability). In some ways, they consider that the notion of sustainability in Korea focuses too strongly on the environment. CCSR argues that many conglomerates are ready for environmentally responsible management, but they are not yet interested in socially responsible management.

11 www.keji.or.kr/pds/list.asp?b_code=keji05
6.0 PUBLIC AWARENESS

'Economy 21' and Hankyoreh Corporate Evaluation Center jointly carried out a survey on the potential for SRI in the Korean market: ‘Domestic Market Potential Survey on SRI’. The survey was conducted during the period 30/05/2003 to 05/06/2003 and published in the Economy 21 Magazine, No.153. The surveyed group consisted of 500 general citizens over the age of 20, and 44 investment specialists such as fund managers or analysts, living in the metropolitan areas such as Seoul.

Findings showed that many Koreans are as yet unaware of SRI, but expressed considerable preference to this new concept. Moreover, it can be said that a great number of investment experts have an inclination to consider corporate social achievement in future investment decisions. Of special note, the results would indicate that Koreans’ viewpoint of corporations was similar to basic SRI principles. It was also noted that Koreans believe that corporates should be managed for the benefit of all stakeholders, including its workers and the community, rather than only for its shareholders.

Recognition and Understanding of SRI

Recognition level for SRI concept was very low. Only 3% of the respondents have ever heard of and understood the concept and details of Socially Responsible Investment, furthermore 8.2% answered that whilst they had heard of the concept they were unfamiliar with the details. 9.1% among those experienced in stock investment and 30.0% of investment experts answered that they did know details of SRI.

Of the 44 investment experts surveyed, including domestic fund manager analysts, (65.2%) chose ‘not very affirmative’ as their response to whether or not people will understand when SRI related financial goods are sold. More positive answers such as ‘relatively affirmative’ (29.0%) and ‘very affirmative’ (5.8%) were smaller in number.

SRI Preference

However, an optimistic sign is that, despite the low level of recognition of SRI concepts, citizens’ preference levels turned out to be very high after the concept of SRI was explained.

Over half of respondents chose either ‘very affirmative’(15.6%), or ‘relatively affirmative’(40.5%) on whether SRI was a correct investment principle suited for the new economic environment. 23.6% of respondents replied ‘negative’. Moreover, 74.3% of experienced stock investors and 75.3% of experienced fund investors replied ‘affirmative’ on the same question.

The result indicated that many investors already consider corporate social contribution as an important standard in investment. 59% of experienced stock fund investors answered that they consider corporate social contribution as an important potential factor in investment. (‘very important’ 17.4%, ‘important’ 41.6%)
The Potential for Investing in SRI Funds

When questioned on their willingness to invest in SRI Funds, many general citizens voiced considerable inclination to invest along SRI related financial strategies. Moreover, experienced investors were even more willing to do so.

When questioned: "Are you inclined to invest if a financial institution markets an SRI fund?" 34.3% of 500 general citizens replied 'yes', while 46.6% replied 'no' and 19.1% replied 'not determined yet'. Of those more qualified, 38.0% of stock investing experienced citizens chose 'yes', while 51.0% of fund investing experienced citizens showed the same inclination.

It seems that investment experts are firmly prepared for investing in SRI options as well. More than two thirds of investment experts answered that SRI is the proper investment principle fitted for the new economic environment. When the question was posed to them, of these 32.4 % of investment experts in Korea answered 'necessary and timely' to the necessity of SRI principles being introduced into Korea, while 54.1% chose 'necessary but premature', and importantly only 8.3% deemed SRI principles 'not necessary'.

Importantly, 33.3% of investment experts surveyed, showed a strong willingness to refer to an analysis of corporate social responsibility when taking investment decisions, so long as the analysis could be considered objective. This result implies that one third of investment experts believe that it is necessary to include SRI principles in corporate analysis or when taking investment decisions.

Understanding of the Role of Corporations

The result indicated that Koreans' basic viewpoint of a corporate is aligned to that of the principles of SRI. It implies that Koreans agree with the concept of stakeholder capitalism, meaning that a corporate should be managed for the benefit of the wider community, not based on shareholder capitalism, meaning that it should be managed only for shareholders.

When questioned "Who do you think should govern a corporation?" The majority of Koreans answered that all members of society, not shareholders or executives, should govern a corporation. To this question, styled as a multiple choice 39.7% of respondents chose 'all members of society' should govern a corporation, while 27.3% voted 'workers', and 21.2% selected 'shareholders'.

Stock-investing experienced citizens seen to share the similar opinions. 37.1% of them chose the option 'all members of society', while 33.8% picked 'shareholders', and 29.5% 'workers'. This further implies that investors also believe that all members of society should share the benefits of corporate management.

When questioned "To whom do you think the special benefit should be given back if a heavy chemical corporation which is being accused of discharging contaminated water made profit?" respondents showed similar tendencies. 56.3% of general citizens and 49.4% of experienced stock investors answered that the benefit should be given back to local residents. Meanwhile, only 8.4% of the former and 11.6% of the latter chose 'to the investors'.

Religious Groups

An issue not covered in the survey, but worth mentioning, is the important role that religion plays in Korean society. Over 50% of Koreans profess to belong to religious faiths and organized religion plays a significant role in Korean life. With respect to investment, Korean religious groups have not played a notable role up to the present, however some have been active in pressuring corporates to adopt improved social standards. It is likely, that Korean religious organisations may find alignment in SRI principles.

12 www.library.uu.nl/wesp/populstat/Asia/skoreag.htm religious affiliation: Buddhist 23%, Protestant 20%, Roman Catholic 7%, Confucian 0,5%; non religious 49%
7.0 CORPORATE GOVERNANCE INITIATIVES & SHAREHOLDER ACTIVISM

Domestic initiatives in the corporate governance area have been very active in Korea. In particular, the Government and NGOs have carried out various activities to improve corporate governance. There have been a series of policy reforms to change the chaebol system, a plutocracy which has been identified as one of the prime reasons for the financial crisis in 1997. This phase of reforming the chaebols and improving corporate governance has almost been fully completed.

7.1 Government's Effort To Improve Corporate Governance

7.1.1 The Government's legislative system in relation to the improvement of Corporate Governance

The director system and board of directors of a corporate supply a legal basis for Korean corporate governance. In addition to this, the Korean government has attempted to enforce stockholder-centered management over the past few years via the following actions:

- **The fidelity clause** - the Government recently established a fidelity clause for directors (clause 3, Art 382 of the commercial law), which reinforces the board of directors, a keynote of Corporate Governance. It asserts that directors who are appointed in the general meeting of stockholders, have every right to decide the business management and to direct the management of the representative director except for the rights of the general meeting of stockholders.(Clause 2, Art 393 of the commercial law)

- **External audit** - according to the 'law on external audits' an external audit by a certificated public accountant is mandatory for a corporate over a certain size

- **External board member system** - the Government has strengthened the external director system, thereby increasing the shareholders' and society's monitoring role on the executive managers. Listed corporate and financial organizations having more than 2 trillion KRW (US $1.7 billion) in nominal assets should have at least 3 external directors

- **Centralized (cumulative total) voting system** - Government has revised the commercial law, and introduced Centralization Voting System to make it possible to appoint a director representing the benefit of the minor stockholders.

- **Auditing committee introduction** - the Government introduced an auditing committee system, especially forcing listed corporations with assets over 2 trillion KRW (US $1.7 billion) to appoint a full-time inspector and compose an inspection committee

- **Stock option system improvement** - the Government, in July 2000, mandated that stock options given to executives are treated as a cost, and has established a 'Stock Option Standard Model' to ensure that an executive cannot get so many stock options that he/she may encroach on the values of shareholders.
7.1.2 Future policies for improvement of corporate governance structure

The Korean government will continue to make efforts to improve corporate governance. Kim Jin-Pyo, the Deputy Prime Minster and Minister of Finance and Economy, joined the 1st International SRI-Conference held in Seoul on 17th, June, stating that the "Government will continue to make efforts to improve corporate governance such as improving corporate accounting transparency". Proposed improvements include the following:

- **Group litigation system** - the Government is planning to introduce a group litigation system to reinforce the rights of shareholders. The bill on group litigation system is now pending in the National Assembly (Congress), and if passed, the system will be implemented next year.

- **Corporate governance index** - the Government has a plan to support stock related organizations, selecting 50 leading companies with good governance, and announce a 'Corporate Governance Index' from September, 2003.

- **Corporate governance rating announcement** - the Government is scheduled to announce a corporate governance rating index after 2004, as a service to investors. The extent of the coverage of the evaluation is not decided yet in detail.

7.2 NGO's Activities Related To Corporate Governance

The minority Shareholder Movement for shareholder value started first among the NGOs. At first, the 'Shareholder Value Movement' was primarily focused on confronting the plutocratic power of the chaebols and aimed at preventing them exercising tyrannical control over their management. The chaebols were able to wield control over the majority of companies through complex cross shareholding arrangements and controlling allocation of capital. At present the 'People's Solidarity for Participatory Democracy' (PSPD) and Citizens' Action Network (CAN) are the most influential NGOs. Whilst PSPD is the most renowned advocate in Korea of minority shareholder rights against Korean Chaebols, CAN is more interested in the broader agenda of stakeholders rights. The PSPD is credited with having achieved a great deal with its strategy of curbing the plutocracies' anti-shareholder actions, through encouraging the exercise of minority shareholder rights.

7.2.1 People's Solidarity for Participatory Democracy (PSPD)

www.peoplepower21.org

The PSPD is carrying out a movement for the improvement of corporate governance. This is being led by the Economic Reformation Center, a subsidiary of the PSPD. The Economic Reformation Center, led by Kim Sang-Jo, a professor of Hansung University, has been active in the inspection of the Chaebol's plutocracies. This has been achieved by activating the rights of minority shareholders, by carrying out a series of citizens’ activities such as public suits or boycotts over the illegal actions of plutocracy executives, monitoring the government's efforts to reform the plutocracies, and campaigning for the legal improvement of corporate governance.
Recently, activities related to corporate governance which were begun by the NGOs are being taken up by private businesses, or government-supported business organizations. One such leading initiative is the ‘Center for Good Corporate Governance’. Another important initiative providing support to the corporate sector and to the general public is the ‘Corporate Governance Service’.

### 7.3.1 Center for Good Corporate Governance
**www.cgcg.or.kr**

CGCG is a business corporation established by the likes of Mr. Jang Ha-Sung, a professor of Korea University, who founded the minority shareholder movement for the first time in Korea. Attorney Kim Joo-Young is the head of this corporation. The Center is undertaking research on the most desirable models of corporate governance for Korean corporates to adopt in the future. It has issued the first quarterly periodical on corporate governance: 'The Quarterly Journal of Corporate Governance'. In addition to this, the Center supplies information and provides consulting services on corporate governance, to the leading Korean companies in Korea, to the markets and to investors.

### 7.3.2 Corporate Governance Service
**www.cgs.or.kr**

CGS is a non-business corporation which consists of 6 organizations. These are the Korean Stock Exchange, KOSDAQ, the Korean Securities Dealers Association, the Korean Listed Companies Association, the Korean Investment Trust Companies Association, KOSDAQCA. The current president of the centre is Kwang-Sun Jeong, a professor of Choong-Ang University. The CGS works to develop policy in relation to corporate governance, to find and promote companies with superior corporate governance, to educate employees of companies, and to revise the model corporate choice rule for constructing corporate governance. The centre has been selecting and awarding 'Corporate Governance Model Companies' since 2001.
8.0 CORPORATE DEVELOPMENTS AND RESPONSE

Since the financial crisis of 1997, Korean enterprises have adopted management policies which take into consideration, corporate governance improvement and shareholder-centered management. These management initiatives have been supported by the strong influence of foreign investors on the domestic market as well as by local NGO's and business organisations. In addition to this, Korean enterprises have been influenced by the recent scandals befalling world-famous enterprises, such as Enron. There has also been a movement to include 'environmental management' or 'ethical management' within the focus of management principles. The general trend has been to adopt the concept of Corporate Social Responsibility (CSR). However, as yet, management policies have not yet fully absorbed some of the more comprehensive and scientific aspects of CSR.

8.1 Report Issuing Status

Environmental Reporting:
Over forty companies including Korean Airline, Samsung Electronics, Samsung Electrics, Samsung SDI, Korea Water Resources Corporation, Yuhan Kimberly, POSCO, Hyundai Motor Company, LG Electronics, LG Chemicals, have or are issuing environmental reports.

Reports in English on-line include the following:

- **POSCO:**
  www.posco.co.kr/en/sustain/environment04_01.html

- **Samsung Electronics:**

The IFC obligated Hana Bank (www.hanabank.co.kr), one of the four largest banks in Korea, to set up an environmental management system and submit an annual environment report before it would invest in the bank and support its merger with Seoul Bank.13

Social Reporting:
No corporate has yet issued a social report. However many companies have been issuing society contribution reports to let the public know the details of their corporate charitable activity.

Sustainability report:
Samsung Electronics is presently preparing to issue such a report.

13 ifcinfo001.worldbank.org/IFCExt/spiwebsite1.nsf/831f47a59a4af3d3c85256d89003302e8/0c0d719d5feb9d5485256c72006e1744?OpenDocument
8.2 Environment Management

Many of the larger Korean corporations have invested in improved environmental management. The following example is a recent notable example, where the company has placed environmental management as a core strategy for its future.

**Hyundai Motor Company / KIA Motors** - Jeong Mong-Gu, the President of Hyundai Motor Company, which is Korea’s biggest motor manufacturing corporation, announced that between now and 2010 he would invest 1.3 trillion KRM (US $1.1 billion) on internal environmental management, heralding environment friendly management as the enterprise’s core strategy.

**Samsung Electronics Co.** This is another corporate example. The company has set 5 criteria for management, being the greening of management, products, processes, the workplace and the local community.

8.3 Social And Ethical Transparency

There is very little reporting on social issues by Korean corporations. However, four significant examples that have been reported are as follows:

**Samsung** - From 2003 onwards, Samsung, the biggest conglomerate in Korea, has made it mandatory for employees to report on senior officials’ delinquency or unjust orders.

**LG** - LG, the second largest conglomerate, constructed a section on their website promoting ethical corporate management and seeking to abolish unjust actions by the company against its affiliate organizations and other unfair business practices. ethics.lg.co.kr/index.jsp

**POSCO** - the worldwide steel corporation, POSCO, recently declared its adherence to ethical standards, and is supposed to continuously monitor the application of ethical evaluation models to its business.

**KUMHO** - KUMHO, (owner of Asiana Air Line, Korea's second largest airline) and its associated companies’ representatives signed an 'Agreement for Ethical Management'. KUMHO declared that it would suspend any contract as soon as any unjust or dishonest business acts were revealed.
9.0 COMMUNITY INVESTMENT AND MICRO-FINANCE

Though corporates in Korea, as mentioned above (8.01) regularly issue reports of their charitable contributions, few examples could be found of Korean corporates or financial organizations investing in micro-finance or similar grass-roots development programmes.

One example of micro-credit is Joyful Union. Joyful Union, an organization under the Yeheun Sahrang Nahum Committee (YSNC), manages microcredit projects following the Grameen Bank (GB) Replication Program. One of its primary goals is educating people to achieve economic independence and self-sufficiency. Grameen Trust of Bangladesh and CITIBANK Korea are collaborating with Joyful Union.

As of January 2001, Joyful Union has disbursed a total of 12,023,000 KRW (US $ 10,200), of which 2,180,043 KRW (US $ 1,850) has already been repaid. The repayment rate is 100%. Loans are usually used for preparation and sale of food products, farming, poultry, and so on. At present, Grameen Trust has arranged training programs for the staff of YSNC & Joyful Union, to help them with successful implementation of the microcredit program, which includes looking into GB’s projects, how loans are given out and how to best utilize them, following the Grameen methodology.14

10.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in Korea

• the emergence of a strong civil society
• civil society values increasingly harmonise with values of SRI
• vibrant religious communities are a potential market for SRI funds
• recent survey shows support for SRI from the public and the investment community
• mutual fund industry well established in Korea
• first steps already, with a domestic SRI fund and research providers in place
• strong Government support for corporate governance and for SRI.

Conclusion

• important to see the existing SRI fund and SRI research evolve and succeed to encourage quicker growth in the industry
• potential role also for global SRI funds to help stimulate and educate the market
• SRI may have the strongest potential for rapid adoption of SRI of all Asian emerging markets

Korea is still un-tilled land for SRI. However it has a potential to prosper and produce an impressive harvest, but only if there is timely rain.

Now the first ritual for that rain is on the way. The press and NGOs are carrying out public campaigns on a significant scale, which will in time invoke people's potential preference to SRI and increase public recognition of its advantages. Even though there are few people who are familiar with SRI, the fact that many investors had an inclination to join SRI related funds after understanding its concept is a positive sign for success in the future.

Public campaigns could well be the means to pressure listed companies to issue environmental, social and sustainability reports. Only after companies disclose their environmental and social achievements to the public will it be possible to construct a reliable SRI evaluation system. This increase in company data and evaluation, providing a reliable SRI evaluation system, would be the second ritual for rain, and encourage the growth of SRI to enter into full swing. Judging from the fact that a majority of investment experts indicated that they would be willing to take SRI criteria into account when making investment decisions if reliable data was available, it is very important that this is provided.

After firstly encouraging public support and secondly providing objective research data and SRI investment models for investment experts, the third step should be finding a 'Rainmaker.' To ensure that SRI is firmly established in the market a leading fund, applying SRI principles and managing reasonable financial returns, should appear as a comet, sparking further public and financial market interest in SRI products. The establishment of the Samsung Eco-fund is already a strong step in this direction.

The sight of millions of Red Devils gathered in front of City Hall Square during the 2002 World Cup and the election of President Roh, a high school graduate, in a come-from-behind success in a seemingly hopeless election last year, are clear signs of the Korean people's passion and enthusiasm. The Korean people also hold strong values that could favour SRI. For instance, 51% are members of religious groups, which are notably well organized and active in Korea, and could potentially provide a market for SRI funds. One could therefore see the potential for Korean investors to switch quickly from a primary focus on economic development to a stronger concern for socially and ecologically appropriate investment and development. Such would have a great potential bearing on the future of SRI in Korea and help establish it in the financial markets.

Furthermore, if a significant foreign SRI fund was to act as the rainmaker and successfully invest and market itself in Korea this would provide the necessary model and help the advance of SRI at greater speed.
11.0 RESEARCH PARTNER

**Won-Jae Lee, staff writer, Economy 21**

Won-Jae Lee has been working as a financial journalist for 6 years in Seoul, writing in various media for Hankyoreh, an independent media group which is focused on social responsibility in Korea. As a staff-writer, he has mainly covered domestic and international stock market analysis, corporate financial activities, and corporate governance & responsibility. Other than that, he has carried out corporate evaluation projects and market research projects related to the financial markets and corporate finance. He has undertaken corporate governance evaluation on Korean companies for 3 years, evaluation on Korean investment brokerage firms, and SRI market research. From August 2003, he is attending an MBA program at MIT, Cambridge, USA for 2 years.

**Kyung-Sook Lee, staff writer, Economy21**

Kyung-Sook Lee reports for Hankyoreh’s economics magazine ‘Economy21’ in Seoul, Korea. Having been working in Hankyoreh weekly media including ‘Economy21’ and the investment magazine ‘Thinkmoney’. She has been mainly analyzing financial issues, domestic and international stock markets, bond markets, and Korean financial policy. Hankyoreh is a media group which is focused on social responsibility for investment, businesses, economic policies, etc.

**Won-Il Park, consultant, Hankyoreh Corporate Evaluation Center**

Won-Il Park has been working as a consultant in Hankyoreh for 3 years, concentrating on corporate evaluation and financial affairs. Before joining Hankyoreh, he worked in Hyundai Mobis & Hyundai Motor Company, which are presently leading companies in the automobile industry in Korea. During that time he had experience in the field of accounting & financing. His current interests are in the development of Sustainability Reporting Guidelines (SRG) evaluation systems in Korea.
### 12.0 GLOSSARY

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>CAN</td>
<td>Citizens' Action Network</td>
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<td>CCSR</td>
<td>Centre for Corporate Social Responsibility</td>
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<tr>
<td>CDEJ</td>
<td>Citizens' Coalition for Economic Justice</td>
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<td>CGCG</td>
<td>Centre for Good Corporate Governance</td>
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<td>CGS</td>
<td>Corporate Governance Service</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>GB</td>
<td>Grameen Bank</td>
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<td>IFC</td>
<td>International Finance Centre</td>
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<td>KRW</td>
<td>Korean Won</td>
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<tr>
<td>NGO</td>
<td>Non Governmental Organisation</td>
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<td>PSPD</td>
<td>People’s Solidarity for Participatory Democracy</td>
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<td>YSNC</td>
<td>Yeheun Sahrang Nahum Committee</td>
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SRI
IN ASIAN EMERGING MARKETS:

THAILAND

Research Partner:
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Project Sponsor: Sustainable Financial Markets Facility, SFMF & International Finance Corporation, IFC

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1.0 EXECUTIVE SUMMARY

When visiting Bangkok for the first time, Thailand strikes one as a comparatively developed country, especially compared to its neighbors. In the immediate vicinity, only Singapore and Malaysia have more comprehensive infrastructure and services. Bangkok in many ways is a modern urban metropolis, with its shopping malls, elevated commuter railway and soon to open subway system. But look beneath the surface and a number of significant development challenges become evident. Although manufacturing has leaped ahead of agriculture as the major export earner, farming still supplies over half the population with their livelihoods. Many of these farms are barely viable economic units and, increasingly, people living in the countryside have to find alternative ways of supplementing their meager incomes. Meanwhile, in the cities the family firm is still far and away the dominant business model and even where companies seek outside finance they generally buy debt rather than sell equity.

In the capital markets, it is rare to find a corporation where the founding family is not the majority shareholder. Labour standards, environmental awareness and protection and corporate governance all lag more developed nations. Moreover, economic growth that was up until recently based on the ready availability of cheap labour is now being squeezed by competition from other countries with abundant labour supplies and lower living costs.

However, Thailand is a nation of entrepreneurs. In the 2002 GEM Survey of Entrepreneurial Activity*, Thailand scored highest (see chart below) of the 36 countries covered (representing 62% of the world’s population). One of the push factors identified in regard to Thailand was that there was no significant social safety net, so people had to fend for themselves. If they couldn’t find a job, for example, they had to find ways to create one. Of the pull factors, there were relatively few barriers to entry in Thailand in most business sectors compared to many neighboring countries in the region or even in developed nations. For most people, for instance,

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who may wish to set up a small business, this was fairly easy to do. The other significant finding of the survey was the high level of women entrepreneurs in Thailand. It is estimated that 56% of all businesses in the country are owned and operated by women. Many of course, consist of little more than small noodle stands but even at the other end of the scale, it is not uncommon for a woman to be the head of a corporation.

In short, Thailand is a country at the crossroads, poised half way between joining the ranks of the developed nations but still caught up by a number of serious constraints that hold it from making the final leap. In fact, social and economic change in Thailand have occurred at an unprecedented rate in the last thirty years, but now, if anything the country is facing bigger challenges that at any time in those three decades as the digital divide and related technological changes threaten to make the gap between the first world and the developing world insuperable. Thais recognize this threat but are uncertain about how best to proceed and of the importance of the role of SRI related values in this transformational process.

2.0 SRI FUNDS

2.1 Domestic SRI Funds

There are no domestic SRI funds registered for sale in Thailand at present.

One possible route for SRI in Thailand would be through the Government Pension Fund and related pension funds, as these already have strict investment criteria that reveal a potential bias towards SRI. As the power of the lower middle class grows and they become increasingly assertive, interest in corporate behavior is also likely to increase. Judging when this will arrive, however, is not easy to determine.

Total net assets under management by local mutual funds totaled 238 billion baht (US$ 5.95 billion) through 283 funds at the end of May 2003, excluding specialist financial institution problem funds and country funds.¹

2.2 Global SRI Funds Registered For Sale

There are no global SRI funds registered for sale in Thailand.

However, "The Securities and Exchange Commission approved five asset management companies to launch foreign investment funds (FIF) in May last year to give many Thai investors their first opportunity to invest in overseas markets. Each fund was allowed to raise up to US $20 million at the start, with a maximum increase to US $40 million. To date, none of the funds have reached their ceilings, although ING, Kasikorn and AJF have all reported considerable inflows in the past several months."²

² Bangkok Post July 17 2003
2.3 Global SRI Funds With Significant Holdings In The Domestic Market

There are currently no major global funds with significant holdings in the Thai market that we are aware of. Calvert has conducted limited research into Thai companies. While there are currently no major global funds with significant holdings in the Thai market, possibly the most important international player to have recently participated in it has been the California Public Employees’ Retirement System (CalPERS). CalPERS is significant because of its importance as a benchmark for similar funds. It is also illustrative of a number of the problems with the approach of such funds when making investments in developing countries’ economies (See Appendix 1). There is more than a strong suspicion that CalPERS’ actions in withdrawing from the Thai market were in part to placate unions in the U.S. that are sensitive about the migration of manufacturing jobs to the developing world. This is certainly how it was read here in Thailand.

2.4 Private Equity Investment And International Development Funds

A considerable amount of international aid has been pumped into Thailand, much of it into environment and community related projects. More recently, however, there have been moves towards injecting investment into development funds, such as the Thai Equity Fund (see box 2.4.1) and other private equity type funds. These funds, which have seen involvement from the private sector as well as the Government and international development agencies, have an emphasis on community capacity building and environmental protection.

2.4.1 International Finance Centre (IFC)

www.ifc.org

In 2000 the IFC approved an equity investment of US $37.5 million to establish the Thai Equity Fund (TEF). TEF is the largest Thai recovery fund launched since the Asian currency crisis and brings together under the same umbrella a group of leading financial institutions representing public, multilateral, and private sector investors. TEF will make direct equity investments in competitive private sector enterprises, including those that are in the process of debt restructuring. The IFC’s strategic priorities for Thailand include a focus on strengthening financial institutions by providing long term equity investments and promoting corporate restructuring through transactions that emphasize improved corporate governance.4

3 www.asria.org/sri/asia/research?expand_all=1
4 ifcIn1.ifc.org/ifcext/factsheet.nsf/AttachmentsByTitle/thailand/$FILE/thailand-july02.pdf
2.4.2 Asian Development Bank (ADB)

Cumulative ADB lending to Thailand as of 31 December 2002 was US $5.35 billion. However the Thai Government pared down its borrowing program in 2002 and did not borrow further from the ADB. Loans are primarily in the areas of energy, transport and communications and social infrastructure.\(^5\)

In 2001 the ADB agreed to invest up to US$25 million in the Lombard Thailand Intermediate Fund, LLC, an offshore fund. The fund's resources to be invested onshore, in the Thailand Equity Fund (TEF) (See 2.4.1). Thai domestic investors are encouraged to invest directly in the onshore fund, which will invest in Thai enterprises. The offshore fund is expected to raise up to US$400 million from international institutional investors, while the onshore fund could raise a further US$100 million from domestic institutional investors.\(^6\) Investment by these funds have to abide by certain corporate investment criteria.

Japan is contributing ¥ 10 billion (about US$90 million) to establish the Japan Fund for Poverty Reduction, which will provide ADB's developing member countries (DMCs) with grants to support innovative poverty reduction and related social development activities that can add substantial value to ADB projects. The Japan Fund's aim is to support ADB's poverty reduction strategy, approved in November 1999, which elevates poverty reduction to the main goal of its operations.\(^7\)

2.4.3 Thai Business Initiative in Rural Development (TBIRD Scheme)

Despite the government's heavy investments and achievements in national infrastructure, it is clear that good roads, electricity, literacy and access to health facilities do not necessarily raise incomes. Established in 1988 by PDA, TBIRD enables villagers to acquire the skills and resources needed to launch and sustain income generating activities in their own communities. TBIRD was created with the following objectives in mind: to encourage successful businesses 'to help improve the quality of life of rural people; to transfer business skills to the villagers', to establish income generating activities for the rural poor; to reduce migration and encourage rural migrants to return home. Villagers and entire communities gain from the investment in capacity building, which pumps energy into local economies and helps start new enterprises and provide job opportunities. The business community gains from helping improve local economies, first hand experience of rural realities and also useful public relations benefits.\(^8\)

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\(^5\) [www.adb.org/Thailand/default.asp](http://www.adb.org/Thailand/default.asp)


\(^8\) [www.geom.unimelb.edu.au/pda/tbird.htm](http://www.geom.unimelb.edu.au/pda/tbird.htm)
2.4.4 Biomass Power Generation

Biomass power generation has been an area when dedicated private equity/direct investment funds have shown considerable interest in Thailand. Given that agriculture is a very important sector for the country, but one that suffers from inadequate investment and low returns, it would seem to be an ideal type of project for development in the rural heartland of Thailand. A pioneer is A.T. Biopower (www.atbiopower.co.th), a biomass project development company working on power generation from domestic and renewable energy sources - principally rice husks - being developed for Nakhon Sawan and three other northeastern provinces. The electricity produced will be sold to the Electrical Generating Authority of Thailand, the state energy supplier, through the Small Power Producer Program, designed to encourage the production of electricity from non-conventional and renewable resources. Small Power Producers (SPPs) engaged in renewable energy production will receive a subsidy for electricity sales to the national grid. The National Energy Policy Offices (NEPO) has set aside 2 billion Baht to ensure that SPPs that generate electricity from agri-waste get tariff rates that make their projects viable. The government is allowing an added-on up to 0.06 Baht/kWhr on top of the general tariff rates set for the SPP scheme.

A.T. Biopower was first developed with seed capital from E+Co (www.energyhouse.com), a non-profit energy investment service that is a spin-off from the Rockefeller Foundation. It is also being undertaken with support from the Energy Policy and Planning Office of the Ministry of Energy (EPPO), the UNDP, the Danish Agency for International Development Assistance, and the Kenan Institute Asia*.

Kasetsart University (KU) has also set up a demonstration project to generate electricity from landfill gasses at Nakhon Prathom as a part of the university's move towards commercializing its research. The construction with two units of 650 kW capacity each has been completed. It is currently being tested. KU is also to perform feasibility studies of electricity production from landfill sites in Bangkok and other two major cities in the Northeast, Nakhon Ratchasima and Nakhon Sawan.

Garbage to ethanol is another promising technology given that Bangkok Metropolitan area produces 8000 tons of garbage a day and is rapidly running out of landfill space.

A study by the Sustainable Energy Network (www.serd.ait.ac.th), an NGO attached to Kasetsart University (KU) that advocates the use of renewable energy, found site selection a prime cause of protests by locals opposed to the siting of such projects in their communities. This demonstrates that examples of 'NIMBY' ("not in my back yard") are just as possible in a country like Thailand. In fact, this may be particularly true in Thailand, where residents in rural areas, have in the past been the recipients of grand infrastructure projects (e.g. Pak Moon Dam Project) that originated in Bangkok and had severe negative environmental impacts with few benefits for the locals. SEN found that while energy developers prefer to locate near the fuel source and the national grid, which helps reduce costs and investment in technology to reduce the impact on the environment, this usually leaves them with zero room for change should local people protest against their projects. Speculators have frequently manipulated local sentiment to push up land prices, particularly since the National Energy Policy Office issued a regulation last year requiring the developers of biomass projects to seek the opinions of people living within a 10km radius of a planned plant. If 80% of respondents within 3km support the project then it would qualify for a state subsidy. Fourteen biomass projects have fulfilled this requirement and have been granted subsidies, although most of these are sugar cane factories or rice mills that had no need to buy more land.9

9 Bangkok Post  April 29 2003
3.0 SRI RESEARCH

3.1 Domestic Research

Currently there are no domestic companies undertaking research specifically into SRI within Thailand. In fact, securities firms in Thailand discount company research because few domestic investors appear to be interested in such research, as their investment strategies tend to concentrate on short-term trading patterns rather than making long-term investments. This may change in the future, however, as more ordinary citizens enter the capital markets.

3.2 International SRI Research Groups Covering the Domestic Market

Among all the Asian markets only the most limited evidence could be found of research being undertaken by international SRI research providers. Calvert has researched ‘Land & Houses’ and ‘National Finance’, Innovest only Advanced Info Service Public Co. and Social Centre claims to have some coverage of the IT Hardware and Telecommunications industries. While there are therefore very limited international SRI research groups currently covering the Thai market, CLSA provides ratings on macro determinants of corporate governance, commentaries on the regulatory environment in Thailand, plus identifying those companies with good CG records. As their latest report notes, over the past five years the top-quartile CG stocks in Thailand “have greatly outperformed the SET by 138% in US-dollar terms.”

4.0 SRI RELATED ORGANISATIONS, INCLUDING NGO'S

4.0.1 The SEEDS

www.theseseeds.org

The SEEDS (Social, Environmental and Economic Development) was established in 2002 specifically to promote awareness amongst Thais of SRI and to help identify opportunities to foster technologies and business models that support the growth of a sustainable future for the societies of Southeast Asia.

4.0.2 Social Venture Network

www.svnasia.or.th

SVN’s mission is to promote business awareness leading to environmental responsibility, basic human rights for all, and justice for every party concerned while considering differences in resources, opportunities and real potentials of organizations or individuals. SVN’s objective is to create networks of environmentally and socially aware entrepreneurial businesses throughout Asia. The SVN annual conference promotes a wide range of alternative business models. It aims to encourage businesses and investors to consider environmental and social criteria as well as economic criteria when assessing business success. It is chaired by the well-known Thai businessman and personality Prida Tiasuwan.

10 www.asria.org/sri/asia/research?expand_all=1
11 CLSA; Corporate Governance in Emerging Markets; 2003; p.94.
4.0.3 Thailand Environment Institute  
www.tei.or.th

Established in May 1993, the Thailand Environment Institute (TEI) is a non-profit, non-governmental organization focusing on environmental issues and the conservation of natural resources in Thailand. Founded on the belief that partnerships are the most effective approach to achieving a more sustainable way of life, the Thailand Environment Institute advocates a participatory approach to shared environmental responsibility. By working closely with the private sector, government, local communities, other civil society partners, academia and in international circles with international organizations, TEI helps to formulate environmental directives and link policy with action to encourage meaningful environmental progress in Thailand. The TEI manages a Business and Environment Program which focuses on three core projects:

- promoting cleaner production and cleaner technologies;
- promoting the adoption of ISO14000 standards; and
- administering the Thailand Business Council for Sustainable Development.

4.0.4 Kenan Institute Asia  
www.kiasia.org

Until recently funded almost entirely by the USAID and supported by the Thai government, the institute is now endeavoring to become self-funding. It has a 'Labor Standards Advisory Service' that offers advice to companies in the labor-sensitive garment industry on how to meet international standards, plus an Environmental Management Division that aims to support companies by coordinating research into environmental management practices and implementation, in particular, by promoting links between US and Thai universities.

4.0.5 The Population And Community Development Association (PDA)  
www.geom.unimelb.edu.au/pda

Chaired by well-known personality and former government minister, Mechai Viraviadya, popularly known as "Mr. Condom" for his encouragement of the use of prophylactics. Founded in 1974, PDA was first active in promoting family planning in urban and rural areas of Thailand, where knowledge of and access to such services were scarce. Other campaigns were tailored to the health of specific target groups such as factory workers, hill tribe villagers and adolescents.

PDA programs now encompass integrated rural development, water resource development, local institution building, medical and health services, income generation and occupational training, and forestry and environmental conservation. It is now one of Thailand's largest private, non-profit development organizations. To see an example of one of their projects which trains farmers in the use of the internet to help achieve fair rice prices: www.panasia.org.sg/news/rnd_st/ict_rnd06s.htm

4.0.6 Thai Environment Net  
www.thaientenvironment.net

This is a private sector initiative, set-up and managed by a team of engineers, professors, scientists and editors who have created a portal for environmental information. A major emphasis is on providing a forum for exchange of data and ideas. The website has been getting supportive feedback from business and industry.
5.0 GOVERNMENT INITIATIVES

5.1 Government Policies And Projects

The Thaksin administration is using expansionary fiscal policy in an attempt to enhance economic stability and lay the foundation for a sustained economic recovery. Its strategy to use the property market recovery to fuel growth in the general economy seems to be working so far. The Bank of Thailand (BOT) is focusing on exchange-rate stability, rather than targeting inflation. There is a particular focus on boosting rural incomes and development and on encouraging small and medium-sized enterprises (SMEs). Policies to diversify export markets and promote agricultural exports are being implemented, and incentives are being offered to substitute imports with locally produced goods. The Thai Government’s 7th & 8th National Plans, which are 5 yr plans addressing the overall economic development for Thailand, also provide specific environmental plans.

In 2002, the Industry Ministry initiated a number of industrial development programs principally aimed to strengthen the competitiveness of small and medium-sized enterprises. It is promoting the concept of the cluster-based development for SMEs based on the ideas of Michael Porter, in a bid to improve competitiveness and productivity, reduce costs, and provide a value chain through the synergies of associated activities. Industrial development under the cluster concept is being implemented using specialized industrial zones or estates, and exclusive zones for small and medium-sized companies. So far, many industrial sectors have developed industry clusters or zoning, including automotive, agricultural, rubber, leather tanning and finishing, ceramics, waste recycling and printing ventures. Tens of billions of baht have been budgeted for liquidity support, training, technological assistance and marketing programs to help SMEs upgrade their competitiveness, expand markets and move up the value chain. Some of these may well qualify under SRI criteria.

The Lampang tableware and decorative ceramic cluster development concept initiated by IFC Thailand is seen as the first cluster project in Thailand. Lampang's 200 ceramics factories currently export about one billion baht worth of products a year and employ some 9,000 workers. The concept aims to boost productivity among small and medium enterprises in Lampang and is modeled on a similar project in Sassuolo, Italy.

Frederic Richard, the branch director of UNIDO’s Strategic Research and Economics Unit, noted that small business operators had to be better prepared to move forward in the new economic era. Accounting systems, online customer services, supply chains and just-in-time management, and information management all needed improvement.

"Most of the applicants lacked business potential and transparent accounting systems because most are family-run", according to Wiwan Tharahiranchote, managing director of One Asset Management. "It's also not easy to convince the SME managements to clarify their accounts as it means they have to pay more taxes." It would appear that too many small companies remain reluctant to implement the necessary changes, whether in the form of improving accounting systems, drafting clear business plans or acknowledging the need to bring in outside managers or shareholders.

12 The Economist Intelligence Unit, April 4 2003
Similar state-sponsored funds have also failed because it is claimed the fund criteria established by the Finance Ministry was too tough. For example, a regulation that only SMEs with debt-to-equity ratios of less than 2:1 would qualify for funding were considered a disincentive to investment, while SMEs blame loan conditions and demands for high collateral as key barriers. According to Patanasak Hoontrakul, president of the Subcontracting Promotion Club, a requirement for the venture capital fund to hold not more than 50% of the paid-up capital of potential partners was one of the key hindrances to attracting investment. Since most SMEs have registered capital of only one million baht, they are limited to receiving 500,000 baht, which is insufficient for business expansion. Furthermore, the requirement to create one board seat once a 50% investment was made was also perceived as another obstacle as SMEs were reluctant to accept this as most were family-run and had never held a board meeting. The requirement that venture receiving assistance must be profitable is a further barrier.

The Department of Industrial Promotion is also preparing its own national SME development plan, in which a new entrepreneurs promotion board will be formed as part of the government's ambitious plan to create 50,000 new businesses within the next two years. The board is a refinement of an existing program run on a smaller scale by the department, which has helped to produce 5,000 new entrepreneurs in the past two years. It initially helped proprietors run sustainable operations, effectively manage costs and prepare transparent accounts.

The National Science and Technology Development Agency, meanwhile, is stepping up its efforts to transform itself into an industrial technology research institute to help strengthen the capacity of SMEs, particularly in the area of technology assistance. The agency would be based on Taiwan's Industrial Technology Research Institute, one of Asia's most successful agencies in enabling the transfer of knowledge to SMEs, and Canada's National Research Council. The United Nations Industrial Development Organization (UNIDO) suggested SME development in Thailand should be based on the pattern in Taiwan where new industrial firms and clusters were encouraged to innovate and upgrade products and capabilities through a proactive strategy.

Another initiative is the creation of a national data center for SMEs, which is a collaborative project of the Office of SME Promotion, the Thailand Institute of Scientific and Technological Research, the National Statistical Office and Krung Thai Bank. The one-stop center will offer a wide range of data services for small business operators, supplying updated information and assistance.

Finally, the Ministry of Science Technology & Env (MOSTE) has 4 main departments focused on managing industrial pollution (PCD), policy aspects of environmental management (OEPP), promoting environmental quality (DEQP) and energy efficiency promotion & development (DEPD).

5.2 Government Attitude To SRI And NGO's

The Thai government is very wary of both NGO and foreign consultants. As the head of research at the SET commented when SRI was mentioned to her: "This is just another form of non-tarrif trade barrier to Thai exports!" There is a common perception by the authorities in Thailand that many NGOs are either following an agenda that is determined outside the country or that they have been set-up principally to provide a livelihood for the activists who run them. Foreign NGO's such as Greenpeace, for example, are also seen as examples of foreigners meddling in sovereign Thai affairs, especially when they pursue issues like garbage incineration that many Thais don't regard as major concerns. (See article "NGOs, Violence and Money"14).

Similarly, the Thai government is very sensitive to the idea that foreign consultants of any stripe may be taking jobs away from locals and enjoying levels of remuneration that are the envy of the average Thai, a theme that the Prime Minister has elaborated on, on different occasions.

14 www.geocities.com/changnoi2/ngos.htm
6.0 PUBLIC AWARENESS

6.1 Public Understanding Of SRI

To date there appears to be little public awareness of SRI, certainly not as a commonly understood framework for investing. However, environmental issues, labour standards and corporate governance all have separate and distinct audiences in the public arena that may coalesce over time.

A Gallup Poll (Gallup International Millennium Survey 1999) interestingly found that respondents in Thailand (as well as Taiwan, Philippines, Korea, Bolivia, Dominican Republic and Columbia) would choose protection of the environment over economic growth by a clear majority (64%). Traffic pollution and the ozone layer was also a prime concern, hardly surprising given that Bangkok has some of the worst traffic problems on the planet.15

6.2 NGOs/ Consumer/ Academic Groups In Thailand

There is a fairly high level of protesting & activism in Thailand. In recent years there have been a lot of protests around landfill sites, which have led to delays in projects & additional costs to corporates - which is leading to an increased environmental awareness and changes to planning by company executives.

Poverty issues are very high on the agenda for NGO’s in Thailand, but pollution and the related health effects are also increasingly seen as important issues.

There is fairly good media coverage of environmental issues and a growing network of environmental journalists in Thailand that make sure environmental and social issues get coverage. In fact, Thailand’s press is relatively but not completely open, and plays and increasingly beneficial role in raising these issues in the public sphere.

PLAN International
www.plan-international.org

Plan International was founded in 1937, is one of the oldest and largest development organizations in the world and is active in hundreds of village communities in Thailand’s poorest regions. Some examples of the projects it is carrying out in Thailand are on providing nutritional information, preventative health care, and improvements in public hygiene and septic systems. In the N.E. of Thailand, they are also involved in setting up village credit unions and silk weaving cooperatives. One of the concepts it is very keen to promote is “Permaculture”, a sustainable farming method.

Community Organizations Development Institute (CODI)
codi.or.th

Set up by the Government in 2001, CODI is a joint resource for NGO’s and the Government to help community organizations best manage their resources. It has wide-ranging objectives to assist with community development, resourcing and micro-financing schemes. It places an emphasis on forming partnerships between different stakeholder groups.16

Foundation For Consumers

Essentially focused on the issue of GM foods, this relatively small group joined in a campaign by Greenpeace to force Nestle’s subsidiary in Thailand to label foodstuffs that include ingredients with GM components. However, there was little reaction from Thai consumers over this issue. Thai farmers are more concerned, with fears that growing GM produce may lead to consumer boycotts in the developed world, especially Europe.

The Consumer Organization Federation

This umbrella group of twenty consumer organizations in May 2003 joined with Greenpeace to try to force large supermarket chains, most of them foreign-owned, to comply with voluntary labeling of foods that contain more than 5% of GM ingredients. Thais generally, however, have little understanding of GMO and are often confused by the claims of NGOs that issue apocalyptic messages without engaging in comprehensive explanations of the complex issues surrounding the subject.

Focus on the Global South
www.focusweb.org

Lead by Philippine academic and social activist, Walden Bello, based in Bangkok. This is an organization that does a thorough job of drawing attention to the actions of multilateral lending institutions, such as the Asian Development Bank, in their engagement with recipient governments.

16 CODI English page: codi.or.th/index.php?option=displaypage&Itemid=63&op=file&SubMenu=
7.0 CORPORATE GOVERNANCE INITIATIVES

Following the Asian economic crisis, corporate governance and recognition of the need to support the rights of minority shareholders were recognized by the Government but are still not readily embraced by Thai corporates. As in the rest of Asia, there are few companies where the majority shareholders are not the founding family.

The most important CG initiative has been that emanating from the Government under the "Capital Market Master Plan" (see Appendix 2). Corporates as a whole have been much slower to move, either because they have problems grasping the various elements than go into CG, or because the requirements of CG cut to the heart of who is in command of the enterprise in question: who has control. As most businesses in Thailand are first and foremost family vehicles for individual family ambitions, the interests of stockholders outside this group may well not align with those of the founding family's. Thai corporates about the costs of compliance, claiming that these undermine the benefits of listing on the SET.

Thai corporates have been to known to question the benefits, claiming tht the costs of compliance undermine the incentives of lising on the SET.

7.1 Influence Of Major Shareholders

Major shareholders in Thailand, as in much of S.E Asia, have traditionally treated the publicly listed company they founded as if it were their exclusive property, and minority shareholders as simply as passive providers of capital. Take just one example, the case of Bangkok Water Resources, a company controlled by one of Thailand's wealthiest families who control one of the biggest banks in the country. Bangkok Water was set up in 1988 to supply water to factories in Sumat Prakarn, but also appears to have been used as a vehicle to siphon money out of the bank into other family-controlled businesses before finally going bust.

7.2 Government Initiatives On Corporate Governance

The Thai Government has been the major driver behind the promotion of CG, due in part to its recognition that Thailand must now diversify beyond an almost exclusively bank-based system of capital allocation. Total market capitalization of the SET is around US$ 70 billion, as opposed to around US$ 120 billion in assets in the banking system.

However, it also seems torn at times between introducing 'foreign notions' of corporate organization and trying to preserve the 'Thai way' of doing things, which is essentially based on connections rather that being rule-based.

The Financial Institutions Act, however, which was brought into effect in March of 2000, aimed at preventing the more egregious abuses by executive directors, administrators and major shareholders. For example, Article 48 prohibits financial institutions from offering credits to their own directors, managing directors, deputies or assistant managing directors. Article 49 prohibits a financial institution from offering more than 5% to any major shareholder, which is defined as anyone holding more than 10% of its shares, as in Germany. Credits offered to all major shareholders combined must be less than 20% of the financial institution's total credit.

To prevent other abuses, such as over-investment in companies, Article 50 prohibits banks and financial institutions from buying more than 10% of the shares in other companies or
investing more than 5% of their investment funds in one company. What’s more, total investments in other companies must not exceed 20% of the financial institution's investment fund altogether.

The current Thai Government has a program to raise awareness of investing and the capital markets amongst both ordinary Thai citizens and, in particular, Thai university students. One expression of this has been the creation of a subsidiary of the Stock Exchange (SET) called "Family Know-How" (www.familyknow-how.com), which aims to organize seminars, events and radio programs to help popularize knowledge of these. The aim appears to be to create a domestic source of investment capital to wean the country off its reliance on foreign investors, as well as to encourage local investors to be less speculative when investing in the stock market. The SET has also arranged a number of "investment fairs", both in Bangkok and the various provincial centers. The focus, however, is mainly on investment and saving strategies, given that many Thais are looking for alternative to bank deposits, which currently offer low rates of interest. There appears to be very little in the way of education on corporate governance issues to date. However, as the market matures, domestic awareness of these issues is likely to grow.

7.3 Progress On Corporate Governance

On entering office, the new government of Thaksin Shinawatra, recognizing the limitations of the existing bank-based system of credit allocation, set out an ambitious program to reform the financial system, called the "Capital Market Master Plan" (see 7.6). One of the plan's leading planks was a campaign, starting in 2002, to promote good corporate governance. By the end of 2002, the following progress on these reforms had been made:

In response to this Government initiative, a 'National Committee on Corporate Governance' (NCCG) has been established with participation of representatives of the government, the SET and Thailand's Securities and Exchange Commission. Six sub-committees have been appointed to be responsible for different aspects of governance.

The National Committee on Corporate Governance (NCCG) identified fifteen core principles of good corporate governance to be promoted as guidelines for Thai companies. These were culled from a much larger number outlined in a report on the subject commissioned by the SET in 2001:

1. Establishment of a clearly defined company policy on corporate governance
2. Protection of stakeholders' and shareholders' rights and benefits
3. Importance of Directors' Meetings
4. Importance of Shareholders' Meetings
5. Leadership, vision, and independence of directors
6. Careful handling to avoid 'conflicts of interests'
7. Promotion of business ethics amongst both directors and employees
8. A balance in the number of directors
9. A clear separation/definition of the roles and responsibilities of the Chairman, Directors, and Managers
10. Appropriate rates of remuneration for directors and executives
11. Scheduling of board meetings with appropriate meeting periods
12. Establishment of sub-committees to examine specific work practices
13. Controls and audits to mitigate against unnecessary risks  
14. Directors' Reports on roles and responsibilities in the preparation of financial statements; and  
15. Disclosure of all relevant information and the establishment of specific unit(s) to communicate directly with shareholders and related parties.

Unfortunately, these 15 principles are all "voluntary". The authorities feel, probably correctly, that it will take some time for a 'governance culture' to take hold in Thailand.

TRIS (the Thai Rating and Information Services Co., Ltd.) instituted a "Corporate Governance Rating Program" in collaboration with the SEC and SET to provide investors with information on corporate governance of Thai listed companies. Companies achieving high governance ratings of "good to very good" ratings in this program are to qualify for a 50% reduction from the SET on their annual listing fees for two consecutive years. However, companies have been very slow to embrace this idea, either because of the cost of commissioning a rating or because of the costs of compliance. However, many companies complain that this is still "too expensive", both to be rated and to comply with the necessary prerequisites. It will also take time for TRIS to rebuild its credibility, after its positive ratings of most of the 56 finance companies (that subsequently failed) prior to the 1997 crash.

7.4  Corporate Governance Organizations

7.4.1 Center For Good Corporate Governance  
www.cgthailand.org/SetCG/center

The CGCG was established to serve as an advisory body as well as a center for the exchange of views between directors and senior management of listed companies as well as prospective listed companies. The Center organized a number of workshops and met with listed companies to exchange ideas on good governance. This was essentially aimed at raising awareness of what constituted corporate governance in this group.

A Class-Action Law, Trust Laws and other related laws, however, were still under consideration.

7.4.2 Thai Investors Association  
www.thaiinvestors.com

The SEC (www.sec.or.th) together with SET (www.set.or.th) and TSFC Securities Ltd. (www.tsfc.co.th) have given their support to the Thai Investors Association to assume the role of a Shareholders Association, to act as the chief advocate in the protection of investors' rights, provide education, and function as an information center for investors.
7.5 Corporate Case Studies

Three cases (see Appendix 3) illustrate some of the difficulties in instituting an environment conducive to SRI in Thailand, in particular resistance to CG. There is still a prevailing climate of denial amongst business leaders in Thailand that their way of doing business in any way contributed to the Asian economic meltdown. Nonetheless, this is likely to be part of the process of assimilation and, as they become more accustomed to dealing with the realities of selling equity rather than buying debt, these attitudes may well change. The Roynet case seems to have had a salutary effect on the Thai authorities and is likely to strengthen reforms related to the rights of minority shareholders as well as the accuracy of reported company information. The TPI and SSM cases demonstrate that powerful and well-connected local tycoons are still capable of riding roughshod over the interests of foreign investors and the Thai courts are willing to be complicit in these actions.

In fact, the government is now exploring the possibility of creating two domestic state-supported distressed asset funds (to be named "Vayupak I" and "Vayupak II") aimed at buying out foreign creditors from "strategic industries" and to be offered to Thai citizens only. They will also be used to invest in state-owned enterprises, to help prevent them falling into the clutches of foreigners. Vayupak I would be offered to the general public, with a starting investment of 50,000 baht (approx. US $1,200) and offer guarantees on principal capital and minimum yields. The second fund would be positioned more towards institutional investors, with no guarantees on returns given and with a starting investment set at five million baht (approx. US $60,000). Some in the local investment community worry that these funds will be used to help avoid or obviate the need for serious reform.

7.6 The Future Of Corporate Governance In Thailand

In a report published shortly after the Asian Economic Crisis, the World Bank identified five interrelated problems in Thailand's corporate governance and disclosure systems:

1. Concentrated ownership,
2. High levels of diversification,
3. Weak incentives,
4. Poor protection of minority shareholders, and
5. Weak information standards

However it also noted, "these problems are no more severe in Thailand than in the rest of East Asia and indeed in many developing countries." 17

The question is then, have there been significant changes since this report was compiled?

The latest CSLA survey gave Thai firms only 4.6 points out of 10 for their corporate governance, whilst better than the Philippines, Indonesia and China, this ranked below Hong Kong, Singapore, India and Malaysia. However, the present government is clearly committed to corporate governance and the foundations are in place for moving forward.

17 Alba, Classens and Djankov, World Bank Paper 1998; Thailand's Corporate Financing and Governance Structures: Impact on Firms' Competitiveness; p.11;
8.0 SHAREHOLDER ACTIVISM

8.1 Media Attention To Shareholder Role

The Thai press has given extensive coverage to the cases. (Roynet, TPI, SSM, see Appendix 3) In particular, the efforts of minority shareholders in Roynet to convene a meeting to elect representatives to replace members of the Yaoprukse family on the company’s board enjoyed extensive reporting at the time. This, however, was very damaging to the credibility of the new small-cap market, the "Market for Alternative Investments", which had deliberately made the requirements for listing comparatively less onerous to encourage SMEs to look to the capital markets rather than banks for finance. Subsequently, many of the MAI’s rules have had to be tightened.

8.2 Emergence Of Minority Shareholder Groups

In May 2002, as part of a government initiative, a "Shareholder Association" was formed under the auspices of the Thai Investors Association. Its mandate was to act to "protect investors’ rights, provide education and function as an information centre for investors...to empower investors and establish good corporate governance of listed companies, thereby reassuring the confidence of investors and enhancing the integrity of the whole capital market system". This was unveiled as part of the Capital Market Development Plan. One of its aims is to be to encourage shareholder to vote at board meetings, and to act as the representative of retail investors "in voicing their opinions to the authorities."

One of the biggest complaints of foreign investors and Fund managers that wish to take longer term positions in Thai companies is that under Thai law they can only vote their shares in shareholder meetings up to a limit of 49% for all foreign shares combined (i.e. foreign shareholders can never outvote Thais in a shareholders’ meeting.) One of the effects of this is that it militates against the "disciplining" effect that minority shareholders (especially fund managers) can have on the actions of a firm's managers). This would seem to undercut any moves to encourage these fund managers to take their responsibilities as owners seriously. Unfortunately, it seems unlikely that this will change soon given local fears of "foreign domination".

8.3 Response To Shareholder Activism

To date, there have been a few exceptions to the generally relaxed attitude to minority shareholders by Thai corporates. One, however, is the largest conglomerate in Thailand, Charoen Pokphand, controlled by the Chearavanont family. It has long been regarded by many as one of the most secretive conglomerates in the country. However, it recently listened to minority shareholders and is now negotiating with them.

Overall, compared to some SE Asia countries there is a fairly high level of environmental activism and protesting in Thailand and there is also relatively open (although still controlled) media coverage of environmental issues.
9.0 CORPORATE DEVELOPMENTS AND RESPONSE

9.1 Level Of Environmental/ Social/ Sustainability Reporting

This is a new area for Thai corporates and ones that do report on any of these tend to concentrate on community-support programs (e.g. Thai Union Frozen Foods, www.thai-frozen.or.th). Foreign controlled companies, such as Siam City Cement and Thai Shell are often more forthcoming. ACCA have not launched Environmental Reporting Awards in Thailand. This may be because they did not feel there was sufficient demand. However, an environmental consultant who ran training courses in Environmental Reporting in Bangkok in 2002 noted that these were well attended, suggesting an interest\(^{18}\) that may result in more reports appearing in the near future. Furthermore, many Thai companies have attained ISO14000 standards, which also witnesses to a growing alertness to these issues (see 9.3 below).

9.2 Award Schemes

Six organizations (The Stock Exchange of Thailand, the Thai Institute of Directors, the Board of Trade of Thailand, the Federation of Thai Industries, the Thai Bankers’ Association, and the Listed Company Association) established a “Board of the Year” Award aimed at encouraging the active development of good corporate governance.

In April 2001, the Thailand Management Association and Sasin Graduate Institute Business Administration of Chulalongkorn University announced the Thailand Corporate Excellence Awards, which aim to promote the development of the country’s management competitiveness and that includes SRI components.

However, it is hard to know how seriously to take these awards, given the interlocking ownership of Thai business.

According to the Thai Institute of Directors (TID)’ Annual Survey of Corporate Governance for 2002, conducted by the TID in conjunction with McKinsey & Co, the majority of Thai listed companies needed to focus more on improving their relationships with customers and diversify the composition of their boards of directors. The 2002 survey ranked 234 companies, up from 133 in 2001. Its scoring criteria were based on five categories:

- Rights of shareholders,
- Equitable treatment of shareholders,
- The role of stakeholders in corporate governance,
- Disclosure and transparency, and
- Board responsibilities

Weak points were investor relations, board composition and the roles of non-executive directors in providing leadership as well as handling governance issues, according to this survey, while annual reports need to better clarify related-party transactions and be more widely disseminated. Fifty of the firms had an average score of 57 points out of a possible 100, based on information disclosure and transparency to the public. The TID and McKinsey aim to survey up to 300 listed companies this year and 400 next year.

\(^{18}\) Carrie Johnson, www.paiaconsulting.com
9.3 Corporates And The Environment

One important feature of the Thai industry and economy is the dominance of the small and medium scale enterprises (SMEs) with an estimated contribution up to 90% of the total industrial output. In 1999, the Department of Industrial Works (DIW) records indicated that a total of 128,350 registered industrial businesses. Of these, 127,809 were small and medium scale industries.

In the past, pollution control relied solely on command-and-control laws and regulations that set emission limits and focus on end of pipe treatment approaches to industry. These efforts are being complemented and supplemented by a strong governmental policy formulation effort. Currently, approaches are increasingly being applied to other sectors such as educational and research institutions, agriculture, farming and aquaculture, hotel and tourism industry, and local governments.

Thailand is probably at the stage of development where the worst excesses of disregard for the environment are coming to an end. Given the past abuses, this is none too soon, but there seems to be a general awareness in Thai society that business and the environment have to be symbiotic. Under the 7th National Economic and Social Development Plan, the Thai Government has given high priority to environmental issues including industrial pollution control. Cleaner Technology (CT) has been highlighted as an important means of environmental management in the 8th National Economic and Social Development Plan. A Pollution Prevention Master Plan was drafted by the public consultation approached with related stakeholders through the Thai National Pollution Prevention Roundtable in 1998, and the Promotion of Cleaner Production Policies and Practices project, conducted by TEI with support by ADB in Oct 1999-July 2000. Over the last ten years, several initiatives have been undertaken to promote the applications of CT implementation in Thai industries. International donors have supported the majority of these initiatives, with Thai universities acting as Thai counterparts.

There has been a very high uptake of ISO14001 in Thailand. As of June 2002, 552 companies were registered in Thailand, as opposed to 333 in Singapore, 367 in Malaysia, 199 in Indonesia & 120 in Philippines. Thai companies have embraced ISO14001 partly because they are dependent on the export market and have realized that there is a need for ISO standards to fully access these markets. This is having a beneficial knock-on effect inside Thai corporations, as once companies have an environmental policy, targets and objectives they increasingly take environmental issues on board. This process is often assisted by the appointment of environmental champions within companies who are committed to making improvements.

USAID set up and funded the Industrial Environmental Management Programme (FTI/IEM) of the Federation of Thai Industries during 1990-95. US cleaner technologies were promoted through the conducting of environmental audits in some industries such as textile dyeing, pulp and paper, food processing and chemical industries.

The Carl Duisberg Gesellschaft (CDG) in association with its South East Asian Program Office assisted small and medium sized industries in the textile, electroplating and food industries. The project was implemented with the assistance of educational institutions such as Asian Institute of Technology, Chulalongkorn University, and Chiang Mai University. A number of training, capacity building and industrial audit activities were undertaken.

The governments of Japan, Australia and Canada financed cleaner technology workshops for representatives from public and private sectors involved in industry and environment.

Promotion of Cleaner Technology in Thai Industry project, supported by the Danish Cooperation for Environment and Development (DANCED) attempted to strengthen Thai environmental auditing and CT expertise at the implementing and advisory level.
Businesses based on environmental technology fabrication (such as production of solar panels and solar lighting systems) have considerable potential in Thailand.

9.4 Corporates And Labour Standards

Thailand's economic success in the decade preceding the Asian economic crisis was attained principally through the expeditious use of cheap labour and a focus on exports. This formula has not been sustainable for some time and contributed to the Thai economic collapse (the Baht-dollar peg dragged the price of Thai goods up to a point where they couldn't compete against lower-cost producers). For example, in reference to a recent survey of the Garment Industry, the Kenan Institute Asia noted: "The Thai garment industry faces increased competition from other garment producer countries and is struggling to compete in the international marketplace. The current trend of auditing contract factories on their labor standards has put additional pressure on the garment industry. Garment producers are facing rising costs, short delivery expectations and decreased profit margins as the multinationals are now adept at evaluating the cost of the production process." In fact, this industrial sector was one of the few experiencing negative growth rates in 2002, along with petroleum and block rubber. Textile products lost market share in the United States and Europe to their free trade area partners, particularly Mexico and the Caribbean nations. Thailand's products have faced increasingly strong competition from several neighbors that have lower production costs such as China, Indonesia, Vietnam, Pakistan and India. Textile production in the first nine months of 2002 contracted by 0.8% compared with 1.5% growth in the same period a year earlier.

Thailand now has a dilemma. In order to progress up the economic food chain, it needs to move away from reliance on industries that utilize poorly-paid, low skilled labour such as much of the garment or electronics industries that currently exist, but lacks the requisite skilled labour force to help this come about. This also creates difficulty for SRI funds, as labour standards may even fall as Thai producers struggle to compete against other countries in the region with lower cost structures. At the heart of the problem is the question of productivity. Productivity in Thai manufacturing has lagged other economic indicators. Without the requisite skills, it is difficult to see how Thai garment producers can lift the value-added component of what they currently specialize in. Restructuring education to deliver better quality at the lower levels (i.e. elementary and high school), especially for the rural masses would make a big difference, but there is little evidence of a desire to see this happen to date. The issues of a living wage and restrictions on overtime are moot if there is no work to be had.
10.1 Local And Internationally Funded Projects/Assessment Of Fund

In 1992, the Government of Thailand established the Urban Community Development Office (UCDO), which was placed in charge of the Urban Community Development Fund that supports activities of urban low-income communities. In 2000, the Government merged the Urban Community Development Office and the Rural Development Fund into the Community Organisations Development Institute (CODI). CODI promotes the development of community organisations and coordinates civil society efforts in the rural and urban areas of Thailand. Its objective is to improve the living conditions and increase the organizational capacity of communities through the promotion of community savings and credit groups and the provision of loans at favorable interest rates as wholesale loans to community organizations.

Micro-finance is largely a government-sponsored activity in Thailand. Micro-finance schemes have been available in Thailand for many years, but offer a cautionary note on the dangers of these types of programs becoming captive of the political process. Too often microfinance, often instigated with the best of intentions, has ended up as an extension of the vote-buying patronage chains that have helped deliver the elections in the poorer, rural provinces of Thailand, especially the Northeast.

The Bank for Agriculture and Agricultural Cooperatives of Thailand (BAAC), and more recently, the Government Savings Bank (GSB) have been the principal vehicles for many of these schemes. First established in 1966 as a government owned agricultural development bank, the BAAC has recently been going through a gradual transformation from a specialized agricultural lending institution to a diversified rural bank that provides a range of financial services. Since 1998, with the assistance of Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH, the development arm of the German government, it has been pilot testing micro-credit programs for extremely poor clients. In fact, this metamorphosis was in response to a thorough and often critical examination of the BAAC by one of GTZ’s researchers.

At the end of 2000, BAAC had 406 micro-loan clients, the majority of whom were women.

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19 from discussions with field-workers in Isaan, NE Thailand
20 Delbert Fitchett Eschborn; Consultative Group to Assist the Poorest Working Group on Savings Mobilization Bank of Agriculture and Agricultural Cooperatives; 1999

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<table>
<thead>
<tr>
<th>Year</th>
<th>Region</th>
<th>Poverty Line</th>
<th>Poverty Line %: Municipal</th>
<th>Poverty Line %: Village</th>
<th>Poor %</th>
<th>Poor % Municipal</th>
<th>Poor % Village</th>
<th>Number of Poor (million)</th>
<th>Poverty Gap</th>
<th>Gini Coefficient</th>
<th>Gini Agric Sector</th>
<th>Gini Non-Agric Sector</th>
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<td>Whole Kingdom</td>
<td>922</td>
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Source: NESDB
The change is in line with a shift of clients and their sources of income in rural Thailand, as it became clear that many non-agricultural opportunities are emerging, such as piece-meal work making fishing nets, etc, part-time work as taxi drivers in Bangkok, or periods working in factories. The majority of rural households in Thailand derive only 35% of their income from farming. The contribution of agriculture to the national income also declined from 36% in 1966 to 11% in 1999, significantly transforming the rural economy. Most family farms are simply too small to be economic units beyond subsistence, despite supporting over half the population of the country. The ratio of non-farm to total farm cash incomes is now above sixty percent. Off-farm opportunities generate demand for a new type of microfinance as many potential clients were women, and as they were not farmers by definition, they could not borrow from the formal banking system.

Previously, the rural financial system was (and often still this) distorted by directed credit or "special projects" implemented by the BAAC in collaboration with government agencies. In fact, many of these projects failed and the borrowers didn't repay their loans. The bank's experience shows that lending to groups collectively tends to result in high rates of default. Within Thai rural society it seems that an individual will accept responsibility for maintaining an asset and repaying a loan for it only if he or she is the sole owner. If responsibility is shared, all too often the result is that no one will accept responsibility.\(^{21}\) In fact, cheap credit frequently does not reach the poor and low interest rates create excessive demand for loans that are often used inefficiently. As Thailand has often demonstrated, farmers obtaining cheap credit invest in lowreturn activities. As well, the borrowers were not the poor, but mainly farmers who were comparatively well off. "Special Projects", or directed credit, still account for 10% of BAAC's loan portfolio.

Looking at the BAAC's large client base and branch, network, Marie Luise Haberberger, a senior rural banking adviser from the GTZ\(^{22}\), argues that there is no alternative but to turn the "Peoples' Bank" into a "new" client-oriented bank offering, the right financial products to the right customers: entrepreneurs, farmers or others who need access to credit other than those offered by traditional money-lenders. The key to sustainability is charging interest rates that are able to cover all incurred costs, rather than constantly requiring government subsidies, but this appears to be a hard sell politically in Thailand. Ms. Haberberger stresses that rural and micro-finance clients are willing to pay comparatively high interest rates for this type of service because the alternative are rural loan-sharks who generally charge extortionate rates, and which are the curse of many rural families who find themselves unable to meet repayments.

The Government Savings Bank of Thailand (GSB) is a state bank that began as a government institution primarily for those earning low to medium incomes. Microfinance products and services were introduced to low-income clients in 1995. At present, services are offered throughout the country through a semi-independent direct lending unit, or a specialty window, to both rural and urban clients. The Government Savings Bank finances 447,709 micro clients through loans that are made to 7,265 community groups and cooperatives. Of the 8,048,000 clients that receive micro-savings services, more than 50% are women. The GSB began offering microcredit services through its People's Bank early in 2001. With 1% interest per month and a 13 month repayment period, the service attracted an impressive 200,000 applications. However, the question remains: is the 1% monthly interest rate enough for the GSB to cover all its costs, since the loan amounts are comparatively small, thus inevitably incurring high administrative costs? Rapid expansion might undermine the long-term sustainability of microcredit services given that interest rate changes are unlikely to cover the programs costs.

\(^{21}\) John Lightfoot; BAAC Experience with Joint-Liability Lending; http://www.gdrc.org/icm/baac.html

\(^{22}\) Bangkok Post article October 2, 2001
Last year, a state-owned commercial bank, Krung Thai Bank, introduced a pilot community-led micro-credit scheme in the small village of Saem Kha in Lampang Province in the N.E of Thailand. Here, the locals are nearly all engaged in basic farming and traditional handicrafts. Recent road construction and electricity connections have exposed the community to the cash economy on a new scale. The project was undertaken by KTB in response to first, a survey that discovered that the 152 households in the community were mired in debt at three times the previous estimate, and secondly, that village leaders had pushed the residents to establish a central savings pool to tackle the problem. The villagers helped establish the schemes parameters and also volunteered their time. KTB lent the community bank three million baht (approx. US$62000) at 6% annually, as well as offering computer services and training in basic banking services. Loans would be limited to US$2200 per person and could not be used to refinance other debt, and ultimately KTB expects the community bank to become self-sustaining. Savings deposits currently pay 1.25% annually and fixed deposits 1.5%, and are set by the bank’s 14-member board. As of June 2003, there were 55 depositors with total savings of approx. US$3000. However, the villages objected to KTB’s suggestion that lending interest rates should be set at 8-9% to reflect market conditions. Instead, they insisted on just 4-5%. Even in the present low interest rate environment, it is hard to see how this can be sustained.

Other policy initiatives by the Thaksin Government include the establishment of a “peoples' bank” to facilitate small scale lending, a three year moratorium on farmers' debts, and provision of a 1 million Baht (US$23,000) loan to every Thai village and urban community to stimulate market production. In a report released on 1 April 2003, the National Economic and Social Development Board (NESDB) stated that most of the funds from the government's one-million-baht village fund scheme were being used for agricultural and business investments, which had increased average family income by some 7%. Less than 2% of borrowers had used loans to repay old debts, and as few as 0.1% to meet household expenses, it said. Almost 90% of villagers were claimed to have paid back their loans as scheduled, while only 7% reportedly borrowed from other sources to meet repayments. The NESDB said around 65% of villagers nationwide had borrowed from the fund, with an average allocation of about 14,000 baht.

However, this glowing review was immediately challenged by the Northern Farmers Alliance, which conducted its own research into the scheme and that contradicts the findings from the NESDB. Somchai Sirichai, said his organization's unofficial survey of 1,336 villages in eight provinces found more than 70% of borrowers were misusing the fund. Most villagers used the money to either buy luxury items, like mobile phones and motorcycles, or repay old debts, he said. In addition, around 12% of the surveyed villages were found to have no access to the fund. (Bangkok Post April 5 2003)

See Appendix 4 (12.4) for a micro-finance case study advocated for Loei Lottery sellers.

### 11.0 ASSESSMENT OF THE FUTURE MARKET FOR SRI

Drivers for SRI in Thailand

- CSR being introduced and adopted by some corporates
- Corporates reporting and adoption of environmental standards still weak but improving
- Corporate adoption of ISO14001 high for the region
- Government promoting corporate governance, notably the Capital Market Master Plan, but enforcement still quite weak

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23 [www.nesdb.go.th/nesdb4-eng.html](http://www.nesdb.go.th/nesdb4-eng.html)
What we appear to be seeing today in Thailand is in many ways a sea change in the character of the country. The current government under the tutelage of Thaksin Shinawatra represents the coming of age of the urban middle class. Unprecedented changes are being undertaken in regard to the endemic corruption that has for so long blighted the development of a civil society in Thailand. Generally speaking, it is axiomatic that the lower middle class in any culture has the most to lose (because they pay taxes) and the least to gain (usually they are not “well-connected”) from corruption, and are thus the least tolerant of a corrupt body politic. Until recently, this sector of society has felt relatively powerless and stoically accepted this set of circumstances. However, it was this group that helped propel the party of P.M. Thaksin (“Thai Rak Thai” = “Thais Love Thais”), to power. The Asia economic crisis brought to a head their frustrations with ‘business as usual’, particularly the quid pro quo of the prevailing political culture. Thailand's new constitution helped to give expression to this frustration. Thailand appears to have gone through a “Cultural Revolution” of sorts in the last two years as a result. “Dark Influences” - mafia figures that were previously though of as untouchable are now being arrested almost daily. Furthermore, Thaksin has emerged as the champion and a master communicator to this lower middleclass sector of society, especially in his weekly radio addresses, religiously listened to by many ordinary citizens.

It is still too early to say how deep this campaign, the “New Social Order” will run (it certainly appears selective and the P.M himself is far from above reproach) but it seems likely that this emergent urban middle class will transform Thailand over the next decade. As wage earners and small business people they will need to also make provision for their retirements/ children's education, etc, and are already looking to the capital markets to grow their savings, encouraged by the government, in the present climate of low interest rates. Just as they are strongly behind the current ‘moral rearmament' campaign, they will also likely demand better governance and transparency as well as environmental and social awareness from the companies they invest in. This is where, in THE SEEDS's opinion, the future of SRI in Thailand lays. Thais are a proud people and reluctant to take advice from outsiders whose motives they suspect, but when it is their investments, their country and their future, socially responsible investing will start to make sense.

### Conclusion

- Significant investor education and distinctive marketing needed in order to develop retail support for SRI. Focus towards women entrepreneurs and also interpreting and presenting SRI as a localized concept would be important
- SRI could gain support of NGO sector if shown to provide fresh perspectives on, as well as to promote and reinforce, broad development goals of equity, poverty alleviation and environmental protection
- Corporates with improving CSR and reporting standards can be identified
- Global SRI funds or Development agency direct investment could provide a best-practice model and facilitate introduction of SRI into the market.

It seems likely that this emergent urban middle class will transform Thailand over the next decade.
12.0 APPENDICES

12.1 Appendix 1: The Saga Of CalPERS' Revision Of Its Investment

CalPERS, the provider of pension services to California’s state public employees is the largest US public pension fund, with assets of $135 billion. The CalPERS' board is composed overwhelmingly of elected officials and political appointees; all of its board members also belong to public service unions.

Initially in 2001, CalPERS made a US$75 million investment in the newly established Thai Equity Fund (TEF) managed by Lombard Inc. The World Bank's International Finance Corporation (IFC) and Government Pension Funds were the other co-lead investors. At the time, William D. Crist, President of CalPERS Board of Administration, hailed it as "an unprecedented opportunity", following the Asian economic crisis to "participate in the renewed growth of Thailand's leading enterprises while securing a good long-term investment for our members". The fund was only to make investments in companies that agree to comply with Government of Thailand and IFC environmental and social policies, including high standards of corporate governance and transparency.

In early 2000, Phil Angelides, the California state treasurer and a CalPERS trustee, announced that CalPERS should take into consideration labor and other human-rights standards in its emerging-nation investments. Previously, CalPERS had employed Wilshire and Associates to develop a selection process that incorporated the use of a range of commercially focused indexes, gathered from reputable published sources. These indexes measured market volatility, regulation and legal system, investment restrictions, settlement proficiency, transaction growth and growth of technology. The previous methodology also included indexes on the level of economic development and political stability. In 2001, it eliminated the growth of technology index, augmented the political stability index and added two new indexes: transparency and labor standards. The transparency index measures monetary and fiscal policy, accounting standards and stock-market listing. These are commercially relevant issues and the measures are compiled by reputable independent sources. The political-stability index measures civil liberties, judicial independence and political risk. A strong argument can be made on commercial grounds for their inclusion and they were also derived from reputable sources.

Four factors, market regulation, settlement times and transaction costs, capital-market openness, and liquidity and volatility weighted equally, comprise 50 percent of the index. However, the distinctive feature of the new model was that it also includes three civil-governance categories: political stability, transparency, and labor practices. Those factors comprise the other 50% of a country’s score. The model prepared by Wilshire Associates, uses a three-point scale for each of the seven categories. For most categories, it relies on expert assessments, such as Freedom House's index on press restrictions, but ultimately it compiles subjective observations into seemingly objective numbers. CalPERS hired the consultancy arm of the NGO, Verite, to compile the measure.

In 2002, with three country categories and five market categories, Wilshire Associates recommended rating each factor equally across the board, except giving a 50 percent greater weight to Market Regulation/Legal System/Investor Protection and halving the value for Transaction Costs (in 2003, this category was combined with Settlement Proficiency to produce seven categories). Country factors would count for 37.5 percent of the total score and market factors as 62.5 percent. Wilshire also recommended a total score of 1.6 as the minimum for CalPERS portfolio investments. Under that recommended scoring system, 17 markets would have qualified, including India, Thailand and the Philippines. However, CalPERS’ trustees chose to set the bar higher, at 2.0, which would exclude that trio. CalPERS agreed with the consultant's concept of over-weighting the Market Regulation category, but it wanted country and market factors to comprise equal portions of the overall total. So the three country
categories were set at 17 percent of the total score (Transparency got knocked down to 16 percent). That meant each was more important than any market factor, including the over-weighted Market Regulation category. Of the 16 countries spanning Latin America, Central Europe, the Middle East, Northeast Asia, and Southeast Asia, CalPERS decided that only four S.E Asian countries didn’t make the grade. Three of these markets were ones where CalPERS already held investments: Indonesia, Malaysia and Thailand. At the time, Thailand ranked 44th out of 49 nations in management practice, according to the International Institute for Management Development (IMD), lending credence to CalPERS’ divestment decision. In 2003, the number of market categories was reduced from five to four, each equally weighted at 12.5 percent, dwarfed by the unchanged values of the three country factors.

Robert Carlson, a member of the CalPERS board as well as a member of the board of the Franklin-Templeton Group of mutual funds, has claimed "the idea of selling shares in disgust has given way to the realization that it makes better economic sense for us to become an agent for change. We believe that we have a duty to put just as much effort into being an active owner as in deciding to be an owner in the first place. Companies that are operated with long-term returns as the primary goal will ultimately reward other stakeholders. Companies driven by short-term goals do not reward anyone in the long term". CalPERS’ withdrawal from S.E Asia (excluding Singapore and the Philippines) contradicts this core principle of constructive engagement. Furthermore, it demonstrates the limitations of the approach of employing passive screens (as most SRI funds do) as it demonstrates that these funds do not take their responsibilities as owners (of stocks) seriously but simply treat the shares they invest in as commodities.

12.2 Appendix 2: The Capital Market Master Plan

Driving the campaign was a steering committee led by the Ministry of Commerce in collaboration with the Thai Security and Exchange Committee (the SEC), the Stock Exchange of Thailand (SET), the Listed Companies Association, and all the associations of securities practitioners. The SEC was given responsible for the evaluation and ratings for good corporate governance of all market-related organizations. The ratings aimed to provide incentives for the implementation of good corporate governance within these organizations. To reinforce and promote the practice of good governance, certain privileges for those gaining good ratings were considered. Secondly, the Association of Securities Companies (ASCO) was asked to establish a guideline on prudence to aid corporate compliance officers in their effort to promote efficient corporate governance practices. Support was to be extended for the establishment and enforcement of the companies’ accounting standards, in line with internationally accepted practice. The enforcement of laws related to capital market activities were to be accelerated and improved. The establishment of a ‘Shareholder Association’ was mooted. Laws in support of the ‘Class Action’ suits were to be introduced and the Law was to be clarified concerning the roles of directors and executives of issuing companies and intermediaries for those cases where they may be guilty of either criminal or commercial misconduct. Furthermore, the Ministry of Commerce and the SEC were required to hold discussions to resolve outstanding issues concerning an amendment to the Thai 'Public Company Act' to provide the SEC with a more effective and integrated regulatory coverage of listed companies.

Intermediary Institutions were to be strengthened. The SEC, the SET, the Association of Securities Companies (ASCO), and the Association of Investment Management Companies (AIMC) were to hold discussions to determine guidelines for the rating of intermediaries and to promote the acceptance of these ratings. Both the Bank of Thailand and the SEC were to study extending the scope of the business operations of the financial intermediaries in the securities business, and Bank of Thailand was asked to consider permitting appropriate fund sizes for overseas investments to be made by investment management companies, something they were previously prevented for doing.

24 www.calpers.ca.gov/whatsnew/press/1999
Finally, the structure of the supervision system was to be improved. The Ministry of Finance was to be given responsibility for establishing a permanent steering committee to handle policy coordination between the supervisory bodies to help ensure greater efficiency in the supervision of the financial markets. The committee was to comprise senior executives from Finance, the Ministry of Commerce, the Bank of Thailand, the Securities and Exchange Commission, and the Department of Insurance. The SEC Board was to be restructured to reflect the changing environment, and the SET was asked to establish a steering committee to determine guidelines for corporatization of the Exchange itself.

12.3 Appendix 3: Case Studies - Corporate Governance

Roynet

Roynet, a loss-making Internet service provider listed on Thailand's recently inaugurated small-cap "Market for Alternative Investments" (MAI), has become a rallying point for investors seeking to strengthen corporate governance and the powers of minor investors and a glaring example of the continuing weaknesses in Thailand's legal framework despite efforts by the Stock Exchange of Thailand (SET) and Securities and Exchange Commission to protect shareholders' rights. As the first ISP (Internet service provider) to raise funds via the capital market, although comparatively small in its size, it was the last to receive an ISP concession, which lasts for 10 years, before the CAT (Communications Authority of Thailand) stopped granting them four years ago.

The saga began when it emerged that the holdings of the Yaoprukse family, the founders of the company, had plummeted from 60% in April last year to zero by December, without any formal notification to securities regulators, as the law requires. Many existing Roynet investors purchased shares late last year on speculation share prices would increase after the firm's positive third-quarter results. But the restated accounts showed a third-quarter net loss of 13.2 million baht and a loss of 36.7 million baht compared with the originally announced net profit of 11.87 million baht for the third quarter and 22.07 million baht for the first nine months following its IPO. The former Roynet managing director, Kittipat Yaoprukse, is now fighting criminal charges for insider trading and disclosure violations relating to these share transactions, plus he has also been accused by securities regulators of accounting fraud relating to Roynet's third quarter financial statements, which were restated after auditors discovered that sales had been incorrectly booked. Shares of Roynet were then suspended from trade leaving many investors frozen in their positions with no avenue for exiting.

A further problem emerged when it was discovered that while Mr Kittipat had notified the Stock Exchange of Thailand electronically on April 8 2003 of his resignation from the company, no written resignation letter was received, putting the legal status of the company into question to the frustration of other shareholders and regulators. Despite publicly announcing his departure from Roynet, Mr. Kittipat remains the authorized signatory of the company and, as a result, the Yaoprukse family remained effectively in control of Roynet even though they have no shares in the firm. Since then, Roynet investors have been left mostly frustrated by their inability to convene meetings to formally appoint a new board, as the right to call a meeting under Thai law rests only with the chairman or a designated director. While the law does give investors the right to request an extraordinary meeting with a company chairman under a petition signed by more than twenty-five shareholders representing more than 25% of total shares, multiple efforts by minority Roynet shareholders to submit such a petition to company directors and management were ignored.

Eventually the shareholders decided to convene their own meeting, taking advantage of a clause within the Civil and Commercial Code. A total of 124 investors, holding a combined 21.45 million shares out of the 61 million outstanding, convened an extraordinary shareholders' meeting on April 29 2003 in attempt to dismiss nine directors, most members or connected to the Yaoprukse family, from the company board, but it remains uncertain whether the move is
legally acceptable. In fact, Commerce Ministry officials said it was likely that the meeting would be declared void.

Subsequently, the Securities and Exchange Commission (SEC) say they would file legal complaints against Roynet directors if the company board fails to convene a shareholders' meeting by June 27. Authorities also threatened to seize property and assets of the directors if any evidence of fraud was found.

The authorities agreed to push for new legal changes to strengthen investor protection, including a reduction in the threshold of shareholders needed to request a shareholders' meeting to 5% from the present 20%. The Commerce Ministry will also establish a committee to consider options in cases where a company chairman or directors refused to call a meeting as requested by shareholders.25

Thai Petroleum Industries

One of the most notorious cases to arise from the 1997 economic crisis in Thailand was that concerning Thai Petroleum Industries (TPI), the country's largest corporate debtor. This case has been seen as a litmus test of Thailand's commitment to reform, in particular in terms of its bankruptcy regime and its new specialist Bankruptcy court, in its treatment of foreign investors. TPI entered business rehabilitation in 2000 with debts of $3.7 billion. More than 140 creditors are involved in the case, including Bangkok Bank, Citibank, the International Finance Corp, the German development bank KfW and the US Export-Import Bank. While the domestic Bangkok Bank is the largest single creditor, foreign creditors hold 52% of total claims. Prachai Leopairatana, the founder of TPI has waged a three-year legal battle to regain control of the company, characterizing it as a nationalist struggle of Thai verses foreign interests. In this, he has the support of TPI staff, whom he has convinced that he will champion against job cuts.

At the heart of the issue for foreign investors are the difficulties in seeking legal redress when things go wrong. One major constraint is proof of bankruptcy, Thai law does not accept the cash-flow definition for determining insolvency (i.e. if a company is unable to pay its debts) recognized in western jurisdictions, instead the law insist on the much more difficult to prove asset-value test (whether company assets are worth more than its debts). When this is combined with Thai cultural preference for consensus and an abhorrence of conflict, the loss of face attached to bankruptcy, sensitivities about "foreign domination", and the generally protracted nature of achieving legal judgments, bankruptcy proceedings can be a minefield for investors.

Currently holding only 16% of the company, Prachai filed at least 36 different lawsuits against the debt-workout administrator, Effective Planners, a Thai-registered subsidiary of the Australian Ferrier Hodgeson. Until recently, it appeared that the Thai Bankruptcy Court, mindful of the international interest in the case as a test of the effectiveness of Thailand's bankruptcy procedures, had given these lawsuits scant credence. In fact, the Court, newly created in May 2000, had in a landmark decision in December of that year, and much to the delight of foreign investors, found TPI technically insolvent, stripped Prachai of his managerial duties and appointed foreign consultants to oversee the company's daily operations.

However, on April 21, 2003, the Court unexpectedly reversed its decision. The court dismissed Effective Planners and accepted Prachai's claim that Effective Planners had failed to meet production targets laid out in the restructuring plan. This suggests a sea change in attitudes in favor of debtor over creditor rights, and even, some foreign investors claim, indicates that Thailand is backtracking on some of the most important reforms implemented after the economic crisis of 1997. This view would seem to be supported by the Prime Minister, who ordered the

25 From reports in the Bangkok Post (April- May 2003)
state-owned Krung Thai Bank to supply new credits to TPI after the creditors refused to release an $80 million line of credit for the company, and was quoted by Kruntep Turakit, the country’s leading Thai-language business daily, as saying: “The Government is here to help the Thai people shake off the foreign yoke.”

Subsequently, the Prime Minister proposed that both sides name fifteen candidates (7 each plus one from the government) to form a joint committee to administer the company. This compromise was rejected by the creditors because of a reluctance to see further involvement by Prachai. The creditors proposed that Gen.Yuthasak Sasiprapa, a former deputy defence minister should head the new planner. There upon Mr. Prachai accused the creditor banks of colluding with Effective Planners to siphon off funds from TPI.

What then followed, on June 13, in a precedent-setting ruling by the Central Bankruptcy Court was the rejection of the new planner (previously the court had accepted the plan administrators as proposed by the creditors) and the appointment of the Finance Ministry as the new plan administrator. It was claimed that the TPI staff would lack confidence in a plan administration headed by Gen Yuthasak, which would make a successful rehabilitation difficult. The court threatened to impose this ruling if the creditors failed to accept this ruling. It appeared to be another victory for both for Mr. Prachai and for the position of debtors vis-à-vis creditors.

It would also appear to signal that the present government is less concerned about fostering a climate that is attractive to international investors, but is more interested in protecting the interests of the local business elite. A move to encourage local investors to enter the Thai capital markets (especially given that bank interest rates are at historical lows) as a substitute for foreign capital seems to be part of Mr. Thaksin’s plan to make the country more “self-reliant”. Thaksin has even suggested that the government might engineer a buyout of claims held by foreign creditors of TPI through the state-owned Krung Thai Bank, an institution frequently used to implement government policy, which, under the present circumstances, may prove irresistible to creditors. However, the risk is that future borrowers may find foreign lenders demanding a premium for lending in the Thai market.

Siam Strip Mill

A similar case but with a different twist has been that of Siam Strip Mill (SSM). Problems started after SSM, owned by tycoon Somsak Leeswadtrakul, reported that its total debt had increased to 61.5 billion baht, with the addition of 35 billion baht owed to Sipco. Previously, SSM’s debt amounted to 26 billion baht, of which 80% was owed to three Japanese creditors. Sipco, controlled by most of SSM’s board members, has a contract to supply power to SSM but has yet to begin doing so. The increase in debt resulted in the three Japanese creditors losing their majority vote in creditors’ meetings and effectively made Sipco a new major shareholder with a 58% vote. Consequently, a new rehabilitation plan proposed by Sipco won 58% of the creditors’ vote in late May, amid opposition from the Japanese creditors - Itochu Crop, Sumitomo Corp and Citibank's Tokyo branch. The administrators were able to do this because of a loophole in the bankruptcy law that confers equal rights on secured and unsecured creditors. This rort effectively returned control of the company back to its original management.

This wheeze was possible because Sipco, an unsecured creditor of SSM, had originally proposed to build a power plant project six years ago to supply electricity to a SSM steel plant. The firm secured a gas-purchase contract with PTT Plc on a take-or-pay basis, meaning it had to pay for natural gas regardless if was used or not. Subsequently, after the Asian financial crisis, both Sipco and SSM failed to finance the projects but under the take-or-pay contract, Sipco still had to pay PTT for gas supplies in turn, that were not taken up. PTT filed a lawsuit against Sipco for debt payment. Sipco then filed a civil lawsuit against SSM for 35 billion baht to compensate for the latter’s failure to buy electricity which had resulted in Sipco's inability to pay PTT. SSM’s Japanese creditors, however, disputed the status of Sipco as a creditor in the civil courts.

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26 Reported by Shawn Crispin in FEER 8 May 2003 P47
Japanese creditors filed an objection with the Central Bankruptcy Court, arguing that a decision by official receivers to accept added debt owed to Siam Power Generation in a restructuring deal, violated the constitution. However, in November 2001, creditors voted against the plan and filed bankruptcy against SSM. In January 2002, Sipco petitioned the court to enter rehabilitation again, which was accepted in June 2002. Court receivers in August then agreed to raise the claims of Sipco to 35 billion baht, based on the damages claimed by the company for SSM’s failure to purchase electricity under a previous contract. Under the new restructuring plan for SSM, creditors would receive from 28% to 50% of their claims. Total debt under the plan is 61.5 billion baht. The previous creditors say the decision by receivers to allow higher debt claims by Sipco effectively gives the company a controlling vote over the structure of the rehabilitation plan. Creditors also question the fairness of equating claims by secured lenders with that of Sipco, a company with shareholding links to SSM. Once again, on 18 June 2003, the Central Bankruptcy Court set a precedent by ruling against the foreign creditors by dismissing their claim for constitutional review and approving the restructuring plan.

12.4 Appendix 4: Case Study - Microcredit Scheme
Advocated For Loei Lottery Sellers

Selling lottery tickets along Bangkok's streets became a popular job among Loei's Khao Luang residents about five years ago when pioneers in the business started bringing home good incomes. Many of the villagers had heavy debts they had run up with the Bank of Agriculture and Agricultural Co-operatives (BAAC) as a result of an Agriculture Ministry initiative encouraging them to go into commercial cultivation of cassava. From an initial ten pioneers a decade ago, 70% of the total population of Tambon Khao Luang, a sub-district of Loei's Wangsa-pung area (in the heart of the northeastern region of Isaan, 500 kilometers north of Bangkok) hawk tickets in the capital's streets. This activity has become their main source of cash income.

What is most interesting about this trend, though, is not the numbers, but the villagers’ attempts to link the work to a financial project organized by the Interior Ministry. The government initiative, which allocates a US$22,000 revolving micro-credit scheme to each village, is intended to strengthen community based economies.

A former official in the credit division of the Bank of Agriculture and Agricultural Cooperatives (BAAC), Kiati-sak Seesan, currently an official of Khao Luang’s Tambon Administration Organization (TAO) has been the instigator for setting up the loan system. While loans would be at a rate of only five per cent, Mr. Kiati-sak outlined, a guarantor would be required. He argued that: "Our real economic activity is lottery selling, so, why waste money on other activities."

However, the lottery business has its downsides. One is the risk the sellers are exposed to. They tell many tales of being robbed and cheated, and of run-ins with mafia gangs. Another negative is the impact on families. The sellers have more income, but less time with their families. The absence of parents has been attributed to a growing problem of premature sex among girls and drug addiction among boys. Also, lonely and tired after working in Bangkok many of the lottery sellers become addicted to gambling, especially "hi-low". Games are often being played when they arrive home. As a consequence, much of their hard-earned cash is squandered before there is a chance to use it for something worthwhile. Furthermore, it is hard to imagine that they would be in any position to service their loans from the BAAC.27

27 Reported by Karnol Sukin in The Nation; 21 February 2001
This tale illustrates the difficulties of tailoring sustainable micro-credit programs that effectively meet genuine local needs and are not hijacked by often well-meaning but poorly informed local government or bank officials. One of the most difficult concepts for many, even educated Thais to grasp is that interest rates need to be high enough to cover the costs of the program if it is to be sustainable. Many feel that it should operate as a subsidy (from conversations with MBA students at Mahidol University School of Management). Microcredit schemes also need to recognize that they have a didactic role in educating rural families in the realities of managing cash, accumulating savings and acquiring a credit record that will allow them to eventually move beyond micro-credit and into the orbit of commercial banks.

In a similar cautionary tale, three officials of a cooperative in Sungai Padi district in Narathiwat Province in Southern Thailand recently disappeared with 17 million baht ($US400000) in savings of the cooperative’s 982 members. The trio had gradually siphoned money off the accounts and lied to colleagues they had won lottery prizes. The three women involved had even divorced their husbands before their disappearance so their former spouses would not have to take responsibility for their crime. Furthermore, police were forced to guard the cooperative's office for fear that the trio's relatives might try to steal key documentary evidence or make an arson attack on it.28 Such stories are all too common.

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28 Bangkok Post 5 April 2003
13.0 RESEARCH PARTNER

Robert Jamieson
Joint-Founder, The SEEDS, Thailand

Rob Jamieson was born in New Zealand but has spent more than a few years living abroad, the last nine in Thailand. He spent the first four years living there domiciled in the North East, the poorest provinces of Thailand, where he taught at the University of Khon Kaen and later at the Mekong Institute (a New Zealand-funded facility aimed at promoting cooperation in the greater Mekong sub-region. In 1998, he moved to Bangkok where he participated in the first review of the Thai Capital Markets undertaken by the ADB after the Asian economic crisis, followed by a spell teaching at Mahidol University's School of Management Science. In 2001, he joined the Stock Exchange of Thailand for an eighteen-month stint. It was during this time that, along with Sari Laaksonen and Tero Raasina that he helped found the SEEDS, an organization designed to promote an understanding of SRI in Thailand. Rob is currently working as a free-lance consultant for, amongst others, John Wiley and Sons and Prentice Hall, as well as looking for opportunities for further involvement in the development of SRI in the region.

The SEEDS

The SEEDS (Social, Environmental and Economic Development) was established in 2002 to promote awareness amongst Thais of SRI and to help identify opportunities to foster technologies and business models than support the growth of a sustainable future for the societies of Southeast Asia.
### 14.0 GLOSSARY

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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>ACCA</td>
<td>Association of Chartered Certified Accountants</td>
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<td>ADB</td>
<td>Asian Development Bank</td>
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<td>BAAC</td>
<td>Bank for Agriculture And Agricultural Co-operatives of Thailand</td>
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<td>BOT</td>
<td>Bank Of Thailand</td>
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<td>CalPERS</td>
<td>California Public Employees Retirement System</td>
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<td>CG</td>
<td>Corporate Governance</td>
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<td>CODI</td>
<td>Community Organizations Development Institute</td>
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<td>CT</td>
<td>Cleaner Technology</td>
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<td>DANCED</td>
<td>Danish Co-operation for Environment and Development</td>
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<td>DIW</td>
<td>Department of Industrial Works</td>
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<td>DMC</td>
<td>Developing Member Country</td>
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<td>EPPO</td>
<td>Energy Policy and Planning Office (Ministry of Energy)</td>
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<td>EU</td>
<td>European Union</td>
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<td>FIF</td>
<td>Foreign Investment Funds</td>
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<td>GEM</td>
<td>Global Environmental Monitor</td>
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<td>GM</td>
<td>Genetically Modified</td>
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<td>GMO</td>
<td>Genetically Modified Organism</td>
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<td>GSB</td>
<td>Government Savings Bank</td>
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<td>GTZ</td>
<td>Development arm of the German Government</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>ISO 14000</td>
<td>International Organization for Standardization - Environmental Management</td>
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<td>ISP</td>
<td>Internet Service Provider</td>
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<td>KTB</td>
<td>Krung Thai Bank</td>
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<td>KU</td>
<td>Kasetsart University</td>
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<td>LLC</td>
<td>Lombard Thailand Intermediate Fund</td>
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<td>MAI</td>
<td>Market for Alternative Investments</td>
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<td>MOF</td>
<td>Ministry of Finance, Thailand</td>
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<tr>
<td>NCCG</td>
<td>National Committee on Corporate Governance</td>
</tr>
<tr>
<td>NEPO</td>
<td>National Energy Policy Office</td>
</tr>
<tr>
<td>NESDB</td>
<td>National Economic and Social Development Board</td>
</tr>
<tr>
<td>NGO</td>
<td>Non Governmental Organisation</td>
</tr>
<tr>
<td>NIMBY</td>
<td>Not In My Back Yard</td>
</tr>
<tr>
<td>PCD</td>
<td>Pollution Control Department</td>
</tr>
<tr>
<td>PDA</td>
<td>Population and community Development Association</td>
</tr>
<tr>
<td>SEC</td>
<td>Thai Security and Exchange Committee</td>
</tr>
<tr>
<td>SEEDS</td>
<td>Social, Environmental and Economic Development</td>
</tr>
<tr>
<td>SEN</td>
<td>Sustainable Energy Network</td>
</tr>
<tr>
<td>SET</td>
<td>The Stock Exchange of Thailand</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium sized Enterprises</td>
</tr>
<tr>
<td>SPP</td>
<td>Small Power Producer</td>
</tr>
<tr>
<td>SSM</td>
<td>Siam Strip Mill</td>
</tr>
<tr>
<td>SWN</td>
<td>Social Venture Network</td>
</tr>
<tr>
<td>TBIIRD</td>
<td>Thai Business Initiative in Rural Development</td>
</tr>
<tr>
<td>TEF</td>
<td>Thai Equity Fund</td>
</tr>
<tr>
<td>TEI</td>
<td>Thailand Environmental Institute</td>
</tr>
<tr>
<td>TID</td>
<td>Thai Institute of Directors</td>
</tr>
<tr>
<td>TPI</td>
<td>Thai Petroleum Industries</td>
</tr>
<tr>
<td>UCDO</td>
<td>Urban Community Development Office</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>UNIDO</td>
<td>United Nations Industrial Development Organisation</td>
</tr>
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</table>
ASrIA, Association for the Sustainable and Responsible Investment in Asia
www.asria.org

ASrIA is a not-for-profit membership association dedicated to promoting sustainable and responsible investment (SRI) practice in Asia. ASrIA has over 100 members including investment institutions managing over US$2 trillion in assets. In order to raise awareness about SRI, ASrIA has run conferences, seminars and workshops, and published wide-ranging research on SRI issues. ASrIA has also created a network of people and organizations committed to developing SRI in Asia. ASrIA's website, www.asria.org, is the primary resource for SRI in Asia, already attracting over 1,800 page views per day and 5,000 subscribers to the regular e-bulletin.

What is SRI?

Sustainable and Responsible Investment (SRI), also known as Socially Responsible Investment, is investment which allows investors to take into account wider concerns, such as social justice, economic development, peace or a healthy environment, as well as conventional financial considerations.

The most successful SRI funds provide investors with dual returns:

- Financial returns that compare well to, and often exceeding, the returns of conventional investments
- Social and environmental rewards that go beyond the direct financial return to the investor

SRI is therefore a positive economic choice about the way we live and the world we live in.