ACCOUNTABILITY ON CLIMATE CHANGE: THE ROLE OF SRI CORPORATE ENGAGEMENT

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INTRODUCTION

Concerns about the global effects of anthropogenic greenhouse gas production surfaced in the 1970s (Hoffert, 1974; Landsberg, 1970; Sawyer, 1972) and have been growing since (IPCC, 1990). The nature of climatic change and global warming presents a large scale problem which requires a societal response. Amidst the new constraints and opportunities from climate change businesses are responding with a wide range of strategies (Kolk, Levy, & Pinkse, 2008; Kolk & Pinkse, 2005). Where there is a lack of clear regulation highly variable responses are to be expected. In a study of Australian corporate responses to climate change Rankin et al. (2011) found that despite limited public policy some companies were voluntarily preparing for a low carbon economy.

Despite Stern's (2006) forceful argument for international collective action current regulatory mechanisms in the global climate change adaptation response do not yet have a coordinated international framework. Still nation states have introduced many different types of regulatory policy options. Regulatory policy options include 'hard' legislation and 'soft' mechanisms, where hard regulation involves enforcement and punishment and soft regulation is permissive and not compulsory (Kuruvilla & Verma, 2006).

In this paper I argue that the effectiveness of SRI engagement on climate change could be enhanced if it served as part of a responsive regulation regime. Social and environmental actors seek to regulate business and hold them accountable (Bendell, 2004). Accountability processes include those which facilitate action on the part of organizational stakeholders (S. M. Cooper & Owen, 2007). Rather than promoting accountability corporate desire for legitimacy is likely to limit the effectiveness of stakeholder actions through manipulation and capture. In contrast, responsive regulation offers a way to conceptualise SRI engagement as supportive regulation, complementary to and integrated with sanctions. A responsive regulatory framework offers the potential to align corporate desire for legitimacy with accountability thereby improving SRI engagement effectiveness.

Soft or voluntary policy options include efforts by non-state actors to regulate business. Soft regulatory mechanisms for climate change also include trans-national reporting, disclosure and engagement efforts such as the Global Reporting Initiative (GRI) and Carbon Disclosure Project (CDP). Socially responsible investment is the result of investors seeking to use the influence of their capital. Formerly associated with negative screens and divestment, socially responsible investment has turned to positive methods such as engagement with companies to revise their environmental, social and governance standards. Socially responsible investor (SRI) engagement with corporations is a soft regulatory mechanism that features in the climate change adaptation response.

Voluntary regulation of corporate social and environmental effects seeks to broaden the focus of accountability. Corporate activities such as sustainability reporting are one response to calls for accountability. However corporate reporting usually results in the giving of an account. Thus corporate social and environmental reporting often results in a limited form of accountability rather than answerability - involvement in a process of being held to account.

SRI engagement is one strategy used by socially responsible investors to achieve environmental, social and governance (ESG) goals. A limited scope usually emerges incorporating the profit maximisation goal, where SRI engagement is, "seen as a means of driving shareholder profit through the risk management of environmental, social and governance (ESG) issues" (Hebb, Hachigian, & Allen, 2012). Despite this limited scope there remains some potential for accountability through SRI engagement seeking, "both information disclosure (process accountability) and management practices that reflect the values of their shareholders (accountability outcomes)" (Newell, 2008, p. 142). Whether the current practice of SRI engagement has the potential to hold corporations to account will be explored in this paper.

SRI engagement is often conceptualised as stakeholder engagement (Gifford, 2010; Hebb, et al., 2012). Mitchell et al. (1997) identify stakeholders through three attributes; power to influence the firm, a legitimate relationship with the firm, and an urgent claim on the firm. However stakeholder "theory does not imply that all stakeholders (however they may be identified) should be equally involved in all processes and decisions" (Donaldson & Preston, 1995, p. 67). Therefore it requires a normative proposition to establish stakeholder theory as an accountability mechanism[1]. The way in which corporate motivation to maintain legitimacy might limit the potential for SRI's as stakeholders to operate effectively as a regulatory mechanism on climate change will be examined.

Although SRI engagement currently performs a variety of supportive regulatory functions such as reframing norms, establishing dialogue and providing resources to improve performance, SRI engagement is currently not integrated with sanctions. As a stand-alone voluntary regulatory mechanism its effectiveness as an accountability mechanism is limited. This paper argues that the effectiveness of SRI engagement on climate change could be enhanced if it served as part of a responsive regulation regime.

Responsive regulation features a pyramid of support which operates in conjunction with a pyramid of sanctions (J. Braithwaite, 2011). Regulators engage with regulatees with an appropriate level of either support or sanctions in an iterated game. Supportive options are linked to sanctions depending upon compliance. If initial interactions do not evoke compliance, then the regulator escalates to higher levels of actions. A responsive regulation policy regime involves both support and sanctions to improve compliance.

SRI corporate engagement can be viewed as a supportive regulatory mechanism; engaging with firms in dialogue, praising those who show commitment and engaging further with those who resist. A pyramid of supports might allow SRI networks to function as supportive

[1] Stoney and Winstanley (2001) suggest the normative basis is that, "…stakeholder interests are ends in themselves and not simply means to ends such as increased efficiency and profitability" (p. 607)

regulatory actors, at higher levels. SRI networks might become involved in coordinated action against corporations who do not respond to initial SRI engagement requests for carbon disclosure.

A key feature of responsive regulation is a super sanction at the peak of the sanctions pyramid. The super sanction is an ultimate punishment that corporations perceive as a deterrent, something to be avoided. Exactly what this sanction could be in the global regulation of climate change is uncertain. However the responsive regulatory approach involves collaboration between actors to design the regulatory system; state regulators, businesses and NGOs forming a partnership to design the regulatory pyramids (J. Braithwaite, 2011). This paper contributes to the literature by extending responsive regulation to the policy problem of corporate adaptation to climate change.

The methodology of the research presented here is grounded on data gathering at an ethical fund, including non-participant observation of engagement strategy meetings and semi-structured interviews. Exposure to practitioner viewpoints prompted an exploration of conceptual frames that fit the practice of SRI engagement. In addition it draws upon an extensive literature including gray literature, as well as a variety of theoretical frameworks.

The paper is set out in the following way. The literature on accountability, stakeholder engagement and responsive regulation is explored to identify the theoretical failure of the current regulatory approach. Next the case of SRI engagement on climate change is described. Then a conceptual framework of responsive regulation is applied to climate change, providing an alternative context for SRI engagement. This is followed by a discussion of the implications and conclusion. The conclusion seeks to summarise how this understanding of the role of SRI engagement as a regulatory mechanism might improve policy.

LITERATURE REVIEW

The choice of regulatory response to climate change has a political economic foundation (following Tinker, 1984). Cooper and Sherer (1984) suggest political economy research should be explicitly normative, descriptive and critical. The normative basis of this paper is that climate change requires a social response and regulation of corporate adaptation should be effective. The normative rationale for regulating the corporate response to climate change is similar to that underlying social and environmental accounting (Spence, 2009), in considering the control and accountability of capital to those who produce the wealth (Puxty, Willmott, Cooper, & Lowe, 1987).

Accountability

The political economy of SRI engagement highlights the relationships between actors, particularly the accountability of corporate actors on social and environmental issues. "Accountability is a very versatile concept that may be applied to all types of social relationships, in which the 'giving and demanding of reasons for conduct' takes place" (Steffek & Hahn, 2010, p. 14). One way in which accountability on financial aspects is considered discharged is through reporting, including the auditing of recording and reporting procedures. Reporting is a narrow interpretation of accountability (D. J. Cooper & Sherer, 1984). Voluntary regulation of corporate social and environmental effects seek to broaden the focus of accountability to a wider group than financial stakeholders (Spence, 2009).

Corporate reporting is key to SRI engagement. Such an approach might request corporations to prepare a report and publicly disclose their carbon exposure. However voluntary reporting on social and environmental issues is not without difficulties. Difficulties in voluntary reporting operating as an accountability mechanism on social and environmental issues include opportunities for, "…corporate posturing and deception in the absence of external verification, and … corporate 'greenwashing' and other forms of corporate disinformation" (Laufer, 2003, p. 253).

Reservations about the potential of environmental, social and sustainability reports appear despite the fact that such reporting is "… designed to empower stakeholders and thereby enhance corporate accountability" (S. M. Cooper & Owen, 2007, p. 649). Others suggest, "… severe reservation have been expressed in the academic accounting literature as to the degree of participatory role played by stakeholders in the process" (S. M. Cooper & Owen, 2007, p. 650).

> "Whilst the corporate lobby apparently espouses a commitment to stakeholder responsiveness, and even accountability, their claims are pitched at the level of mere rhetoric which ignores key issues such (as) the establishment of rights and transfer of power to stakeholder groups" (S. M. Cooper & Owen, 2007, p. 665).

Examining the potential for accountability through social and environmental reporting, even if it were mandatory, leads Cooper and Owen (2007) to conclude that if the process does not facilitate action on the part of organisational stakeholders it would be unlikely to improve accountability.

Accountability as answerability implies an additional dimension to reporting (Bendell, 2004). This goes beyond merely giving an account to being held to account for actions undertaken. In this sense accountability can be "defined as the ability of people affected by a corporation to regulate the activities of that corporation" (Bendell, 2004, p. v). Cooper and Owen also find that, "if accountability is to be achieved stakeholders need to be empowered such that they can hold the accountors to account" (2007, p. 653).

<u>Socially responsible investment engagement</u>

SRI engagement is an activity undertaken to promote ESG performance. As shareholders SRI are direct stakeholders and prima facie have some potential to influence corporate behaviour and monitor activity (Hachigian, 2011). SRI engagement is, "seen as a means of driving shareholder profit through the risk management of environmental, social and governance (ESG) issues" (Hebb, et al., 2012, p. a). This focus on risk management and value in SRI engagement, shares the same limitations for accountability as corporate social and environmental reporting; it may obfuscate the conflicts inherent in commercial activity (Spence, 2009).

Stakeholder theory has been offered as one explanation for SRI engagement (Allen, Letourneau, & Hebb, 2012; Gifford, 2010; Hebb, et al., 2012). Given finite resources, managers must determine which of the many groups that display an interest in regulating corporate activity on climate change should be considered stakeholders and therefore receive management attention. Michell, et al. (1997) suggest such salience is defined by power, legitimacy and urgency.

> "With limited time, energy and other resources to track stakeholder behaviour and to manage relationships, managers may well do nothing about stakeholders they believe possess only one of the identifying attributes, and managers may not even go so far as to recognize those stakeholders' existence" (Mitchell, et al., 1997, p. 875).

Thus if SRI stakeholders do not possess salience, their engagement will be less successful.

Gifford's research into corporate engagement by socially responsible investors extended Mitchell's stakeholder salience framework. He, "…found that a strong business case and the values of the managers of investee companies are likely to be the most important contributors to shareholder salience" (2010, p. 79). The explanatory power of SRI engagement through the descriptive theory of stakeholder salience needs careful examination. Stakeholder "theory does not imply that all stakeholders (however they may be identified) should be equally involved in all processes and decisions" (Donaldson & Preston, 1995, p. 67). The stakeholder concept juxtaposes, "serving the needs of shareholders through dividend maximization, and serving the needs of a wider constituency of stakeholders" (Stoney & Winstanley, 2001, p. 604). Thus financial motivations may outweigh SRI interests.

In order to assess the potential of SRI engagement to effect corporate change this tension between profit maximisation and stakeholder claims warrants examination. Legitimacy theory, both as an attribute of stakeholder salience and as a theory of corporate action, provides some insights into how this tension might affect the interactions. Legitimacy stems from stakeholder relationships with the corporation, its "relevant publics" (Lindblom, 1994). Legitimation is the process of justifying a right to exist, "…the corporation may wish to evaluate its legitimacy status and communicate that status to the relevant publics …" (Lindblom, 1994, p. 4).

The corporate desire for legitimacy is a strong motivation leading to manipulation and seeking to maintain control. "The use of the CSD [corporate social disclosure] is oriented toward manipulating the perceptions of the relevant publics rather than toward educating and informing them" (Lindblom, 1994, p. 15) [added]. Brown and Fraser describe the limitations of voluntary corporate responses as; "the dominance of capital-oriented values and perspectives is such that CSR [corporate social responsibility] and SEA [social and environmental accounting] are likely to fall victim to business capture and lead to mystification rather than liberation" (2006, p. 110) [added].

This potential for manipulation in efforts to maintain corporate legitimacy directly impacts on the potential for SRI engagement to operate effectively as a voluntary mechanism on climate change. Baker elaborates on business capture in engagement:

> “However, the concept of capture has subsequently been extended to characterise the highly selective nature of corporate engagement with stakeholders, and the control by management of the agenda and dialogue with stakeholders. The absence of binding corporate commitments to the outcomes of such processes, and the apparent divorce of these processes from corporate decision making is taken as evidence of the “success” of managerial capture” (2010, p. 848).

These limitations on SRI to effectively represent societal interests are a constraint to realising social benefits from SRI engagement. Corporate self-interest is likely to limit the answerability potential of SRI’s as stakeholders. Voluntary adaptation mechanisms such as engagement may thus face difficulty in providing sufficient incentive for corporate change.

Although SRI engagement faces limitations as a stand-alone policy measure, it could improve social welfare as a supportive regulatory mechanism. Voluntary regulatory mechanisms have the potential to be more effective when integrated with hard mechanisms. Griffiths et al. (2007) and Utting (2005) identify integrating market mechanisms with corporate regulation as an important economic adjustment pathway. Integrating soft mechanisms with legislation, the carrot and stick approach, is a key feature of responsive regulation. Responsive regulation will be explored with particular attention to the mode of implementation which draws upon both supportive activities and sanctions as possible courses of action.

Regulation

Responsive regulation offers a way to conceptualise SRI engagement in the regulatory space. This regulatory framework offers potential improvement in accountability and effectiveness. A responsive regulatory approach involves integrating supportive activities with sanctions (Ayres & Braithwaite, 1995). Responsive regulation features both a pyramid of support as well as a pyramid of sanctions (J. Braithwaite, 2011)operating conjunctively. The pyramid of support is a strengths based pyramid.

> “The first idea, therefore, is to move up a pyramid of supports that allows strengths to expand to solve more and more problems of concern to the regulator; when that fails to solve specific problems sufficiently, the regulator … starts to move up a pyramid of sanctions.” (J. Braithwaite, 2011, p. 481)

In contrast to supportive activities operating in isolation, responsive regulation posits that a negative pathway also needs to exist in order to change corporate behaviour. At the peak of the pyramid of sanctions lies a super punishment. “Ayres and Braithwaite (1992) suggest that there needs to be a clear possibility, somewhere within the regulatory environment, of a maximally potent sanction, or “super punishment”” (Islam & McPhail, 2011, p. 795). This super punishment should be nondiscretionary.

Super punishment works as a deterrent because regulation is an iterated game, a series of interactions between regulator and regulatee. The pyramid suggests, "unless you punish yourself for law-breaking through an agreed action plan near the base of the pyramid, we will punish you more severely higher up the pyramid (and we stand ready to go as high as we have to)", (J. Braithwaite, 2011, p. 487). "A paradox of the pyramid is that to the extent that we can absolutely guarantee a commitment to escalate if steps are not taken to prevent the recurrence of lawbreaking, then escalation … will rarely occur" (J. Braithwaite, 2011, p. 489). That is the regulatory context involves creating a culture of compliance.

Responsive regulation invokes the social setting in the implementation. "Collective action problems in the purely economic arena are overcome in part through the transformation of economic wrongs into moral wrongs" (Ayres & Braithwaite, 1995, p. 160). The social setting involves building relationships. "We have shown that analyses of what makes compliance rational and what builds business cultures of social responsibility can converge on the conclusion that compliance is optimized by regulation that is contingently cooperative, tough and forgiving" (Ayres & Braithwaite, 1995, p. 51).

"The job of responsive regulators is to treat offenders as worthy of trust, because the evidence is that when they do this, regulation more often achieves its objectives" (J. Braithwaite, 2011, p. 489). "The most important way we improve regulation, according to the responsive approach, is by conceiving of regulatory culture not as a rulebook but as a storybook and helping one another to get better at sharing instructive stories" (Shearing and Ericson, 1991, in J. Braithwaite, 2011, p. 520).

Summary

SRI engagement as a voluntary mechanism fails to make corporate constituents answerable on social and environmental issues. Responsive regulation offers a regulatory framework within which the supportive benefits of SRI engagement could be integrated with sanctions. To see substantive corporate adaptation on climate change we need to nest SRI engagement within a responsive regulatory frame. The way in which this integration might enhance effectiveness of SRI engagement as a climate change mechanism will be investigated.

THE CASE OF SRI ENGAGEMENT

The operation of SRI engagement in promoting ESG performance is explored to further consider SRI engagement as a regulatory mechanism for corporate adaptation to climate change. The way in which SRI engagement is conducted, including whether the scope of engagement using the business case is likely to result in sufficient adaptation is further analysed. A business case contributes to salience in stakeholder engagement (Gifford, 2010) yet this does not avoid manipulation and capture by corporations as they seek to maintain legitimacy.

Engagement is one way for SRI to promote ESG issues. SRI maintains an explicit focus on social and environmental factors rather than centring solely on financial returns (Cowton, 2004). However there exists potential incompatibility (Kreander, McPhail, & Molyneaux, 2004). The potential for conflict may limit the efficiency of ESG engagement on ESG social good issues (Sullivan & Mackenzie, 2006). In practice, SRI climate change engagement is often framed using the business case. Thus the potential of 'business-case' engagement to yield social benefits on climate change should be critically evaluated.

Responsible investment engagement is commonly, "seen as a means of driving shareholder profit through the risk management of environmental, social and governance (ESG) issues"(Hebb, et al., 2012) . ESG considerations may not be central to SRI:

> "The basis of the ESG movement is less about the *values* investing commonly associated with the socially responsible investing ("SRI") funds, and more about long-term *value* investing focussed on reduced risk and improved shareholder value." (Hess, 2007, p. 223)

Often ESG issues are viewed through the financial (risk-return) perspective; "The critical point is that performance on ESG issues can influence the profitability of companies and other investments" (Sørensen & Pfeifer, 2011, p. 60). This lens suggests that ESG issues that do not have a direct financial impact could be ignored. The implication for SRI is that some ESG goals that cannot be expressed in financial terms may be viewed as less important. Some social and environmental impacts of climate change fall into this category. Thus the business case (or financial perspective) is a serious limitation for a regulatory mechanism with a net social benefit goal.

SRI engagement is also constrained due to the voluntary nature of the mechanism, "…voluntary action was limited to those decisions that would not adversely affect a corporation's share value" (Bendell, 2004, p. 17). SRI engagement lacks the potential to achieve systematic change due to the voluntary nature of responses (Haigh & Hazelton, 2004). Voluntary actions are likely to lead to superficial attempts to respond to wider societal concerns for corporate social responsibility due to managerial capture (O'Dwyer, 2003). In the evolution of SRI engagement, coordination has played a significant role, perhaps even moreso for climate change engagement.

Two significant coordinated engagement efforts are the Principles of Responsible Investment (PRI) and the Carbon Disclosure Project (CDP). The PRI emerged from collaborations between the United Nations and institutional investors. The PRI is a norm entrepreneur in the investment sector and PRI membership spans all major capital markets. Its activities include engaging at the regulatory level with stock exchanges, corporate engagement (via a clearinghouse designed to facilitate coordination among shareholders) and assisting investment funds and asset managers to implement the principles[2]. The CDP provides support for calculating, recording and reporting carbon and other greenhouse gas emissions, as well as corporate engagement and policy consultations with governments among other activities. The CDP reporting framework is notable for its definition and delineation of scope of emissions. Coordinated SRI engagement offers some potential to improve corporate response.

[2] Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.+
Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.+
Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.+
Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.+
Principle 5: We will work together to enhance our effectiveness in implementing the Principles.+
Principle 6: We will each report on our activities and progress towards implementing the Principles.
Downloaded from http://www.unpri.org/about-pri/the-six-principles/

Yet despite these significant coordinated engagement efforts, the voluntary nature of participation mean that as a regulatory mechanism, SRI engagement is limited. Particularly so for climate change where there is a lack of clear regulation and uncertain reputational risks, highly variable voluntary responses are to be expected. Studying Australian corporate responses to climate change Rankin et al. (2011) found that, “proactive companies have implemented internal organisational systems such as environmental management systems as well as using external NGO guidance provided by CDP and the GRI standard to report their responses about climate change risks” (Rankin, et al., 2011, p. 1061).

As the current potential of SRI engagement is limited, two kinds of regulatory changes might improve corporate adaptation; improving the mechanism and integrating the mechanism with harder regulatory options. As suggestions for supportive regulation, Clark and Hebb note that;

> “regulators must sustain their current initiatives in the area of corporate governance: that is, improving transparency with respect to corporate decisionmaking, ensuring that boards of directors have independent directors, and, most importantly, expanding shareholder and stakeholder representatives” (Clark & Hebb, 2004, p. 2029)

Hachigian (2011, p. 49) indicates the type of benefits available from improving the engagement mechanism:

> “This paper suggests that synergies are possible. Through leveraging shareholder legitimacy, urgency and to some degree, power, the state can effectively create a mechanism for monitoring the behaviour of corporations, without expending significant resources on monitoring and regulating. On the other side, shareholders are provided with more instruments and avenues to engage with issuers, thereby allowing them to manage their ESG risks more effectively.”

Earlier arguments for increased accountability are one rationale for improving and integrating regulatory policy options. “Rather than seeing corporate self-regulation and voluntary approaches as a superior alternative to governmental and international regulation, the corporate accountability agenda suggests a re-articulation of voluntary and legal approaches” (Utting, 2005, p. 386). Bendell describes the relationship between voluntary and mandatory as, “one being crucial to the effectiveness of the other in delivering true corporate accountability” (2004, p. v). Integration of corporate regulatory settings with market mechanisms could be an important economic adjustment pathway to climate change (Griffiths et al. 2007).

Integrating SRI engagement with hard regulatory mechanisms such as securities exchange regulation and corporate regulation is possible. For example the US Securities and Exchange Commission published a ruling in 2010 outlining grounds for climate change minority shareholder proposals being included in company meetings. However there are no examples of integrating soft mechanisms with hard mechanisms on climate change. SRI engagement can be integrated with sanctions at the national level which hold deterrence implications for trans-national organisations. Here the example of coordinated engagement mechanisms is instructive. Both the PRI and CDP have engaged with securities exchanges regarding listing rules and disclosure requirements surrounding ESG risks. Securities exchange de-listing could well feature as the super sanction in a responsive regulatory regime. That is, if soft engagements to improve disclosure and accountability fail, a lack of compliance could involve sanctions such as restrictions on capital raising, and ultimately suspension from trading.

Voluntary adaptation mechanisms such as engagement on social and environmental issues may face difficulty in providing sufficient incentive for corporate adaptation. To increase the effectiveness of SRI engagement, a cohesive policy regime addressing climate change is required. Rather than operating as a stand-alone voluntary mechanism, the way in which SRI engagement as supportive mechanism could be integrated with hard regulation will be explored through a responsive policy regime.

CONCEPTUAL FRAMEWORK OF RESPONSIVE REGULATION FOR CLIMATE CHANGE

In viewing SRI engagement as a regulatory instrument this paper analyses the form of corporate regulation for climate change. Tinker (1984) advocates exploring the foundation of regulatory problems in a political economy approach. Political economy suggests explicitly considering the social, economic and political context. Puxty, Willmott et al. (1987) argue that the market, the state and the community provide modes of regulation. Cooper and Owen (2007) critically analyse corporate accountability in regulation for social and environmental issues. In this paper so far we have examined the features of SRI such as accountability, the legitimacy of corporate actors, and the potential for a voluntary mechanism to effect corporate adaptation. In this section we explore the potential of responsive regulation as a policy regime for climate change, within which SRI engagement functions as a supporting mechanism. A responsive regulatory regime involves state and non-state actors in regulation.

Responsive regulation of climate change

Developed from theories of restorative justice (of crimes) and regulatory enforcement, responsive regulation has been applied to settings such as taxation (V. Braithwaite, 2007), nursing home regulation and transport safety (J. Braithwaite, 2011). One possible formulation of responsive regulation to climate change policy is used to illustrate the way in which such a framework could integrate SRI engagement with hard mechanisms (see figure one). The proposed responsive regulation framework would involve a fundamental change in SRI engagement moving from a voluntary mechanism to a supportive mechanism (but not voluntary). SRI engagement practitioners have many advantages as corporate regulatory actors; they have a supportive orientation (which government agency regulators find difficult to attain), they already engage corporations in a targeted manner (at no cost to the government), and are intimately familiar with key components of the strengths pyramid such as what types of corporate action are required for compliance with CDP reporting of different scopes, and GRI processes such as auditing.

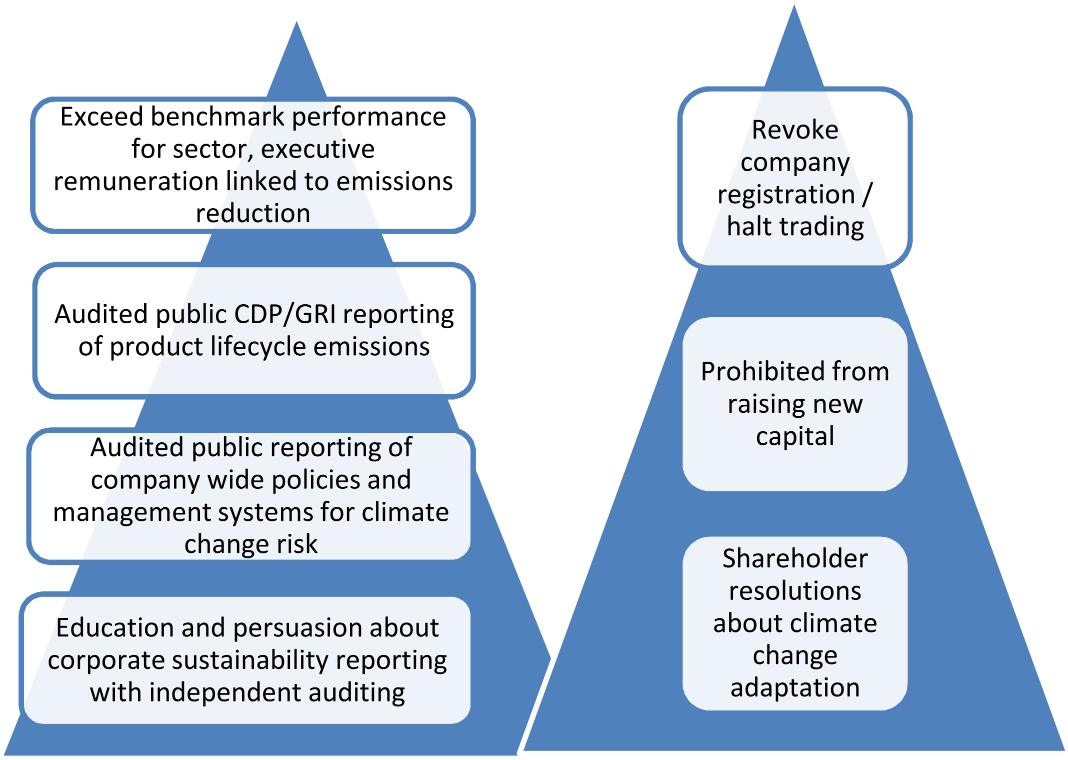

Figure 1: The responsive regime: a pyramid of supports and a pyramid of sanctions

Responsive regulation features a pyramid of support which operates in conjunction with a pyramid of sanctions (J. Braithwaite, 2011). Regulators engage with regulatees with an appropriate level of either support or sanctions in an iterated game. If initial interactions do not evoke compliance, then the regulator escalates to higher levels of actions. The direct linkage between the pyramid of supports and the pyramid of sanctions changes the nature of SRI engagement, from voluntary to one of compulsory compliance, albeit with a supportive orientation. Other regulatory actors such as government agency corporate or securities regulators might be involved in regulatory enforcement on the pyramid of sanctions, activities such as prohibiting capital issues and halting trading / deregistering the corporation.

Benefits of SRI engagement in the responsive regime

As part of a suite of regulation addressing climate change responsively, SRI engagement as a supportive regulation mechanism could fulfil some key functions. One significant problem with SRI from a critical perspective, its use of the “business-case” discourse, becomes a key benefit, a desirable attribute, as it signals a shared language and established dialogue between actors. Such dialogues become more structured and purposive in the responsive regulatory regime. However the clear progression of the pyramid of supports provides a signal that increasing compliance is expected.

SRI corporate engagement has a supportive orientation, engaging with firms in dialogue, praising those who show commitment and engaging further with those who resist. A pyramid of strengths would allow SRI networks to function as coordinators of voluntary regulatory actors (individual SRIs), and then involving coordinated action against corporations who do not respond to requests for disclosure of carbon exposure.

Supports and sanctions

Higher levels of supportive action might include a letter from investors such as in the CDP Carbon Action initiative. The importance of networks of actors becomes clear, if individual company contact by an SRI does not achieve satisfactory outcomes, then other SRI’s can be recruited in enforcement action. Continued non-compliance would then prompt a move to a regulatory sanction. This illustrates the change in orientation of SRI engagement from being a voluntary mechanism, to being a supportive mechanism integrated with hard regulation.

Regulatory sanctions involved at the lowest level of the sanctions pyramid might involve current corporate governance mechanisms of control and accountability. Sanctions further up the pyramid would involve government agency regulators in securities issue restriction and corporate de-registration. This progression and indicative path of escalation shows how an integrated policy regime could offer enhanced effectiveness. Companies would have a clear self-interest compliance to avoid interactions with government regulators, and this acts as an incentive to cooperate with SRI engagement requests for climate change adaptation.

Hard regulation

An example of sanctions in capital markets can be found in a Canadian based company Talisman Energy Inc. The oil and gas exploration company took a stake in a Sudanese state oil company. At the time Sudan was embroiled in a particularly bloody civil war. The company was listed on the Toronto Stock Exchange as well as the New York Stock Exchange. U.S. government sanctions against Sudan banned the Sudanese oil company from participating in U.S. equity markets (Nguyen & McKenna, 2001). Amendments to legislation were proposed which specifically targeted prohibited capital raising or trading in the United States. The Securities and Exchange Commission raised concerns about U.S. companies benefitting countries targeted by sanctions, linking mandatory disclosure to human rights issues (McKenna, 2001).

Capital market sanctions foreshadowed in the political arena included delisting Talisman from the New York Stock Exchange (Nguyen & McKenna, 2001). Talisman eventually sold its Sudanese interests. Studying the Sudan example led Windsor to concluded that, "… enforcement occurs largely by stock exchanges and national jurisdictions" (Windsor, 2009, p. 306). If the major stock exchanges participated in establishing the responsive regulatory sanctions, then the sanctions would be effective as a global deterrent. Such sanctions mesh with the global context of SRI engagement and international financial market actors.

Effective regulation

The responsive regulatory regime on climate change outlined above is comparatively simpler than the current system of financial accountability regulation. Corporate regulation for financial accountability involves an extensive framework of supportive mechanisms as well as sanctions. Supportive regulation includes mechanisms such as international accounting standards, professional bodies for directors and accountants, corporate ratings, investor briefings and stakeholder engagement. Hard regulation involves legislation such as for corporate reporting, securities legislation, corporate governance and exchange disclosure rules. For the errant corporation, sanctions include a range of remedies including halting trading and director liability. Thus the pyramids of sanctions proposed for climate change is comparable, and the responsive regulatory approach offers an integrated approach to enforcement.

The benefits for policy effectiveness of SRI engagement as regulatory actors become clear once Braithwaite's (2011) nine principles of responsive regulation are applied to climate change policy. These principles are interpreted for the SRI context as:

i) Understanding the context of business activity and the generation of climate change impacts,
ii) Structured dialogue giving voice to stakeholders, agrees outcomes and monitoring, help actors to find their own motivation to improve, communicate resolve to stick with a problem until fixed,
iii) Engage those who resist with fairness, show them respect by construing their resistance as an opportunity to learn how to improve regulatory design.
iv) Praise those who show commitment, support their innovation, nurture motivation to continuously improve, help leaders pull laggards up through new ceilings of excellence,
v) Signal that you prefer to achieve outcomes by support and education to build capacity.
vi) Signal, without threatening, a range of sanctions including an ultimate sanction that is formidable, that can be used as a last resort.
vii) Network with partners that can assist with escalating support.
viii) Elicit active responsibility for making outcomes better in the future.
ix) Learn, evaluate how well and at what cost outcomes have been achieved, communicate lessons learned.

Establishing the regulatory regime

The responsive regulatory approach involves collaboration between actors to design the regulatory system. State regulators, businesses and NGOs forming a partnership to design the regulatory pyramids (J. Braithwaite, 2011). A responsive regulation system should be negotiated between parties. "… we favour enforcement pyramids that are a product of tripartite negotiations within particular regulatory communities at particular historical moments" (Ayres & Braithwaite, 1995, p. 161). "In the end, the choice of a specific form or forms of delegation is likely to be highly contextual" (Ayres & Braithwaite, 1995, p. 160). "(T)ripartism, is not only construed as a way to fill regulatory gaps, but also as a way to mitigate against regulatory capture" (Islam & McPhail, 2011, p. 795)

IMPLICATIONS AND CONCLUSION

SRI engagement operates as a voluntary regulatory mechanism for accountability on climate change and other ESG issues. As a voluntary mechanism it has limitations for holding corporations accountable for their social and environmental effects on climate change.

Conceptualising SRI engagements through stakeholder theory does little to address corporate self-interest, such as motivations for legitimacy which result in manipulation and capture. Business case engagement has inherent limitations as a regulatory mechanism.

This paper explored an alternative articulation of SRI engagement as a soft mechanism with hard regulation for climate change. A responsive regulatory regime based upon the key strength of SRI engagement, its supportive orientation. This feature is desirable in a policy regime where supportive regulation operates in conjunction with sanctions. Rather than being characterised by hard-nosed enforcement, the responsive regulation regime is characterised by respect and trust. Corporate self-interest is now to avoid sanctions and therefore to comply with supportive mechanisms.

The challenge for SRI is to work collaboratively with business and government actors to develop a responsive regulation regime. State actors, business and SRI cooperatively develop the pyramid of support and pyramid of sanctions. The global scale presents a number of challenges for the policy response to climate change. Further conceptual work remains to be done as the global nature of climate change spans regulatory boundaries and jurisdictions. The problem of developing countries in climate change problem also needs further consideration.

Responsive regulation theory capitalises on the strengths of SRI engagement as supporting corporate adaptation to climate change. SRI networks such as PRI and CDP could play a role in escalating issues. Such progression up the pyramid of supports is an integral part of a responsive regulatory approach. SRI as a supportive mechanism linked to a pyramid of sanctions is likely to be more effective than as an isolated voluntary mechanism. For enforcement efficiency, responsive regulation must involve genuine sanctions (such as de-listing) which are just and hold deterrence capacity. By increasing SRI engagement accountability (answerability) to stakeholders is likely to improve. Thus integration of SRI engagement with hard regulatory options represents a cohesive policy regime that efficiently addresses corporate adaptation to climate change.

This paper addressed a gap in the literature on climate change regulation in focussing on the way in which a comprehensive regulatory regime could enhance corporate adaptation through increasing compliance with SRI engagement. The implication for SRI practitioners is that lobbying for a supportive regulatory regime has a high priority.

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