Abstracts

Green Investment: Will "Realo Funds" Break Out of Their Niche Markets?

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1. Introduction

The 1970s saw the first generation of green investment funds where absolute criteria decide on acceptance of companies in the portfolio: renewable energy, ecological farming are welcome, heavy industry is not. Investors in these "fundi funds" accept a lower than average profitability. As a result, these funds remained a niche player in the financial markets.

Recently, a second type of green investment funds started to spread from USA and UK via Switzerland to other countries. In these "realo funds", relative criteria decide on acceptance of companies in the portfolio: the best in class from all sectors of industry are welcome. Two developments have stimulated the appearance of realo funds. A practical stimulus for realo funds is the development and application of standardised sets of metrics (Environmental Performance Indicators - EPIs) with which it becomes possible to report, assess and investigate the environmental performance of industry. Starting in the USA, several countries now boast initiatives to benchmark environmental performance of companies. Operational methods, although not always sophisticated, have been developed. A theoretical stimulus for realo funds is new and challenging theories about the relation between business environmental performance and profitability. Conventional wisdom, based on comparative static and on diminishing returns theory, learns: as soon as low hanging fruit is harvested, environmental costs will increase and business profits will decrease. A new wisdom tells the opposite: based on dynamic, Shumpeterian theories a positive return on environmental strategies is prophesied (Porter and Van der Linde, 1995; Russo and Fouts, 1996). These theories tell that best companies in the environmental class will in the medium to long run also perform best in profitability. In consequence, it can be envisaged that realo portfolios will show better financial performance than average (Van der Woerd and Vellinga, 1997).

According to dynamic theories, realo funds offer opportunities for win-win solutions: what is good for financial investors is also good for the environment. But how well is the foundation of these theories? And, aside from anecdotal stories, what is the empirical evidence of these theories? Furthermore, if the evidence is there, will this mean that green investment funds can escape from their traditional niche markets? A fundamental change in investor's behaviour requires co-operation between at least two change agents: providers of business environmental metrics and portfolio managers, i.e. banks. It is far from certain whether a co-operation between metrics and portfolio managers will flourish automatically.

IVM has started a Ph.D. research to review historical developments and assess future potential of realo investment. This paper reports on two aspects of actual developments. A practical approach analyses the rise of systems of environmental metrics, their character and status (Chapter 2). EPI-metrics is at the basis of realo portfolios. Chapter 3 presents preliminary evidence on financial results of realo funds. A theoretical approach delves deeper into the fundamentals of win-win theories. It is argued that reasons behind dynamic theories can be found in a search for business' value drivers (Chapter 4). However, fundamental research about the relation between environmental performance and value drivers is almost absent. Therefore, the Ph.D. research intends to focus on this field (Chapter 5). The final Chapter 6 summarises conclusions of preceding chapters and discusses their implications for the path towards sustainable development.