

**MACKENZIE, C., 2006.** The scope for investor action on corporate social and environmental impacts. In: C. MACKENZIE and R. SULLIVAN, eds. *Responsible Investment*. Greenleaf: New York. 2006. pp. 20-38.

UKSIF summary, 2009.

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### I. Key points

What are the causes of harmful social and environmental impacts by companies?

1 - Companies seek to maximize shareholder returns, but market failure produce negative social impacts:

- Externalities (where the benefits or costs of an exchange spill over onto other parties): the price of a product or service may not reflect its social value
- Public goods: reduction of open access resources by overuse
- Inefficiency of monopoly power: lead companies to set prices too high or to produce goods of insufficient quality or quantity
- Imperfect information: consumer cannot accurately assess the quality or costs of products or services

Government and the society attempt to impose sanctions to companies benefiting from market failure.

2 - Companies fail to maximize shareholders returns due to:

- Agency problems: there is a gap between the interests of company directors and employees may well not be the same as those of the shareholders.
- Bounded rationality: ignorant or incompetent executives that make mistakes

What can investors do?

- **Shareholder activism:** institutional investors have a range of formal rights (appointment of board directors, board's remuneration policy, appointment of auditors, annual reports and accounts) and informal rights and powers (ability to meet and influence the board, ability to generate media or press coverage, encourage other investors to exert formal powers) relating to companies.

- **Enhancements to investment analysis and decision-making:**
  - Financial analysis affect share price, which affect company behaviour
  - Investment analysis fails to give correct value of ESG issues
  - Enhanced analysis includes penalties on companies that exploit market failures in the value of the company.
- When companies would consider exploit market failures:
  - Time: short-term focused investors do not care about the penalties, which are long-term, particularly if they are intangible and uncertain
  - Breadth: investors of many companies care about the behaviour that one imposes on another and the wider consequences
  - Returns: investors worried about absolute returns want to address agency problems and bounded rationality - corporate governance benefits will be shared by all.
- Conclusions
  - Long-term investors that invest in a large number of companies will not be interested in exploiting market failures.
  - Investors that base their return performance on absolute returns have an interest in improving corporate governance and addressing agency problems.

## II. Key quotes

- Capitalism has many strengths, and investors play a crucial and positive role in providing and efficiently allocating capital” (Mackenzie 2006, p. 20).
- “It is likely to be much more straightforward for investors to take action to reduce the harmful social and environmental impacts associated with agency problems and bounded rationality than it is for them to address market failure” (Mackenzie 2006, p. 32).
- “Furthermore, if you did try to do something about the problem through shareholder activism, the financial benefits of any success you have in improving governance will be shared by all the company’s other investors” (Mackenzie 2006, p. 33).
- “In conclusion, our model suggests that investors can take action through shareholders activism and enhanced analysis to address agency problems and bounded rationality and, to a lesser extent, market failure. Investors can also address agency problems and bounded rationality through enhanced analysis. Market failure cannot be addressed in this way, although better analysis of the costs of government and social penalties may be useful” (Mackenzie 2006, p. 37).