

**CORPORATE SOCIAL
RESPONSIBILITY AND
CORPORATE GOVERNANCE:
CONCEPTS, PERSPECTIVES AND
EMERGING TRENDS IN
IBERO-AMERICA**

DEVELOPMENTS IN CORPORATE GOVERNANCE AND RESPONSIBILITY

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DEVELOPMENTS IN CORPORATE GOVERNANCE AND
RESPONSIBILITY VOLUME 11

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PREFACE

Corporate Social Responsibility (CSR) has become an established part of business to such an extent that it is no longer questioned that it has a role to play in business decision making. Indeed it seems to have become generally accepted by businesses and their managers, by governments and their agencies, and by the general public that there is considerable benefit in engaging in CSR. Consequently every organisation tends to have its CSR policy which has been translated into activity. Despite the fact that many people remain cynical about the genuineness of such corporate activity, the evidence continues to mount that corporations are actually engaging in such socially responsible activity, not least because they recognise the benefits which accrue. So altruism is no longer a prerequisite of CSR activity as enlightened self-interest shows it to be beneficial. It seems therefore that the battle is won and everyone accepts the need for CSR activity – all that remains for discussion is how exactly to engage in such activity and how to report upon that activity. Even this has been largely addressed through such vehicles as GRI and ISO26000.

There has also been considerable change in the emphasis of corporations reporting of their CSR activity which has taken place in recent years. This change is not just in terms of the extent of such reporting, which has become more or less ubiquitous throughout the world, but also in terms of style and content. When researching into corporate activity and the reporting of that activity in the 1990s it was necessary to acknowledge (Crowther, 2002) that no measures of social or environmental performance existed which had gained universal acceptability. Good social or environmental performance was subjectively based upon the perspective of the evaluator and the mores of the temporal horizon of reporting. Consequently any reporting concerning such performance could not easily be made which would allow a comparative evaluation between corporations to be undertaken. This was regarded as helpful to the image creation activity of the corporate reporting as the authors of the script were therefore able to create an image which could not be refuted through a comparative evaluation of quantitative data. Instead such images could be created through the use of linguistic and non-linguistic means. Thus each company was able to select measures which created the semiotic of social concern and environmental responsibility and of continual progress, through the selective use of measures which support these myths. As a consequence of the individual selection of measures to be reported upon, a spatial evaluation of

performance, through a comparison of the performance with other companies, was not possible and a temporal evaluation was all that remained.

Even the definition of what constitutes CSR has been contentious and uncertain. The broadest definition of corporate social responsibility is concerned with what is – or should be – the relationship between global corporations, governments of countries and individual citizens: a redefinition of the Social Contract. More locally the definition is concerned with the relationship between a corporation and the local society in which it resides or operates. Another definition is concerned with the relationship between a corporation and its stakeholders. Each of these definitions is pertinent and each represents a dimension of the issue. A similar debate is perhaps taking place in the arena of business ethics – whether corporations should be controlled through increased regulation or not, and whether the ethical base of citizenship been lost and needs replacing before socially responsible behaviour will ensue in whatever manner this debate is represented, it seems that it is concerned with some sort of social contract between corporations and society.

This social contract implies some form of altruistic behaviour – the converse of selfishness (Crowther & Caliyurt, 2004) – whereas the self-interest of Classical Liberalism connotes selfishness. Self-interest is central to the utilitarian perspective championed by such people as Bentham, Locke and J. S. Mill. Similarly Adam Smith's free-market economics is predicated on competing self-interest – recognising what he regarded as inevitable despite his personal concern for ethical behaviour. These influential ideas put interest of the individual above interest of the collective. The central tenet of social responsibility however is the social contract between all the stakeholders to society, which is an essential requirement of civil society. This is alternatively described as citizenship but for either term it is important to remember that the social responsibility needs to extend beyond present members of society. Social responsibility also requires a responsibility towards the future and towards future members of society. Subsumed within this is of course a responsibility towards the environment because of implications for other members of society both now and in the future. Essentially the argument is that CSR must be considered as a process of development for every organisation – a process which is still taking place.

Sustainability is a term which seems to a great extent to have replaced CSR in the language used within corporations and it is a word which is used by everyone and everywhere – to such an extent that its meaning has become somewhat nebulous. Thus it is just a general term to mean anything but create an impression of considerate and beneficial behaviour. A quick look at dictionary may lead us to a list of definitions as: ability to suffer (loss or injury); ability to be supported (emotionally or physically); ability to keep going for a long time (business); ability to be kept going, ability of being sustainable; ability to survive without human interference, ability to continue in existence (botany). On the whole therefore one can get the impressions that sustainability relates to survival. Many a time we might have seen people who use sustainability as a

synonym for sustainable development whereas sustainability is the target for sustainable development. Sustainable development as indicated in ISO 26000 is 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs', an echo of the Brundtland definition of 25 years previously. All that is done under the title, sustainable development, is only aiming at sustainability of the ability to survive.

The concept of corporate governance is also one which is in the public spotlight. It is undeniable that corporate governance is fundamental to the continuing operating of any corporation; hence, much attention has been paid to the procedures of such governance. A significant part of the reason for this is due to the developments brought about through globalisation. A great deal of concern has been expressed all over the world about shortcomings in the systems of corporate governance in operation: Britain, Australia, most other Anglo-Saxon and English speaking countries, and many other countries, have a similar system of governance. Conversely Germany is a good example of where the distance between ownership and control is much less than in the United Kingdom and United States, while Japan's system of corporate governance is in some ways in between Germany and the United States, and in other ways different from both (Shleifer & Vishny, 1997). By contrast, in India the corporate governance system in the public sector may be characterised as a transient system, with the key players (viz. politicians, bureaucrats and managers) taking a myopic view of the system of governance. Such international comparisons illustrate different approaches to the problem of corporate governance and the problem of ensuring that managers act in their shareholders' interest. Recently of course much attention to this issue has been paid by institutional investors (Cox, Brammer, & Millington, 2004).

Good governance is of course important in every sphere of the society whether it be the corporate environment or general society or the political environment. Good governance levels can, for example, improve public faith and confidence in the political environment. When the resources are too limited to meet the minimum expectations of the people, it is a good governance level that can help to promote the welfare of society. Governance is of concerned with both the rights of shareholders and, increasingly, the rights of other stakeholders. There is also considerable debates as to whether corporate governance and corporate social responsibility are separate concepts of whether they are interrelated – and indeed which is a subordinate part of the other. Opinions vary but it is clear that there is some kind of relationship.

Most people would say that corporate social responsibility is an Anglo-Saxon concept which has been developed primarily in the United Kingdom and the United States. Critics however would say that it is only under the Anglo-Saxon model of governance that there could ever be a need for CSR. They would argument that the Cartesian dichotomy is a peculiarly Anglo-Saxon development which led directly to the notion of a free market as a mediating

mechanism and the acceptance of the use of power for one's own end, in true utilitarian style. This has led to the loss of a sense of community responsibility which removed any sense of social responsibility from business. This therefore necessitated its reinvention in the form of corporate social responsibility, just as it necessitated the development of codes of corporate governance.

The Latin model of governance however is founded in the context of the family and the local community and is therefore the opposite of the Anglo Saxon model, being based on a bottom up philosophy rather than a hierarchical top down approach. Thus this model is based on the fact that extended families are associated with all other family members and therefore feel obligated. In such a model of governance the sense of social responsibility remains strong and is applied to firms just as much as individuals. This sense of social responsibility has never therefore been really lost and consequently there has been no need for its reinvention.

As already stated, discussion has taken place as to whether corporate governance is an aspect of corporate social responsibility, or vice versa. In this book we will see various authors adopt one position or the other so it seems that they are inevitable interrelated – good governance must recognise CSR and effective CSR must accommodate governance. The various contributors to this book examine governance and social responsibility in various locations focusing within Ibero-America and in various types of business and organisation. If space was not a factor, then many more locations and types of business could be examined in a similar manner. The focus of this book is upon the Ibo-American world and a consideration of what distinctive features of the CSR and CG can be found there. Thus one question to consider is whether or not the group of countries – in Ibero-America and Europe but culturally connected – give a different interpretation of the concepts and whether lessons can be learned from this study. So one thing that is apparent is that these are issues of considerable significance all over the world. In doing so we need to consider the issues raised and explore commonalities and differences. And lastly in this chapter we will need to take these debates and the arguments from the chapters in this book in order to consider a prognosis of what the future might hold for corporate governance and social responsibility procedures and practices. This is something which we do not attempt but leave to each individual reader.

This book constitutes a contribution towards the debate concerning the role of corporate governance and corporate social responsibility throughout the world and the perceived need to develop appropriate standards and practices through its focus upon one particular cultural area. We have sought to show similarities and differences in practice and understanding throughout this area and also that cultural issues are an important element which is often omitted from any analysis. Nevertheless the debate about such procedures continues and we consider that we need to complete the analysis undertaken in this book by offering some form of prognosis, albeit subject to criticism and challenge for many reasons. So we start by stating that many companies regard corporate

governance as simply a part of investor relationships and do nothing more regarding such governance except to identify that it is important investors/potential investors and to flag up that they have such governance policies. The more enlightened recognise that there is a clear link between governance and corporate social responsibility and make efforts to link the two. Often this is no more than making a claim that good governance is a part of their CSR policy as well as a part of their relationship with shareholders. We hope that the reader agrees with us but welcome any alternatives understanding – all help develop the discourse.

It is recognised – and amply demonstrated throughout the contributions from the various authors in this book – that these are issues which are significant in this part of the world, just as elsewhere, and a lot of attention is devoted to this global understanding. Most analysis however is too simplistic to be helpful as it normally resolves itself into a simple duality of rules based versus principles based. Our argument is that this is not helpful as the reality is far more complex. It cannot be understood without taking geographical, cultural and historical factors into account in order to understand the similarities, differences and concerns relating to people of different parts of the world. The aim of this book has been to redress this by asking subject experts from different parts of the world to explain the issues from their particular perspective. Our prognosis is that this debate will continue and mature and that vested interests will seek to develop codes and standards with universal application. This has not yet happened with financial reporting so will take time with governance and CSR. Moreover we argue that any such code or standard will only survive if it is designed to be sufficiently flexible to allow for the full extent of cultural variation throughout the world. With that we invite you to read the book and contribute to the future debate.

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PART I
THEORETICAL PERSPECTIVES

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SUSTAINABILITY INDICES IN LATIN AMERICA: CAN FINANCIAL MARKETS PUSH FOR CSR?

Adrian Zicari

ABSTRACT

The chapter describes the recent history of Sustainability Indices in three Latin American countries: Brazil, Mexico, and Chile. In these countries, local Stock Exchanges have been recently launching their own Sustainability Indices. This ongoing trend may indicate a particular way of addressing Socially Responsible Investment (SRI) in the region. The chapter relies on secondary data, mainly documents published by the Stock Exchanges themselves, and on some selected academic and practitioner oriented articles. All three countries present some common features. In all cases, local stock markets launched Sustainability Indices, and their composition has been publicly available from the beginning. Consequently, SRI is now developing in the region in a different way from that of developed markets. The chapter is based on secondary data only. Further research may involve interviews and surveys with different stakeholders (i.e., investors, quoted companies, public officials). The illustration of a different way of developing an SRI market may help public officials and investors from other countries, either in Latin America or elsewhere, who intend to promote SRI. There are few studies on SRI in Latin America, and comparative research between different countries in the region is still rare.

Keywords: SRI; Latin America; Sustainability Indices

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INTRODUCTION

This chapter intends to describe the recent history of Sustainability Indices in three Latin American countries: Brazil, Mexico, and Chile. A Sustainability Index is a selection of shares quoted in a particular stock market. Differently to conventional stock indices, in a Sustainability Index shares are chosen according to environmental, social or governance (ESG) criteria. Thus, these indices do not select companies according to size or industry but in relation to ESG criteria. Usually the purpose of a Sustainability Index is to provide a benchmark (i.e., a comparison between a conventional index and a Sustainability Index in the same stock market). Additionally, if the composition of the Sustainability Index is publicly available, investors could take that information into consideration for their investment decisions. By this doing, Sustainability Indices can contribute to the growth and development of Socially Responsible Investment (SRI).

In each of those three aforementioned countries, local Stock Exchanges have been recently launching their own Sustainability Indices: Brazil in 2005, Mexico in 2011 and Chile in 2015. This ongoing surge of Sustainability Indices in three Latin American countries is remarkable as SRI is still quite new in the region. This situation largely contrasts with that of developed markets, where SRI has become a common investment practice. For instance, the US SIF (Forum for Sustainable and Responsible Investment) estimates that one sixth of funds invested by professional managers in the United States are related to some approach of SRI (US SIF, 2014).

As Giamporcaro and Gond (2016) emphasized, the cornerstone of SRI markets is “calculability,” which is the measurement of CSR performance of quoted firms. In developed markets, this measurement is done by expert analysts, either employed by investment funds or by social rating agencies. For instance, Crifo and Mottis (2016) survey SRI analysts working at asset management companies and institutional investors in France, while Sakuma and Louche (2008) present analysts at the core of the SRI market in Japan and Bengtsson (2007) illustrates a similar picture for SRI in Scandinavian countries. In all these descriptions, there is a collection of market actors (i.e., investors, advisors, companies) who collectively develop “calculability” for SRI at the core of their respective markets.

However, the situation seems to be quite different in Brazil, Mexico, and Chile. While some differences exist, all three countries share a similar approach: an index created by the stock market (not by investors or fund managers), whose composition is freely distributed (so that any investor could use that information at no cost) and that aims to be the cornerstone of the SRI industry in each country. Thus, “calculability” in these countries would not be performed by a collective effort of many actors (as it is the case in developed markets), but through the impulse of a Sustainability Index created by local Stock

Exchanges. The fact that three different countries in Latin America share a similar approach suggests that the region may be developing a particular way of addressing SRI.

Consequently, the purpose of the chapter is to explain how those Latin American indices operate, and to discuss their potential impact on the development of SRI practices in those local markets. Additionally, the perspectives for SRI in these three markets are contrasted with those of developed markets, as Latin American stock markets tend to have smaller size, less liquidity and lack (or scarcity) of ESG rating agencies.

Regarding methods, the chapter relies on secondary data, mainly documents published by the Stock Exchanges themselves. Academic and practitioner oriented articles will be also cited. While the chapter would include tables and figures, its focus is not quantitative, as it intends instead to provide an introduction to SRI in Latin America from the viewpoint of Sustainability Indices.

THE CONTEXT: STOCK EXCHANGES IN LATIN AMERICA

In order to explore how Sustainability Indices can contribute to SRI in Latin America it is necessary first to understand how Stock Exchanges in that region are. [Schneider \(2013\)](#) points out that Latin American countries can be considered as hierarchical economies – a particular type of capitalism which is different from that of Anglo-Saxon countries. In hierarchical economies, companies are largely financed by owners themselves (e.g., families, States, foreign investors). Consequently, share ownership is usually concentrated among few investors and the role of stock exchanges is relatively small ([Schneider, 2013](#)). Thus, while stock exchanges exist in Latin America and can be quite active in some countries, the bulk of corporate financing is still done directly through private owners – in a “hierarchical” way.

This limited role of stock exchanges in Latin American economies can be illustrated by the information produced by the Federation of Iberoamerican Stock Exchanges (FIAB), which regularly produces statistical information about those markets. Drawing from their 2016 *Factbook* ([FIAB, 2016](#)), data was selected for four of the largest markets in the region. While there are many more other stock markets in Latin America, this analysis of these four markets can be extended to the other remaining markets in the region. [Table 1](#) presents market capitalization for the stock markets in Argentina, Brazil, Chile, and Mexico.

While these numbers may seem large, they can compare with those of a relatively mid-sized European market. For instance, the market capitalization for local companies in Spain amounted to 783 billion dollars ([FIAB, 2016](#)). As an

Table 1. Market Capitalization – End of Year 2015.

Countries	All Firms	Local Firms	Foreign Firms
Argentina	254	56	198
Brazil	479	478	1
Chile	193	190	3
Mexico	903	403	500

Source: FIAB, *Factbook* (2016, p. 9).

Note: In billions of US\$ dollars, rounded numbers.

additional comparison, the New York Stock Exchange (NYSE) had a market capitalization of more than 19 trillion dollars in June 2016 (www.nyxdata.com, accessed in August 2016).

This is not only a matter of size; it is also an issue of how much each stock exchange represents the economy of its country. For instance, less than a half of the market capitalization for Mexico corresponds to local firms, and the proportion is even smaller for the Argentinean market (approximately 22% of that market capitalization corresponds to local companies). Furthermore, some of the most relevant industries for each country are not represented in those stock markets. For instance, Brazil, a country with a long tradition of agricultural production, has no local agricultural firms quoted in its market for the year 2015 (FIAB, 2016). A similarly curious situation happens with Chile, the largest producer of copper in the world, which has no local mining firm quoted in its stock market (FIAB, 2016). While Mexico has a more diversified set of industries quoted, there are no utilities companies in its stock market. As a consequence, any Sustainability Index (or for that matter any index) from those markets will not be able to include companies that correspond to large parts of the economic activity of those countries.

Another problem in Latin American stock exchanges is the scarce opportunity for diversification. This issue can be illustrated with the following two tables. Firstly, as Table 2 indicates, few companies are quoted in each stock exchange. For instance, the Argentinean exchange has less than a hundred firms listed. This implies that any Sustainability Index (or for that matter any index) in those stock markets would have a hard time selecting stocks while keeping some diversification in the index. This issue can be particularly difficult when selection criteria are related to ESG and not only to conventional criteria (e.g., size, industry). Otherwise said, a Sustainability Index that selects stocks from such a limited amount of possibilities may end up with scarcely diversified portfolio, which implies higher risks for investors.

Secondly, as Table 3 indicates, only a few companies represent a relatively large part of market capitalization for each of these markets. For instance, the 10 largest local companies in Chile represent 46% of the market capitalization for domestic firms in that market and this figure increases to 63% for

Table 2. Number of Companies Quoted – in 2015.

Countries	All Firms	Local Firms	Foreign Firms
Argentina	99	93	6
Brazil	359	345	14
Chile	310	223	87
Mexico	143	136	7

Source: FIAB, *Factbook* (2016, p. 12).

Table 3. Share of 10 Largest Local Firms by Market Capitalization – in 2015.

Argentina	63
Brazil	51
Chile	46
Mexico	56

Source: FIAB, *Factbook* (2016, p. 18).

Argentina. As these stock exchanges have such a high concentration of their market value in only a few large companies, leaving aside any of these large firms would greatly reduce the diversification of any index – either a sustainable or a conventional one.

Finally, Latin American stock markets tend to be less liquid than stock markets of developed countries (Agudelo, Giraldo, & Villarraga, 2015; Galdi & Lopes, 2013), a feature shared with emerging markets of other regions of the world (Bekaert & Harvey, 2003). Liquidity is important for two reasons. Firstly, all investors prefer liquid stock markets, as they can enter and exit more easily from those markets. Economists have long emphasized investor's preference for more liquid investments under uncertain conditions (Baldwin & Meyer, 1979). Particularly in the case of emerging equity markets, the positive link between liquidity and return has been documented (Jun, Marathe, & Shawky, 2003). Besides investor preferences, less liquid markets tend to have higher transaction costs (Marshall, Nguyen, & Visaltanachoti, 2016). As stock indices periodically change their portfolio composition (i.e., they “rebalance”), investors that track any stock index would have to adapt their invested portfolio to the new index composition. Consequently, those higher transaction costs would make this periodical rebalance process more expensive in a less liquid market.

Table 4 includes two indicators of market liquidity: turnover velocity and total value of stocks traded. Turnover Velocity corresponds to the value of

Table 4. Indicators of Market Liquidity.

Country	Turnover Velocity, Domestic Shares (Percentage)	Total Value of Stock Trading (Billions of US\$ – Rounded)
Argentina	5.23	5
Brazil	80.9	487
Chile	8.06	22
Mexico	24.67	110

Source: FIAB, *Factbook* (2016, pp. 14, 17).

transactions in a given year (in this table, the year 2015) compared to the average market capitalization for the same year. The larger the ratio of Turnover Velocity, the more liquid the market is. It can also be noted that this figure can be computed for the entire stock market (as it is the case here) or for an individual stock. For the four stock markets, only the Brazilian one is relatively liquid (80.90%), a figure that can be compared with that of the Spanish stock exchange (110.48%), (FIAB, 2016). Furthermore, this comparison can be illustrated by market capitalization figures (in Table 1). While the Mexican market almost doubles the Brazilian market in terms of market capitalization, the Brazilian exchange has traded four times more than the Mexican one. It can also be seen that the Chilean and Argentinean exchanges are far less liquid.

This issue of lower market liquidity is not necessarily a limitation for *creating* an index, as a set of stocks can still be selected in a less liquid market. However, lower market liquidity remains a challenge for *investing* in an index, as transaction costs may be higher in a less liquid market (Amihud, Hameed, Kang, & Zhang, 2015; Marshall et al., 2016)

CALCULABILITY AS A KEY CHALLENGE

All the previously mentioned limitations of Latin American stock exchanges (e.g., concentration, reduced liquidity) are generic issues that would impact any index based on those exchanges. Thus, no matter if an index includes or not ESG issues, it will have to address those aforementioned challenges. However, there is a particular issue that corresponds only to Sustainability Indices (and not to conventional ones). This is the availability – at reasonable cost – of ESG information about listed companies; otherwise said that the calculability of SRI could be feasible and affordable. While information for conventional indices tend to be easy to find (i.e., size of company, industrial sector), the

choice of stocks according to ESG criteria asks for a wealth of information that can be difficult or expensive to find (or both).

In the case of Latin America, not many companies provide information about their ESG performance. This fact does not necessarily mean that there are few socially responsible firms (Vives, 2011b), only that the practice of corporate social reporting is relatively less common in the region. For instance, Table 5 shows the amount of companies in the same four countries that have corporate reports registered in the Global Reporting database for the year 2015 (data accessed in December 2016). It has to be noted that a company can indeed produce a social report and not register it at that database, thus the figures in Table 5 may possibly underestimate the total amount of reporting firms for those four countries. In any case, there are more Brazilian reporting firms than reporting firms from the other three countries combined. A similar situation can also be seen for Global Compact participants (data accessed in December 2016), where Brazilian firms are also the more numerous.

Producing a sustainability report and participating in the Global Compact is not necessarily synonymous with being a socially responsible company. A company can have poor ESG performance and still produce a sustainability report. However, it can be argued that a reporting company has begun the path to more sustainable practices, as it is disclosing relevant information that can be seen by stakeholders. In the particular case of socially responsible investors, information from sustainability reports is at the core of the analysis for their investments decisions. By the same token, participation in the Global Compact does not imply any particular ESG performance. However, it is most possible that a company that adheres to the Global Compact is also making a public commitment to improve its ESG performance.

ESG information about listed companies can come out from the same companies (i.e., corporate reports, announcements) or from third party sources (for instance, news related to those companies). Socially responsible investors can use both of them for making investment decisions. For instance, they can analyze sustainability reports from companies while they can also scan for third party information. Thus, socially responsible investors could gather different pieces of information in order to achieve a substantiated opinion about the

Table 5. Reporting/Participating Firms by Country.

Country	GRI Reports 2015	Global Compact Participants (Large Firms)
Argentina	91	112
Brazil	259	246
Chile	59	44
Mexico	110	176

Sources: GRI database, available at www.globalreporting.org; Global Compact participants, available at www.unglobalcompact.org, both accessed in December 2016.

ESG performance of a company before buying its stocks. However, this type of analysis, which we could identify with the “calculability” process proposed by [Giamporcaro and Gond \(2016\)](#), can be bothersome and expensive for an individual investor.

As a consequence, the common practice in stock markets in developed countries is to rely on specialized rating agencies. By means of their particular know-how in analyzing stocks according to ESG issues, these agencies can provide information to socially responsible investors at a lower cost – because the cost of their analysis is shared among many different investors (i.e., economies of scale). Consequently, in those developed countries, ESG rating agencies are usually at the core of the SRI investment process – as investors tend to rely on their analysis for their decisions. However, the situation is completely different in Latin America, as there is scarce local ESG analysis in the region ([Kumar & Siddy, 2009](#); [Vives, 2011b](#)). While international rating agencies may study some large firms based in Latin America, few local studies are done about ESG performance in the region. For instance, [Novethic \(2013\)](#) provides a comprehensive list of ESG rating agencies in different areas of the world, with only one group mentioned in Mexico.

THE ROLE OF STOCK EXCHANGES

Having seen the lack of easily available ESG information in Latin America, we can now explore how local stock markets can help to overcome that situation. [Morales and van Tichelen \(2010\)](#) propose that emerging countries stock markets should be “issuing guidelines for voluntary adoption of ESG practices and reporting” (p. 5) and developing sustainability indices. The first idea has already been adopted by many stock exchanges, which are now asking for more information to their listed firms. For instance, the BM&FBovespa (the official name of the Sao Paulo stock exchange) created a policy of “Report or Explain” for their listed companies. According to this policy, these companies are invited to inform “whether they publish a regular sustainability report and where it is available, or explain why not” [BM&FBovespa \(2011, p.1\)](#). In Argentina, the stock market regulatory body (the equivalent of the American SEC) has been requiring environmental information for listed companies that operate in environmental high-risk industries ([Comisión Nacional de Valores, 2009](#)). While in this latter example, the requirement does not come from the stock market itself but from a regulatory body, the outcome is the same: an institutional demand for more information from listed companies.

Besides, many stock exchanges in emerging markets have been launching Sustainability Indices. Esty Environmental Partners (EEP) mentions a large number of emerging market Sustainability Indices as of March 2011

(EEP, 2011). Some of these indices are organized or owned by the same exchange while others are managed by an international index provider (e.g., DJSI). The oldest Sustainability Index in an emerging market is that of South Africa (2004) and the second is that of Sao Paulo (2005). It can also be seen that the two other Latin American Sustainability Indices studied in this chapter are relatively more recent: Mexico, since 2011 and Chile, since 2015. Thus, the trend towards more Sustainability Indices corresponds to emerging markets as a whole and it is not limited to Latin America.

EEP (2011) contend that Sustainability Indices are a “cost-effective way for investors to identify companies with higher sustainability performance” (p. 9). By creating a Sustainability Index, stock exchanges give away valuable information to potential investors, and this information can be considered as a “subsidy” for those investors. Thus, investors can either take into consideration the composition of the Index as a reference for their portfolio or they can just track the Index (i.e., follow the Index composition in their portfolios). This “subsidy” can be particularly important in the context of Latin America, as there is little ESG analysis in the region. As a consequence, the creation of Sustainability Indices can partially compensate for the lack (or scarcity) of ESG rating agencies in the region, thus allowing the calculability process to be easier and less expensive.

For investors, the more valuable information is not the Index composition itself but the methodology for assessing ESG performance. Vives and Wadhwa (2012) suggest that this framework should be widely communicated, while EEP (2011) put this higher transparency about how the Index is built as their first recommendation. A good understanding of the inner mechanisms of these Indices can help investors to make their investment decisions. Besides, for those investors who simply track an Index, a better understanding of the Index methodology would also improve their confidence in the Index they are following.

In any case, information from Sustainability Indices has to be taken with care (Vives, 2011a) particularly if decisions about a particular company are to be made. For instance, a “best-in-class” index includes the best company in each particular sector, without exclusion of any industrial sector from the Index. Thus, an oil firm or a tobacco company can be included in the composition of a best-in-class Sustainability Index, even if their business could be considered controversial. And by the same token, a very responsible firm could perhaps not make it into the Index, just because another firm in the same industrial sector has better ESG performance. In consequence, Sustainability Indices cannot perfectly replace for the lack of ESG rating agencies, as both serve different purposes: Sustainability Indices are meant for reference or benchmark for SRI portfolios while ESG rating agencies evaluate ESG performance of particular firms. Having said this, information from Sustainability Indices in the context of Latin America can still help SRI investors to make their decisions.

ISE, THE FIRST SUSTAINABILITY INDEX IN THE REGION

The ISE (Corporate Sustainability Index, or “Índice de Sustentabilidade Empresarial” in Portuguese) was created in 2005 by the Sao Paulo Stock Exchange. It was the fourth Sustainability Index in the world and the second one in an emerging market. Several stakeholders were involved in the creation of this index. Some of them are: the Brazilian Institute of Corporate Governance (IBGC), the International Finance Corporation (IFC), the Ethos Institute (a sustainability think tank), the Brazilian Ministry of Environment, the United Nations Environmental Program (UNEP), and a local business school, among others.

The ISE is based on data collected from listed companies that want to participate. Those companies are invited to respond to an extensive questionnaire. This questionnaire corresponds to seven different dimensions: general, product nature, corporate governance, economic and finance, environmental, social, and climate change (Macedo, Barbosa, Callegari, Manzoni, & Simonetti, 2012). For the 2016 version of the questionnaire (BM&Fbovespa, 2016), the *General Dimension* includes 30 questions, which explore the commitment to the company to sustainable development (i.e., whether a sustainable development policy is formally described, explicated, and linked with managerial practices, whether the company takes into consideration the Sustainable Development Goals of the UN). The *Product Dimension* asks for a description of company’s products risks for clients and society, information to consumers and disclosure of administrative or judiciary sanctions related to the firm’s products. The *Corporate Governance Dimension* considers the relationship among shareholders, transparency, legal compliance, structure and practices of the corporate board, and quality of management. The *Economic and Finance Dimension* studies risks and opportunities, contingency plans, and financial performance. The *Environmental Dimension* is divided in different questionnaires, according to the environmental risk of the industry. Thus, there are questionnaires for companies that deal with renewable resources, non-renewable resources, logistics, non-financial and financial services. The *Social Dimension* includes a comprehensive analysis of the firm’s relation with its stakeholders: employees, clients, suppliers, and community at large. Finally, the *Climate Change Dimension* considers the potential impact of that issue in the company and how the firm plans to adapt and possibly to mitigate climate change risks.

The submissions from companies are later analyzed and evaluated in order to make the selection for the Index. Beyond scoring well in the questionnaire, there is a minimum liquidity requirement (i.e., being among the two-hundreds more liquid firms in the market, Macedo et al., 2012). The ISE can include a maximum of 40 companies, while each industrial sector has a cap of 15% of the whole Index composition (Wodianer & Dobes, 2010). The ISE is rebalanced

yearly – that is to say, its composition is changed each year according to the new submissions made by companies. For the year 2017, the ISE portfolio is composed of stocks from 34 firms that correspond to 15 different industrial sectors (BM&Fbovespa, 2016).

The ISE is a “positive screening” index, which means that no industrial sector is a priori excluded. This differs from indices that follow a “negative screening” approach, where companies from some controversial industries (e.g., tobacco, alcohol, firearms) are not allowed to participate. However, as the ISE questionnaire includes a dimension related to “product nature,” the company’s industrial sector may still have an impact of its score (Wodianer & Dobes, 2010).

As the ISE has already been in operation for more than a decade, there is already some time perspective to assess the impact of this Sustainability Index on SRI in Brazil. Besides, this longer term horizon is also necessary as investors usually wait for an index to have a track record of several years before making investment decisions (EEP, 2011). Kumar and Siddy (2009) list ten SRI funds in that country, with aggregated holdings of approximately 315 million US dollars (end of 2008). In a more recent publication, Macedo et al. (2012) list eight SRI funds in Brazil, and estimate that their total assets correspond to approximately 380 million US dollars (2012). It may be seen that these figures are relatively modest for such a large country, and that they represent only a small fraction of the investment fund market, as Kumar and Siddy (2009) point out. While Macedo et al. (2012) explain that seven SRI funds were created in Brazil after the launch of the ISE, Vives and Wadhwa (2012) point out that the two largest SRI Brazilian funds were already created before the inception of the ISE (the earliest SRI fund in Brazil dates from 2001). Consequently, it is possible that ISE helped the consolidation of the SRI market in Brazil (i.e., more SRI funds), but this claim remains difficult to prove. And in any case, the total volume of the SRI market remains small.

An interesting question is how the ISE returns compare to that of a conventional index. This is perhaps a question that has been posed many times for different SRI strategies, and not only for this particular Index. Margolis and Elfenbein (2008) present their comprehensive meta-analysis (with J. Walsh) of 167 different studies on the relation between social and financial performance. This is perhaps the largest compilation of studies on the issue, covering more than three decades of publications. They conclude that there may be only a minor correlation between social and financial performance, with the exception of corporate scandals that can negatively impact on the firm’s value. In the context of Brazil, Orsato, Garcia, Mendes-Da-Silva, Simonetti, and Monzoni (2015) compile several academic studies on the same issue. Some of them compare the performance of the ISE with that of a general market index while others study the relationship of the ISE with company value (for instance whether the entry of a company to the ISE increases its market value). Orsato et al. (2015, p. 165) conclude that there is “no evidence of financial value

creation.” It has to be noted that this is not necessarily a discouraging conclusion. For one part, SRI investors may still prefer to invest in companies with better ESG performance even if financial results remain the same. Besides, there may be other positive implications for investors and for companies, as it will be seen later on.

Furthermore, the question remains about how SRI investors actually profit from the information provided by the ISE. In this sense, [Vives and Wadhwa \(2012\)](#) distinguish between the use of an Index either as a reference or as a benchmark. In the first situation, the Index provides information that is useful for SRI investor’s decisions. These investors, who follow an “active” SRI investment strategy, make their decisions taking into consideration several factors, being the participation of a stock in the Sustainability Index just one of them. Thus, they do not strictly follow the Index composition. On the other hand, a “passive” SRI investment strategy would call for tracking the ISE. This means changing the fund composition each time the ISE rebalances (i.e., once a year).

There is some discussion about how exactly Brazilian SRI funds use information from the ISE. [Wodianer and Dobes \(2010, p. 59\)](#) contend that nine SRI funds have their investment policies “aligned” with the ISE, while [Kumar and Siddy \(2009, p. 23\)](#) state that many SRI funds “use the ISE index to guide their portfolio construction.” In any case, it seems difficult to ascertain whether the SRI funds adopt active or passive investment strategies. For their part, [Vives and Wadhwa \(2012\)](#) consider that those funds use the ISE as a reference.

Possibly one reason for not using the ISE as a benchmark lies in the cost of yearly rebalancing. For instance, for the year 2009, two companies exited the ISE while eight companies entered the Index ([Wodianer & Dobes, 2010](#)). Being that the ISE had 30 companies for the year 2008 ([Wodianer & Dobes, 2010](#)), a hypothetical SRI fund that was tracking the ISE at that moment would have incurred in significant transaction costs (i.e., selling two stocks and buying eight other ones). This high transaction costs could be a serious limitation to the more widespread use of the ISE as a reference. [Vives and Wadhwa \(2012\)](#) propose different ideas to make the Index more stable over time. Among them, increasing the number of stocks in the ISE, so that the yearly rebalancing would have a smaller impact on the Index composition and adapting the Index procedures to reduce stock rotation.

Nevertheless it is possible that the ISE contributes in a different way to improve ESG performance; not by providing information to SRI fund managers at no cost but by directly influencing corporate practices. This resonates with [Vives and Wadhwa’s \(2012\)](#) notion of “financial influence”: some companies aim to improve their ESG performance as they expect that investors will increase their demand for the firm’s stock. Thus, the company expects to reduce its cost of capital on the long run. More specifically for the ISE, the process of answering the questionnaire can raise awareness of different ESG issues to improve, thus initiating an organizational learning process, as [Wodianer and](#)

Dobes (2010) suggest. Besides, it is possible that companies interested in entering the ISE would make particular efforts to improve their practices, thus achieving higher ESG performance. In a similar vein, Orsato et al. (2015) emphasize non-financial reasons for companies to adhere to the ISE, among them: reputational value, the possibility of gaining knowledge and coercive isomorphism. Curiously, as financial advantages for participating companies seem difficult to prove, Orsato et al. (2015) contend that those non-financial reasons would better explain companies' interest in participating in the ISE. These conclusions are consistent with a study that shows the influence of ISE on the practices of companies (Vives, 2010). In that study, even those firms that have never been in the Index are also influenced by it, as those firms use the Index questionnaire for their improvement of sustainability practices.

THE TWO NEWCOMERS: SUSTAINABILITY INDICES IN MEXICO AND CHILE

During this decade, two new Sustainability Indices were launched in Latin America: the first one in Mexico in 2011 and the second one in Chile in 2015. As both experiences are relatively recent, it is still difficult to evaluate their impact on SRI. Consequently, this chapter presents only the most important facts about those new Indices.

The "IPC Sustentable" is the Sustainability Index created by the Bolsa Mexicana de Valores (official name of the Mexico Stock Exchange) in 2011, with the involvement of Eiris (a European ESG rating agency) and a local university. Listed companies are selected on the base of publicly available information and this information is assessed on the basis of three criteria: environmental, social, and corporate governance (Bolsa Mexicana, 2013). The environmental criteria correspond to 50% of the total weighting and it includes water use, wastewater and solid waste pollution and energy use. The social criteria amounts to 40% to the total weighting and it includes working relations, implementation of ethical codes, community relations, and equal opportunities. Finally, 10% of the weighting corresponds to corporate governance, which includes shareholder relations, transparency, structure, and practices of corporate boards (Bolsa Mexicana, 2013).

Companies need also to comply with some minimum liquidity requirements (i.e., a minimum float). There are also rules for preventing too much concentration on some stocks: no stock can represent more than 15% of the Index, and the five largest stocks cannot represent more than 60% of the Index. This 15% cap rule exists also in the case of the ISE. And also similarly to the ISE, the IPC Sustentable rebalances yearly.

As of January 2016, the IPC Sustentable had 35 stocks, with a considerable participation of services companies. The largest participating stock is soft-drink

company (almost 15% of the Index), while the second one is a telecommunication firm (more than 12%). Then, a multimedia company, a commercial firm and a finance group account each one of them for approximately 10% of the Index (Bolsa Mexicana, 2016).

In any case, the concentration issue still remains. For instance, the Index composition for January 2016 (Bolsa Mexicana, 2016) shows that the five largely represented stocks account for more than half of the Index. As a consequence, if ever one of these stocks exits the index it would imply material transaction costs for any tracking SRI fund.

The case of the Chilean Sustainability Index is even more recent, as it was launched in 2015. The Bolsa de Santiago (Chilean Stock Exchange) partnered with S&P Dow Jones Indices to launch a sustainability index. This Index, whose official name is Dow Jones Sustainability Index Chile, was launched with 12 firms out of the 40 stocks included in the general stock market index (El Mercurio, 2015). In terms of methodology, this Index follows the best-in-class approach. The assessment is made on the basis of information submitted by listed companies. If a company decides not to answer the questionnaire, the evaluators can use publicly available data (S&PDJI and RobecoSam, 2015). For the year 2016, the Chilean index includes 21 firms from 9 different industries (S&P Dow Jones, 2016). Similarly to the Brazilian and Mexican indices, there is also a 15% cap for any single stock participation. And also similarly to the other indices, there is a yearly rebalance of the Index composition. Perhaps the most important difference from the Brazilian and Mexican indices is that the Chilean Index has the brand name of an international Index provider. Both the Brazilian and the Mexican exchanges chose instead to develop an Index with a name of their own. It will be interesting to see in the next few years if this choice of launching a sustainability index with a widely known brand will accelerate the international awareness for this Index.

CONCLUSIONS

While SRI is today a global practice, it is still differently developed at the local level. This idea is consistent with the broader argument of *Matten and Moon (2008)*, who contend that social responsibility is differently understood and put into practice in different geographies. Even in developed markets as those of Japan (*Sakuma & Louche, 2008*) and Scandinavia (*Bengtsson, 2008*), SRI has been adapted to local needs. *Gond and Boxenbaum (2013)* present contextualization as an adaptation process that simultaneously allows the global diffusion of a practice (in this case, SRI) with its adaptation to the local peculiarities. This parallel “glocalization” (*Gond & Boxenbaum, 2013*) has also been described by *Shin and Zicari (forthcoming)* for corporate reporting practices in

South Korea and Brazil, where global standards were implemented while local realities were also considered.

Particularly in the case of Brazil, Mexico, and Chile, the local Stock Exchanges have been launching Sustainability Indices in the recent years. While these indices also exist in developed markets, their surge normally happened at a mature stage of the market. For instance, the FTSE4Good (the London Sustainability Index) has been launched as recently as 2001, while SRI has a longer history in that country. Furthermore, as EEP (2012) explain, the surge of Sustainability Indices is a consolidated trend in emerging markets, Latin America included.

In the particular case of Latin America, the three cases analyzed show some common features as seen in Table 6. All three Sustainability Indices were launched by the local stock markets. While the stakeholders initially involved in each case were different, in all three cases the leading actor was the local stock market. In all three cases, the Sustainability Index composition is publicly available. This giving away of public information could possibly be a conscious strategy from stock exchanges; as a way of diminishing the cost of calculability practices for SRI in the context of lack (or scarcity) of ESG local rating agencies. While the composition of a Sustainability Index cannot be the only input for investment decisions, a SRI investor can still benefit from knowing the composition of the local Sustainability Index. However, it seems that those indices are not widely used for passive investment strategies (i.e., benchmark), a possible reason being the costs of yearly rebalancing. Besides, the Brazilian experience suggests that Sustainability Index influences companies by encouraging them to improve their ESG practices. It remains to be seen if the same impacts will be reported for the two more recent indices.

Further studies should aim at collecting primary data, particularly interviews with different stakeholders (i.e., reporting firms, investors), thus following the trend of Orsato et al. (2015) for the Brazilian market. As the Mexican and Chilean indices are much more recent, we should expect similar studies for those markets in the next years. Those future studies should explore how information is used by investors and whether companies actually change or adapt

Table 6. The Three Sustainability Indices.

Country	Name	Launched in	Approach	Rebalancing Frequency	Main Initial Stakeholders
Brazil	ISE	2005	Best-in-class	Yearly	Business school and IFC
Chile	IPC Sustentable	2015	Best-in-class	Yearly	S&P, DJSI
Mexico	DJSI Chile	2011	Best-in-class	Yearly	Eiris and a university

their business practices in order to enter the Sustainability Indices. Furthermore, with the passage of time, the existence of additional market information will allow for quantitative studies on the indices' performance (e.g., performance of Sustainable Indices vs. that of conventional Stock Exchange Indices). This kind of study has already begun to be done in Brazil (Souza Cunha & Samanez, 2013), and we may expect similar studies in the future for Mexico and Chile.

A common challenge for all three indices seem to be the relatively lack of liquidity in their home markets and their concentration on a few companies. This situation is consistent with Schneider (2013) description of stock markets having a limited role in Latin American economies. It is possible that this direct involvement of the three stock exchanges in the development of SRI investment intends to address those aforementioned challenges and particularly the still relative lack of awareness of SRI among investors in the region.

Consequently, this chapter suggests that SRI is now developing in the region in a different way from that of developed markets: with the direct participation of local stock exchanges that aim to gather a critical mass of highly respected stakeholders. This collective effort of stock exchanges and stakeholders is intended to overcome the common limitations of stock markets in Latin America: relatively low liquidity, concentration in a few stocks, scarce information about ESG performance, and consequent difficulty and expensiveness of SRI calculability. By this doing, these three Latin American countries may succeed in contextualizing SRI to their local situations, as Gond and Boxenbaum (2013) suggest for the successful international diffusion of SRI practices. Being this SRI contextualization an ongoing process, the outcomes of this original approach in Brazil, Mexico, and Chile may be of interest to other emerging economies, either in Latin America or in the rest of the world.

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