Social accountability and the finance sector: the case of Equator Principles (EP) institutionalisation
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CHAPTER 1: INTRODUCTION

“Why did they do it? It was the right time…and should it have been done earlier? Probably yes…but as I said, it’s like evolution. Things don’t evolve naturally. You normally need a huge shock to the system and then things will adapt and change and that’s how evolution takes place. And the Equator Principles is part of that evolution which says; banks, financial institutions, have reached the stage now where, from a project finance perspective in this case, we need to be more responsible, end of story, get on and do it.” (Australian EPFI)²

1.1 Introduction

On June 4th, 2003, ten commercial banks: ABN Amro, Barclays, Citigroup, Crédit Lyonnais³, Credit Suisse First Boston⁴, HVB⁵, Rabobank, Royal Bank of Scotland, WestLB and Westpac, launched the Equator Principles (EP) in Washington D.C. The EP were designed as a set of voluntary, environmental and social (E&S) risk management guidelines for financial institution (FI) project finance activities.⁶ Project finance, though a small part of FI operations, has traditionally represented the most visible and tangible E&S impact of the financial sector. This is because it is associated with the financing of large, environmentally sensitive projects such as dams, mines, and oil and gas pipelines, largely in the developing world and emerging economies. In addition, these projects had attracted the attention of international non-governmental organisations’ (NGOs) financial sector campaigns since the late 1990’s.

² One of the Equator Principle Financial Institution (EPFI) interviewees included in this research.
³ Which later became Calyon and was renamed Credit Agricole Corporate and Investment Bank in 2010.
⁴ Now the investment banking division of Credit Suisse, as rebranded in 2006.
⁵ Which merged with the UniCredit Group in 2005 and is now known as UniCredit Bank AG.
⁶ Project finance is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure to default. This type of financing is usually used for large, complex and expensive installations such as power plants, mines, transportation and telecommunications infrastructure. Project finance may take the form of financing of the construction of a new capital installation, or refinancing of an existing installation, with or without improvements. The borrower is usually a Special Purpose Entity (SPE) which is not permitted to perform any function other than developing, owning and operating the installation. As a consequence the repayment depends primarily on the project’s cash flow and on the collateral value of the project’s assets (Equator Principles II, 2006).
In adopting the EP, Equator Principle Financial Institutions (EPFIs) were, voluntarily, committing themselves to the application of E&S principles to their design, execution and management of project finance loans, and pledging not to engage or provide finance to clients that would not comply with EP requirements. Whilst the development of the EP was deemed “revolutionary” by the financial sector, in terms of how the Principles could advance their E&S risk management procedures (for project finance), they also received widespread criticism from NGO stakeholders. This was because the original structure of the EP made no provision for EPFI reporting on their implementation of the Principles at organisational level, nor was there any form of accountability mechanism designed for institutional level governance amongst the EPFI “network”. Hence, from the beginning, the EP “phenomena” was subject to social accountability debates, which have continued throughout the relatively short history of the Principles.

In this research, accountability is recognised as “identifying what one is responsible for and then providing information about that responsibility to those who have rights to that information” (Gray, 2001, p.11). In addition, “social accountability” is used to denote environmental and social accountability collectively.

1.2 Research Objectives and Questions

The aim of this research is to evidence, understand and explain the EP institutionalisation process between 2003 and 2008 and its effects on EPFI social accountability over this period. Therefore, this thesis conducts an in-depth examination of why and how the EP became a “taken-for-granted” (institutionalised) aspect of adopting commercial bank project finance activities, and whether this enabled and/or constrained their social accountability between 2003 and 2008. Hence, this study seeks to answer the following research questions:

1. Why and how did the EP institutionalisation process emerge?
2. Why and how did this process evolve between 2003 and 2008?
3. What effect did this process have on EPFI social accountability (i.e. related to their project finance and/or broader activities) over the period 2003 to 2008?

These research questions are answered by tracing this EP institutionalisation process from:
1. The initial “shock” or “jolts” that “induced” this process i.e. NGO campaigns for more accountable and sustainable finance prior to 2003, to;

2. The financial sector response and launch of the EP in 2003, and thus the initiation of EP institutionalisation, through to;

3. The implementation, modification and evolution of the EP between 2003 and 2008, hence capturing the how of the institutionalisation process.\(^7\)

In doing so, the effect of this EP institutionalisation process on EPFI social accountability, and vice versa, between 2003 and 2008 is critically analysed and discussed.

1.3 Theory

This research broadly combines two theoretical approaches. Firstly, the concepts of accountability and legitimacy are utilised in order to understand and explain: 1) why NGO financial sector campaigns led to the initiation of the EP; 2) why NGO/societal debates would continue to influence, and be influenced by, EP institutionalisation between 2003 and 2008; and 3) how EP institutionalisation affected EPFIs.

Secondly, this research uses the Dillard et al. (2004) framework on institutionalisation\(^8\) as a conceptual guide to illuminate the complex, political and “multi-level” nature of the EP institutionalisation process from 2003 to 2008. Dillard et al. view institutionalisation as a structuration process (Giddens, 1976, 1979, 1984) occurring over societal, organisational field (institutional) and organisational levels. That is, they perceive a reciprocal and recursive (ongoing) relationship to exist between the “structures” that underpin a specific “institution” (i.e. the norm/value/standard being institutionalised), and the knowledgeable and reflexive “agents” that interact with these structures. Here, “structures” refers to the legitimation (rationale), signification (meaning) and domination (power) properties associated with/underpinning the institution in question. Dillard et al. view this iterative relationship between structures and agency as mobilised through daily interaction between (societal, organisational field and organisational) “criteria” and “practice”, and manifested in the emergence, evolution and “acceptance” of an institution over time. This research

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\(^7\) Whilst 2003 to 2008 is the period under investigation in this research, this researcher is keen to point out that she views the EP institutionalisation process as an ongoing process, that will (and has) continue(d) to evolve post-2008.

\(^8\) Which won the Mary Parker Follett Outstanding Paper Award in Accounting, Auditing & Accountability Journal for 2004.
views the EP as an institution (standard) and uses the Dillard et al. framework to understand and explain how the EP emerged in 2003 and evolved to become the accepted (institutionalised) standard for more sustainable/accountable project finance by 2008.

1.4 Research Method

This research interprets, and represents, the EP institutionalisation process from the perspective of some of the most prominent actors associated with the EP phenomena i.e. EPFIs and NGOs and, to a lesser extent, some broader EP stakeholders. The research adopts a qualitative methodological approach and applies qualitative research methods to capture the views of these actors within the broad EP field or “domain”. This involves a case study incorporating 29 semi-structured interviews,9 (participant) observation and extensive documentary analysis. The in-depth theorisation and interpretation of this case material produces “rich”, context-specific (interviewee-informed) insights into the case of EP institutionalisation between 2003 and 2008.

While there is a range of FIs adopting the EP, it is commercial banks10 that will be the specific focus of this research. This is primarily because it was commercial banks that developed and launched the EP, and secondly because of this researcher’s ease-of-access to some of these banks. In addition, the terms EPFIs and commercial banks will be used interchangeably throughout this research.

1.5 Research Contributions

A number of theoretical and empirical contributions arise from this research. Firstly, no prior work specifically focused on the EP, the accountability dynamics surrounding them or their institutionalisation, has been conducted within the accounting discipline to date. Secondly, no specific work on EP institutionalisation has been conducted within the very small number of existing studies on the EP in the broader corporate social responsibility (CSR)/sustainable finance literature. This research makes unique empirical contributions to both of these bodies of literature, as it privileges qualitative analysis of the EP institutionalisation process, from the perspective of key EP actors. Furthermore, this

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9 Involving 31 individual interviewees and representing 25 different organisations i.e. ten NGO, ten EPFI and five broader EP stakeholder organisations (one law firm, one environmental consultancy, two mining companies and one mining industry association).

10 Most of the commercial banks in this research also have active retail, investment or asset management arms.
research makes substantial theoretical contributions to this literature as is outlined here. With regard to the social accountability literature, this research mobilises the concepts of accountability and legitimacy in the unique context of an institutionalisation process, and also considers how parallel processes of accountability and institutionalisation can influence one another. In addition, few studies have focused on NGOs as exerting “institutional pressure” on organisations or examined how that pressure may “induce” and influence an institutionalisation process (but see Lounsbury et al., 2003; Den Hond and De Bakker, 2007). Accordingly, this research, which focuses on NGO accountability/legitimacy demands as influencing the emergence and evolution of the EP institutionalisation process, addresses these gaps in the extant literature.

In terms of institutional theory, this research directly addresses some of the recent critiques and calls for the expansion of institutional theory research in the literature (e.g. Lounsbury, 2008; Scott, 2008). It does so in a number of ways. Firstly, it focuses on institutionalisation as a process, as opposed to an outcome, and adopts a qualitative, longitudinal and multi-level approach to study this process. Secondly, it recognises the powerful role and influence of agents in institutional processes (Di Maggio 1988; 1991) and how “embedded agents” (Seo and Creed, 2002) can actually be enabled, as opposed to constrained, by their positions in order to affect organisational and institutional change (Greenwood and Suddaby, 2006; Reay et al., 2006). Thirdly, it evidences heterogeneity, as opposed to homogeneity, across organisational perceptions of, and reactions to, institutional pressures and norms, and highlights how “followers” in organisational fields do not always engage in “mindless imitation” (Lounsbury, 2008) of “innovators” in the field. In doing so, it also illustrates that the dichotomy between the pressure to “conform” or “perform” regarding institutional demands does not always exist (Heugens and Lander, 2009); and that the former can actually enhance the latter. More broadly, this research considers the potential relationship between institutional theory and notion of accountability in general, and highlights the possible need to theorise the relationship between an institutionalisation process and the accountability of the agents involved therein.

Finally, this research provides a unique “contextual” setting for the application of the Dillard et al. (2004) framework. It also offers useful suggestions for the extension and development of the model through more in-depth consideration of its: (1) notions of criteria
and practice; (2) interpretation of an organisational field; and (3) need to conceptualise institutional dynamics at *intra-*organisational level. In short, this research prioritises theoretical and empirical concepts, approaches and perspectives that are largely absent from the existing literature.

In addition, this study offers some practical implications for a wide range of EP stakeholders in that it acts as a highly informative “introduction” to the evolution of the EP since 2003, which, to the best of this author’s knowledge, has not been completed to date.\(^{11}\) Furthermore, this research offers two key recommendations to EPFIs in order to help them *further* improve their EP accountability: 1) greater transparency is needed surrounding EP governance at organisational field level i.e. regarding the manner in which the current EP management structure operates; and 2) there is a need for greater transparency and clarity surrounding the internal auditing of the *process* by which the EP are applied to project financing arrangements *within* EPFIs, as well as the external assurance of the same.

**1.6 Thesis Structure**

This thesis is structured into ten more chapters as follows.

Chapter Two, the literature review, is divided into two parts. Firstly, it provides an overview of some of the existing literature within the broad “sustainable” finance field, as well as extant studies on the EP *per se*. Part two conducts a review of what will be termed the “theoretical” literature and is further divided into two sections. The first section is concerned with the interpretation and application of the concepts of accountability and legitimacy in this research, while the second provides an overview of institutional theory and its evolution and critique in the literature. The latter acts as the foundation for a more in-depth consideration of institutionalisation processes and the explanation of the Dillard et al. (2004) framework on institutionalisation in Chapter Three.

Chapter Three, the main theory chapter, is divided into two parts. Firstly, it analyses how the notions of an “institution” and “institutionalisation” have been defined and understood in the literature and how they will be interpreted in the context of this research. Secondly, it introduces the Dillard et al. (2004) framework on institutionalisation and provides an in-

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\(^{11}\) Freshfields Bruckhaus Deringer (2005) and Watchman et al. (2007) have been used in a similar vein in the past but are not academic texts.
depth explanation of its constituent parts. This encompasses an explanation of Giddens’ (1976, 1979, 1984) structuration theory and outlines how it is used by Dillard et al. to conceptualise the process of institutionalisation within their model. The chapter concludes with an overview of how the Dillard et al. model is interpreted and mobilised within this research.

Chapter Four focuses on the research methodology and methods adopted in this study and is broadly divided into three sections. Firstly, it discusses the differences between quantitative and qualitative methodological research and explains how this researcher adopts a qualitative, interpretive approach to this research. Secondly, it discusses qualitative research methods, outlines how they are incorporated into case study research, and explains how and why a case study approach has been adopted in this research. Finally, this chapter provides an in-depth explanation of how this case study on EP institutionalisation was designed, executed, theorised and written into a case narrative.

The aim of Chapter Five is twofold. Firstly, it aims to introduce some “contextual” information about the EP case study “site” or domain i.e. where the EP phenomena “plays out”. This includes a discussion on the nature of project finance and the EP initiative. The objective is to “set the scene” for the case narrative on the EP institutionalisation process in the following chapters. Secondly, this chapter aims to briefly introduce the manner in which the case narrative will be structured, in order to provide a “roadmap” for the discussion of the research findings.

The case study narrative is then structured over Chapters Six to Nine as follows. Chapter Six analyses why and how the EP emerged and introduces the beginning of the EP institutionalisation process (research question 1). Chapter Seven focuses on the incremental progression of the EP institutionalisation process between 2003 and 2007 and is divided into three sections (research question 2). The first section (7.2) analyses the “early” adoption of the EP, the emergence of the EP organisational field and EPFI organisational level adaptation to the EP over the course of 2003 to 2005. The second section (7.3) focuses on the revision of EP I, broadly between 2005 and 2006, and the launch of EP II (Equator Principles II) in July 2006. Finally, the third section (7.4) critically analyses the nature of the late(r) adoption of the EP between late 2005 and 2007, and highlights how the EP were,
by late 2007, recognised as *the* standard (institution) for more sustainable project finance. Chapter Eight then turns to the critical analysis of the evolution of the EP institutionalisation process, towards better governance of the EP initiative, between 2007 and 2008 (research question 2).

Having discussed the evolution of EP institutionalisation over societal, organisational field and organisational levels between 2003 and 2008 in Chapters Six to Eight, Chapter Nine conducts an in-depth analysis of EP institutionalisation at EPFI *intra*-organisational level through the *actual* project finance process (research question 2). The objective is to evidence the EP as a fully “accepted” or institutionalised facet of project financing for EPFIs. In doing so, this chapter also attempts to extend the Dillard et al. (2004) framework to *intra*-organisational level. In addition, the effects of the EP institutionalisation process on EPFI social accountability between 2003 and 2008 will be discussed throughout Chapters Six to Nine. This highlights how EP accountability processes affected, and were affected by, EP institutionalisation over this period, and how EP institutionalisation acted to enable, rather than constrain, better EPFI social accountability overall (research question 3).

Chapter Ten conducts an in-depth discussion of this research and is divided into two sections. The first section reintroduces the three research questions framing this case study and, through the application of the Dillard et al. (2004) framework, explains how the case narrative answered these research questions. The second section discusses some theoretical implications of this thesis and is further divided into two parts. The first part critically discusses the Dillard et al. (2004) framework, offering some suggestions as to how this framework might be advanced. The second part discusses the possible need for deeper consideration and theorisation of the relationship between an institutionalisation process and the *accountability* of the agents involved in that process.

The thesis then moves to a conclusion in Chapter Eleven and offers some suggestions for future research. This thesis now turns to the literature review in Chapter Two.