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Editorial
Linking Responsible Investments to Societal Influence: Motives, Assessments and Risks

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ABSTRACT
This introduction of the special issue about responsible investments deals with the main theoretical, methodological and empirical challenges. It also highlights the key features of the papers in this special issue. Copyright © 2011 John Wiley & Sons, Ltd and ERP Environment.

Introduction

In this special issue on socially responsible finance and investment, we present a selection of recent papers. Several of these papers were delivered at the 15th International Sustainable Development Research Conference in Utrecht, the Netherlands, July 2009. Some were solicited after this conference. We were only able to select a small number of the papers offered. Although this might be disappointing for those who were rejected, it is good news from a scientific point of view, as it shows there is a lot of academic interest in doing research and publishing about socially responsible finance and investment. This special issue is the sequel to a previous special issue in *Sustainable Development* that resulted from the 13th International Sustainable Development Research Conference (see Scholtens *et al*., 2008).

The link between sustainable development and socially responsible investing (SRI) is simple and straightforward. With SRI, the investor tries to account – in some way or another – for sustainable development. In practice, this usually boils down to taking into account environmental, social and governance issues of firms in the investment decision. At the level of the firm, the ways in which firm managers and directors try to achieve sustainable development usually are defined as corporate social responsibility (CSR). Then, SRI is investing that includes – in some way or another – the investment object's CSR.

In this introduction, we shall first briefly discuss some major challenges of the current research in socially responsible finance and investment. We focus on theoretical, methodological and empirical issues. Then, we introduce the papers in this special issue.

Issues

There is good news and there is bad news. The good news is that a lot of research is being done on sustainable development and CSR. However, the bad news is that all researchers still struggle with the definition of

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sustainable development and with the key determinants (see Keitsch, 2010). As a result, a coherent theoretical framework of sustainable development is still missing. This translates into the lack of a proper framework regarding the analysis of CSR and SRI as well.

Since the 'Brundlandt Report' of the UN World Commission on Environment and Development (1987), sustainability has become the key issue in environmental and development policy. Sustainable development has been gradually translated into CSR for environment, social and governance policies at the level of the firm (see, e.g., Elkington, 1998). Both terms have found their way in the academic world as well, as can be witnessed by the large number of papers that have appeared in the last two decades on sustainability and CSR. However, in none of these papers has there been developed a coherent theory of sustainability, SRI or CSR. Instead, there is the call for a new paradigm that integrates ecological, social, development and governance issues. This call is not new. An example is the article by Klaassen and Opschoor in *Ecological Economics* in 1991, which actually predates the United Nations Conference on Environment and Development in Rio de Janeiro! Klaassen and Opschoor (1991) assess different views of economics on the sustainability of economic growth and welfare. They conclude that the traditional neoclassical economic paradigm is complementary to a more ecological view of economic processes. Edward Lazear (2000) is more critical. He describes how economics has invaded intellectual territory that was previously deemed to be outside the realm of economics. He introduces the notion of economic imperialism to discuss the power of economics as a scientific discipline. Korhonen (2002) argues that economics has serious difficulties in the light of CSR and that, therefore, a new paradigm is needed. But, then, where is a new paradigm when you need it? Paradigm switches can only be determined (long) after the moment at which they actually took place (Kuhn, 1962).

We find that papers about sustainable development and CSR derive their hypotheses from a very wide range of theories and notions, be it thermodynamics and entropy law, human rights declarations and religious motives, ethics and philosophy, finance and accounting, management and organization. This suggests that it is currently an eclectic approach, which takes account of (some of) the multidimensional properties of the key concepts. Maybe one day we shall witness a paradigm switch and a new discipline (sustainomics, sustainology, sustainosophy?) may arise. Maybe sustainable development and CSR will remain to be studied from a wide variety of theories and perspectives. In this special issue, the reader will find that the papers – although all of them focus on one particular phenomenon, namely investing – derive from quite different literature backgrounds as well.

Of course, we do not know in which direction future research about CSR and sustainable development will be heading. From the research that has been published so far and from the huge number of working papers, it does not really seem to be a problem that a coherent theoretical framework is missing. Very many issues regarding SRI, CSR and sustainable development are addressed and they are being investigated from various disciplines. We are convinced that in the coming decade the increase in the literature will result in the construction of notions, ideas and maybe theories which more and more integrate concepts that are key to SRI, CSR and sustainable development. Thus, we expect that the literature will mainly be driven by societal phenomena, rather than by theoretical advances. We are curious, of course, whether our expectations will be rejected or confirmed. In ten years time, we hope to be able to report the findings in this journal.

The reflection above about theoretical perspectives *linea recta* translates into methodology. So far, we see from the literature that existing methodologies have been used in a quite straightforward manner to analyze problems and issues with respect to sustainable development and CSR. In particular, the investigation of the multidimensional issues connected with these phenomena, for example accounting for overlapping generations and taking ethical issues on board, results in pragmatic and eclectic approaches. However, we did not encounter specific and unique methodologies to investigate SRI, CSR and sustainable development. Fortunately, some authors suggest how to account for CSR when applying conventional methodologies. A well known example is the paper by McWilliams and Siegel (1997), who describe how to integrate CSR in event studies. Event studies are widely applied in the finance literature and basically try to find out whether unexpected news significantly impacts upon firm value (see MacKinlay, 1997). A recent example is provided by Lundgren and Olsson (2010), who study whether bad news in the form of environmental incidents affects firm value negatively. McWilliams and Siegel (1997) show how to apply event studies in an appropriate manner when investigating CSR. More specifically, they point out that event studies of CSR may be quite sensitive to research design issues such as the length of the event windows used and confounding events. In this special issue, the paper of Chegut *et al.* (2011) can be placed in the tradition

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of McWilliams and Siegel (1997) by investigating best practices in the financial performance analysis of sustainable mutual funds. An example of such an appropriate financial performance analysis that accounts for aspects of sustainability is the paper by Manescu (2011).

We very much applaud these approaches as they may advance our understanding of SRI, CSR and sustainable development. However, as with theory, we are not sure whether a specific methodological toolbox will mature over time and what it will actually look like.

In addition, there is a crucial problem with data. This, of course, is related to the lack of appropriate definitions of the constituents of sustainable development, CSR, SRI and the like, as well as to the lack of a coherent and robust theoretical framework. Especially in the behavioral sciences, researchers have to rely upon opinions about sustainability and responsibility, or they have to make do with ticking boxes that list several issues that – in some way or another – may relate to sustainable development. Chatterji *et al.* (2009) show that the opinions are just what they are, namely opinions. That is ratings by information specialists are reflections of the specialists' opinions. There does not need to be a direct link with sustainability of the entity being rated. In this special issue, Hedesström *et al.* (2011) go into this matter. As for the ticking of boxes, Scholtens (2011) shows how this works out for the insurance industry. Given that there is a lack of a theoretical framework, he cannot assess whether particular insurers contribute more to sustainable development than others.

Papers

In this special issue, we have five very different papers that try to advance the research on SRI. In particular, the denominator is that they all try to link responsible investments to society. They especially investigate in one way or another motives for responsibility in investing, ways to assess responsible investments and risks engaged with responsible investing.

Responsible investing has recently become part of the mainstream investment landscape. For example, in the US, SRI amounts to more than \$3 trillion (\$3000 billion) (source: SIF, 2010). Since 2005, the US's SRI assets have increased by more than 34 percent while the broader universe of professionally managed assets has increased by about 3 percent. From the start of 2007 to the end of 2009, a three-year period when broad market indices such as the S&P500 declined and the broader universe of professionally managed assets increased by less than 1 percent, assets involved in sustainable and socially responsible investing increased by more than 13 percent (from \$2.71 trillion to \$3.07 trillion). In all, SRI assets in the US at year-end 2009 top \$3 trillion; nearly 1 out of every 8 dollars under professional management (SIF, 2010). For Europe, Eurosif's biannual study for 2009 shows that total SRI assets under management have increased from €2.7 trillion to €5 trillion, as of 31 December 2009 (Eurosif, 2010). This represents a spectacular growth of about 87% since the data was previously collected two years before. Furthermore, the European SRI market remains largely driven by institutional investors, representing 92% of the total assets under management. Bonds are now the favored asset class among SRI investors, representing 53% of total SRI assets, while equities make up about 33% of total SRI assets (Eurosif, 2010).

Chegut, Schenk and Scholtens (2011) assess and analyze in their article 'Assessing SRI fund performance research: best practices in empirical analysis' the empirical academic research carried out on socially responsible funds to create an overview of current practice as well as pointing out best practice research in an attempt to improve the quality of SRI financial performance analysis. They perform content analysis and meta-ethnographic analysis on 41 SRI mutual fund performance studies. Five different themes of research were established and assessed. The themes are (a) data quality, (b) social responsibility verification, (c) survivorship bias, (d) benchmarking and (e) sensitivity and robustness checks. For each of these themes, they develop best practices. For example, for sound SRI fund performance analysis, they find it is important that research pays attention to dividend yields and fees and that it incorporates independent and third party social responsibility verification. Furthermore, the authors advise to correct for survivorship bias and to test with multiple benchmarks, as well as to analyze the impact of fund composition, management influences and SRI strategies through sensitivity and robustness analysis. These best practices aim to enhance the robustness of SRI financial performance analysis. They find that best practice research is much more demanding for SRI performance analysis than for 'conventional' performance analysis.

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Manescu (2011) explores in 'Stock returns in relation to environmental, social and governance performance: mispricing or compensation for risk?' stock returns in relation to issues concerning environmental, social and governance (ESG) aspects. Her study utilizes panel data on publicly traded US firms between Q3:1992 and Q2:2008. The only ESG aspect that was found to have a significant effect on the development of the pricing of firms, the risk-adjusted stock returns, was community relations – an effect due to mispricing. It is, furthermore, detected that the employee relations' moderating effect on stock returns changes sign, making the relationship positive between Q3:1992 and Q2:2003, whereas in the period Q3:2003–Q2:2008 there is a negative correlation between employee relations and risk-adjusted returns. Also here the underlying effect comes from mispricing, but the author finds evidence for the negative effect being compensated for by low non-sustainability risk. During the later parts of the period analyzed, the mispricing effects can be held responsible for the negative effects of human rights and product safety on risk-adjusted stock returns. The conclusion of the paper is that ESG aspects do have value significance, but are not yet fully incorporated into stock prices. Manescu's (2011) findings may be important for both investors and corporate strategists. Investors may be interested in new evidence that ESG performance is value relevant or that certain non-sustainability risks exist. Firms may find it useful to be aware that they can reduce their cost of capital by investing in particular ESG concerns.

Hedesström, Lundqvist and Biel (2011) compare in 'Investigating consistency of judgement across sustainability analyst organizations' how seven prominent investment information providers on ESG issues rank the same set of companies. They compare the rankings within two industries – automobile and paper & forestry – with regards to environmental performance issues. They refrain from the assessment of social aspects in their study. They find that there exists a consensus among the seven ESG analyst organizations about which corporations in the automobile industry are the laggards regarding environmental performance. However, they disagree about which corporations are on the efficient environmental performance frontier. Concerning the paper & forestry corporations the patterns of ratings by the ESG analyst firms are even less congruent. According to Hedesström *et al.* (2011), the ESG analyst firms do apply criteria for those environmental targets that are of most concern if applying an upstream and downstream perspective along the value chain of the corporations. The analytical consensus seems to be less congruent for environmental aspects with less visible impact. Thus, this paper shows that it especially is the opinion of the rating agencies that matters for the ranking. This confirms the findings of Chatterji *et al.* (2009). As such, it shows the need for a much more robust framework to assess firms' environmental performance.

In addition, the result provided by these ratings agencies is incongruent with the demands from their environment. For example, governmental bodies such as the European Commission ask for standardization and transparency of the ESG analyst firms' methods. The analysts, however, regard their individual rating criteria as part of their competitive advantage; they do not want to share their 'tricks of the trade'. However, if these ratings are to gain a larger impact on the behavior of firms, there is a need for increased transparency of these methods and increased consistency with respect to the selection of environmental and social criteria.

Jansson and Biel (2011) investigate in 'Motives to engage in sustainable investment: a comparison between institutional and private investors' the drivers for responsible investment. They use questionnaires for different investor groups to invest under social and/or environmental selection criteria. The study reveals that among the beneficiaries – retail and institutional investors – environmental and social aspects constitute the guiding values for investments, while the portfolio managers of the investment firms instead focus on the financial effects arising from adopting ESG criteria. Furthermore, they find that private investors are concerned with the long-term returns of SRI investments while the institutional investors seem more attuned to reducing financial risks through ethically screened investments. Investment management institutions put more weight on financial returns than their beneficiaries do. The private and institutional investors are, hence, found to pay more attention to environmental and social aspects and apply a wider scope to the fiduciary duty than the institution that actually manages the portfolio. This is an illustration of the well known agency problem in economics and management (Jensen and Meckling, 1976).

Scholtens (2011) illuminates in 'Corporate social responsibility in the international insurance industry' the CSR of international insurance companies. The aim of his article is to find out to what extent the insurance industry incorporates issues of sustainability in their businesses. The article highlights the importance of the insurance companies as financial intermediaries in society e.g. by monitoring firms and managing some of their financial

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risks. The framework for assessment is applied to different insurance segments such as financial conglomerates and life insurance companies as well as mixed and general insurers.

The study, including more than 150 institutions from 20 different countries, reveals considerable differences between types of insurer and between countries. It appears that many insurance institutions deal with social issues, such as sponsoring and voluntary work, and with corporate governance. Only a very limited number of insurance firms have adopted environmental codes and standards of practice and most of these only deal with internal aspects such as energy consumption, greenhouse gas emissions and waste handling. However, they do not incorporate environmental aspects into the – for the insurance industry – more pressing need of the assessment of the performances of the households they insure. Furthermore, they seem to disregard environmental and social aspects in the allocation of their assets. It appears that financial conglomerates deal more thoroughly with CSR issues than other types of insurers. European and Japanese insurance companies appear to deal on a much more comprehensive basis with sustainability aspects than the North American insurers. Within the European insurance industry, it appears that insurers from France, Spain and Norway succeed in dealing with CSR issues best. The size of insurers' market capitalization is found to have a positive correlation with well developed CSR policies and with insurance firms' inclusion in sustainability indexes.

Scholtens' conclusion is that most insurance companies have not well integrated sustainability aspects into their operations. Most insurance institutions fail to systematically address environmental issues when assessing their customers and when allocating their assets.

End

To summarize, this special issue covers key elements that play a role in socially responsible finance and investing. It investigates motives, assessments and risks that connect with this type of investing and brings forward new results and perspectives. This special issue shows a glimpse of the richness of the research areas connected with sustainable development from a social sciences perspective.

The editors of this special issue hope and expect that the debate will continue and invite researchers to continue to discuss their ideas within the realm of the International Sustainable Development Research Society and to submit their contributions to *Sustainable Development*.

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