CHAPTER 1

Socially Responsible Finance and Investing: An Overview

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INTRODUCTION

What is the main goal of a business firm? Many have debated this question over the years. The response largely depends on one's view of to whom the firm is responsible. Some contend that corporations are only responsible to their shareholders and do not have other obligations to society besides complying with applicable laws, ethical standards, and international norms. Hence, corporations should operate to meet the best interests of shareholders within these constraints. Others take the broader view that corporations have responsibilities to stakeholders other than shareholders. *Stakeholders* refer to those who have an interest or concern in the firm because of how its activities affect them. Stakeholders consist of owners, management, employees, suppliers, customers, the local community, and others.

Donaldson and Preston (1995) discuss three versions of stakeholder theory: normative, instrumental, and descriptive. Normative stakeholder theory views a firm's behavior through an idealistic social or moral lens. That is, this version focuses on how firms "should" act. Instrumental stakeholder theory views stakeholder relationships as the means to some end, such as maximizing firm value. By contrast, descriptive stakeholder theory uses the stakeholder model as a tool for describing the activities and interests of the firm. In general, instrumental stakeholder theory seems to fit the needs of performance-oriented investors better than other approaches. Others provide an extensive treatment of stakeholder theory (Friedman and Miles 2006; Freeman, Harrison, Wicks, Parmar, and de Colle 2010; Phillips 2011).

Jensen (2001, p. 8) offers the following observation about a firm's goal:

> How do we want the firms in our economy to measure their own performance? How do we want them to determine what is better versus worse? Most economists would answer simply that managers have a criterion for evaluating performance and deciding between alternative courses of action, and that the criterion should be maximization of the long-term market value of the firm. . . . This Value Maximization proposition has its roots in 200 years of research in economics and finance.

Most financial economists would agree that the fundamental purpose of a business firm, especially a corporation, is to maximize returns to its shareholders. This view is consistent with instrumental stakeholder theory, which considers the stakeholder network as the means to the end of wealth creation. For example, Friedman (1962, 1970) treats shareholders as ends to firm performance and explicitly measures performance as profit. As Friedman (1970, p. 32) notes, the responsibility of business firms "will generally be to make as much money as possible." Proponents of this view contend that the notion of corporate social responsibility (CSR), which is also called corporate conscience, corporate citizenship, social performance, and responsible business, distracts from the economic role of business.

Others, such as Freeman (1984, 1998), have different views. Freeman (1998, p. 126) states that "we must reconceptualize the firm around the following question: For whose benefit and at whose expense should the firm be managed?" He proposes replacing the narrow focus on shareholders with a broader set of obligations. Porter and Kramer (2011) echo this sentiment by proposing that the purpose of the corporation be viewed as creating shared value and not just profit. They maintain that corporations can make more long-term profits by embracing CSR. According to Baker and Powell (2005), achieving shareholder wealth maximization assumes that managers operate in the best interests of shareholders, avoid actions designed to deceive financial markets in order to boost the firm's stock price, and act in a legally and socially responsible manner. Given these assumptions, Baker and Powell (p. 12) state that "shareholder wealth maximization is consistent with the best interest of stakeholders and society in the long run."

Although shareholder wealth maximization has gained considerable traction in the academic and business communities, the concept of social responsibility has also gained momentum. Socially responsible finance includes responsibility from the corporate side (corporate social responsibility) as well as the investor side (socially responsible investing) in the capital markets.

CORPORATE SOCIAL RESPONSIBILITY

In the late twentieth century, an increasing number of corporations started to think about their effect on society at large, mainly because of growing consumer awareness of corporate activities around the world. Some corporations decided to embark on corporate social responsibility programs designed to offset some of their effects on the world while also generally improving corporate practices (Campbell 2007). *Corporate social responsibility* (CSR) is a form of corporate self-regulation integrated into a business model. That is, CSR is the decision-making and implementation process that guides all company activities in protecting and promoting

international human rights, labor and environmental standards, and compliance with legal requirements within its operations and in its relations to the societies and communities where it operates (Carroll 1999). CSR involves a commitment to contribute to the economic, environmental, and social sustainability of communities through the ongoing engagement of stakeholders, the active participation of communities affected by company activities, and the public reporting of company policies and performance in the economic, environmental, and social arenas.

In theory, CSR policy functions as a built-in, self-regulating mechanism whereby business should monitor and ensure its support to law, ethical standards, and international norms. Thus, business should embrace responsibility for the impact of its activities on the environment, consumers, employees, communities, stockholders, and all other members of the public sphere. Also, CSR-focused businesses should proactively promote the public interest by encouraging community growth and development, and voluntarily eliminating practices that harm the public sphere, regardless of legality. Norman and MacDonald (2004) show how CSR deliberately attempts to include public interest into corporate decision-making and focuses on a triple bottom line: people, planet, and profit.

The practice of CSR is much debated and criticized. Not surprisingly, CSR has both fans and detractors. Proponents contend that a strong business case exists for CSR. They argue that corporations can benefit in multiple ways by operating with a perspective broader and longer than their own immediate, short-term profits. Critics maintain, however, that CSR distracts from the fundamental economic role of businesses. Others argue that CSR is nothing more than superficial window-dressing while still others contend that it is an attempt to pre-empt the role of governments as a supervisory body over powerful multinational corporations (Archel, Husillos, and Spence 2011; Harrison, Bosse, and Phillips 2010).

SOCIALLY RESPONSIBLE INVESTING

Socially responsible investing (SRI), also called ethical investing and green investing, is an investment that is considered socially responsible because of the nature of the business the company conducts. SRI uses environmental, social, and corporate governance (ESG) criteria to generate long-term, competitive financial returns and positive societal impact (SIF 2010). That is, investors limit their investment alternatives to securities of firms whose products or actions are considered socially acceptable (Bollen 2007). For example, socially responsible investors might avoid investment in companies that produce or sell addictive substances such as tobacco, liquor products, or gambling and might seek out companies engaged in environmental sustainability and alternative energy/clean technology efforts (Statman 2004). Unlike traditional investing that focuses only on financial returns, SRI combines both financial goals and social responsibility (Derwall, Koedijk, and Ter Horst 2011).

Socially conscious investing is growing into a widely-followed practice. For example, retail investors can make socially responsible investments in individual companies, follow SRI indexes, or through a socially conscious mutual fund or exchange-traded fund (ETF). Mutual funds and ETFs provide an added advantage in that investors can gain exposure to multiple companies across many sectors with a single investment. Yet some question whether investors sacrifice performance

for the sake of ideology (Hong and Kacperczyk 2009). That is, just because an investment touts itself as socially responsible does not mean that it will provide investors with a good return.

PURPOSE OF THE BOOK

The purpose of this book is to provide a comprehensive view of the growing field of socially responsible finance and investing. It discusses the socially responsible foundations and their applications to finance as determined by the current state of this research. The book is written by noted scholars—both academics and practitioners—who provide a synthesis of what is known about each topic no matter whether the evidence is flattering or not. Of the books currently available in this area, many tend to focus on one narrow topic, such as how to measure socially responsible activities in a firm, and to be written from a proponent's point of view. This is not the case with *Socially Responsible Finance and Investing*, which takes a wide-ranging view and offers multiple perspectives.

The socially responsible framework for viewing business activities is likely to increase in popularity. This movement is already becoming popular with the European business community and scholars there. The ideas are now gaining a foothold in the United States. With a focus on the recent financial collapse, other bailouts, and the environment, the U.S. interest in socially responsible finance is likely to continue increasing.

FEATURES OF THE BOOK

Socially Responsible Finance and Investing has several distinguishing features.

- Perhaps the book's most distinctive feature is that it provides a comprehensive discussion of the theory, empirical work, and practice within the various topics covered in socially responsible finance and investing. The book not only attempts to blend the conceptual world of scholars with the pragmatic view of practitioners, but also to synthesize important and relevant research studies including recent developments. The book takes an objective view and avoids an advocacy position.
- The book contains contributions from numerous authors. The breadth of contributors assures a variety of perspectives and a rich interplay of ideas.
- This volume discusses the results of empirical studies that link theory and practice. The objective is to distill them to their essential content so that they are understandable to the reader.
- Each chapter contains discussion questions that help to reinforce key concepts. This feature should be especially important to faculty and students using the book in classes.

INTENDED AUDIENCE

This book should appeal not only to an academic audience—researchers, professors, and students—but also to industry professionals, lawmakers, and regulators. For example, both academics and practitioners who are interested in socially

responsible finance should find this book to be useful given the scope of the work. It should also be appropriate as a stand-alone book for undergraduate or graduate-level business courses related to the topics contained in this book. Further, libraries should find this work to be a suitable reference book.

STRUCTURE OF THE BOOK

The remaining 23 chapters are organized into four sections. A brief synopsis of each chapter by section follows.

Section I. Foundations and Key Concepts

Chapters 2 through 6 provide the foundation for understanding socially responsible finance and investing. Chapter 2 offers an in-depth discussion of stakeholder analysis, while Chapter 3 examines how different business disciplines view CSR. Chapter 4 introduces the concept of business models and social entrepreneurship. Chapter 5 discusses the legal framework in which SRI operates. Chapter 6 concludes this section by examining various international and cultural views toward SRFI.

Chapter 2 Stakeholder Analysis (Lloyd S. Kurtz)

Social investors often incorporate elements of stakeholder theory into their work. Many believe that firms with good stakeholder relationships should be viewed as better managed and therefore likely to offer superior financial performance. Empirical research has strengthened the case for a correlation between good stakeholder management and superior firm-level financial outcomes. These findings strongly suggest that a stakeholder worldview has validity and that analyzing stakeholder relationships can aid in investment analysis. Although many theoretical approaches are available, a modified form of instrumental stakeholder theory seems to fit best with the needs of investors. In this framework, good management may be defined as the efficient allocation of resources to stakeholder management, such that a large surplus remains for owners and managers. Stakeholder analysis of this type aids in assessing management quality and clarifies the relationships among stakeholders, owners, and managers. The resulting insights are often relevant for the valuation of the firm. Stakeholder analysis therefore has the potential to improve fundamental analysis, and stakeholder relationships deserve the attention not just of social investors, but of managers and investors in general.

Chapter 3 Corporate Social Responsibility (Heather Elms and Michelle Westermann-Behaylo)

This chapter identifies varying approaches to CSR in the business ethics, finance, accounting, and marketing literatures. In particular, it identifies a series of current themes in the business ethics literature that are not yet reflected in the finance, accounting, and marketing literatures as evidenced by a review of the articles published in the high-quality journals of these functional disciplines. The analysis suggests that greater consideration of these themes by the functional literatures and greater appreciation of the focus of the functional literatures by the business ethics literature may lead to a better understanding of the CSR phenomenon.

Chapter 4 Business Models and Social Entrepreneurship (Michael A. Pirson)
The 2007–2009 financial crisis caused many to question the basic premises of the current business system and the financial services industry. Some suggest that corporations should aim to regain legitimacy by pursuing shared value rather than mere financial value. Managers may be able to look at the field of social entrepreneurship to learn how to create such shared value. This chapter presents the concept of social entrepreneurship and introduces two areas in which social entrepreneurs have created novel business models: microfinance and social impact investing. The lessons that can be learned for shared value creation are discussed for the financial industry as a whole and those interested in socially responsible finance. The chapter concludes by presenting several caveats.

Chapter 5 Fiduciary and Other Legal Duties (Benjamin J. Richardson)
In common law legal systems, such as in the United Kingdom and the United States, fiduciary duties exert an important influence on institutional investors' latitude to practice SRI. Obligations on fund managers, trustees, and others who have custody of investors' money generally require that they invest prudently in their best financial interests. In limited circumstances, this legal framework may allow SRI such as when these investments offer comparable returns, the fund's constitution mandates SRI, or if beneficiaries consent to SRI. Recent statutory reforms in some jurisdictions have created a more enabling legal environment for SRI than in the past.

Chapter 6 International and Cultural Views (Astrid Juliane Salzmann)
Even though public and corporate interest in investment with social and environmental considerations is growing, the current literature remains vague about the underlying motives of investors. This chapter investigates the effect of the institutional environment on the social and ecological behavior of firms and investors around the world. It reviews four structural theories—legal origin, endowments, religion, and cultural values—and examines their usefulness to explain cross-country differences in social responsibility. Despite some isolated findings, where research has given explanations for developments in the field of sustainable finance, a deeper understanding of their general determinants remains incomplete. Existing research has primarily focused on religion and culture as explanatory factors for ethical issues in finance. Exploring the impact of the legal origin and endowments might also seem fruitful, but elaboration on the relevance of these theories remains a field for future research.

Section II. Society and Finance

The impact of social concerns on financial activities has evolved over time. Some of the nine chapters of this section describe this evolution in different segments of society, while others detail recent financially irresponsible events. Chapter 7 describes the history of the role of social, environmental, trust, and ethical issues in business. The religious aspects of social responsibility for finance are detailed in Chapter 8. Chapter 9 focuses on the development of microfinance and social banking. Managerial compensation has long been a controversial issue in society and is discussed in Chapter 10. Chapter 11 shows how externalities in the financial

services industry have led to negative outcomes. A large energy efficiency and sustainability trend occurs in real estate. The aspects of real estate sustainability in society are the focus of Chapter 12. Chapters 13 and 14 describe the roles of federal housing policies and predatory lending to the financial crisis. Lastly, Chapter 15 details the history and recent developments in the financial secrecy industry and its role in society.

Chapter 7 Social, Environmental, and Trust Issues in Business and Finance (Christoph F. Biehl, Andreas G. F. Hoepner, and Jianghong Liu)

This chapter discusses social, environmental, and trust (SET) issues relating to business and finance in a historical context. Social issues relating to the concerned societal groups emerged beginning in the mid-twentieth century and have had an increasing impact on business ever since. Recently, societal groups have voiced anxieties about the trustworthiness of certain businesses, especially large financial institutions. These societal trends can be business relevant in both a positive and negative way. Managing these stakeholder concerns can, for instance, build trust and consumer loyalty, but it also costs corporate resources. Due to a consistently increasing complexity of business and finance and a similarly consistently increasing speed of information exchange among concerned stakeholders (e.g., via social media), trust-based businesses such as financial institutions are likely to increasingly face the challenges and opportunities resulting from societal concerns about SET issues.

Chapter 8 Religion and Finance (Luc Renneboog and Christophe Spaenjers)

Individuals' economic attitudes are frequently observed to vary in a systematic manner with religious affiliation or religiosity. As a consequence, religion is also correlated with a range of financial-economic outcomes. Research has established the importance of religion at the macro-economic level, and has shown that the religious environment may affect the behavior of managers and institutional investors. Much less evidence exists on the role of religion in the financial decision-making process at the household level. Therefore, this chapter uses data from a well-recognized household survey to investigate the relationship among religious affiliation, economic attitudes, and saving and investment decisions in the Netherlands. The evidence shows that differences in economic beliefs and preferences can partially explain the higher propensity to save by all religious households and the lower investments in stocks by Catholic households.

Chapter 9 Social Finance and Banking (Olaf Weber and Yayun Duan)

This chapter describes social banking, impact investment, and microfinance as areas of social finance. Each tries to achieve a positive social impact on society, the environment, or sustainable development through social finance and banking. The data show that social finance is successful in creating both a financial and a social return and has been growing in recent years. Impact measurement indicators have yet to be developed to adequately measure the financial and social impact of social finance. Furthermore, transaction costs have to be reduced to maintain attractive financial returns, and broader client groups have to be addressed to increase the impact of social finance.

Chapter 10 Managerial Compensation (Kose John and Samir Saadi)

This chapter surveys the recent literature on managerial compensation, focusing on the main issues that spurred intense debate in the popular press, academia, and from regulatory agencies. In particular, the literature review discusses whether the high levels of executive compensation are justifiable, and whether executive compensation schemes induce unethical behavior by executives. While most of the empirical evidence supports the view that the high levels of executive compensation are excessive and unethical, an emerging stream of literature provides rational explanations for the observed levels of executive pay. Ample evidence also shows that some compensation packages induce executives to manipulate their pay. This chapter also summarizes a limited, but growing, literature linking managerial compensation to corporate social responsibility. This literature suggests that the structure of managerial compensation matters to corporate social performance.

Chapter 11 Externalities in Financial Decision Making (Janis Sarra)

This chapter examines externalities in financial decision making. It explores how the structure of financial products and services has led to considerable harm to individuals and firms, suggesting that the incentives created by the current structure of financial services need serious re-examination. Socially responsible investment could play an important role in retooling the system to ensure that financial decision making and investment contribute to, rather than detract from, the long-term social, economic, and environmental sustainability of firms.

Chapter 12 Real Estate and Society (Piet Eichholtz and Nils Kok)

Real estate can play a key role in averting further climate change because of its high contribution to pollution and substantial energy consumption. Interest in green and sustainable buildings has grown dramatically in recent years with increasing awareness of these factors. This chapter explores the economic significance of the energy efficiency and sustainability trend in real estate, addressing the financial performance of green buildings, in both the United States and international markets. The behavior of corporations with respect to housing decisions is discussed, analyzing how real estate can be used as a proxy for corporate social responsibility. The chapter then investigates how institutional investors integrate sustainability in their allocations to real estate, measuring the environmental performance of dedicated property fund managers.

Chapter 13 Federal Housing Policies and the Recent Financial Crisis (Ronnie J. Phillips and Kenneth Spong)

The recent financial crisis and housing debacle destroyed wealth for homeowners and resulted in a substantial taxpayer bailout. Some contend that federal housing policies were a major reason for the crisis. In particular, public policies adopted under the goal of promoting greater home ownership, especially among low-income individuals, may have led to much weaker mortgage lending standards and put many homeowners at greater financial risk. This social goal of increasing home ownership, and thereby promoting wealth accumulation by low-income families, has a long history and has been supported by both political parties and a wide range of policy makers. This chapter reviews the key laws and policies adopted to promote homeownership and the manner in which they may have

contributed to weaker lending standards, excessive debt burdens, and, in turn, the housing and financial crisis. Several alternative approaches are suggested to promote the goal of greater homeownership and wealth building among lower-income families without threatening the financial health of such families or putting the financial system and taxpayer at risk.

Chapter 14 Predatory Lending and Socially Responsible Investors (Christopher L. Peterson)

This chapter attempts to provide a simple introduction to the complex finance, law, and policy of consumer credit markets with an eye toward helping responsible investors begin to develop the ability to shun predatory lending. While no consensus exists on what lending practices are socially corrosive, responsible investors looking for opportunities in consumer financial markets have an obligation to make their best effort to identify and avoid predatory loans. This chapter first provides a brief introduction to some of the more controversial current lending practices. Next, it summarizes evidence of self-defeating consumer borrower behavior. Then, it provides a cursory characterization of the rapidly evolving law of consumer finance. Finally, this chapter suggests several warning signs of predatory lending that can serve as a starting point for further investigation.

Chapter 15 Use and Misuse of Financial Secrecy in Global Banking (Ingo Walter)

This chapter explores financial secrecy as a product that is traded in organized and unorganized markets. It examines demand functions based on the disutility of financial disclosure, and supply functions based on the ability to impede financial disclosure. The "price" is defined as the displacement of the risk/return frontier incorporating financial secrecy, as opposed to a benchmark frontier lacking protection against financial disclosure. Agency and enforcement problems are examined in the presence of financial secrecy, with an emphasis on tax evasion and money laundering. The framework developed in the chapter is useful in explaining the behavior of principals active in the market for financial secrecy, namely, strategies of individuals, firms, and countries active in the supply of financial secrecy, civil and criminal enforcement actions, and financial flows across regulatory jurisdictions motivated by financial secrecy considerations.

Section III. Corporate Engagement

This section consists of five chapters dealing with the topic of corporate engagement. Chapter 16 focuses on the role of governance in CSR. Chapter 17 investigates the various ways of measuring CSR from the perspective of different stakeholders. Chapter 18 discusses corporate philanthropy from the perspectives of value enhancement and agency cost. Chapters 19 and 20 examine institutional investor and social activism.

Chapter 16 Corporate Social Responsibility and Governance (Lorenzo Sacconi)

Corporate social responsibility (CSR) is a model of corporate governance (CG) extending fiduciary duties from fulfillment of responsibilities towards the firm's owners to fulfillment of analogous fiduciary duties toward all the firm's

stakeholders. After considering the place of CSR in the debate about alternative CG modes, a full-fledged social contract foundation of the multistakeholder and multi-fiduciary model is presented. The chapter shows that CSR is a social norm that would endogenously emerge from the stakeholders' social contract seen as the first move in an equilibrium selection process that reaches the equilibrium state of a CG institution. The social contract provides a model of the impartial mediating reasoning performed by a board of directors striving to balance different claims of stakeholders. It also allows deducing the multistakeholder objective function that socially responsible firms maximize, and then provides a specification of the particular fiduciary duties owed to each stakeholder according to its position.

Chapter 17 Measuring Responsibility to the Different Stakeholders (Amir Rubin and Eran Rubin)

This chapter provides a discussion of the complexity of having an all-encompassing measure that quantifies corporate social responsibility (CSR) performance of a firm. It suggests an approach for measuring the different aspects of CSR, aimed to better align social and corporate goals. The chapter analyzes the different stakeholders associated with CSR and their interrelationships. The chapter contains a survey of the literature on stakeholder specific measures, whose purpose is to provide transparency on how a corporation affects a specific group of stakeholders. The chapter also presents a brief history of stakeholder specific responsibility measures and discusses how these measures are used in both academic work and practice.

Chapter 18 Corporate Philanthropy (Janet Kiholm Smith)

This chapter explores a myriad of issues related to corporate philanthropy. The historical accounts of firm involvement in social causes provide perspective for understanding the empirical evidence regarding the determinants of corporate giving and its impact on firm performance. The two primary hypotheses for giving programs, value enhancement and agency cost, generate testable implications that have been widely studied. Overall, the results suggest that enhanced financial performance is not the overriding concern of managers when authorizing corporate contributions. Instead, most evidence points to the prevalence of agency costs. However, the evidence cannot refute the notion that some firms align their philanthropy with underlying strategy and may be successful at leveraging their giving to differentiate their product or work environment. This chapter identifies various methodological and data-related challenges for research on corporate philanthropy.

Chapter 19 Institutional Investor Activism (Diane Del Guercio and Hai Tran)

For the past quarter century, institutional investors have been frequent activist shareholders on corporate governance issues. A large literature of academic research examines whether this activity is effective in influencing target firms and enhancing the performance of both target firms and activists' portfolios. The importance of this question stems from the role of institutional investors as large and influential investors in the capital markets and as financial fiduciaries who are entrusted with the assets of millions of clients and beneficiaries. This chapter examines the many parallels between the issues that institutions face today in incorporating environmental, social, and governance criteria into their

investment and activism programs, and the issues arising 25 years ago in the context of corporate governance. In short, socially responsible activism appears to be in the early stages of gaining momentum and legitimacy among mainstream institutional investors, with a steady stream of academic research likely to follow.

Chapter 20 Social Activism and Nongovernmental Organizations (Jonathan P. Doh and Deborah Zachar)

This chapter provides an overview of the role of social activism in the realm of socially responsible finance and investing. The chapter begins with a brief review of various perspectives on corporate social responsibility, focusing especially on the role of stakeholder theory and stakeholder management. It then documents the emergence of civil society actors such as nongovernmental organizations (NGOs) as critical players in the process by which stakeholders influence financial decisions through their activism. Next, the chapter describes the various mechanisms through which activists influence finance and investments. The chapter concludes with suggestions for further research.

Section IV. Socially Responsible Investing

The four chapters in this section examine the investment aspects of social responsibility. Chapter 21 focuses on the corporate long-term value associated with the firm making socially responsible investments. The last three chapters discuss various aspects of social responsibility in the investment industry. Chapter 22 discusses the risk-adjusted performance of SRI institutional investors and financial companies. This is followed by Chapter 23, which details the historical development of SRI and its investment performance, and concludes with predictions about its future. Lastly, Chapter 24 demonstrates the money flows into and out of SRI funds globally.

Chapter 21 Corporate Socially Responsible Investments (John R. Becker-Blease)

Corporations making socially responsible investments have attracted considerable interest in the popular press over the past several decades. The impact of these decisions on corporate value and the intended beneficiaries is the subject of a substantial academic literature in management and economics, and a small but growing literature in finance. Researchers suggest five potential sources of long-term value from corporate social responsibility (CSR) focused investments. This chapter reviews the literature associated with each potential source of value, and concludes that the preponderance of evidence is consistent with the hypothesis that CSR-focused investments are associated with long-term value creation.

Chapter 22 SRI Mutual Fund and Index Performance (Halil Kiymaz)

This chapter provides a review of the literature on socially responsible investing (SRI) with particular emphasis on empirical evidence of mutual fund and index performance. SRI is no longer a negligible segment of international capital markets. During the last two decades, SRI has increased sharply, reflecting the changes in investor sensitivities in social, environmental, and ethical issues. The main issue for firms is whether providing a risk-adjusted return to investors is possible while being socially or ethically responsible. Although the issue is far from being

resolved, the existing literature tends to report that a cost is associated with investors willing to invest in SRI. Further, investors appear to accept lower performance to seek their moral choice of investment.

Chapter 23 Performance Implications of SR Investing: Past versus Future (Nadja Guenster)

This chapter discusses the impact of socially responsible investment (SRI) strategies on portfolio performance. It focuses on two common investment strategies: investing in firms with leading environmental, social, and governance (ESG) policies and shunning firms that are involved in "sinful" business activities. Examples of so-called sinful business activities are tobacco, alcohol, gambling, and weapons. Two opposite effects have influenced the performance of SRI methods over the last decades. First, a strategy of overweighting firms with high ESG standards and underweighting firms with poor standards earned positive abnormal returns. Second, SRI investors lost out on high returns on sin stocks. Although socially responsible investors, in aggregate, often experience similar performance to conventional investors, this is likely to change. In an efficient market, firms with high ESG standards should not earn higher returns than firms with low standards. The empirical evidence suggests that this equilibrium is approaching. Then, socially responsible investors missing out on the high sin stock returns are likely to underperform conventional investors.

Chapter 24 Money Flows of Socially Responsible Investment Funds around the World (Luc Renneboog, Jenke Ter Horst, and Chendi Zhang)

This chapter studies the money flows into and out of socially responsible investment (SRI) funds around the world. In their investment decisions, investors in SRI funds may be more concerned with ethical or social issues than with fund performance. Therefore, SRI money flows are less related to past fund returns. Ethical money is less sensitive to past negative returns than are conventional fund flows, especially when SRI funds primarily use negative or sin/ethical screens. Social attributes of SRI funds weaken the relationship between money inflows and past positive returns. However, money flows into funds with environmental screens are more sensitive to past positive returns than are conventional fund flows. Stock picking based on in-house SRI research increases the money flows. These results give evidence on the role of nonfinancial attributes, which induce heterogeneity of investor clienteles within SRI funds. No evidence of a smart money effect is found, as the funds that receive more inflows neither outperform nor underperform their benchmarks or conventional funds.

SUMMARY AND CONCLUSIONS

Since the late 1960s and early 1970s, CSR and SRI have gained considerable momentum. Since that time much discussion and research has focused on these two areas. According to Sparkes (2002, p. 65), "CSR and SRI are two sides of the same coin. Yet, the two terms differ in that SRI takes a bottom-up approach that focuses mainly on the power of investors, while CSR is a top-down approach that requires more action from corporations than investors."

Both the theory and practice of CSR and SRI have been moving ahead at a rapid pace, and this momentum is likely to continue in the future. Thus, gaining an understanding of the key principles and concepts of CSR and SRI as well as the empirical evidence involving these topics is more important than ever. Although this is a daunting task, this book can help provide the basis for achieving this understanding. Enjoy the trip as you explore the many facets of socially responsible finance and investing.

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ABOUT THE EDITORS

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