

Socially Responsible Investments, as a Trend on the European Capital Market

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Abstract: *Purpose* – A diagnosis of the situation on the socially responsible investments market in Europe. Secondary purposes: outlining the theoretical frames of corporate social responsibility and of socially responsible investments and showing the dependency between them and creating a profile of a socially responsible investments market in Europe.

Methodology – The method of critical literature analysis within the area of CSR and SRI has been used in the article. Additionally, the method of analysis of secondary data from the reports of FTSE4Good, Eurosif and Vigeo has been used in this paper.

Result – Showing dependency between the development of CSR indexes and the socially responsible investments and highlighting the profitability of these kinds of investments.

Originality/value – Changes in the area of index development and socially responsible investments in Europe have been presented in the article.

Keywords: corporate social responsibility, *socially responsible investing*

Introduction

The functioning of a great business greatly affects its surroundings – it creates employment conditions, influences peoples' economic situation which also influences the standard of living. Enterprises' activities often also affect the natural environment. Corporations create a style of consumption present in a given society and people representing them often take an active part in public life, affecting the adopted solutions that create order and harmony in a country. In view of such great companies' influence on the reality that surrounds us, consumers ought to start demanding concrete actions and recompensation for the negative and undesired results of the market activities of those entities. The response to the growing demand that modern enterprises face is the concept of corporate social responsibility (CSR). The development of the CSR concept has contributed towards the situation in which more investors have started to see socially responsible companies as valuable business partners. It has given rise to the idea of socially responsible investing (SRI). CSR and SRI can be treated as coherent and mutually complementing elements of well-balanced economic growth.

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The purpose of this paper is to diagnose the situation on the socially responsible investments markets in Europe. Considering the wide range of this problem, the author has decided to draft additional secondary purposes. The first one is outlining the theoretical frames of corporate social responsibility and of socially responsible investments and showing the dependency between them. The second one is creating a profile of socially responsible investments market in Europe. This paper has theoretically an empirical character, the critical literature analysis from the area discussed with subject has been the method used in this article. Additionally, the method of analysis of secondary data from the reports of the FTSE4Good, Eurosif and Vigeo has been used in this paper.

1. The core of business responsibility

In the 1990s a broad discussion about ethics in business life was carried out. People tried to establish to what extent economic subjects should be held responsible for the not always positive effects of their actions (Jastrzębska 2011, p. 106). The concept of social business responsibility, that is recently becoming more important, has its roots in the mentioned period. Nowadays, CSR is a combination of the voluntary actions of both enterprises and legislature on the domestic and international level. New initiatives engaging a country's administration, non-government organisations, and business leaders are still aiming to integrate social, economic, and environmental matters with the enterprises' activity and the adopted business strategy.

Literature gives many definitions of social responsibility, one of the most common ones is the one introduced by the European Commission that treats CSR as a "companies" responsibility for their influence on society (...) in order to:

- maximize creating common values for their owners/shareholders, other interested parties, and society as a whole,
- recognise, prevent, and soften their possible negative results" (Odnowiona strategia UE na lata 2011–2014...).

The business of responsibility is a long-term and strategic approach that relies on searching the most profitable solutions for co-operation between enterprises and their surroundings. It means intensified investments in a company's human resources, in its relations with stakeholders and in the protection of the natural environment. The international ISO 26000 Norm, that contains the guidelines concerning social responsibility, is the basic source of information for enterprises interested in gaining profits from operating in a socially responsible way. The Norm enumerates 7 key areas, on which the companies should focus. They are shown below in Figure 1.

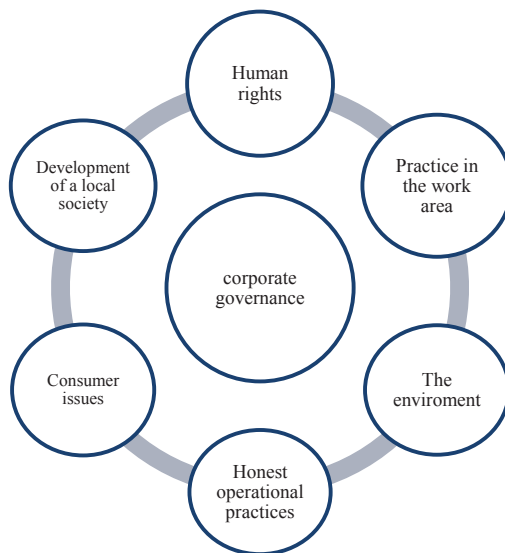


Figure 1. Areas of responsible business

Source: *Wytyczne dotyczące społecznej odpowiedzialności.*

To fully use the CSR concept it is vital to join socially responsible activities with the broader long-term business goals of enterprises. It creates many chances for companies, such as:

- the access to the capital of investors, who, while making decisions, take into consideration ESG¹ factors, for example reporting and taking part in responsible market indexes,
- the opportunity to take a leader's position due to involvement in social, ecological, and economic issues important for the company and its environment,
- the opportunity to recruit talents – employees show greater commitment to work in the organisations that consider socially responsible objectives,
- the opportunity for innovations – through affecting the managing of stakeholders and the social and environmental situation, CSR creates innovations and even leads to the distinction of new markets (for example renewable energy),
- the opportunity to improve a company's image,
- the opportunity for better risk management – through contact with the environment/stakeholders, it becomes possible to recognise potential problematic planes (Jak zyskać na odpowiedzialności? CSR w strategiach spółek giełdowych 2012).

¹ Factors on the basis of which the rankings and extra financial evaluations of enterprises, countries, and other organisations are created: E – environmental, S – social responsibility and G – corporate governance.

2. The core of socially responsible investments

Apart from the factors listed above, it can be noticed that companies which in their actions take social criteria into consideration are an interesting market niche from the investors' point of view. On the basis of the CRS concept, in the financial investments sector, the idea of *socially responsible investment* has been created. The basic factor that distinguishes SRI from other kinds of strategies is the emphasis on the strategy of assembling the investment portfolio. While creating it, investors take into consideration not only purely economic factors but also the question of if the company operates in accordance with ethical norms (Duliniec 2015: 40). Therefore, we are dealing with the well-known portfolio theory that assumes the normative theory of assembling assets that are a part of an investment portfolio², extended by environmental and social aspects. Now, it is important to highlight the complexity of assembling those companies that declare CRS activity. The European agency EUROSIF, that reports the state of socially responsible investment on the old continent, adopts the following strategies of companies' selection (European SRI Study 2014):

- *exclusions*, based on the concept of avoiding investment in enterprises which face ethical reservations. This group includes companies connected to the military, tobacco and the nuclear power sector and subjects that are accused of breaking international laws and agreements, unethical treatment of animals, or co-operation with political regimes,
- *positive screening*, assumes the active recruitment of companies when the operations or products are characterized by particular values for society and the environment, companies dealing with purifying drinking water and caring for its quality can be given here as an example (SRI Connect),
- *best in class*, based on selecting socially responsible companies among the companies from a particular branch or sector,
- *engagement and voting*, the evaluation of companies' commitment in implementing the elements of socially responsible business in their operations and long-term strategy,
- *impact investing*, adding enterprises, funds, and organisation, that apart from generating return rate also affect the natural environment and local community, to the investment portfolio,
- *ESG integration*, the selection of subjects which in their operations follow the broadly understood ESG factors (European SRI Study 2014).

The core of socially responsible investments is connected not only to the pro-society activities. It is worth pointing out that it is above all the enormous mechanism of investment capital flow. Socially responsible investments are becoming a more popular alternative for the classical forms of allocating capital. It is estimated that the worth of the SRI market has perked in 2014 by 20 trillion EUR.

² The investor's main purpose is to maximize the return rate of the engaged capital in relation to the level of risk taken (Markowitz 1952).

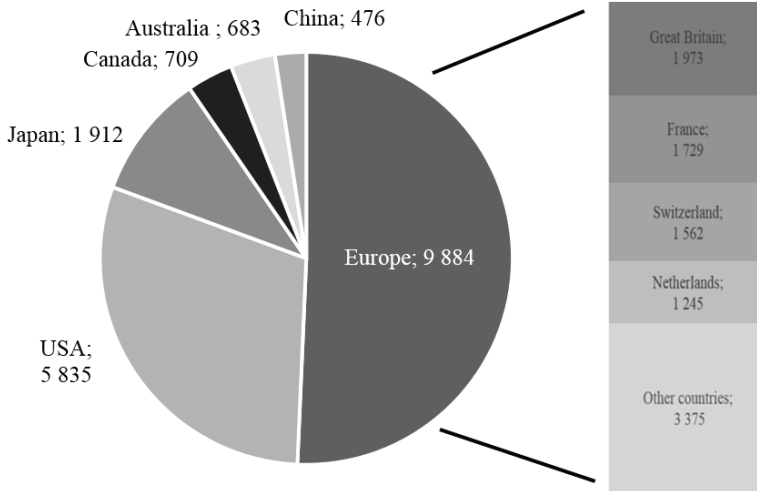


Figure 2. The structure of the socially responsible investments market in the world (bln EUR)
 Source: developed based on: Sobótka (2016); European SRI Study (2014).

The indisputable leader on the world’s socially responsible investments market is Europe. The value of assets located in socially responsible subjects, in the year 2014 was 9,885 bln EUR. The prominent development of SRI can be observed especially in Great Britain (1,973 bln EUR), France (1,729 bln EUR), Switzerland (1,562 bln EUR) also in the Netherlands (1,245 bln EUR). The aggregated assets in those four countries comprises over 65% of all socially responsible investments made on the continent. The second large socially responsible investments market, which is estimated to be worth 5,835 bln EUR, is the United States. A relatively new but still important player on the SRI market is Japan, with a market potential of 1,912 bln EUR. The influence of remaining countries implementing the green investments concept is significantly smaller, as presented: Canada 709 bln EUR, Australia 683 bln EUR and China 476 bln EUR. Market tendencies that allow assuming that the development of socially responsible investments market may further dynamically develop in time are currently observed.

3. CSR indexes and responsible funds in Europe

The spreading of corporate social responsibility has forced markets to create mechanisms of verification and valuation of companies. It is a result of the fact that both individual and institutional investors have to base their decisions on a number of financial effectiveness measurements, extended in this case with ESG factors. The turn of the 21st century marked the beginning of the trend of creating indexes when companies were characterised by high

ethical standards and which realised the assumptions of a broadly understood policy of balanced development.

The first social responsibility index in Europe was the FTSE4GOOD, created in July 2001. This index, noted on the London Stock Exchange, was created in order to measure the effectiveness of the companies functioning in accordance with global standards of corporate social responsibility. Thanks to the benchmark which made it possible for both individual and institutional investors to build asset portfolios containing companies functioning in accordance with broadly understood ethical norms. Index construction is based on the two most important methods of verifying CSR companies, which are negative and positive selection (Adameczyk 2013, p. 13).

Over the years, the family of FTSE4GOOD indexes dynamically developed, and new benchmarks based on companies' alternative forms of *screening* have been created. Nowadays, FTSE4 GOOD Indexes include over 2,000 enterprises functioning on 23 world markets (FTSE www.ftse.com/Analytics). Table 1 shows the juxtaposition of the chosen FTSE indexes containing their return rate and variability ratio.

Table 1

Juxtaposition of profitability and variability of the chosen FTSE indexes

The name of the index	Index' return rate (%)						Variability (%)		
	3M	6M	YTD	12M	3YR	5YR	1YR	3YR	5YR
FTSE4Good Global 100	4.8	-3.4	-1.0	-5.9	17.5	32.8	15.1	12.9	13.6
FTSE4Good UK 50	6.8	-6.6	-1.2	-12.3	1.0	8.4	21.3	18.0	15.4
FTSE4Good Europe 50	6.0	-6.1	-1.0	-12.1	1.0	2.9	19.7	16.4	16.6
FTSE4Good US 100	4.8	-1.3	0.0	0.3	41.7	79.9	16.6	12.4	11.9
FTSE USA	7.3	0.2	1.6	0.5	36.8	67.7	16.4	12.6	12.2
FTSE4Good Australia 30	15.4	9.1	5.4	-10.8	-15.4	3.8	25.6	20.3	21.1
FTSE Australia	15.3	9.6	5.5	-8.6	15.3	-5.2	24.8	20.2	21.4
FTSE4Good Japan Benchmark	2.6	-7.4	-6.0	-9.8	5.5	30.5	24.2	18.0	14.8
FTSE Japan	6.4	-2.8	-2.3	-5.3	10.3	30.5	24.3	17.6	14.0

Source: developed based on: FTSE www.ftse.com/Analytics.

From the perspective of the potential investors allocating capitals in CSR indexes, apart from the fact that they function in accordance with ethical norms, the return rate they reach should also be important. Effectiveness of the socially responsible investments, from the moment of creating such investment instruments, has become the subject of numerous studies. Without doubt, the most popular method is studying the relationships between traditional indexes and those that are based on ESG factors.

Comparing the short-term and long-term return rate of the indexes belonging to the FTSE4Good group, a few important conclusions can be made. As is shown in table 1, it cannot be explicitly stated that responsible indexes achieve better results than major market indexes. In 5 years, European FTSE4Good indexes have achieved much lower return rates

than major world indexes of such kind. As an example one can point to such indexes as the FTSE4Good UK 50 (8.4%) and the FTSE4Good Europe 50 (2.9%) that have noted drops of 12 pp in the analysed period. In contrast, the American FTSE4Good US 100 has achieved a long-term profitability rate of 79.9% which was 12.2 pp higher than the main FTSE USA benchmark. Therefore, one cannot explicitly validate or negate the supremacy of socially responsible indexes over traditional market indexes from the perspective of their profitability, in the case of the FTSE4Good indexes group.

With the development of the CSR concept, market need in the field of creating financial products that would allow individual and institutional investors to participate in socially responsible investments has been born. It has given rise to the so called socially responsible financial products, which are defined as all products and services provided by banking, insurance and investment managing sectors which, in their investment decisions, take social, ethical, and environmental criteria into consideration. Most funds of this kind invest accumulated money in the company’s shares. Thanks to the benchmark, created by market indexes such as the FTSE4Good or Dow Jones Sustainability Index, it is possible to select subjects fulfilling particular criteria [Opinia Europejskiego Komitetu Ekonomiczno-Społecznego...]

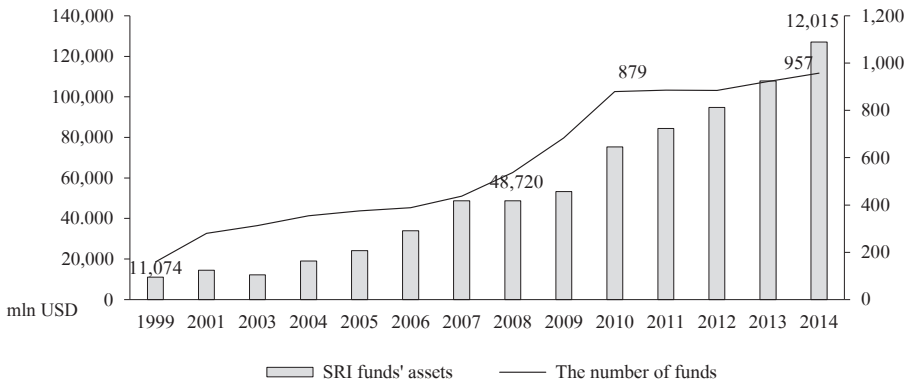


Figure 3. SRI Funds Market in Europe

Source: developed based on: Krupa (2012), p. 314; Vigeo (2014).

The market of responsible investment funds has been systematically growing in Europe. Based on the Vigeo reports, in 15 years the worth of assets aggregated in these types of financial products has grown from 11,074 bln EUR to 127,015 bln EUR. The number of functioning SRI funds has also dynamically grown, from 158 in 1999 to 957 in 2014. Evident growth in the number of funds functioning in Europe took place during the years 2008–2010; therefore, in the period of the world financial crisis. The specificity of the sub-prime crisis has influenced in large part the limitation of investors’ trust towards the capital

market, the niche created has been filled by funds operating in accordance with ethical norms.

The data presented in Figure 2 strongly confirm the development tendencies of the SRI market in Europe. However, one has to wonder what incentives are investors locating capital in those kinds of investment products taking into consideration. Based on the carried out observations on the profitability of European CSR indexes, which companies are a vital element of the portfolio of the discussed funds, one can question the viability of these kinds of investments, as they are not characterised by bigger return rate from the involved capital than in the case of classical forms of investments.

In order to make more precise conclusions, it is worth mentioning other studies on the profitability of socially responsible investments. Valuable observations on the matter have been made by Bauer, Koedijk, and Otten (2005). They have analysed 103 SRI funds functioning in the USA, Germany, and the UK, over a period of 10 years. In the results of the study, no statistically important difference between the profitability of classical funds and those creating investment portfolios based on ethical criteria was made. It is vital, however, that the SRI funds have been characterised by significantly smaller sensitivity on market hesitancy than the traditional funds. It could mean that SRI funds work better as a capital deposit with a long-term purpose than as a part of aggressive investment portfolios with a short-time purpose.

Conclusions

The dynamic development of the concept of corporate social responsibility is without doubt one of the most break-through moments that have taken place in the modern economy. The expansion of capital instruments based on SRI criteria is without doubt the result of investors' change of approach, which, in their decisions, began to take into consideration ethical matters. In this paper, it has been proven that the development of the CSR indexes is closely correlated with the growth of socially responsible investments, as the first ones are the benchmark which allows investors to allocate capital in accordance with a standing investment strategy based on ESG factors.

The observations made by the author have not shown the supremacy of socially responsible investments over the traditional investment approach. In the case of analysing the main Indexes of the FTSE4Good family by their profitability in 5 years' time, no major aberrations from the remaining benchmarks have been observed. The lack of this dependency has also been shown by the results of the study of investment funds presented in this paper. On the basis of all this, one can state that the dynamic development of a socially responsible investments market in Europe is, in great part, conditioned by behavioural factors.

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INWESTYCJE SPOŁECZNIE ODPOWIEDZIALNE, JAKO TREND NA EUROPEJSKIM RYNKU KAPITAŁOWYM

Streszczenie: *Cel* – Diagnoza sytuacji na rynku inwestycji społecznie odpowiedzialnych w Europie. *Cele poboczne:* nakreślenie ram teoretycznych społecznej odpowiedzialności biznesu oraz inwestycji społecznie odpowiedzialnych oraz wykazanie ścisłej zależności między nimi oraz charakterystyka rynku inwestycji społecznie odpowiedzialnych w Europie.

Metodologia – W artykule wykorzystano metodę krytycznej analizy literaturowej z zakresu CSR oraz SRI. Dodatkowo w pracy posłużono się metodą analizy danych wtórnych pochodzących z raportów FTSE4Good, Eurosif oraz Vigeo.

Wynik – Wykazanie zależności między rozwojem indeksów CSR, a inwestycjami społecznie odpowiedzialnymi oraz wykazania rentowności tego typu inwestycji.

Oryginalność/wartość – W artykule przedstawiono zmiany, w zakresie rozwoju indeksów oraz inwestycji społecznie odpowiedzialnych w Europie.

Słowa kluczowe: *społeczna odpowiedzialność biznesu, odpowiedzialnie społecznie inwestowanie*

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