# GLOBAL FINANCIAL CRISIS AND THE EMERGENCE AND MATURING OF SOCIALLY RESPONSIBLE INVESTMENTS

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## ABSTRACT

Purpose – *The purpose of this study is to show how socially responsible investment (SRI) could represent a powerful tool (trust recovering in political and economic institutions) in the case of failure or stagnation of economic and financial growth. The purpose of this chapter is to evaluate the current status of SRI in the context of the recent financial and economic crises. The main objective of this analysis is to consider the different benefits and challenges that this type of investment transactions bring into the international economy, and how SRI entrance could represent a major benefit not only for investors a different approach to corporate sustainability but as an important possibility in times of global economic and political crisis.*

Methodology/approach – *By analysing the literature about SRI, it has been developed a discussion regarding its benefits and obstacles in today's financial scenario. By evaluating the performance of SRI in the*

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*context of the global financial crisis and the important opportunities regarding development, we would like to present the SRI as an important tool in today's Post 2015 development agenda.*

Findings – *After revising the existent literature, it has been found that there are two important discussions in the field of SRI. The first one is related with the financial performance of SRI in contrast with the conventional investment funds while the second one is related with important considerations about the SRI in the context of the global financial crisis. After considering the arguments from the different authors, we address some conclusions regarding the importance of SRI in nowadays sustainable development discussion.*

Practical implications – *Due to failure in the traditional modus operandi of financial institutions and the recent global crises, investors, corporate executives and governments are increasingly paying more attention on the social, environmental and ethical behaviour of individual managers, shareholders and institutional investors. Therefore, it is being observed a shift and maturing process in SRI from an exclusive practice of few and specialised niche investment funds with minor financial implications and limited economic importance, to mainstream adopted by a growing number of institutional investors at the international level. This shift may influence companies and managers to adopt universal values and to assume a committed and strategic CSR agenda to respond to markets and societal expectations, in order to have guilt-free and sustainable investment and sustainable financial markets.*

Originality/value – *Within the context of the Post 2015 development agenda, the role of business and the private sector has become crucial for funding the new sustainable development goals (SDGs). This chapter not only discussed the relationship between SRI as an alternative to overcome financial crises and lack of sustainability in investment, but it does also conceptually demonstrates the potential of SRI to achieve the funding of the SDGs.*

**Keywords:** SRI; CSR; corporate governance; SDGs; Post 2015

## INTRODUCTION

The history of capitalism has been accompanied with a diverse (in terms of duration, frequency and ferocity) range of cyclical financial crises

associated to financial missteps, inflationary spikes, government defaults, international and domestic debts, and banking panic since medieval times, and have historically been universal rites de passage for emerging and established market nations (McDonough, Reich, & Kotz, 2010; Reinhart & Rogoff, 2009). Recently, since the 1990s, the world has experienced a considerable large number of financial crises: the collapse of Japanese asset price bubble in 1990, followed by the Scandinavian banking crises; the 1992−1993 speculative attacks on European currencies (Black Wednesday); the 1994−1995 economic crisis in Mexico; 1997−1998 the devaluation and banking crisis across Asia; 1998 Russian financial crisis; 2000−2001 Turkish economic crisis; 1999−2002 Argentine economic crisis; 2001 the dot.com bubble; 2008−2011 Icelandic financial crisis; 2007−2008 global financial crisis; 2010 European sovereign debt crisis; 2014 Russian financial and crisis and 2015 the Euro crisis. However, as Reinhart and Rodoff (2009) have historically described, the severe economic and financial crises that broke out in 2008, which have been considered the worst financial crisis in the Great Depression of the 1930s, implies that 'this time is different', as it threatens the collapse of large financial institutions (which was previously prevented by the bailout of banks by the national governments), the free-market/post-liberalism form of capitalism since the 1980 and the increasing financialisation of the world economy.

The idea of creating a more sustainable financial sector may have emerged from the unquestionable financialisation of economic sector at the international level, and therefore, the consequences of its failure affecting political, economic and social dynamics around the globe. Different discussions have become visible at the political and economic levels, and the SRI seems to be a possible alternative to the current financial system promoting sustainable development. SRI considers financial and non-financial criteria to establish where to invest (Guay, Doh, & Sinclair, 2004). It means that SRI is a type of investment which additionally to the normal risks and return dynamics includes social and environmental concerns in the construction of the equity portfolio (Sparkes, 2008). This implies that SRI excludes from an investment portfolio certain companies with unacceptable social or environmental practices (idem).

SRI has not only demonstrated a better performance in the post-global economic crisis, but it is a growing trend in the financial market, and it is also a good possibility for companies and investors to engage in corporate social responsibility standards and respond to the current demands of sustainable principles.

The following chapter evaluates the concept of socially responsible investing, its origin and evolution within last decades. Later on, findings concerning the arguments analysing the benefits and obstacles of this investment practice addresses, and a discussion regarding the importance of the SRI in the context of global financial crisis will be presented. Finally, some conclusions regarding the increasing importance of SRI in sustainable development are drawn.

This chapter analyses the different studies concerning SRI. By evaluating different authors, it presents the benefits and deficiencies of SRI in nowadays scenario. Specifically, it analyses the emergence and maturing of SRIs in the context of the global financial crisis. The purpose of this study is to show how SRI could represent a powerful tool in today's development agenda.

## SOCIALLY RESPONSIBLE INVESTING

Event though, still there is not consensus in terminology to refer to ethical, social, green and SRIs, during the last decades SRI has emerged as a way to connect the financial sector with social expectations of stability and predictability of the financial institutions, and the developing link with the practice corporate social responsibility and corporate governance (Sparkes & Cowton, 2004). The idea of taking into account environmental, social and governance (ESG) considerations in the investment process has presented a significant growth during last years, but the introduction of ethical and social standards in the investment process is not entirely new (Clinebell, 2013). SRI has become an investment philosophy which has been embraced by an increasing number of investment institutions at the international level (Sparkes & Cowton, 2004). The foundations and values behind of SRI can be found in different religions as Catholicism, Judaism, Methodism, and Quakers, shareholders ethical demands and social movements, which promoted moral standards within their communities (Berry & Junkus, 2013; Guay et al., 2004) and therefore, in daily activities like free, transparent and fair trade. However, the explicit incorporation of ESG aspects in the investment choices is a relatively new trend (Oh, Park, & Ghauri, 2013). Ethical and socially committed investing was highly encouraged during the 1920s by religious groups (Guay et al., 2004); in 1960s by the anti-war social activism; in the 1970s the firm SRI Pax World Fund was established (idem); during 1980s, with the corporate governance crisis, SRI found its

turning point (Clinebell, 2013); in 1999 was launched the Dow Jones Sustainability Index (DJSI) as the first global sustainability benchmark (Gonzalez-Perez & Leonard, 2015); in the year 2000, the Pension Disclosure Regulation in the United Kingdom was amended to include that all pension funds should disclosure the degree of the ethical, social and environmental considerations (Guay et al., 2004); this was followed by the insertion of the SRI clause into REISTER pension legislation by the German Green Party (idem); in 2013, the United National Global Compact in partnership with Sustainalytics launched the Global Compact 100 index in which are included the 100 companies that have demonstrated leadership and commitment to the 10 UN Global Compact Principles (Gonzalez-Perez & Leonard, 2015); and more recently in 2014 the World Investment Forum focused on investing in the Post 2015 sustainable development goals (SDGs), and it was hold a Sustainable Stock Exchanges Global Dialogue (UNCTAD, 2014).

Social Responsible Investment can be defined as the consideration of social, environmental and corporate governance impacts in the financial investment decision-making process. The main purpose of this approach is to promote sustainability principles in the financial sector and consequently in the society (Capelle-Blancard & Monjon, 2012). The strategies implemented by the SRI are commonly: security screening, shareholder advocacy and community investment (Clinebell, 2013; Martin, 2008). The first one is related with the importance of filtering business practices in this process; SRI funds use negative screening to identify specific products, sectors or companies that do not comply with certain social requirements (tobacco, alcohol, weapons and pornography are commonly rejected sectors) while positive screening identifies business practices that could be considered as a SRI (Berry & Junkus, 2013). The shareholder advocacy and activism refers to the ability of investors to actively promote sustainable practices within the decision-making process of the firms. Finally, community investment is associated with the implementation of social investments in unattended communities (Branch, Ma, Shafa, & Shaw, 2014).

Throughout this process, investors and financial institutions seek to guarantee sustainability within the financial supply chain; by integrating SRI principles in their operations, investors receive returns that exceed financial gains (Escrig-Olmedo, Muñoz-Torres, & Fernández-Izquierdo, 2013). In this regard, this perspective combines the possibility to create greater long-term value for both investors and companies, and the idea of encouraging ethical standards within business. In the international arena, SRI principles are nowadays promoted by several international institutions,

which seek the implementation of ESG principles in the financial sector. Among these initiatives, the United Nations Principles for Responsible Investment and the Social Investment Forum can be highlighted. Those are the financial indexes which make tangible companies' efforts in the social and environmental investing, and can also attract more investors into this trend (Berry & Junkus, 2013).

This type of efforts can be evident by the growth that these investments have presented recently; approximately 11 per cent of the United States professionally managed assets are involved in SRI, and this number ascends to 17 per cent in Europe (Berry & Junkus, 2013; Cortez, Silva, & Areal, 2012; Oh et al., 2013). This practice is also evident in Nordic countries like Sweden, Norway, Denmark, and Finland, where it presents the largest growth rates (Scholtens & Sievänen, 2013). Due to these efforts, and to the devastating consequences of the last financial crisis, SRI has emerged as an alternative in the *moral crisis* of capitalism (Capelle-Blancard & Monjon, 2012). Conclusions regarding the financial performance of SRIs are not clearly conclusive; as it will be presented, some authors support the thesis of better returns, others support studies showing the underperformance of these funds, and some other show there is not a statistically significant difference between conventional investment performance and SRI.

## METHODOLOGY

Based on a review and subsequent analysis of the reviewed literature, the present conceptual chapter evaluates different studies concerning SRI. Conclusions regarding SRI from different authors in the field will be useful to identify the nature and the different effects of SRI, and consequently the possible emergence and maturing of this type of investments in the context of global financial crisis.

## FINDINGS

There is not real consensus in literature about the exact causes of the 2008 financial crisis; although, within the different arguments, commodities boom, deregulation in the system, easy credit conditions, subprime lending, increased debt burden or overleveraging, growth of the housing bubble,

financial innovation and complexity, a short-term approach of financial investors, incorrect pricing of risk, boom and collapse of a shadow banking system, and systemic crisis emerge as common explanations by different analysts. The apparent stability and liquidity that preceded the collapse of the economic crisis could not be sustainable, and resulted in a financial and economic crisis (Jayadev, 2009). Although there is a consensus about the possibility that SRI has in terms of conciliating financial and sustainable development interests (Capelle-Blancard & Monjon, 2012).

The introduction of SRI principles in the process of investment has different consequences in the financial market, in the companies, and in sustainability standards. The process of developing SRI principles, and in a more tangible way, SRI funds (SRF), has demonstrated the creation of more long-term value than conventional investing (Oh et al., 2013). In this sense, some authors see the implementation of SRI as a way to avoid consequences of the *short-termism* that caused last financial crisis (Cortez et al., 2012). SRI is becoming an increasing trend in the financial sector, whereas the traditional investing model seems to be declining (Scholtens & Sievänen, 2013). One of the most important consequences of this type of investing is their ability to improve firms' performance; by inserting in this process, companies can build a competitive advantage (Escrig-Olmedo et al., 2013), and consequently, they can surpass the performance of their peers in the long run (Oh et al., 2013).

Due to the 2008–2009 financial crisis, the financial market has undergone changes in its structure. Some authors suggest that consumers and investors pay increasingly more attention to democratic values within companies and responsibility in the market (Scholtens & Sievänen, 2013). The imminent emergence of the SRI in developed countries suggests a twist in consumer habits within the financial sector; consumers will prefer to purchase products and services that come from firms investing in CSR practices (Berry & Junkus, 2013). By integrating socially responsible stakeholders in the decision-making process of the companies, there has been an increase in the number of socially responsible stocks in the financial market. In this sense, shareholder activism along with SRI is becoming integral parts of other increasing trend: CSR (Oh et al., 2013), which can be considered a great gain in sustainability.

Another spillover effect possibly caused by the implementation of SRI is the promotion of socially responsible business practices. The incorporation of SRI practices by the fund managers can improve the performance of their funds and also change the social, environmental, and corporate governance practices within the companies (Oh et al., 2013). The establishment

of CSR principles together with the SRI can create better ESG conditions. For instance, many banking institutions have decided to engage in the financing of renewable energy and emissions trading; these type of initiatives have direct effects over the companies' reputation (Oh et al., 2013). And, in this sense, they can consequently increase the value of their shares in the financial market (De Leaniz & Del Bosque, 2013). Also, enterprises with a good reputation can be more protected from changes in the market share price, and they also can present more stability than other firms that are not engaged in these practices (Cortez et al., 2012). Moreover, companies can get profit from the high growth potential that products with sustainable standards have (Oh et al., 2013).

Despite the evident growth of the socially investing in the financial markets of developed countries, this trend presents some difficulties that could eventually obstacle its effective position in the financial sector. These weaknesses are related with the structural organisation of the financial system itself and also with institutional framework surrounding investments around the world.

The first limitation regarding SRI is associated with its capacity to be applied in the different financial markets. This is the case of developing countries, in which the presence of SRI is still limited. For the case of Latin America, despite the big efforts that companies have done in sustainability principles – according to *The Sustainability Year Book 2014* (RobecoSAM AG, 2014) companies in the emerging markets are increasingly becoming more comparable to their developed market peers – the establishment of an appropriate SRI structure has not been possible. Vives (2012) argue that the Latin American territory does not have the favourable conditions for these initiatives in terms of economic and financial capacity, structure, and even culture. Compared to developed countries (such as United States and Spain), even the most developed Latin American countries have a relatively weak banking sector and share market. Latin American stock exchanges do not have the needed market capitalisation and liquidity for the appropriate establishment of SRI funds. In this sense, it seems that the absence of SRI alternatives goes beyond the sustainable aspirations. Even, those investors interested in SRI engagement in this region tend to incur in higher transaction costs than those in developed markets.

Besides these economic reasons, institutional and cultural aspects can also be considered as impediments in the socially investing process. The case of the Nordic countries, which present the highest SRI growth rates, demonstrates that in spite of the differences between their financial

markets, the role of institutional investors, religious movements, and investment strategies are common strategies in their SRI models (Scholtens & Sievänen, 2013). The lack of institutional pressure on socially investing and CSR in developing and less developed economies appear to be one of the biggest obstacles for SRI (Oh et al., 2013). Also, cultural considerations must be taken into account: fee investors in Latin America are formally committed with responsible investing principles (Vives, 2012).

Another structural problem related with SRI is the absence of academic support in the field. Despite the big amount of academic articles that have been published during last years (Capelle-Blancard & Monjon, 2012), this practice is still not a major area of studies in financial education. Even though social investing has become a very important part of the investment in the world, since SRI principles are sometimes outside of the classical risk and return framework, educators tend to ignore this investing process in their lectures (Clinebell, 2013). This situation is also considered as a lack of SRI institutional framework.

Due to the last financial and economic crisis, the financial sector has experimented a reputation crisis. The unemployment, financial instability, fiscal debt, and growth stagnation created by the economic recession changed the way in which consumers perceive the structure under the financial system (Culpeper, 2012). On this regard, some academics suggest that it will take time and big efforts to rebuild companies' reputation. Despite the benefits of entering in sustainability indexes like the Dow Jones Sustainability Index and the FTSE4 Good, the process of regaining trust in the financial sector will be difficult and will demand clear results (Oh et al., 2013).

Another important issue concerning the obstacles of SRI is its restrictive nature. The negative screening (the most widely used screening process) prohibits the finance of certain industries like alcohol and tobacco, and in this way, it limits shareholders' portfolios opportunities. These restrictions make the socially investing funds less attractive to investors seeking risk diversification. Also, funds with a negative screening tend to incur in higher costs related with monitoring, which some shareholders are not willing to undertake (Cortez et al., 2012). Becchetti, Ciciretti, Dalò, and Herzel (2015) identified three important additional costs that investors consider when committing with SRI: the acquisition of needed CSR specific information, the missed diversification opportunities, and the cost related with the possibility of disinvesting in a company that cannot be considered responsible anymore. Finally, for the case of SRI funds, on average, they do not provide protection from eventual market downturns (Amenc, 2010), mainly because the conventional investments remain the majority of the traded assets.

Socially investments have rapidly grown since 1980s (Capelle-Blancard & Monjon, 2012). According to the United Nations Principles for Responsible Investing (UNPRI, 2013), their number of signatories has increased during last years. From 2006 to 2013, signatories have increased from about 100 to almost 1,200, and the assets under management increased from almost USD 4 trillion to USD 35 trillion. Also, based on the Forum for Sustainable and Responsible Investment, the assets engaged in sustainable and responsible investing practices in the United States increased about 500 per cent since 1995 (Oh et al., 2013). This fact demonstrates the capacity of the market to accept SRI as part of the financial system in spite their possible challenges.

## DISCUSSION

### *SRI beyond Financial Returns*

Based on the previous considerations in terms of benefits and obstacles concerning SRI, authors defend their analyses of the financial performance of the SRIs and specifically the socially responsible funds. In this way, in terms of the financial performance of the socially responsible funds, the literature and academic research is not completely conclusive. Some authors argue SRI outperforms conventional investments: Galema, Plantinga, and Scholtens (2008) conclude that SRI portfolios have significant impact on stock returns. Leite and Cortez (2015) suggest that SRIs 'do not imply any sacrifice in terms of financial performance'. Becchetti et al. (2015, p. 2560) argue the limited diversification of SRI defended by other authors with the purpose of showing the underperformance of socially responsible funds does not seem to be a problem for SRFs since in 'limited market segments they seem to perform better than in the global one'. Some other authors defend SRIs underperform the conventional funds (Guenster, 2012). Finally, most of the researchers have found there is not a clear difference between the financial returns of conventional and socially responsible funds (Renneboog, TerHorst, & Zhang, 2007). Bauer, Derwall, and Otten (2007) conclude that returns are not significantly for the case of conventional funds versus ethical mutual funds. Cortez, Silva, and Areal (2009) have also found a 'neutral performance' when comparing conventional funds and SRI.

Although the multiple benefits concerning CSR that the SRI initiatives could bring to the international economy scenario, one of the most import

findings is related with their performance in a global economic crisis. Along with the performance discussion, it has emerged an analysis concerning the performance of the SRF in an economic crisis scenario, Nofsinger and Varma (2014), and Becchetti et al. (2015) argue that, in general terms, SRI have a better performance in the period after the financial and economic crisis. Branch et al. (2014, p. 31) have found how 'socially responsible investing universe as a whole seemed to have outperformed the overall market' when analysing the performance of socially responsible mutual funds during last economic and financial global crisis.

Last financial crisis has shown the importance of credit and risk management institutions for generating growth. In conclusion, it has been shown how important 'appropriate institutions are for the correct functioning of the financial sector' (Gauri & Qureshi, 2013, p. 9). Actually, since the 1980s the majority of responsible investment has been done through is via institutional investors (Scholtens & Sievänen, 2013). The connection between SRF and institutional screening both at a national and international level could serve as a way to promote sustainable principles towards the prevention of global crisis. Through the promotion of regulation, SRI can become a powerful tool in the global financial crisis scenario.

Even if it could be assumed that none of the SRI funds could represent an eminent risk in the financial sector and that danger in the market can only be caused by traditional investments, the interconnection of the financial markets could easily create another financial crisis and could also affect SRI funds; interdependence in the global financial market is still a risk in an eventual crisis scenario (Lartey & Farka, 2011). Due to this fact, SRI's ability to outperform in a global economic crisis emerge as the major reason to promote this type of investments, in spite of its inability to prevent a future global economic crisis.

Additionally, the principles of SRI can also be useful when addressing the consequences of possible global financial crises. In this respect, it is useful to analyse the role of the financial sector in development and consequently in the compliance and financing of the Post 2015 Development Agenda. The connection of the financial sector with the rest of the industries can represent an important opportunity for development: the access to financial services for the bottom of the pyramid, the financing of entrepreneurial activities in developing countries, the employment generation and the possibilities of industrialisation through the financing of science and technology programs can be seen as great improvements that can be done through the financial sector based on SRI principles (Culpeper, 2012).

After analysing the emergence and maturing of SRI in the global financial crisis, it can be seen how the discussion about the financial returns of socially responsible funds and conventional investments is no longer useful in a global economic crisis scenario. Although it would be possible to affirm – based on the existent literature – that SRFs may perform better in these scenarios, the current analysis is directed to how SRI can be useful to achieve sustainable goals not only in the private sector but in the society as a whole. By investing in SRI, investors would not only promoting sustainable principles but they would not be necessarily sacrificing their economic interests.

## CONCLUSIONS

SRI is increasingly becoming more important in the investment market around the globe. The long-term consequences that the implementation of SRI can bring to the financial market, institutional investors, and corporate executives are clearly beneficial for ESG decisions. The long-term value creation, the generation of competitive advantages, and the promotion of CSR are great gains for the international economy. The SRI establishment presents some difficulties arising from additional costs and from the current financial structure: the lack of robust financial markets in developing countries, the weak institutional framework in some countries, and also cultural conditions. These obstacles have, at some point, held up the proliferation of this investment practice in the financial market, and consequently, the total replacement of the traditional investments.

SRI represents today a great opportunity in the global financial crisis for both recovering and prevention. Apart from the discussion about the financial returns, its ability to conciliate environmental, social, and economic interests within organisations suggests an important possibility of promoting a more sustainable financial sector that could lead to more opportunities for sustainable development in today's development 2030 agenda.

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