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Socially Responsible Investment: To What Extend Company Benefits From Being Ethically Sound When Attracting Investments?

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<p>Socially Responsible Investment (SRI) has recently become a trend among the investors, but how beneficial it is to invest to socially responsible companies? This paper investigates, to what extend company benefits of being ethically sound when attracting investment, over the time period of June 2009 to April 2014. This research identifies the performance of SRI funds compared to conventional funds, and how it affects the overall performance.</p> <p>To answer the questions, this dissertation will present the changes over the past five years, which are implemented through FTSE group. The SRI fund index is compared to the regular fund index to see the growth changes. The result from the study indicates that there is no significant difference between two indices, although SRI funds seem to start to perform better in the future.</p>	
Keywords	<i>Socially Responsible Investment (SRI), ethical investment, conventional fund, Corporate Social Responsibility (CSR), Corporate Financial Performance (CFP)</i>

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1 Introduction

Socially Responsible Investment (SRI) has recently become a trend among the investors. In relation to this, many questions have been raised: Can socially responsible companies create value? If not, are investors willing to accept lower returns in exchange for socially responsible holdings? The previous literature has been focusing on investigating whether fund performances can be improved by investing in socially responsible companies. Most of the studies find neither positive nor negative relationship between social responsibility and fund returns. To get a better understanding of the concept of SRI, these questions need to be investigated further.

According to Business for Social Responsibility (BSR), corporate social responsibility (CSR) is defined as "achieving commercial success in ways that honour ethical values and respect people, communities and the natural environment." Alternatively, according to Frooman (1997:227), the definition of CSR is the following: "An action by a firm, which the firm chooses to take, that substantially affects an identifiable social stakeholder's welfare." In other words, a socially responsible company should take into account the policies and business practices that goes beyond the minimum legal requirements and contribute the welfare of the key stakeholders. By doing so the company can engage more to the market and gain more competitive position. But in the end, even if the company includes CSR into the strategy, does it pay off? Being socially aware can be an advantage for the company, but most studies have showed that the performance of the company is not related to CSR. But before analysing the benefits of the CSR, this dissertation will look how the socially responsible investment funds and conventional investment funds behave, and how that is related to companies.

Recently Kreander et al. (2005), Gregory and Whittaker (2007) and Bauer et al. (2007) have researched if there is a difference between the SRI funds' and conventional funds' performance, and the result has showed that there is no significant link between them. In this paper the relationship between SRI funds and conventional funds is tested by comparing both returns over the time period of 2009-2014. In the studies the assumption is that ethical funds perform relatively equal to each other, however, as

the fund performance is usually a combination of firm level performance and fund management performance, the results are not that straight forward.

There are two aims in this thesis. First of all, the most important aim is to investigate whether companies benefits of being ethically sound. There are a lot of studies, which have investigated the relationship between CSR and financial performance, with various results. This paper will investigate the topic from investment point of view, and research if it affects on the companies' and their performance. The assumption is that being ethically sound benefits the company in a long run, especially now that CSR is becoming more and more important to the people. It seems to be that the trend is to focus on more CSR and so far, the awareness of the topic has been growing all the time.

Secondly, to find the most accurate result for the question if the company benefits from CSR, the aim is to investigate how SRI fund and conventional funds behave over the time. Is there a positive relationship between social responsibility and the performance of the companies and moreover, are SRI funds more profitable than ordinary funds? The assumption for this is, that for long-term investments, ethical funds will perform better than conventional funds, which will further relate to the performance of the companies.

To see how the funds behave in the market, they are compared to each other by placing the both funds into FTSE index group, which will show how the funds have changed over the time. Additionally, the changes have been calculated and compared to each other, as well as related to economic changes in the markets. Although the method shows the accurate changes over the time, the limitations are that the data can be found just for the past five to ten years. In other words, this research will focus on the changes of the past five years and the assumption is based on the historical information and the results found in this thesis.

The results from this thesis show that the performance of the SRI funds does not differ from performance of the regular funds. However, as a growing trend on focusing more

on social responsibility, it can be predicted that SRI might grow in the future, and it even might perform better than regular funds. At companies level, the result means that it really does matter if company is ethical sound. The result might not be seen straight away, but CSR will pay off in the end as investors and people want to focus more on corporations, which bring the value through the CSR.

The paper is structured as follows. First of all section 2 provides a literature review and overview of the concept of CSR and SRI. In section 3, the research methodology is introduced and explained. The data will be analysed and discussed in section 4, and all is concluded in the final section of this paper.

2 Literature review

2.1 Introduction

The starting point for the literature review was to explain and define meaning of the socially responsible investment (SRI). However, before we can fully understand the concept of SRI, it is important to look the base of social responsibility by defining what corporate social responsibility (CSR) means. CSR have a many different definitions from various authors, and most relevant for this paper will be defined through the next chapter. Moreover, before relating CSR to SRI, I will explain the relationship between CSR performance and financial performance, which will introduce the core concept of SRI. All the topics have similar features, which makes it even more important to understand how all works, before analysing SRI any further.

2.2 Defining corporate social responsibility (CSR)

Early ideas of CSR goes as back as to the 1916s, when J.M. Clark stated "if men are responsible for the known results of their actions, business responsibilities must include the known results of business dealings, whether these have been recognized by law or not". The subject of Business and Social Welfare was introduced to Stanford in 1931 by

professor Theodore Kreps, and he was the first who used the term "social audit" in relation to companies for reporting social responsibilities (Katsoulakos et al., 2004). A little later, in 1942, Peter Drucker argued in his second book, *The Future of Industrial Man*, that corporations have a social dimension as well as an economic purpose.

However, the early roots of CSR can be found already in 18th century in actual business practices of successful companies. One of the companies who show corporate responsibility was Cadbury chocolate makers in the UK, which was found by Cadbury Brothers. By opening the "factory garden" in Bournville, it heralded new era in industrial relations and employee welfare. In 1900 Cadbury demonstrated present vision of CSR as a "successful business in successful communities" by establishing whole Bournville Village instead of just one factory. This was established for promoting green environment for the society. But work continued the same as the more employees came to the company. The special issue in the work environment was that all the employees were thought as part of the family of Cadbury Brothers, which was not common in those days, or even at present time. Furthermore, in 1918, Work Councils were set up, one for men and another for women, and they were democratically elected, which presented fair working environment not just for the company, but also for the society (Katsoulakos et al., 2004).

Another company, Johnson & Johnson, was performing well in the early times of CSR. Their vision for Credo – a statement of belief – was that the final responsibility was to their stockholders. The operating principles were making sound profit, experience new ideas, provide new facilities etc., so that the stockholders would realize a fair return to their investments. These principles was established 1940s (Katsoulakos et al., 2004).

The decade of the 1960s was a significant growth period, which defined more accurately what CSR means. One of the most prominent writers in that period, Keith Davis, argued that CSR refers to "businessmen's decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interest" (Davis, 1960: 70). He stated that it was vague idea, but should be in the managerial context. Moreover, he defended the some socially responsible business decisions can be justified by a

long and complicated process, where is a good chance of bringing long-run economic gain to the firm, thus paying it back for its socially responsible outlook.

Davis became well known from his views concerning the social responsibility and business power. His statement "social responsibilities of businessmen need to be commensurate with their social power" from Iron Law of Responsibility is famous even today. Davis's contributions to the definitions of CSR were so significant that some authors consider him as a Father of CSR designation (Carroll, 1999: 71).

Another major contributor of the CSR definition in the 1960s was Joseph W. McGuire, as he stated: "The idea of social responsibilities supposes that the corporation has not only economic and legal obligations but also certain responsibilities to society which extend beyond these obligations". The definition is considered to be more precise than in the past as he defined it as extending beyond economic and legal obligations, even though he didn't clarify what those obligations were. Later on, though, he elaborated it by saying that the corporation must take an interest in politics, in the welfare, of the community, in education, in the "happiness" of its employees and in the whole social world. In other words, business must act "justly" as a proper citizen should (Carroll, 1999).

The fundamental definition of social responsibility came from a foremost thinker of this subject, Clarence C. Walton, who said: "In short, the new concept of social responsibility recognizes the intimacy of the relationships between the corporation and society and realizes that such relationships must be kept in mind by top managers as the corporations and the related groups pursue their respective goals." (Walton, 1967: 18) In other words, Walton described that the essential ingredient of the company's social responsibility should include a degree of voluntarism and accept that some costs are involved for which it may not be possible to gain any direct measurable economic returns (Carroll, 1999).

In the 1970s, Harold Johnson was the first who presented the term "conventional wisdom" which was defined as the following: "A socially responsible firm is one whose

managerial staff balances a multiplicity of interest. Instead of striving only for larger profits for its stockholders, a responsible enterprise also takes into account employees, suppliers, dealers, local communities, and the nation". The statement is important to note, because he is hinting at the possibility of a stakeholder approach and actually names some of the specific interests groups. Furthermore, Johnson presented a view of "utility maximization", which assumed that the prime motivation of the business firm is utility maximization, where enterprise seeks multiple goals instead of only maximum profits, which also supports the previous statement (Carroll, 1999).

In the end of the 1970s, Archie B. Carroll, suggested his own definition of CSR, after exploring the whole meaning of social responsibility and need for clarification regarding that component of CSR that extended beyond making a profit and obeying the law: "The social responsibility of business encompasses the economic, legal ethical, and discretionary expectations that society has of organizations at a given point in time" (Carroll, 1979: 500). The definition is still one of the most popular definitions at a present time even though many think that economic component should be considered as an aspect that firm do for itself rather than for society (Carroll, 1999).

But at the same time, Milton Friedman argued in New York Times (09/1970): "There is one and only one social responsibility of business -- to use it resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud." His vision was that social responsibility as a social tendency is more hostile towards free society and free markets, and all supporting activities towards social causes were stealing from the shareholders. Furthermore, his argues that corporation cannot be responsible, which on the other hand brings a problem. If corporation is not responsible and lets say, don't pay its bills on time, no one will engage to that firm. So that proves that corporations don't only have legal responsibilities, but also moral ones (Friedman J., 2013).

Of course, any business, if it wants to be successful over the time, needs to maximize profits, but it needs to be done in a way that it meets the needs the stakeholders. And

when the needs changes, the business have to adapt the new behaviours, if it wants to survive as a successful firm. And that is the point what Friedman misses in his statement. Moreover, many people support the view even today, although the statement has been given over 40 years ago, and it is not adaptable for the present time, as demands are much higher. Consumers expect more value from what they are buying, employees want more than just a paycheck and communities demand more than what is required from the corporation. (Friedman J., 2013)

While companies need to show the reliability of themselves to shareholders by providing proofs of returns, meeting the obligations to debt holders or banks, it is important to state that corporations have responsibilities towards the stakeholders as well (Freeman, Velamuri, Moriarty, 2006). Fulfilling the responsibilities is important for the company, as the successful company is nowadays seen as a successful outcome of a recipe using various ingredients supplied by many people, in other words called stakeholders. (Hancock, 2002) By stakeholders, it can mean such as consumers, employees, society, publishers, suppliers, government etc. – all which can affect in a way or another whether the corporations will succeed in a market. Furthermore the corporations' mission is to serve the public, which means by providing desirable products and services, and not harm the community, or otherwise they cannot compete in free markets (Hellsten, Mallin, 2006).

It seems to be that the present trend of the companies is to be socially responsible. Movement of CSR is trying to make corporate responsibility as a common practice for most of the corporations to create an impact that can make a difference in sustainability of our world and the quality of life of the present and future generations (Katsoulakos et al., 2004). They put a lot of effort and money to market, communities, and especially to the long-term sustainability, to be recognised as an ethical company. That is what the consumers and society expect from the companies. It has also affected to many organizations for making CSR the top priority in their business. The main focus is on environmental issues, as every company have a large carbon footprint. Every effort for lowering the footprint is considered to have good effect for the company, and society as a whole (Cooney, 2014).

Company can also be responsible through philanthropic way by donating to local or national charities, and practising ethical labour by treating employees fairly and ethically, especially when operating internationally. (Fallon, 2014) And it is not just being responsible for the consumers, but also for the future employees, as they are seeking more and more for the employers who are responsible and can fit to the frames of the triple bottom-line: people, planet and revenue (Cooney, 2014).

2.2.1 Corporate Social Responsibility (CSR) and financial performance

The impact of the Friedman's argument of not supporting the CSR was big, and because of that the growing interest in operationalizing CSR and seeing if it had any relation to financial performance appeared. Most appropriate research was from Philip Cochram and Robert Wood (1984), as their empirical study observed, that scholars were becoming more interested in the question whether socially responsible companies were also profitable. If they were, that would add arguments in supporting the CSR movement, and opposite way. Cochram and Wood (1984) made various surveys to study the relationship whether social performance and financial performance had been operationalized in the past, and decided to use a reputation index as their measure of CSR. The index what they used was the Moskowitz index, which was created by Milton Moskowitz, an observer of the CSR scene and writer. The reputational index categorized firms as "outstanding", "honorable mention", or "worst". Cochram and Wood (1984) admitted the weaknesses of this CSR measures and called for new measures (Carroll, 1999).

Alternatively, as companies seem to keep CSR as a priority in the business, new studies came to research whether there was a relationship between CSR and financial performance. The results, which were produced by the researches, were very contradicting. Many studies prove that there is a negative impact of CSR on profitability, while others support a positive impact. Moreover, there are two schools of thought: the cost-

concerned school, which represents the negative relationship and value creation school, which supports a positive relationship, (Hassel et al., 2005).

The cost-concerned school was founded in the neoclassical view of economics. Adam Smith's (1776) theories conducted that the "invisible hand" will guarantee socially optimal solutions in the marketplace. This view has been one of the most influential perspectives of economics and it has been the main reason for interpreting the relationship of CSR and financial performance (Walley and Whitehead, 1994). Companies, which decide to reduce socially negative practices, will have higher costs and the bottom line will be affected negatively. The negative relationship between CSR and financial performance can be seen in the figure 1 below (Wagner, 2001).

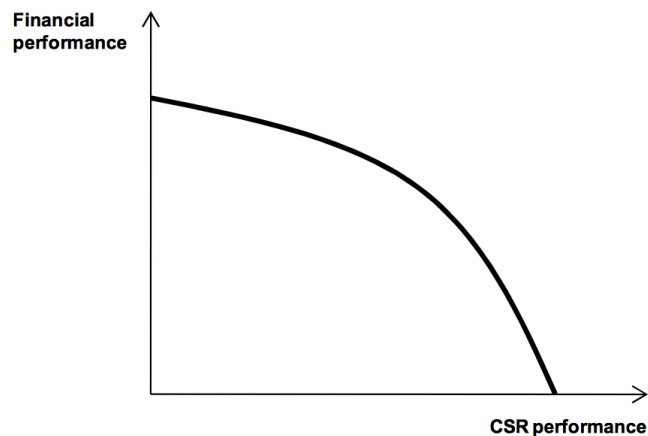


Figure 1: Negative relationship between CSR performance and financial performance

Additionally, Vance (1975) argues the negative relationship as well by using almost the same methodology as Moskowitz did. He proves that if the profit maximization is the most important aspect, by investing socially responsible portfolio, would cause you loss of profit. Generally, the neoclassical way of thinking supports a trade-off between CSR

and corporate economic interest (Burke and Logsdon, 1996). Aupperle, Carroll and Hatfiel (1985) also suggest that there is insufficient evidence to prove, that companies with superior social responsibility are more profitable than other companies as their empirical studies gave no significant result of a result between CSR and profitability.

Value creation school, on the other hand, argues that the competitive advantage increases with CSR investment if it is applied in the right way. If the business approach and innovation is forced to consider in new way, the development of new technologies will rise creating competitive advantage (Porter and van der Linde, 1995). Therefore, the relationship between CSR and CFP is considered as a positive one, which is showed below (Wagner, 2001).

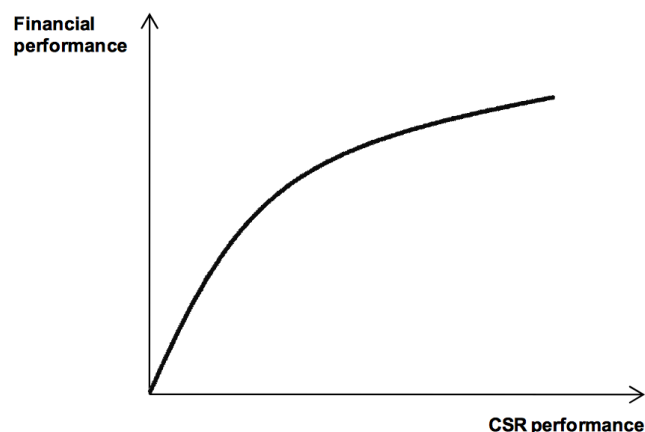


Figure 2: Positive relationship between CSR performance and financial performance

Additionally, Moskowitz (1972) argued further, that there is a positive relationship between corporate performance and corporate social awareness. He performs a comparison of stock price development of several companies with “perceived” high CSR to the development of the Dow Jones Index, finding that the CSR companies outperform the Dow Jones Industrials. He argued that social responsibility increased firm value, if CSR activities were demanded and valued by investors (Moskowitz, 1972).

Waddock and Graves (1997) wanted researched this topic as well, if there were a relationship between corporate social performance (CSP) and financial performance. They found out that there is a positive impact, which they term "a virtuous circle". The evidence showed that the causation runs in both ways meaning the more CSP, the better financial performance and vice versa. In financial strong companies, it is not possible to have that much freedom to invest in CSP, because of the slack of resources but more financially challenging companies can implement intentional corporate social strategy aiming to boost company's image. Either way, there is a positive relationship between financial performance and CSP. (Karlsson, Chakarova, 2007)

As there are more on more studies researching the relationship between social responsibility and company's performance, it has caught the interest of investors. Socially responsible investment has become more popular after there have been proves of the same or greater returns on investment, compared to the conventional investment. The next chapter will introduce the topic of the social responsible investment and explain its relevance for the companies.

2.3 Defining socially responsible investment (SRI)

According to socially responsible investment forum, SRI recognizes corporate responsibility and societal concerns as valid parts of investment decisions. It considers that both the investor's financial need and investment, impact on society. Its investors usually encourage companies to improve their practices in environmental, social and governance issues (SRI Forum, 2010).

There are many ways of interpreting the term socially responsible investments. One of the definitions involves "Integrating personal values and societal concerns with investment decisions" (Statman 2006; Schueth 2003; Shank et al. 2005). But from the theoretical perspective, the argument is that there is no theoretical model to determine how much social responsibility is appropriate, or what is the optimal trade-off between

social responsibility and other investment criteria, especially risk and return. Thus, SRI is lying outside the framework of the common and efficient markets, it is used in finance theory to decide the attractiveness of an investment (Berry, Junkus, 2012).

The Charity Times stated (09/1999), on the other hand: "Ethical means excluding specific companies; SRI means seeking out particular companies to invest in". Investment Adviser (11/1999) argued as well: "Through the 1990s, the emphasis of ethical investment had moved away from avoidance towards supporting the positive aspects of a company's approach to business".

The root of ethical investment, or commonly known as a SRI goes as back as 18th century, where it was first time found in religious movements (Quakers and Methodists). The founder of Methodism, John Wesley (1703-1791), thought that the use of money was the second important thing after the New Testament teachings. For generations, religiously motivated investors have been avoiding investing in enterprises, which kept slaves or harmed fellow human beings (Schueth, 2003). The concerns about fair employment grew and ban for buying or selling slaves was established. Moreover, as religious investors decided to start investing in the stock markets, all sinful companies, which associated with products such as guns, liquor, tobacco and weapons, were avoided (Newbegin, 2011).

Even today, the religious perspective on socially responsible investment can be seen as a reflection by the investing standards promulgated in various religions. Good example is published guidelines for social responsible investing in 2003 by the United States Conference of Catholic Bishops, which includes excluding investments in companies that do not promote the common good and promotion of shareholder advocacy and investments, which are for achieving economic justice or "the common good" (Clinebell, 2013).

Furthermore, in order for a firm to be considered for inclusion in the fund, it must first be proved, that the firm makes a positive contribution for the environment, health and society or quality of life. This provision is also made in the Trust's criteria for compa-

nies, which have made significant improvements in their operations. Good example of this is an energy producers, who have introduced "clean burn" technology in coal-powered generation. After applying positive criteria, the company is assessed against Trust's negative criteria, which relates for example animal testing, armaments and human rights. Depending on how company performs, researchers decide if company meets all the criteria and is suitable for investment. One of the crucial aspect is, that at least 10% of a firms turnover should derived from activities, which are deemed to meet Trust's positive criteria, before the firm can be approved for the investment (Taylor, 2000).

Nevertheless, while the Methodists and member of other religions applied some principles to their investments through the years, it was not until 1960s that socially responsible investing went forward as an investing discipline. Mostly the reason was because young people in the U.S. were against the Vietnam War and boycotted companies that provided weapons used in the war. Companies had to start to think what their actions were for keeping investments coming in (Donovan, 2014).

In the 1970s, Christian Church quoted SRI: "Investors should seek the best investment opportunities on financial grounds and then work from within to alter corporate practices that are at variance with social concerns of the church." In other words, the idea was that the "corporate persuasion" was probably the most efficient way to improve the social impact of a company in which a church organization held an investment. At present time, this idea is referred to as shareholder activism – collective efforts which investors can use affecting the behaviour and actions of a company (Katsoulakos et al., 2004). For instance, investors who were concerned about environmental issues could invest in renewable energy sources, such as solar energy and wind, and investors concerned with world poverty could invest in microfinance. Private and institutional investors, who wanted to invest into specific areas or show investees concrete examples, could prefer this approach (Rients, 2011).

Additionally, in 1970s, the first major non-governmental organization (NGO), Greenpeace, adopted policies, which shifted the emphasis away from governments towards

action in the corporate section. The most relevant examples are campaign against Shell by Brent Spar and campaign against major US and European banks (Katsoulakos et al., 2004). Furthermore, Ralph Nader, environmentalist and later independent candidate for president of the United States, succeeded in getting two socially based settlements on the annual meeting proxy ballot of General Motors, the largest employer of the country at the time. This was good development for SRI, although both votes failed, as it was the first time for socially responsible issues to appear in a proxy ballot (Donovan, 2014).

As time passed, progress continued for SRI, most notably through the effort to end the racist system of apartheid in South Africa. Both, individual and institutional investors took their money out from companies with operations in South Africa, which lead many U.S. corporations to divest themselves of their South Africa operations. That caused economic instability within South Africa and contributed to the eventual collapse of apartheid. Furthermore, with the incidents of Bhopal and Chernobyl, the environment became top of mind for socially responsible investors (Donovan, 2014; Schueth, 2003). That led to sufficient proliferation in SRI mutual funds, and the popularity towards ethical investments, grew a lot. The Domini Social Index, made up of 400 primarily large-capitalization corporations, was established in the U.S. in 1990. The corporations were selected by social and environmental criteria and it provided investors with a benchmark to measure the performance of screened investments versus unscreened counterparts. For long-term, it would help asset managers to select the companies which could be included into their portfolios (Donovan, 2014).

However, the first global index, which tracks the financial performance of the leading sustainability-driven companies worldwide, was The Dow Jones Sustainability Indexes. The purpose of the index was basically same as previous one, providing reliable and objective benchmarks for managing sustainability portfolios, but now the indices were collected around the world. Moreover, in 1990s, the corporate sustainability was seen as a business approach, which was created for achieving long-term shareholder value by gearing strategies. The operations controlled the market's potential for sustainability

products and services, while at the same time it successfully reduced and avoided sustainability risks and costs (Katsoulakos et al., 2004).

2.3.1 Applying SRI for decision-making progress

When applying SRI, it usually contains some practical difficulties. The basic investment decision includes whether investor uses an exclusionary or inclusionary SRI filter. The exclusionary approach filters out certain corporations based on products or certain behaviour when choosing investments for a portfolio. Common excluded products are alcohol, tobacco and weapons. A company might also be excluded if it shows certain behaviour, such as violations of labour norms, for example child labour or collaborations with particularly repressive regime (Berry, Junkus, 2012).

The inclusionary approach is more difficult than a previous one, as it involves adjusting the weights of an investment in a company depending whether its behaviour is more or less social responsible. An investor would give "points" for acting positively in SRI sense, and then choose whether to invest or not to the company. This approach have a high degree of subjectivity and the investor much choose clearly, to which corporate behaviour to focus on, and decide how much importance assign to each type of the activity. After this, investor rates a company quantitatively based on these criteria and relates the score to the portfolio compositions. After results is the decision of how much of the portfolio should be in the particular company. Compared to the exclusionary approach, this is more complex approach to use and it is not surprise, that the relatively narrow and simple, product exclusion approach, is the most often used when engaging the social responsibility investing (Berry, Junkus, 2012).

Moreover, when considering the investment decisions, it is argued that investment should not be immune from ethical research as there is nothing special about investment in generally. This *prima facie* for SRI guarantees its exclusion from the ethical considerations that are brought to beat on other areas of life. Miller (1992) argued that "Any individual or group which truly cares about ethical, moral, religious or political

principles should in theory at least want to invest their money in accordance with their principles". As already mention, the ethical investors were concentrating mostly on non-sinful investment bodies, and only for past two to three decades of late modernity, such perspective has been explicitly reflected in dedicated SRI retail funds offered to the public (Sparkes & Cowton, 2004).

The *prima facie* case, is derived from an ethical case for avoidance that consistent standards of behaviour, which should be applied in all areas of life, including investment. Larmer (1997: 400) argued that holding a share suggests approval and that "simply approving of an immoral action is immoral". Miller (1996: 3), on the other hand, suggests, "The righteousness of any monetary return is conditional on the absence of the exploitation of customer, workers, creditors and suppliers". In other words, the "moral purity" or integrity in their words seems to be a priority.

However, purity seems to have a lot of critique, as many writers, such Simon et al. (1972), describe it as "hopelessly naive". This is mainly because it brings along endless series of arbitrary decisions (Sparkes and Cowton, 2004), while the search for purity appears to lead into moral paralysis in today's complex world (Powers, 1971). Therefore Simon et al. (1972) have suggested including moral effectiveness to moral purity. In other words, they are more interested to affect the companies by adopting CSR into their operations rather than keeping investment portfolio "clean". Alternatively, Berry and Junkus (2012) argues that investors seem to prefer to reward the companies, who perform positively on social policies rather than exclude companies based on a certain products or policies. Problem is that as long as the company is on a small scale, it is unlikely to have any impact on larger companies, because the share price will tend to return to a level reflecting financial fundamentals. Furthermore, this has led to some arguments that SRI should involve active attempts to put pressure on corporations by taking advantage of shareholder rights. (Sparkes & Cowton, 2004)

In recent years, school shootings, human rights and healthy working conditions in factories that produce goods for corporations, have become crucial points for investors with dual objectives for their investment capital. But the most recent issue, which has

awakened investors to opportunities inherent in directing investment capital toward a truly sustainable future, is the climate crisis, as it affects globally to everyone (Schueth, 2012). These are main reasons for companies as well, to focus more on sustainability, and being more socially responsible.

Based on the literature review above, as well as recent changes within the investors and companies, my research question for this thesis is expressed as:

To what extent company benefits from being ethically sound when attracting investments?

My intention is to research how much it matters if company is ethically sound from the investment point of view. Additionally, the supporting questions will be if SRI is more profitable than conventional fund and opposite way, is there a positive relationship between social responsibility and the performance of the companies, or is social responsibility just an image for attracting investors to be more social aware? So far the answer has been changeable, and my intention is to research why.

2.4 Conclusion

To understand the socially responsible investment and how it works, it is important to go back in time where the roots are coming from. CSR has been introduced a long time ago and it has developed a lot through the time. Understanding CSR creates better perspective for SRI and how it can be used in recent time. However, it is important to notice that there are criteria that have to be adopted inside the companies before they can be considered as a socially responsible company. But in the end, how much it matters, if the company is socially aware?

There are many studies, which shows that social responsibility has increased the value of the company, but on the other hand many authors have proved that socially responsible companies have not performed better than anyone else, or they have performed even worse than others. But in the end, to what extend company benefits from being ethically sound?

In the research methodology I will introduce the ways that will be used to answer that question. Additionally, I will explain different ways of using methodology, and I will analyse the data that I have been collecting.

3. Research Methodology

3.1 Introduction

The primary focus in this paper is to concentrate whether company benefits from being ethically sound from investment point of view. Moreover, the focus will be on question if socially responsible investment is more or less profitable than conventional investment. Before I will analyse the questions, this chapter will discuss the data collected and the methods that I have used to collect relevant literature and what I will be using to analyse the data. Moreover, I will explain the progress of choosing the research method, as there are various ways to do it.

3.2 Data and Sources

Dawidowicz (2010) points out the importance of selecting the area of research in order to collect relevant literature review. Fink (2010) alternatively, discuss that there is a different possibilities to perform comprehensive literature review, such as databases, Internet, journals and books (Nybom, 2012). By presenting the sources of information that is been used in this dissertation, it can be continued by someone else that address to its validity.

The first step of the paper was to search what have been written about this subject. University of Wolverhampton provided a huge variety of databases from where the most of the literature is taken and been used as a secondary information. Additionally, I have used academic sources from Internet to expand more the literature and knowledge of the subject

Literature that I have been using, explains the positive and negative angles of social responsibility and company's performance. However, most of the studies research only whether there is just a positive or negative relationship between social responsibility and the performance. There are a lot supporting studies, such as Moskowitz (1972), and my intention is to study to what extend the company benefits for being ethically sound. Nowadays the huge concentration is on the CSR, but does it really matter in the end of the day, if a company is socially responsible or not. Moreover, many of the studies are from the point of view of the company, but my intention is to research it from the investment perspective.

3.3 Research Approach

In early stage of the process, I decided to use primary data collection method, in other words, questionnaire for investors. According to Mack et al. (2005), the qualitative method of research provides better understanding of social norms based on values. But the strength of the qualitative method is also a weakness, as a person conducts it and it contains a risk of bias (Flick, 2009).

Nevertheless, in the questionnaire the possible questions would have been; If social responsibility matters for investor, do investors invest to socially responsible companies, which is more important: profit or environmental issues, and should social responsibility be key aspect for companies when they are doing business. The result, hopefully, would have shown how much investors pays attention if the company is socially responsible and moreover, if the social responsibility actually matters in the

end of the day. However, as a strict time frame, the possibility to use questionnaire was impossible as there would not be enough of answers, and the result would have not been accurate. So alternative method for the questionnaire, which I am using, is the secondary data collection, which is mostly taken from FTSE Group.

FTSE Group is the leading global indexing and analytical solutions provider, which calculates thousands of unique indices that measures and benchmarks markets and asset classes worldwide. FTSE is owned by London Stock Exchange Group and the indices are used extensively for investment analysis, performance measurement, asset allocation and hedging. Asset managers, leading pension funds, exchange-traded fund (ETF) and investment banks, just to mention few, work with FTSE to benchmark their investment performance and use indices to create ETFs index tracking funds and index derivatives. FTSE also provides exchanges around the world with their domestic indices. (FTSE, 2010)

All the indices that are in the FTSE, are constructed and updated every 15 seconds, using the trusted, and also tested, methods that have made FTSE indices a byword for reliability of information. Furthermore, FTSE4Good index series identifies companies that match up to a set of social responsible criteria, which are established by Ethical Investment Research Services (EIRIS), as a result of organization's long involvement with an experience of the ethical investment market and businesses in which it invests. (Hancock, 2002)

The main concentration is on FTSE4Good Global index and FTSE100 index, which will be compared with each other and analysed how the social responsible investment affects the company and the investment. My intention for analysis is to research from different trading websites information, which will show me how these two indices differs from each, if they actually do so. Furthermore, the analysis will be compared in different times frames, and in this paper, the changes are between 1 year and 5-year timescale. 1-year index will be considered as a short-time investment period and 5-year index will show the long-term investment period. This is because usually social responsibility is seen as a long-term solution for achieving competitive advantage

(Whitman, 2013). Hopefully, these figures will show how the indices have changed over the time compared to each other, and give a result whether social responsibility matters or not.

Over the research in the Internet, I have found many relevant websites, which I have been comparing with each other's. Although the charts can be taken from any of the relevant websites, I have chosen to use TeleTraders website (<http://www.teletrader.com/ftse4good-uk-index/index/chart/tts-402719>), where I can straight to compare FTSE4Good Global index and FTSE100 index. Positively enough, these charts showed most clear percentage change over the time, but for the disadvantage, I can state that most of charts in the websites – including this as well – has only past 5-10 years starting from this date. This is because socially responsible investments have not been introduced until 10-15 years ago (Gajdosova, 2011). This means that in this paper, the analyses will be made within the timescale of the past 5 years.

After I have compared the indices which other and analysed them, I will do some calculations. First of all, I will calculate short-term growth changes for both indices and compare them with each other to see the changes between them. Predictably, the one who have been performing better will stand out even more. Secondly, I will calculate the average growth rate for both indices, which probably will support the short-term calculations. Additionally, the average growth rate will show the overall picture of the research and I can start to conclude all the findings that I have. I will analyse all the findings from each of the figures and calculations and sum it up with including companies' perspective. The result form the indices has an affect for the companies and I will discuss how it relate to the companies and the strategies that they have. Primary aspect is to see if the social responsibility important for the companies or is it just for the image. Moreover, the result should show if it does matter whether companies concentrate on sustainability or not.

3.4 Conclusion

For the success of this paper, the importance is not only in literature review but also on the relevant data that have been chosen. Narrowing the relevant data is hard step and my choice is to use the information from FTSE Group. The theory is collected from the FTSE Group, but indices I will take from a trusted Internet site. The research method is going to start from comparing indices with each other and analyse the findings. By analysing the findings from the perspective of the investments and later of companies, there is a possible to bring out an important point for the subject. Initially, it should answer the research question, to what extent the company benefits of being ethically sound. Moreover, it should show whether the SRI funds performs better over the time compared to conventional investment funds.

4 Findings and Analysis

4.1 Introduction

This chapter will show and analyse the data, which I have collected, and explain the most relevant findings of the topic. Purpose is to compare different views, and find the most accurate answer if company benefits from concentrating on corporate social responsibility, and whether there is a positive – or negative - relationship between CSR and performance of the company. Additionally, I will analyse the data through indices by comparing them to each other over the specific timeframe, do some calculations, which will create even more accurate results. In the discussions and analysis through the chapters, I will use the terms such as conventional investment fund, which will refer to FTSE100, and ethical investment funds will refer to FTSE4Good.

4.2 Empirical results

The figure 3 below shows the short-time result for the investment. The time is one year calculated from April 2014 back. As we can see from the chart, for the first six months, there is no significant change in return compared to conventional investment. Only after 6 months, the difference has been growing and in the end, the SRI fund has more return on it than the counterpart. The problem is that looking just for the past year can give quite false picture of the issue, especially when it comes to investments. For instance, by comparing one-year result from the figure 3 to year 2010 – 2011 from the figure 4, we can see that the result is quite interesting. In the year between 2010 and 2011, we can see that SRI fund have not paid off during the year and moreover, the return of it has usually been lower than from conventional fund. It shows that it does not help to look just for the changes or growth just for the one year, but it has to be compared either to the earlier years or look for the longer period of time.

Furthermore, figure 4 shows that from the middle of the year 2009 until 2013, the changes between ethical and conventional investment funds, have been relatively unchangeable. Only after the middle of the year 2013, the SRI funds have started to pay off. It can mean that over the certain period of time, the return from ethical funds can be better than long-term investment on conventional funds. On the other hand, the result can be completely opposite. Even though the return of SRI funds is good in the end of the fifth year, the huge gap between ethical and conventional investment funds have come up just in the year 2013. In other words, this leads to one of the supporting question of the dissertation whether ethical investment fund is more profitable, and the concluded answer is negative. Ethical investment seems not be more profitable than conventional fund.



Figure 3: FTSE 100 vs. FTSE4Good 2013-2014



Figure 4: FTSE 100 vs. FTSE4Good 2009-2014

It also seems that the answer for the question whether the conventional fund is more profitable than ethical fund, is negative. On the figure 4, the conventional and SRI funds have been compared over the past five years. The figure shows that there is no

significant change between two indices, they actually seem to have similar changes over the time. The difference is that in certain period of time ethical investment fund seems to do better and other way around.

However, to be more exact with the growth rate, and to confirm which one of the indices is actually more profitable, the growth rate needs to be calculated. First of all, the most interesting changes are in the end of the 2009 and the change from 2013 to 2014. To calculate these changes, I will use simple growth rate formula, which will show percentage growth for both of the indices.

$$PR = \frac{(V_{Present} - V_{Past})}{V_{Past}} \times 100$$

Figure 5: Growth Rate formula

Where:

PR = Percentage rate

$V_{present}$ = Ending value / Present value

V_{past} = Beginning value

First of all, I calculated the five-month period in the end of 2009 and the five-month period in the end of 2013 and the beginning of 2014 to see, how the both indices have been growing on that period of time. Moreover, in these two periods, the growth has been the highest and I will investigate which of them actually have better growth rate and perform better. The result shows that in the end of 2009 FTSE100 had a huge growth compared to FTSE4Good. The reason is because the regular fund had fall dur-

ing 2009 so down compared to ethical fund that the rapid growth resulted much better growth rate.

The growth rate, which started in the end of 2013, is slower compared to 2009, but now the ethical funds perform way better than conventional funds. Ethical funds now grow much faster than regular funds and until this day there have not been changes to that. This result brings back the calculations to the starting point, as the both funds have performed better compared to the other on specific time. To resolve this problem, I decided to calculate the average growth rate over the five years, to see the big picture. This calculation will show the difference in long run performance and give answer for whether ethical funds performs better over the longer period of time. For the calculation, I have used compound average growth rate formula, which is used for both indices over the period of 2009 to 2014.

$$\text{CAGR} = \left(\frac{\text{Ending Value}}{\text{Beginning Value}} \right)^{\left(\frac{1}{t}\right)} - 1$$

Figure 6: Compound Average Growth Rate formula

Where:

CAGR = Compound average growth rate

t = number of periods

The result from the calculations shows that for the longer period of time, FTSE100 performs much better than FTSE4Good. Even though the figure 4 seems at first to show that ethical funds would perhaps perform better over the time, it is not actually the

truth. Mostly the reason is the same as in the first calculation that the peak in the 2009 growth on conventional fund was so rapid, that it affected positively to the whole growth. Ethical fund survived faster from the recession, which helped it perform slightly better in the 2009, but the growth and survival from 2009 until this day, have been better for the conventional funds. This leads to the conclusion that even though ethical funds are performing better in short-run, especially for the past year, the conventional funds have performed better for the past five years. To see what is the reason for it, I will analyse the findings in the next chapter.

4.3 Analysis of result

The overall result from the figures 3 and 4 is that there is no significant change between the investment funds. However, there is relatively high growth in ethical investment fund in the end of the year 2009 and 2013. These growths are quite interesting, because in 2009 there was economic recession going on, but on 2013 and even today, the recession is not that bad anymore.

The financial crisis started on 2007 and it affected almost on everything especially the investments. In recession, the companies cared about the survival and put the profitability in their priority aspect. CSR came after profitability and many companies argued that the reason was because the consumers did not want to pay extra for CSR product. Most of the reasons were that they could not afford it. (Welch, 2009) This view of the companies makes the growth of the ethical investment funds even more interesting, as the growth is totally opposite result from the views. Welch (2009) argued, that even in uncertain times, companies must include CSR to their business, which partly could explain the growth of the ethical funds. But Welch also argued that money should come first, because without profit, company cannot give it away and support CSR (Welch, 2009).

According to study of Giannarakis (2011), CSR performance started to grow already in the end of 2008, but noticeable growth started in 2009 until early 2010. His findings

showed that companies, which took CSR seriously in their businesses, increased their CSR performance even though business environment did not support investments in CSR initiatives. He explained that because of the trust failure in businesses and capital markets occurred and led to the collapse of the financial institutions, the social cohesion and stakeholder expectations were constantly changing over that time (Kitchin, 2002). The assumption was that companies probably increased their performance not only because of the common benefits from CSR implementation such as economic performance (Schiebel and Pochtrager, 2003), but also because of the lost trust in businesses (Decker and Sale, 2009). The trust indeed was the most important issue between companies and stakeholder for survival of economic crisis (Edelman Trust Barometer, 2010).

The building trust of the companies by implementing the CSR could benefit companies a lot and gain more investments. The assumption is that it benefitted the companies to that extend that the growth could occur in the late 2009 and overall perform better than conventional investments. Companies probably tried to differentiate themselves and redefine the trust between companies and society (Giannarakis, 2011), and benefitted in that mission affecting the overall growth in ethical investments. However as we can see from the figure 4, ethical fund started to decrease and probably the reason was because of the Greek, Irish, Portuguese and Spanish financial downturns, which affected the global economy and especially North America (Giannarakis, 2011).

Winston (2008) argued that if company would delay actions of sustainability plans, it would probably make huge mistake. He stated that in most economic downturns, companies, which have the means to invest in smart ways and keep including the sustainability plans within the business, rebound the fastest when the economy turns around (Winston, 2008). Although this did not happen straight away after he said that, it seem to be the right view, if we look at the growth rate of ethical investments in the end of 2013. Although the economy is not stabilised completely, it is in better condition that it used to be several years ago. Truly sustainable companies probably kept their mission to be socially responsible and in the end of 2013, it paid of by the huge growth. Moreover, the behaviour of the CSR companies could helped them as they rather did

changes inside the company, for example organising flexible work conditions for employees, rather than give up with the social responsibility (Barror, 2009).

Additionally, the view of the differentiation was important during the recession, as it also might have helped the ethical investments to grow especially in 2013. Investors started to focus more on ethical funds and search right companies to invest in. Benson et al. (2006) suggested few years ago that SRI fund managers are better stock pickers, and these skills lead to higher SRI fund returns. Because SRI fund managers have fewer assets to select from and thereby having a better knowledge of specific investments in their potential investment set, they can familiarize to the set better than counterparts (Benson et al., 2006). The higher concentration on companies and investment portfolios can bring a good return on the investment and in the future it might be higher than the return from conventional funds. As the company's social responsibility is in important role for SRI decisions, the next chapter will analyse the result from the perspective of the companies, whether it affects them or not.

4.3.1 Company perspective

So far the research is made from the perspective of the investments, as it is most important issue before analysing the company's perspective. The main issue is to find out if the ethical investments benefit companies at all. The result shows that it does not matter whether the investment is ethical or not, if the concentration is on performance. However, for the long-term sustainability plan, especially nowadays, the difference can grow to be huge. Past year has showed that the recovery of financial crisis will affect both, ethical and conventional funds, but so far the ethical funs have been performed better. Or course, it is hard to say whether this growth will continue, but if it does, the ethical companies are in good position in the market.

As I pointed out from Winston's (2008) argument that companies might take a huge mistake not to concentrate to sustainability plans, my finding underline the argument. Even though so far the ethical and conventional funds have been performing relatively

the same, it is important that companies keep focusing on socially responsible activities. They might not have the best result straight away, but as the result showed the growth from 2013 until today, it is becoming more and more important that companies concentrate on being socially aware. Future is hard to predict, but once the financial crisis is stabilised and investors have searched all this time the good companies to invest in, it might turn out that the best companies to invest in are the socially responsible ones, based on the growth of the past year.

4.4 Conclusion

By comparing ethical and conventional fund indices to each other, I have created the picture how the both indices operate over the time. Although the past five years is quite short time scale, I have found partially how ethical investment funds behave compared to conventional funds. To support my viewing from the indices, I calculated the growth rates to see more accurately, which of the funds perform better in short run and in long run. It seems to be, that even though ethical investment funds perform well over specific time periods, overall growth is better on conventional funds. Additionally, it seems to be that there is no significant linkage to companies whether they include CSR to their strategy or not. However, past year has showed that recovery from the financial crisis has affected positively on ethical funds, and the growth rate can turn around in the future, which means that the companies with CSR strategy will probably perform better than the other ones. And that would lead to the fact that it is important for the companies to keep sustainability in their business, and not to stop being ethically sound.

5 Conclusion

The purpose of this paper has been to research if the company benefits of being ethically sound when attracting investments. Moreover, the aim was to research the topic

from the investment point of view. Additional questions were developed for supporting the study and understand more the field of Socially Responsible Investment (SRI). Those questions were if SRI funds are more profitable than conventional funds, and is there a positive relationship between social responsibility and the performance of the companies. It seems to be that popularity of SRI funds have been growing and the aim is to see, how SRI funds performance differs from conventional funds. Previous studies have shown that there is no significant difference in performance when it comes to SRI funds and conventional funds, but my aim was to study if the company benefits to attract more investments when focusing on CSR activities.

First of all, after careful research of the relevant literature, I established the research question; to what extend company benefits of being ethically sound when attracting investment. The purpose was to investigate that when company is ethically sound, does it attract more investment. Moreover, my intention was to see if the company performs better when it concentrates on CSR. For supporting question my intention was to study if SRI funds perform better than conventional funds. Starting point for analysis was to compare SRI fund index to conventional fund index. By having those indices I could compare the performance over the specific time period, which was the past five years. However, the problem was that because trend of SRI have become aware just 10-15 years ago the relevant data quite narrowed. In this thesis the data is from the past five years, which will give result for what have been happening recently in the field of SRI.

The results have been showing that even though the growing trend of SRI, the conventional funds performs better than the ethical funds. The SRI funds, have been performing well in certain periods of time, especially for the past one year, but the survival of conventional funds from the financial crisis have been so rapid, that so far regular funds pays off better. Additionally, these changes can be adjusted for the companies as well. Corporate Social Responsibility (CSR) seems to be important issue nowadays, but the benefits on engaging CSR to company strategy is not high. From the investment point of view it does not seem to matter, whether the company is ethical or not. However, as for the past year the SRI funds have had relatively high growth rate, the

benefits of being ethically sound is high. As the returns are higher, it attracts more investors to invest in ethically sound companies. The concentration is more and more on CSR issues and those companies who have included the CSR to their strategies, will probably perform quite well in the future. It can be of course, short growth for ethical funds, as we have seen it before, but this is the first time that the growth rate has been going up for such a long time. It can be the stage where SRI funds starts to perform better than the conventional funds and start to attract more and more investments.

5.1 Future Research

In the process of writing this thesis, many new questions have arisen concerning this topic. First of all, as there are so many studies done from different angles of the topic, there is not much of primary data available. It would be interesting to study how the research could be developed more through the collecting relevant data from actual investors, see how the decisions are actually made and how much the companies' CSR strategy affect the decision making. Furthermore, more extensive studies could be made to explore more the relationship of CSR and profitability, and to determine if those relationships will hold consistently over the time. Timing in the relationship is also important, as it would be valuable to research how long it takes for the impact of CSR on financial performance to be revealed. Additionally the timing for SRI is important as it usually is not short-term decision and the result can be seen over the long run. From this study, I realized as well that more data on SRI should become available, as it would give even more understanding of the concept.

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