

Social Responsible Investments and Performance

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Abstract

This research paper shows the growing power of the practices of sustainable finance in the financial markets. The socially responsible investments (SRI), defined as a strategy to select issuers on the basis of both ESG Corporate Responsibility that financial factors, are rising a growing amount of capital. In fact, between 2012 and 2015 the SRI global asset increased of 61%, amounting to 21.4 billion of dollars. The proliferation of ethical indices in the various financial centers of the world is related to a significant growth of assets managed according to an investment strategy that rewards socially responsible companies. After the financial crisis of 2007, ethical or sustainable indices have generally performed better than traditional indices, which they are derived through a selection of stocks that are subject to strict requirements, the author show the performance of ethical finance compared with those of the traditional sector.

Keywords: corporate social responsibility, socially responsible investment, performance, ethical investing

1. Introduction

The statistical analysis it has been demonstrated how thanks to diversification strategies, the standard deviation of a portfolio is lower than the weighted average of the standard deviations of the individual securities, provided that the correlations between pairs of securities is less than 1 (Ross et al., 2012). In fact it is one of the measures to evaluate the volatility of the yield of a security or a portfolio and, for this reason, the risk of an investment. To build an efficient portfolio, in fact, it is necessary to identify a combination of securities that will allow to maximize the expected return for the same risk, by exploiting the trends are not perfectly correlated of individual securities. Is there therefore, an ethical sacrifice in terms of ethical investor's performance? Based on the principles of classical finance, that by increasing the number of securities considered in a portfolio, the damage produced on the performance of the ethical portfolio is progressively reduced. This because the potential diversification and the profit reached by the investor are very socially responsible similar to those of an investor who does not focus on ethical investments. By diversifying portfolios sufficient and operates on several markets, unrelated to each other, securities of an ethical fund will be exposed to only market risk, while the diversifiable risk will decline, although not canceling. A second reason that supports the non-existence of an ethical sacrifice is the fact that the choice of the securities in which to invest is made on the basis of a more extensive and detailed since, besides traditional analysis, there is also a necessary analysis of ESG factors. An ethical fund should be able to select the best securities, minimizing the risk of the portfolio. It is useful for this purpose to reiterate the importance of the reporting process on CSR issues and the value of information that flow from it, to support and confirm what previously supported on the Corporate Social Reporting and Accounting. Can be said that is it convenient to have securities in the portfolio of ethical funds? It has been shown that ethical funds have performed better than traditional funds during the period of crisis and post-crisis (2007), assuming the role of insurance for investors.

2. Literature Review

Bollazzi (Bollazzi et al., 2017) and Bollazzi and Risalvato (2018) show that sustainable financial management also allows to exclude from the investment the securities of companies that are outside the ESG criteria, avoiding investing in companies that have reported losses in the stock market; this risk control allows to avoid compromising the performance of the portfolio in terms of yield. Looking at the graphs on the performance of ethical funds is

possible to confirm that the performances of the latter are not worse than those of traditional investment funds. The example of the bottom (Figure 1), Banca Etica sgr (a sgr is an Investment Management Company - IMCO - in Italy), shows how the fund performance in terms of yield are higher in average than those of its benchmark, consisting for 90% MSCI Developed World Markets and 10% from index BofA Merrill Lynch Euro Government Bill. Some authors (Hansen et al., 2012) have shown that the out-performance of ethical funds can be attributed to the considerable weight of small caps in socially responsible portfolios, according to the phenomenon known as the small firm effect, according with Fama and French (1992), to which the performance of small businesses seems to be higher than the large companies.

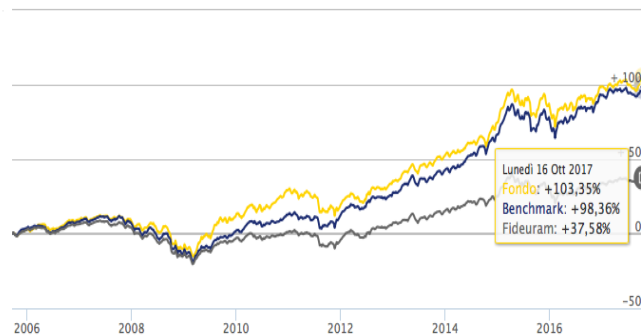


Figure 1. Performance of Fondo Etica Azionariato, Gruppo Banca Etica SGR

Moore (2014) has shown that ethical funds that invest in small companies and growth-style, i.e. with large growth prospects, it is required multidimensional models to see if the good performance can be attributed to a greater extent in the management style or selection ethics. Other research has highlighted how ethical funds have a period of four or five years that under-performance than traditional funds, where:

- IMCO need some time to learn how to better manage the stock selection strategies;
- Companies included in the portfolio tend to create value in the long term, because the characteristics of the ESG business strategy and process with which it is built by the company; the long-term perspective on which CSR enables ethical funds that invest in socially responsible companies to outperform than traditional funds in the long run.

The ethical indices are been developed to support investors and fund managers in their investment processes, a sort of certification of quality on the environmental and social of a company and a recognition of his activities.

3. Data Analysis

The Companies that have developed ethical indices and offer services and solutions for sustainable investments was created by the idea that it is possible to operate in the market according to the traditional logic of creating value, and considering the aspect of ESG Responsibility. As demonstrated by discussing the performance of ethical funds that invest in responsible companies, on returns in terms of cost, evidenced by developments in the ethical indices on the financial centers of the world. The ESG factors allow, in fact, to manage the related risk factors and to anticipate future cases of destruction of value for the investors. Empirical studies on the relationship between socially responsible and financial performance of the securities show, in fact, that the correlation between the two terms is positive. Ethical indeces using the same criteria as ethical rating, but are created according to certain models of composition and calculation to be comparability of each of them with the corresponding traditional index of reference, such as the Word DJSI can be compared with the MSCI World and the MSCI World SRI. Below there is a graph (Figure 2) that allow to compare the ethical index trend with the traditional, in which the performance of CSR indices are in average better than the corresponding classic index. Ideally, the economic crisis began in 2008, the year of the bankruptcy of US Investment Bank Lehman Brothers and the subsequent collapse of the financial markets has brought with it many negative consequences, but also stimulated the emergence of a new awareness of the issues of CSR and ethical finance. As can be seen from the graph in analysis, until the outbreak of the speculative bubble, the traditional index and its filtered version have substantially same yields. In January 2008 the gap between them began to widen, showing the same trend, but the ethical index consistently over-performs the traditional one. Among the main ethical indeces we include:

- Ftse Ecpi Italy, collaboration with ECPI Group, a company that provides ESG and financial advisory services;
- Ftse4Good, born after the acquisition by London Stock Exchange of Russell Investments, the asset management company operating globally;
- Dow Jones Sustainability Index, offered in collaboration with S&P Dow Jones Indices and RebeccoSam, a company specializing exclusively in sustainable investments.

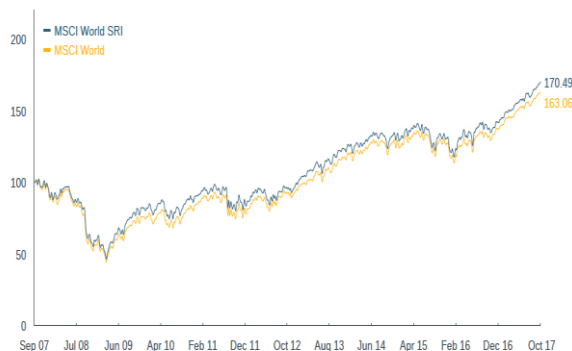


Figure 2. Comparing the MSCI World and the MSCI World SRI in the period Sep 2007 – Oct 2017

Observing the broadcast of market of the socially responsible fund, many ethical indices were created in different areas of the world in order to support the investment choices of anyone who wants to invest in the stock market or mutual funds in accordance with the ESG criteria. These indices are a benchmark for those investing in socially responsible funds, as they allow comparing the performance of the fund with the market trend. The managers, however, can choose a selection of titles where to invest. The comparison between ethical and conventional indices, moreover, allows highlighting the performance of ethical finance compared to the traditional one. Ethical indices are now present in most of the world's financial centers, each group of indices uses negative and positive screening criteria to create, inside, thematic indices such as, focused indices on certain geographic areas, on certain sectors or indices that consider only the environmental performance of companies, such as the FTSE CDP Carbon Strategy Index. In Italy the business of consulting services for sustainable investments has been formed in the university, following the initiative of a group of professors from the University Bocconi in Milan. The aim was to develop research methodologies in the finance ethics and responsible investment. This business idea, once taken out of the university environment, has led to the creation in 1999 of ECPI, at the time the first European initiative for the creation and selection of financial products with high social value. ECPI, in 2000, has launched the first ethical rating model and the first ethical index, the ECPI Ethical Index Euro, adopted as the standard licensed by many fund managers. Currently there are 14 companies listed at the Italian Stock Exchange included in this index: ENI SpA, Intesa San Paolo SpA, Unicredit SpA, Assicurazioni Generali SpA, Fiat Chrysler Automobiles, Telecom Italy SpA, Snam Rete Gas SpA, Atlantia SpA, CNH Industrial, Tenaris SpA, Luxottica Group SpA, Terna SpA, Mediobanca SpA, Saipem SpA. From 2007-2008 ECPI has undertaken a strategy of international expansion and extension of the range of products and services. Thanks to its ECPI research capacity created database, rating methodologies and indices covering, every asset class investable, based on the founding principle that every asset class, each fund manager, or any form of investment produces a return (and while a certain risk level). This is the result both of its financial performance, both of extra-financial factors, such as the company's attitude towards the environment in which it operates, the interaction with factors and actors social different and the set of governance rules and regulations that guide it. The development of products for the investment management and advisory services allows managers and institutional investors asset to use sustainability indices and the company's engineering efforts to achieve their mandates, to create sustainable investment funds, to perform portfolio sustainability screening and alternative investments such as real assets, private equity or private debt. ECPI has also launched its ESG Index Series in China in collaboration with CSI and the first Responsible Index Series for the Italian market in collaboration with FTSE Group. ECPI develops and builds indices and strategies of indices and performance data of each ECPI Index, calculated by the S&P Dow Jones Index, are diffused from the main data providers, such as Bloomberg, Datastream and Reuters. The FTSE ECPI Italy SRI Leaders is an equally weighted index made up of a selected basket of Italian companies that exhibit excellent characteristics in environmental, social and corporate

governance. ECPI to create by various indices of the FTSE ECPI family periodically analyzes the public record of the top 100 companies listed on MTA and only companies with EE or higher rating can be part of it. The benchmark FTSE ECPI SRI is an index made up of a selection of companies among the top 100 listed on the MTA with sustainability rating greater than or equal to E +. The weight of these companies with bright ESG performance is weighted by float-adjusted capitalization. Another important index belonging to the London Stock Exchange Group is the FTSE4Good index, which evaluates the performance of companies globally have high standards of social responsibility. This family of indices, in which we find FTSE4Good Environmental Leaders Europe 40 Index, FTSE4Good Europe, FTSE4Good Global, FTSE4Good and FTSE4Good UK USA FTSE, is the result of the FTSE and Russell indeces. The aim of the union was, in fact, create a new leading global index that can create analysis and solutions to investment process. The last frontier of FTSE Russell is the series of Green Revenues indeces that track only companies that generate revenues green, a critical component not considered by current models of sustainability. Currently investors' attention is also paid to the issue of climate change, the green revenues and how to identify them. Faced with the development of public environmental policies, investors try to evaluate the impact of the green economy in their portfolios, quantifying the revenues from goods, green products and services, since the transition to a green is the new emerging market. Globally, however, one of the major indices is the Dow Jones Sustainability Index formed by a series of indices among which find the DJSI Word that comprises about 10% of the largest 2,500 companies listed on the world with excellent performance environmental, social and governance. The strategy analysis of companies belonging to 59 sectors evaluated according to ESG criteria by the DJSI; It has now created a lively competition to be included in this prestigious index. For the Electric Utilities sector, the best company of the year 2016 is the Italian Terna Rete Elettrica Nazionale SpA. In order to ensure quality and objectivity of assessments, each year the processes of analysis applied are assigned to the review by Deloitte. Only 12 Italian companies are included in the DJSI World, including Snam, Enel, Eni, Terna, Telecom and FCA. The presence of Italian companies in the indices is limited. In Italy, in fact, there are the lack of companies with a potential positive ESG rating, but the small number of listed companies with sufficient market capitalization and, thus, with sufficient liquidity in order to become part of the indeces. Globally the work of ethical rating agencies remains important because the economic value lies in the ethical function, or in the fairness and transparency of the processes of generation and distribution of value.

4. Ethical Funds in Italy: Etica SGR

In 2016 the number of socially responsible funds in Europe was in 2413 (Figure 3), with assets under management amounted to 476 billion of euro. The rate of growth has been particularly rapid, as shown by the trend of the period from 2010 to 2016, during which the amount of assets under management grown by 89%. Out of the total of investment funds in Europe, ethical funds are only 3.4% and assets are managed by these 3.3%.

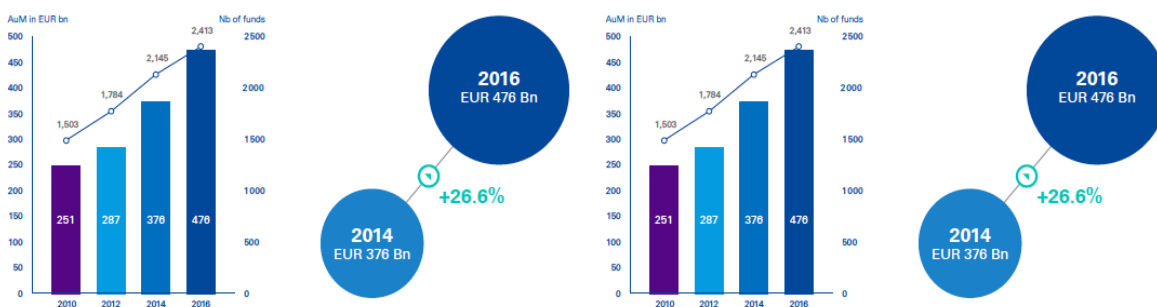


Figure 3. Kpmg, European responsible investing fund market 2016

As for segmentation, Figure 4 shows that more than two-thirds of the ethical fund applies a strategy of positive or negative screening. The thematic funds, i.e. those that invest in a particular environmental focus, social or governance, are about one third of the fund of the SRI market in terms of number of funds and 13% in terms of assets under management.



Figure 4. Kpmg, European responsible investing fund market 2016

Certainly the funds that invest according to the environmental issue remain the largest portion between the thematic funds. This could be traced to the fact that evaluate the environmental performance of an issuer is easier both in qualitative and quantitative terms, given the nature of the factors involved. Most European ethical funds invest globally, while 23% only in the Eurozone funds or Europe. Compared to the same sample for analysis, the search *Kpmg, European responsible investing fund market 2016* shows that 41% of the amount of assets under management is invested in equity and 25% in bonds. Among the most present in the European SRI Portfolios actions, can find the French Sanofi in first place, followed by Vodafone and the French Total, Unilever, the Italian Eni and GlaxoSmithKline. It also increased the percentage of funds that invest only in emerging markets, due to the progressive improvement of the quality of extra-financial information: in 2014 were 5%. Over the past decade the economies of emerging countries have become an investment opportunities: the traditional models that investors use to identify investment opportunities in emerging markets are failing because it also requires social and environmental responsibility. Even China, once notoriously reluctant to these issues, has included in its 12th Five-Year Plan initiatives to improve environmental conditions. Companies in emerging markets are really controlling risks related to the lack of sustainability and taking advantage of the opportunities associated with CSR are preparing to become the global leader in creating long-term value. Figure 5 show how is increasing significantly the number of companies from emerging countries included in the DJSI if since the beginning of 2000 there were significant extent Brazilian companies, south Africa and Taiwan, since 2008, have become part of this index also Chinese and Indian companies, although in a number minor. France is ranked first in Europe to total invested in SRI funds, while Italy ranks at the bottom along with Spain and Denmark. The three biggest ethical funds are also French: BNP Paribas Mais (Bop Paribas AM), Amundi TRESO ISR (Amundi AM) and Fonsicav (Natixis AM).

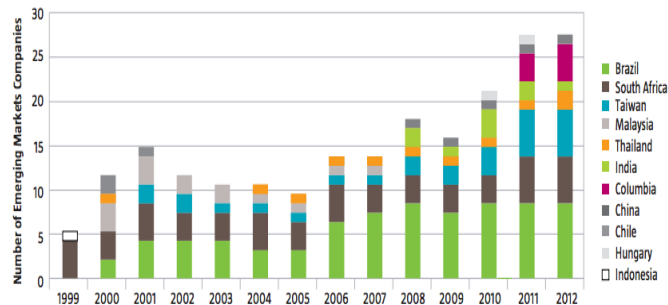


Figure 5. Representation of the number of companies from emerging countries in the DJSI since 1999, the year of its launch

Regards the Italian situation, the first financial institution ethics was born in 1999, Banca Popolare Etica, which today is the only bank in Italy to inspire all its activities, both operational and cultural, to the principles of ethics finance: transparency, right of access to credit, efficiency and attention to non economic consequences of economic actions. At this banking group belongs Etica sgr, an asset management company that promotes and exclusively

manages mutual funds for socially responsible investment with the aim to represent financial values ethics in financial markets, by raising awareness and financial operators towards socially responsible investment and corporate social responsibility. Ethica sgr aims to invest in the real economy to reward companies and States which respect the environment and human rights, without sacrificing performance opportunities, in the medium long term. This is also reflected in the selection process of the bonds initially aimed to exclude States and companies involved in controversial activities (negative screening) and subsequently directed at identifying the most honest businesses based on the analysis of the CSR aspects of issuers (positive screening and best in class). Etica sgr, in fact, does not invest in the fields of armaments, tobacco, gambling, nuclear power, pesticides, and in companies or countries involved in activities prejudicial to human rights; currently it does not invest even in the financial, oil and mining. They also excluded from own portfolios, securities which states have the death penalty or do not guarantee political freedoms and civil rights. The issuers that have exceeded the negative screening are subjected to a detailed analysis in respect of environmental, social and governance parameters and each is assigned a score based on synthetic evaluation of ten indicators. However, these calculation methods are specific to each fund and for this reason are not publicly available. Over a certain score, issuers are classified as best in class in their field and become part of the investible funds of Etica sgr. These analyzes are based on information provided by affiliate partners such as ICCR (Interfaith Center on Corporate Responsibility), PRI (Principles for Responsible Investments), CDP (Carbon Disclosure Project) and EuroSif (European Forum for Sustainable Finance), NGOs such as Amnesty International or on information derived from company documents published by companies. Also direct dialogue with the companies themselves to Etica sgr is an important source of extra-financial information. In addition, Ethica sgr plays engagement activity on behalf of the underwriters, and consistent with the principles of responsible investment. The financial management of the funds is delegated to Anima sgr, who actively manages the portfolio on the basis investable universe and the investment policy defined by Etica sgr. Anima sgr performs financial analysis and trading in the securities, dealing with a specific market benchmark. Customers can choose from 5 different portfolios depending on their risk tolerance: Ethics Shareholders is the more risky portfolio because is composed by equities, which by nature have a certain yield, while Ethical Bond (Mixed or Short Term) are the two portfolios less risky because formed only by bonds; Ethics Balanced and Ethical Balanced yield are two compounds both portfolios of bonds that actions, which allow a limitation of the risk related to the uncertainty of the typical performance of equities.

5. Conclusions

Although ethical finance is only a small percentage of total amounts of investments, transparency and green economy issues will increasingly attract resources in the next years, in line with the planet's conservation trends. The rise of ethical rating agencies and ethical indeces has helped this process. Following this commitment, the larger investment funds have publicly announced that they will include more climate funds in their portfolios. It is not surprising that the market statistics of European investment funds with SRI criteria reflect this growing trend. The analysis of this paper was made on the basis of reports from individual funds, but it would be interesting to analyze the performance of individual sectors in a wider period under observation. In addition, over time, the number of funds should increase and thus also the possibilities to analyze a statistically significant population. It would be a good result if in the next 4 years, in 2022, the proportion of assets invested in ethical funds will be 10%. Undoubtedly, the fact that these indices overperform the traditional indices might to be a further incentive for all investors.

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