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Re-embedding financial stakes within ethical and social values in socially responsible investing (SRI)☆

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ABSTRACT

The aim of this study is to understand how the definition of ethics in finance has steered socially responsible investing (SRI) towards a financial approach where ethics is guided by finance. Following a critical perspective of historical and modern SRI, we advocate a reconceptualization of the SRI paradigm through a framework that re-embeds finance in ethical and social values according to Polanyi's theory of embeddedness. To conclude, we propose an SRI model where impact measurement and extra-financial performance guide investments.

1. Introduction

Anchored in a deep crisis of values, finance (considered as the accumulation of wealth that Aristotle described as an unnatural chrematistic[1]) is today in a complete break with the ethical, social and environmental challenges of the modern world. The embedding problem that Polanyi (1944) raised, whereby social and economic relations can be considered as the adjustment of variables maximizing shareholder value (Lagoarde-Segot, 2015; Paranque, 2015) and self-regulated markets, also applies today to the framework of sustainable and responsible finance.

Within this new finance, socially responsible investing (SRI) – or ethical investing as originally called – can be regarded as a preeminent issue given the exceptional interest that institutions and academics lend it (Revelli and Viviani, 2015). According to the latest Global Sustainable Investment Alliance report (GSIA, 2014), global SRI assets represent US$ 21.4 trillion and 30.2% of total assets managed in the world (in other words, almost one in three assets are SRI-managed). The weight of SRI in the financial industry and the virtuousness of the label itself raise the question of the ethicality and embeddedness of SRI.

In this study, we first attempt to understand the real position of ethics within the concept of SRI and identify the causes of its financial drift. Second, we propose a model to embed the financial aspect of SRI in ethical values that should help formalize investments that promote impact measurement and extra-financial performance.

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[1] Taken from Aristotle's Nicomachean Ethics.

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2. SRI: from niche ethical identity to global financial practice

2.1. Ideological and philosophical debate: can SRI really be viewed as ethical investing?

In some people's minds, ethics is associated with morality.[2] For others, ethics is based on codes of conduct, deontology or principles defined by law and charter. It is very difficult to approach the concept of ethics and appropriately define its boundaries in view of the numerous transformations over time since antiquity (in the approach of Greek philosophers such as Socrates, Plato, Aristotle and Epicurus) to modern ethics according to Kant (deontological ethics) and more recently, the ethical principles applied to different areas of inquiry (e.g., bioethics, environmental ethics, social ethics, business ethics and medical ethics). For Strudler (2003) or Morin (2004), ethics relates more to a person's own judgment and implies the notion of free will, while viewing 'moral values' as the guidelines or boundaries of a framework that the person must remain within.

Since the appearance of the first 'ethical fund' in 1928 (the Pioneer Fund[3]) and even more so in the 1970s and the boycotting of companies doing business in South Africa due to the apartheid regime, the term 'ethical investing' refers to integrating social values in financial investments. At that time, ethical investing was considered a niche market (Revelli, 2015) for activists with a prioritized ethical stance. However, considering the above definition of ethics, is the term 'investing' compatible with the notion of ethics? In finance, investing incurs an expense, which should ultimately generate a financial, tangible or intangible return. The principle of a return or profitability is therefore, systematically addressed when an expense is effectively incurred. Any financial investment (in the stock market sense) is always intended to maximize shareholder value in the short, medium or long term. This has been the case since the shareholder revolution of the 1970s–1980s when shareholders assumed control over company strategies to the detriment of corporate governance and directors, against a backdrop of market expansion and abandoning production targets for financial targets (Lazonick and O'sullivan, 2000; Wilberg, 2008). This implies that ethical investing is still investing and should therefore be profitable. But can profitability and ethics be compatible? In the financial economics dogma of Friedman (1962) or in agency theory (Jensen and Meckling, 1976), individualism through investing and the search for utility cannot be reconciled with a relation with the "Other" as defined by Levinas (1969). The decorrelation of the real economy and the financial economy through financialization prevents acknowledging that *homo economicus* is able to grasp the notion of a social relationship shared with the rest of the community. The 'rational' economic agent in the neo-classical dogma (Keen, 2001) makes decisions and optimizes his choices in accordance with profitability and risk criteria with the sole aim of maximizing personal interests. The short-term pursuit of maximized profitability, today implemented in financial practices over markets, cannot be the norm that determines investment behaviour, since this is incompatible with building sustainable societies.

In line with this argument, the main question on SRI that the scientific community has attempted to explain and demonstrate for over 20 years is whether ethics through investing results in profit or financial sacrifice (Revelli and Viviani, 2015).

2.2. From the philosophical debate to the scientific debate: SRI financial performance

The last point raised in the previous section is fully reflected in scientific debates on the SRI concept. SRI research has mainly focused on the quest for financial profitability, in other words, aiming to understand whether or not this type of investment has a financial cost compared to a conventional investment if the other aspects of investing (such as the economic, social or ecological effects) are excluded. According to Capelle-Blancard and Monjon (2012), 72.5% of studies published in the field of SRI between 2000 and 2009 dealt with the topic of financial performance. The authors (p.247) add that "maybe too much attention has been paid to this issue".

Researchers were initially interested in studying the causal link between corporate social performance (CSP) and the "account-based" corporate financial performance (CFP) of companies (Orlitzky et al., 2003; Margolis et al., 2007). Subsequent to institutionalizing corporate social responsibility (CSR) and sustainable development (SD) in portfolio strategies (Revelli, 2015), the debate on the CSP/CFP relationship then logically shifted to the debate on SRI financial performance. From an empirical viewpoint, the findings of several decades of research have been unable to overcome the lack of consensus on this point, concluding that SRI has either a positive or a negative effect on financial performance, or even no effect at all (null effect). A recent meta-analysis of 85 studies and 190 experiments (Revelli and Viviani, 2015) concludes that there is no difference between SRI financial performance and conventional investments, that the results are heterogeneous across studies considering the various combinations of methodologies and implying that a non-financial analysis is not a particular factor in either performance or the alpha measure.

Researchers may have focused on this research theme due to the simultaneous availability of financial data and the first non-financial data published in the 1980s by social rating agencies[4] or financial data suppliers such as Bloomberg and Thomson Reuters, flooding the non-financial data and analysis market. The mining of these data has therefore, enabled their

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[2] Unlike morality in its Latin etymology (mores, customs), which refers to the concepts of good and bad, implying rules of conduct and norms to be complied with, the word ethics originates from the Greek ethikos (moral and ethos, habit, customs, character, state of the soul).

[3] Based on the exclusion of 'sin stocks' (invested in tobacco, alcohol, gambling...) and influenced by religious values.

[4] MSCI ESG Research (formerly KLD and Innovest), Vigeo Eiris (Vigeo merged with Eiris), etc.