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Investing in socially responsible mutual funds: Proposal of non-financial ranking in Italian market

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ABSTRACT

Currently, one of the main instruments of Socially Responsible Investment is mutual funds. Their growth in the financial market has been remarkable over the past few years, which has also paralleled the growth in the business ethics literature.

The aim of the present work is to present a methodology useful to define a portfolio selection model for measuring the attractiveness of socially responsible asset investments. The result is the definition of a non-financial ranking to complete financial information about mutual funds for investors demanding Corporate Social Responsibility. The methodology focuses on social responsibility decision-making criteria and their weights agreed by the main stakeholders. The research, based on a well-known multi-criteria method, the Analytic Hierarchy Process (AHP), proves that the methodology is feasible and gives useful results for investors demanding social responsibility.

1. Introduction

The increasing number of socially responsible enterprises encourages investors to create socially responsible funds, investing in these enterprises and promotes increasing integration of the society through this socially responsible activity (Oikonomou et al., 2012). The modern socially responsible investment is based on the growing social awareness on the part of investors. The first modern socially responsible mutual fund, the so-called Pax World Fund was incorporated in 1971 in the United States. The Fund was specifically incorporated for investors objecting the war in Vietnam. Since 1990, the socially responsible investment industry has been rapidly growing in the United States of America and in some other countries such as Australia or France. However, the growth and interest in Italy has been much more slower (Jegourel and Maveyraud, 2010). Over the past several years, the world economy has been affected by the current long economic recession, and the asset management industry has not been immune to these negative impacts. Thus, the overall asset management market in Italy has seen total assets under management reduce considerably, due to, firstly, contagion effects from the global financial crisis. Nevertheless, and despite this very difficult economic context, or perhaps because of it, the Socially Responsible Investing (SRI) market is gaining popularity. The current socially responsible investment market in Italy could be described as an

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emerging market. It seems that more and more people are responding positively to the investments that provide a good financial return as well as a good return for society and the environment. This change in attitude has led to the growth of Socially Responsible Investing. Socially Responsible Investing can be broadly defined as an investment process that integrates not only financial but also environmental, social and governance considerations into investment decision making. In fact as stated by Andrikopoulos et al. (2014) the legitimacy, the identity and the social impact of financial investments go beyond the generation of revenues for providers of capital, through financial intermediation. Currently, the main instrument of SRI is investment in socially responsible mutual funds. The term “fund” is used to refer to a ready-made financial product where investors’ money is pooled into a portfolio and a fund manager decides which shares to buy. A socially responsible fund is a fund where the selection of investments is based not only on financial but also on social, environmental, governance or other ethical criteria.

There is an increasing agreement that not all the relevant information for an investment decision can be captured in terms of financial criteria. Zopounidis and Doumpos (2013) acknowledge the growing inclusion of non-financial criteria in recently published financial multicriteria decision-making models. Practitioners and researchers have acknowledged the growing concern of investors, individual and institutional, about ethical, environmental, social and governance issues, even if just taken as a way of decreasing the investment risks. Some recent examples are the works by Drut (2010), Ballestero et al. (2012), Dorfleitner and Utz (2012), Bilbao-Terol et al. (2013), Pérez-Gladish et al. (2013), and Utz et al. (2014).

Therefore, any model of SRI asset allocation should integrate social and financial dimensions. The main objective of the paper is to explore the impact of different portfolio restrictions, expenses and value added criteria on the performance of both types of funds. In fact, recent studies suggest that in many situations a more complex decision model may be at work.

There are many economic problems such as the selection of portfolios, where the choice of the best decision should be made taking into account several criteria and using multi criteria techniques. In this paper, a methodology, based on Analytic Hierarchy Process (AHP) proposed by Saaty (1980), is developed for extending the portfolio selection model of Markowitz (1959) in order to include the evaluation of the non-financial criteria. The proposed approach allows considering tangible and intangible factors and involves acknowledging that the decision maker is responding to multiple objectives (De Felice and Petrillo, 2014).

Our results illustrate how for the most inefficient funds the superior performance of SRI funds is significant. This paper is structured as follows. First, we will shortly describe the Italian mutual fund industry in terms of assets under management and returns. Subsequently, the different performance metrics and the research model are explained in Section 3 in order to describe the methodology for the profiling of stakeholders and the ranking of the funds. In Section 4, the application of the proposed methodology to the case study is presented. Finally, results obtained and conclusions are analyzed.

2. Literature review: the SRI market

Despite the economic importance of the European mutual fund industry, European-registered funds are an under-research topic (Vidal-García, 2013). Ducassy and Montandrau (2015) asserted that empirical evidence of the influence of shareholders and governance practices on corporate social responsibility (CSR) pollicises mixed, and most studies have been conducted in the United States. Leite and Cortez (2014) have started to analyze the performance and investment styles of internationally oriented Socially Responsible Investment (SRI) funds, domiciled in European markets, in comparison with characteristics-matched conventional funds. Furthermore, in spite of the astounding growth of Italian finance, there are no studies that have compared Italian mutual funds with SRI. Prior literature suggests that investors are attracted to SRI vehicles from a desire to match their investment policies with their values (Abdelsalam et al., 2014). The SRI industry could play a key role in getting Europe’s economy back on track. The 5th Sustainable and Responsible Investment Study by the European Forum for Sustainable Investment (Eurosif, 2012) details the continued growth in assets under management (AuM) of the European SRI market and also reveals opportunities for future growth. The study highlights the growing diversity and sophistication of sustainable investment strategies in practice today. The assets managed by the European market for socially responsible funds in the year 2012 has reached 95 billion euro consolidating the growth (+12%) of the recent years. This result is a confirmation of the strength of this segment of the asset management business that has maintained positive net inflows even during periods of markets volatility. The Italian mutual fund industry has suffered a significant downsizing over the last 12 years, showing a constantly decreasing trend, from about 42% of GDP in 1999 (more or less aligned with the European average) to 8% in 2011.

According to Fig. 1, in Italy the SRI market remains considerably less developed than many of its Northern European neighbours.

It remains a niche investment strategy dominated by a few large institutional investors. According to European SRI Study (Eurosif, 2012) despite the fact that the legal framework for SRI in Italy remains less robust than in many of its European neighbours, several recent developments point to promising perspectives in the near term horizon. The overall development of socially responsible investment in the country still largely lags behind, mostly as a result of insufficient information, specifically little interest in and understanding of benefits and relevance of SRI on the part of investors.

Thus, one of the aims of this paper is to contribute to stimulate SRI in Italy by providing investors with more information about socially responsible mutual funds. SRI strategies require an evaluation of the investment instruments in terms of a diverse set of environmental, social and governance criteria. Nevertheless investors, especially retail, have a limited capacity