



Socially Responsible Investment and cleaner production in the Asia Pacific: does it pay to be good?



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ABSTRACT

The growth of Socially Responsible Investment (SRI) has been impressive during the last two decades. Such growth has stimulated financing of developments and improvements in cleaner production methods, consumption patterns of responsible corporations and, in general, changed behaviour towards corporate sustainability. However, cleaner production investments vary across different regions in the world for several reasons such as: capital availability, the stage of development of banking systems, the existence of appropriate finance mechanisms, available corporate know-how and technology risks. This research aimed to provide relevant information about the outcomes of integrating environmental, social and governance issues for cleaner production into investment strategies in the Asia Pacific region for managers, practitioners, academics, institutions and investors. Research focused on analysing the performance of the Dow Jones Sustainability Asia Pacific index (DJSI-AP) because the index applies a 'Best in Class' investment screening method, being more relevant to fostering cleaner production. Results indicate that the social and environmental screening process neither represents a burden of cost generation for companies, nor an additional burden on their SRI financial performance. Finally, the research results emphasize that investors can support businesses committed to increasing their environmental performance through improvements in cleaner production processes.

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1. Introduction

The distinguishing feature between conventional and Ethical or Socially Responsible Investment (SRI) is that the latter uses social and environmental criteria when managing quoted equity portfolios (Cowton, 1994). This non-conventional investment approach is aligned with the principles of the United Nations Global Compact,¹ which form a unifying framework that is internationally recognized for asking companies to embrace, support and enact a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption. In sum, SRI refers to an investment discipline that adds concerns about social and environmental issues to normal financial concerns about risk and return as determinants of equity portfolio construction (Sparkes, 2002). During the 21st century SRI has experienced a large increase both in

volume and value in Europe and the United States for several reasons (EUROSIF, 2010): a) the potential to shift corporate behaviour towards cleaner production and more sustainable consumption patterns; b) increasing demand from institutional investors; c) the integration of environmental, social and governance (ESG) principles into conventional financial services; and d) external pressure from the stakeholders (Zhang et al., 2008) and major non-government organisations (NGOs) worldwide.

It is worth mentioning that the appearance and development of SRI equity indexes has also figured highly in the growth and consolidation of SRI markets in some regions. Examples of such growth are: a) in the United States, the Domini 400 Social index, the Dow Jones Sustainability North America index and the Dow Jones Sustainability United States index; and b) in Europe, the Dow Jones Sustainability Europe index, the Dow Jones Sustainability Eurozone index and the FTSE4Good Europe indexes. In general, SRI equity indexes apply different screening methods in order to select certain firms on the basis of environmental, social and ethical criteria (Barber, 2007). However, it might be expected that cleaner production is not recognised by most of the social and environmental screens. Thus, the idea that cleaner production is inherent and essential part of any SRI can be questioned. This is explained

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¹ These principles enjoy universal consensus and are derived from the Universal Declaration of Human Rights, The International Labour Organization's Declaration on Fundamental Principles and Rights at Work, The Rio Declaration on Environment and Development and The United Nations Convention against Corruption.

because the screens delineate a certain model of sustainability and Corporate Social Responsibility (CSR) which can include or exclude cleaner production innovations. However, the literature indicates that among the different screening methods, the 'Best in Class' approach recognises cleaner production processes and innovations and thus is relevant to fostering investments in cleaner production (O'Rourke, 2003). This is because the 'Best in Class' screening method refers to a reformist approach to corporate environmental management for cleaner production which focus on rewarding companies with good environmental and social track records relative to their industry (O'Rourke, 2003). Trends such as changing environmental regulation, changing demographics and uses of scarce environmental resources are taken into account for each industry sector. Specifically, the company's relative position within a sector is assessed according to how well it is likely to perform financially, socially and environmentally in the future. As O'Rourke (2003) indicates, it is here that there is the closest connection to concepts of cleaner production and SRI in that they try to reward behaviour which is preventative, takes a life cycle approach to products and processes, is risk reducing and also cost effective. As O'Rourke (2003) indicates, the screening mechanism is based on concepts of eco-modernisation and eco-efficiency to which cleaner production is closely allied (please, refer to Section 3.2. for further details about the links between the 'Best in Class' screening method and cleaner production).

Increase in the volume of SRI equity indexes, at a global level, has awakened the interest of academics, practitioners and policy makers in assessing the financial outcomes from investing in these non-conventional stock exchange indexes, thereby examining the relationship between corporate social, environmental and financial performance. To date studies have focused on Europe and the United States (Collison et al., 2008; Schröder, 2007; Statman, 2006). However, interest in carrying out research into the performance of SRI equity indexes has not been undertaken in the Asia Pacific to the best of the authors' knowledge. This absence is remarkable when considered within the context of the development of SRI markets that represent over €65 billion of investment (EUROSIF, 2010). The Australian SRI market is the largest in the Asia Pacific, representing about €56.5 billion in 2010 (EUROSIF, 2010). Other SRI markets in the region, such as the Japanese, have also increased, representing about €4 billion in 2010 (EUROSIF, 2010).

Bearing these issues in mind, the aim of this paper is to assess the outcomes of integrating environmental, social and governance issues into core investment processes in the Asia Pacific setting in order to provide academics, institutions, investors and other stakeholders with relevant information for investment which might encourage cleaner production. Focus is on analysis of the performance of the Dow Jones Sustainability Asia Pacific index (DJSI-AP), which comprises a set of leading sustainability companies selected from stock markets in the Asia Pacific. Although there are other SRI equity indexes in the Asia Pacific² most of them are country-focused and do not use a 'Best in Class' screening method. The latter is crucial because, as previously mentioned, this method is relevant for fostering investment and cleaner production of companies best managing their sector-specific sustainability-related challenges. Furthermore, analysis of the DJSI-AP facilitates obtaining a better global overview of the implications around the financial performance of SRI in that geographical context. Further, this research introduces some methodological innovations

(detailed in the following sections) which will lead to more reliable and robust results, thus overcoming the limitations shown by previous research in the field. This will result in obtaining more relevant information for improving several processes such as: a) stakeholder evaluation of the social and environmental performance of companies; b) assessment of social and environmental strategic policies by firm's managers; c) addressing the relationship between corporate performance and several environmental practices, among others. The main results indicate that investments in cleaner production processes carried out by companies which want to improve their environmental performance do not have a negative influence on corporate performance. Thus, because good environmental performance is identified with good business health and higher value of the firms by stakeholders, companies in the Asia Pacific have an incentive to adopt cleaner production methods. These ethical investment forces towards sustainability investments in the Asia Pacific context, thus contribute to improving corporate commitment to cleaner production.

The rest of the paper is organised as follows. The next section analyses previous literature in the field and develops the working hypotheses. The third section introduces the econometric models to be used and describes the sample and available data. Results are provided in section four. Conclusions, further discussion and future research opportunities appear in the final section.

2. What do we know about the impact of ethical investment on cleaner production?

Research about SRI performance dates back to the 1970s (Moskowitz, 1972), and has grown significantly in recent decades because of the increased attention to corporate sustainability and to corporate social and environmental performance (Sardinha et al., 2011). In general, the main concern of SRI research is to provide a convincing examination of the hypothesis that *SRI must underperform the market and other well-diversified portfolios* (Renneboog et al., 2008a). This hypothesis is supported by the tenets of Modern Portfolio Theory (MPT) for two main reasons: a) SRI portfolios are subsets of the market portfolio; and b) the social and environmental screening processes essential in SRI decisions restrict investment opportunities, reduce diversification efficiencies and thereby have an adverse impact on performance (Lee et al., 2010).

Most research in this field focuses on the analysis of differences in risk-adjusted returns between SRI and conventional investment funds (Hamilton et al., 1993; Luther et al., 1992; Luther and Matatko, 1994; White, 1995). In general, these studies do not produce evidence of outstanding or under-performance of SRI funds. However, the results of these studies need to be interpreted with caution because: they neither consider the transaction costs of purchase and sale of investment funds, nor do they take into account the ability of portfolio managers to produce outstanding performance (Schröder, 2007), an issue that could interfere with the SRI screening processes. Later studies have tried to mitigate these shortcomings by comparing SRI and conventional funds possessing similar characteristics (Bauer et al., 2005; Gregory et al., 1997; Kreander et al., 2002; Michelson et al., 2004; Statman, 2000; among others). Although several studies reveal significant outstanding performance (Derwall et al., 2005; Derwall and Koedijk, 2009) or under-performance (Geczy et al., 2005; Renneboog et al., 2008b) by SRI funds, they generally conclude that SRI and conventional funds show similar return performance (Barnett and Salomon, 2006; Bauer et al., 2007; Lee et al., 2010).

The literature addressing SRI performance also contains papers which analyse the risk-return associated with SRI equity indexes (Schröder, 2007). Most prior academic research into analysing the performance of SRI equity indexes during the 1990s focused on the

² The Australian SAM Sustainability Index, the Dow Jones Sustainability Japan 40 index, the Dow Jones Sustainability Korea index, the Ethinvest Environmental Australia index, the Westpac–Monash Eco index Australia, the Australian Cleantech Index and the FTSE4Good Australia 30 index, among others.

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