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Is it costly to be both Shariah-compliant and Socially Responsible?

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Abstract :

Positive ethics associated with socially responsible investments (SRI) is challenging the limits of Islamic investments' conservative approach to promote corporate social responsibility. In this study, we test the integration of social performance measures (companies the most virtuous or high-rated in terms of Environmental Social and Governance (ESG) issues) in Islamic portfolios using KLD social ratings. We seek to determine the financial price of complying both to Islamic investment and SRI principles. To do so, we measure the financial performance of self-composed Islamic portfolios with varying ESG scores. The results indicate no adverse effects on returns due to the application of ESG screens on shariah-compliant stocks during the 2007-2011 periods while reporting substantially higher performance for the portfolios with good records in governance, products, diversity and environment issues. On the opposite, a negative performance is associated with an SRI strategy of disengagement from shariah-compliant stocks with community and human rights controversies. Our performance measures are controlled for market sensitivity, investment style, momentum factor and sector exposure.

KEYWORDS: Islamic investment; Environmental, Social and Governance (ESG) performance; Investment decision; Portfolio choice.

JEL: A13, G11, G15, M14

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