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Examining socially responsible investment preferences: A discrete choice conjoint experiment

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ABSTRACT

Using a hierarchical Bayesian estimation of a discrete choice conjoint model, this research examines preferences for different responsible investment characteristics from the perspective of pension beneficiaries. We conducted a choice-based conjoint experiment in which participants were invited to select a preferred investment portfolio among different options by combining attributes such as socially responsible investments and impact investments. Based on a sample of 334 respondents, the results show the utility and relative importance that members of the administrative organization of a Dutch pension fund with a cooperative structure attach to the socially responsible portfolio. Latent class analysis yielded three segments of pension beneficiaries with different levels of psychological distance toward socially responsible investments.

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1. Introduction

The conventional form of investing is vulnerable to high-volatility events and crises in the financial markets. Most importantly, conventional investing has proven insufficient for addressing important social issues. A newly introduced investment culture, known as “impact investing”, strives for long-term social gains by addressing social problems rather than attempting to maximize financial returns. Additionally, pension funds and other institutional investors are increasingly examining investments through the lens of social responsibility and are pursuing more active roles in corporate governance. This study explores preferences for a socially responsible portfolio by employing a discrete choice conjoint experiment. Our sample consists of members of the administrative organization of a Dutch pension fund with a cooperative structure in the healthcare sector.

Responsible investments have increasingly gained momentum over the past few years. Institutional investors, such as pension funds, are proactively integrating such practices into their investment strategies as they acknowledge sustainability and social responsibility as part of their fiduciary duty (Koedijk and Slager, 2011). Nevertheless, pension fund beneficiaries’ preferences for

investments to satisfy responsibility criteria have not been sufficiently investigated. Moreover, the literature provides contradictory findings regarding the long-term financial performance of responsible funds compared with that of conventional funds; therefore, concrete conclusions have not been made.

With respect to member inclusion in the design of the investment policies of pension funds, particularly with respect to their impact and socially responsible investing in the long term, we must first address the effect of psychological distance on individual preferences. The phenomenon of psychological distance can be illustrated by the following example. In general, when people are asked for their preferences regarding sustainable animal production, they can rather easily identify the criteria with which farmers should comply. In this case, people cite criteria such as “animal welfare”, “environmental impact”, “impact on children’s health”, and “impact on health in the long run”. Generally, people indicate that they believe these conditions are important. In addition, they understand that the end user should pay the extra cost of sustainable production. However, when the same people must make the same decisions while standing in front of shelves in a supermarket, they address concrete and short-run architectures of choice (van Trijp, 2013). Thus, discussing long-term effects in relation to the next generation and in connection with people elsewhere in the world results in different choices from those made in supermarkets or grocery stores.

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Construal level theory (CLT) posits that distal and abstract thoughts are formulated at a higher construal level and that they therefore are placed at a further psychological distance with respect to the reference point (Liberman and Trope, 2008; Trope and Liberman, 2000, 2003). In contrast, thoughts closer to the reference point of the self, here and now, are more concrete and formulated at a lower construal level and can thus be placed at a closer distance. Furthermore, high-level (low-level) construals are characterized by desirability (feasibility). Moreover, the shift from high- to low-level construals and from desirability to feasibility may result in somewhat inconsistent intertemporal decisions (Trope and Liberman, 2003; Zhao et al., 2007). Whether the perceived immediate costs outweigh future benefits can also explain the inconsistency in intertemporal choices. When viewed from a distance, the benefits outweigh the costs, but when the moment to make a choice arrives, the costs appear larger than the anticipated costs, resulting in changed preferences (Eyal et al., 2004). Typically, future benefits loom larger than future costs, but in the present, the reverse is true (Eyal et al., 2004), implying that savings in the short run represent a cost – rather than a benefit – for the future (Lynch and Zauberman, 2006).

CLT holds that greater psychological distance is associated with people's abstract beliefs and core values. The theory predicts that concrete construals have a higher probability of implementation because they are considered more feasible and attractive than abstract construals (Liberman et al., 2007). Using our previous example of sustainable production, we note that people often state their support for sustainable products. However, they do not purchase such products when they are confronted with short-term choice architectures because feasibility prevails over desirability. This example illustrates the inconsistency between stated preferences and real choices.

Similarly, we can argue that long-term investment preferences characterized by social responsibility and social impact traits formed at a higher construal level are considered desirable and less feasible; therefore, they are located further from and contrast with the financial aspects of pensions. In Fig. 1, we show the psychological distance of several investment characteristics in a two-dimensional map: social and temporal. Impact investment criteria, such as healthy aging, and socially responsible criteria, such as sustainability, are depicted at a higher psychological distance than financial return criteria because they are assumed to be more abstract construals. Choice inconsistency will emerge when people who favor socially responsible criteria choose an investment portfolio based on financial criteria shifting, which itself is based on their initial preference. In such a case, our selfish short-term interests seem to be at odds with our collective long-term interests.

In this study, which is based on a discrete-choice modeling framework, respondents consider trade-offs between investment criteria such as impact investment (Impl), socially responsible investment (SRI), and the additional cost in the selection process of a socially responsible investment portfolio, given that the opportunity to make such a decision. In the research design of the present study, we argue that even if responsible investments achieve worse, the same, or better financial returns as conventional investments, pension beneficiaries must pay the extra cost stemming from the screening process, *ceteris paribus* (i.e., maintaining the portfolio's risk/return profile). The framework to elicit individual preferences is based on random utility theory (McFadden, 1986; Louviere et al., 2000). Empirical data for this study were collected from individuals who work in the care and welfare sector in the Netherlands by using a web-based discrete choice survey. Each survey instrument contained 10 choice profiles and compared 3 attributes of 2 responsible investment portfolios. The attributes varied from 3 to 10 levels according to a full profile choice-conjoint

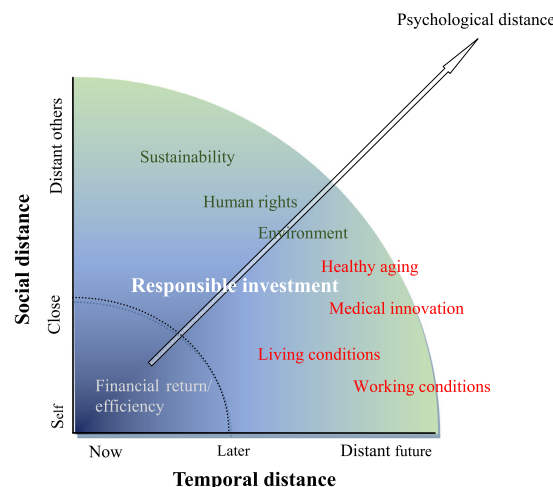


Fig. 1. Investment levels and psychological distance.

design. The results of the analysis of the Hierarchical Bayesian (HB) regression models show the relative effect of the Impl criteria, SRI criteria, and costs on the selection of a responsible investment portfolio.

Decker and Trusov (2010) postulate that conjoint analysis represents a widespread class of methods for eliciting preferences—particularly for identifying and evaluating new product concepts. Rietjens (2011) employs a conjoint model to determine the pension system preferences of pension fund participants. The results of her analysis indicate that pension fund participants place the investment performance attribute second in importance to the coverage ratio index. Parient (2011) uses a choice-based conjoint (CBC) framework and a conditional logit model to estimate the demand for microcredit in Serbia. Accordingly, we followed a discrete CBC framework using Sawtooth Software. We use this method because it closely emulates the real circumstances under which the decision-making process occurs. Furthermore, a discrete choice-based design results in less noisy data than a traditional conjoint design that use ratings, and because of a few attribute combinations, this design was preferred to more advanced designs such the adaptive conjoint analysis. Note that because this study utilized the Sawtooth Software's CBC analysis, each respondent did not see the same combination of attributes and levels. In this computerized experiment, 300 versions of the questionnaire were created. Our sample consisted of 3600 members working in the Dutch healthcare sector, and we received 334 completed questionnaires in return.

Our study contributes to the literature of socially responsible investment (SRI) and provides insight into the literature on impact investments. We build a hypothetical investment portfolio that comprises investments that fulfill certain SRI and impact criteria, and we investigate the utility level that pension beneficiaries gain from each level and attribute to this socially responsible investment product. We know little about pension beneficiaries' preferences related to responsible and impact investments. We explore this issue by calculating utility coefficients that reflect the relative influence of the 17 attribute levels of this study with regard for the decision to invest in a SRI portfolio. Furthermore, we derived importance scores that reflect the sensitivity of pension beneficiaries' choices to variations in the levels of each attribute. Finally, this study examines whether pension beneficiaries would sacrifice financial efficiency by contributing a small part of their expected pension income in exchange for investments that add social value and whether they are capable of making consistent

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