Investment Style and Perceived Drivers of Adoption of Socially Responsible Investment among Swedish Institutional Investors

Magnus Jansson, Anders Biel, Maria Andersson, and Tommy Gärling

Department of Psychology, University of Gothenburg, Gothenburg, Sweden

SIRP WP 10-05

Sustainable Investment and Corporate Governance Working Papers, Sustainable Investment Research Platform
Investment Style and Perceived Drivers of Adoption of Socially Responsible Investment among Swedish Institutional Investors

Magnus Jansson¹, Anders Biel², Maria Andersson³, and Tommy Gärling⁴

Department of Psychology, University of Gothenburg, Gothenburg, Sweden

Abstract

A survey was conducted to investigate investment style and drivers of socially responsible investment (SRI) among institutional investors. Respondents were 60 professionals working as SRI or non-SRI investors in 19 different Swedish banks, pension funds, or mutual fund companies. The results showed that non-SRI investors perceived market regulations to be a stronger driver of SRI, while SRI investors perceived others’ behaviour to be stronger driver. No differences were found between SRI and non-SRI investors with respect to short-term vs. long-term or active vs. passive investment styles.

Key words: socially responsible investments, drivers, institutional investors, investment style

¹ Magnus Jansson, Department of Psychology, University of Gothenburg, P.O. Box 500, SE-40530 Göteborg, Sweden. E-mail: Magnus.Jansson@psy.gu.se, Telephone: 046-(0)31-7861938,
² Anders Biel, Department of Psychology, University of Gothenburg, P.O. Box 500, SE-40530 Göteborg, Sweden.
³ Maria Andersson, Department of Psychology, University of Gothenburg, P.O. Box 500, SE-40530 Göteborg, Sweden.
⁴ Tommy Gärling, Department of Psychology, University of Gothenburg, P.O. Box 500, SE-40530 Göteborg, Sweden.

This research was financially supported by a grant from the Swedish Foundation for Strategic Environmental Research (MISTRA) to the program “Behavioural Impediments to Sustainable Investments”.

Correspondence concerning this article should be addressed to Magnus Jansson, Department of Psychology
Introduction

As a response to global environmental and social challenges, an increased interest in socially responsible investment (SRI) has been observed during recent years. International organisations such as the United Nations Environmental Program (UNEP) have promoted SRI through their initiative Principles for Responsible Investments (PRI). This initiative has more than 400 signature companies promising to adhere to the six following principles of SRI: (1) to corporate environmental, social and corporate governance issues into analysis and decision processes; (2) being active owners; (3) disclosing environmental, social and governance issues; (4) promoting acceptance and implementation of Principles for Responsible Investments (PRI) within the investment industry; (5) enhancing effectiveness in implementing PRI; and (6) reporting progress in implementing SRI (UNEP, 2008). In Europe, the Enhanced Analytic Initiative (EAI) has strived to call investors’ attention to the importance of placing environmental and social issues on the investment agenda.

These initiatives have indeed put SRI on the agenda and enforced a rapid increase in SRI during the last few years. SRI has developed from a marginal phenomenon associated with churches and charity organisations to represent about 18% of all assets managed within the financial industry in Europe (Eurosif, 2008). In Sweden the SRI market has experienced a similar growth, representing today as much as 10% of the total mutual fund market (Eurosif, 2008).

Even if SRI has gained ground it is still not the main investment alternative for most investors. Previous research has mainly addressed drives and obstacles to SRI by investigating the financial returns on SRI investments compared to conventional investments. According to modern portfolio theory (Markowitz, 1952), any restriction on the investment universe may counteract effective risk diversification and hence reduce risk-adjusted returns. Thus, critics of SRI claim that SRI compels managers to reject a large number of potential good investments, which provides lower returns for a given level of risk. Another issue is the additional administrative costs of selecting companies and monitoring that they are fulfilling SRI criteria (Asmundson & Foerster, 2001).

Although the logic of modern portfolio theory seems indisputable, it may have less practical importance as every actively managed portfolio also implies some form of exclusion (The Dutch Association of Industry-Wide Pension Funds, 2008). Further, advocates of SRI argue that the integration of environmental, social and governance (ESG) information would offer better opportunities to evaluate environmental and social liabilities, as SRI grants responsible investors an informational advantage compared to conventional investors (Kurtz, 1997). Moreover, research suggests that there is no difference in risk-adjusted returns between SRI mutual funds (Bauer, Koedjik, & Otten, 2005; Hamilton, Jo, & Statman, 1993) or has reported differences in return - both in favour of SRI and in favour of non-SRI investments (Statman, 2000; Rennebog, Horst, & Zhang, 2008). SRI mutual funds in Sweden have delivered higher returns than conventional funds during the period from 1996 to 2006, regardless of whether returns are assessed during the last one, two, three, four, or five years (Lundberg & Westholm, 2006).

Albeit that a vast body of research suggests that there is no financial difference in performance between SRI and non-SRI investments, there is still scepticism among fund managers about the financial performance of SRI. Hence, many institutional investors regard lower return on SRI as an important obstacle to SRI. In empirical support a recent survey
showed that about 30% of fund managers experienced the “return issue” as an obstacle to implementing SRI (Responsible Investor, 2008).

In the same survey 20% of fund managers claimed that legislation and their responsibility toward their beneficiaries to maximise return (the fiduciary duty) prevent implementation of SRI. Fiduciary duty is defined as the investor’s responsibility to manage assets in the interest of their beneficiaries in a prudent, loyal and careful way (The Dutch Association of Industry-Wide Pension Funds, 2008). Similar numbers are presented in a study of 110 long-term investment managers in the UK (Guyatt, 2006). Modern portfolio theory and beliefs about SRI’s suboptimal diversification seem to be the major reasons why some institutional investors argue that SRI is not consistent with their fiduciary duty. However, its legal status has been strongly questioned lately in a report by the law firm Fresfields Bruckhaus Dingers stating that investors may integrate environmental, social and governance issues into an investment decision if it is consistent with the view of the beneficiaries (The Dutch Association of Industry-Wide Pension Funds, 2008).

Another impediment to SRI is fund managers focus on short-term return. According to some research (Froot, Scharfstein & Stein, 1992) investors having a shorter investment horizon have a tendency to follow others (“herd”), overemphasize short-term information such as technical analyses and underweight information relevant to evaluate long term prospect, including social and environmental information about corporations.

The strive to maximise return in the short-term, and the institutionalised use of short-term evaluation measures of financial performance in the financial sector, would then seem to impede integration of environmental, social and corporate governance issues in the investment process (Guyatt, 2006). Hence, SRI is supposed to benefit from a long-term investment perspective. Although the thesis of short-termism as an obstacle to SRI has face value it has, however, not yet been empirically verified.

Previous research has, besides the focus on short-term return, emphasized herding and gravitation to the defensible as major impediments to SRI (Guyatt, 2006; Jurvale & Lewis, 2008). In order to minimise reputational damage and act as prudent investors, portfolio managers, as well as institutional investors at the organisational level, feel the need to justify investments decisions internally and externally. As investors work in a highly competitive and insecure sector where carrier prospects depend on skill to track or, at best to beat different indexes, there is a need in case of underperformance to justify investments to their customers and superiors. This need for justification encourages adherence to conventional investment styles where strictly conservative economic criteria guide investment decisions. Longer-term intangibles such as information about companies’ environmental and social performance are then disregarded by portfolio managers and by company financial analysts (Guyatt, 2006; Jaworski, 2007).

Although financial drivers and impediments to SRI have been the main focus of research, lately also behavioural determinants of SRI including investors’ values and environmental attitudes have been investigated (“Author”, 2009; Nilsson, 2008). To follow up and complement this line of research, the present study aims at investigating perceived drivers of SRI among portfolio managers and the impact on investment style as driver of SRI. Understanding drivers of SRI of investors is important should one wish to promote SRI along the lines of Principles of Responsible Investments.
Method

Sample and Procedure

All major Swedish investment institutions, in total 38, were invited to participate in a survey. After an initial contact by mail and phone with the CEO and/or Head of Governance, questionnaires were distributed to all companies that agreed to participate (n = 19). Sixty of the distributed questionnaires were answered, which represents a response rate of 25.0%. The respondents included representatives of three of four of Sweden’s largest banks, four of Sweden’s six public pension funds and the majority of ethical and socially responsible mutual fund companies. Among those who refused to participate, the majority was non-SRI mutual fund providers. At least one respondent and frequently several represented each investment bank, mutual fund company or pension fund. Respondents divided by industry classification are shown in Table 1.

Table 1 about here

Twenty-seven of the respondents worked as portfolio managers, 17 as senior investment managers, 6 were investment consultants or advisors, and 10 were board members or CEO’s in their respective companies.

Questionnaire and Measures

The questionnaire assessed investors’ beliefs, attitudes, and investment intentions related to different issues of SRI (defined as investments integrating social and environmental concerns). The questionnaire was first pilot-tested on a small number of portfolio managers before it was finalized. The final version consisted of five parts of which three are reported here. In the first part respondents were asked about the name of their company and which funds they represented, their title/position in the company, the number of years they had worked in the investment management industry, the techniques currently used in their own company to achieve SRI, and how much of their company’s capital that was under management in SRI assets. In order to classify respondents as SRI and non-SRI investors the answer to this question and several others were combined. These other questions captured methods that are applied in the investment community to assess SRI: screening and diverting from industry/branch and from countries, negative screening of companies, positive screening or best-in-class approach, corporate engagement, and investments based on sustainability indexes. Investors that applied none or only one of these measures were classified as non-SRI investors and investors that used more than one method were classified as SRI investors.

The second part of the questionnaire contained nine questions about potential drivers of SRI (see Table 2). All questions were answered on a 5-point scale ranging from 1 (definitely deters SRI) through 2 (slightly deter SRI), 3 (no impact), 4 (slightly promote SRI) to 5 (definitely promotes SRI).

Table 2 about here

In the third part three questions were asked about investment styles. The first were asked to assess the extent to which the respondents act as short- or long-term investors. The first question read: “When buying stocks, what is in general your investment horizon?”. Responses were recorded on a scale ranging from 1 (One month) to 5 (More than one year). The second
question, “Indicate to what extent you have adopted a passive or an active investment strategy”, aimed at capturing the extent to which respondents are “index investors” or try to beat the index by stock-picking. Responses were recorded on a scale from 1 (Mainly passive) to 5 (Mainly active investment strategy). The third question read: “When buying stocks, to what extent do you rely on a technical or a fundamental analysis, respectively?” aimed at assessing the extent to which respondents use fundamental or technical analyses of stocks. Responses were recorded on a scale ranging from 1 (Mainly technical) to 5 (Mainly fundamental analysis).

Results

Table 3 displays descriptive statistics for drivers of SRI by group of investors. As may be seen, the non-SRI investors gave lower ratings than SRI investors to the first five questions but higher to the remaining four questions. t-tests indicated that an “Increasing number of institutional investors” adopting SRI, was rated as reliably a more important driver to SRI by non-SRI investors while the importance of “Uniform criteria of SRI” was rated as a reliably more important driver by non-SRI investors than by SRI investors.

In order to assign the questions to meaningful groups, the answers to the drivers were submitted to a Principal Component Analysis (PCA) extracting three factors with eigenvalues 3.1, 1.8, and 1.1. An orthogonal varimax rotation was chosen because an oblique rotation yielded close to zero correlation between the extracted factors. The first five drivers (#1 to #5, see Table 3) had loadings > .50 on the first factor. Although item 4 also loaded on this factor, the remaining items with high loadings support an interpretation of this factor as representing “herding”. A herding index was therefore constructed by averaging across items with high loadings, excluding item #4 (Mean = 4.42; SD = 0.70; Cronbach’s α = .79). Drivers #7, #8, and #9 had loadings > .50 on the second factor. It is interpreted as “regulation”. An index was computed by averaging across these three items (Cronbach’s α = .70). Only #6 “Tax reduction for private investors” loaded on the third factor and was excluded from further analyses.

The index measures were subjected to a discriminant analysis showing that the indexes discriminate between the investor groups, Wilkes’ lambda = 0.84, p = .007. The standardized discrimination function coefficients were for Herding = -0.76 and for Regulation = 0.86, respectively, thus reflecting that the non-SRI investors perceived less influence of herding and more of regulations than did the SRI investors.

To investigate whether investment style may work as an impediment to SRI, non-SRI and SRI investors were compared regarding length of their investment horizon, whether they act as passive or active investors, and whether they differ with respect to the extent to which they rely mainly on fundamental or technical analyses in their investment decisions. As displayed in Table 3, t-test yielded no significant difference between SRI and non-SRI investors on any of these measures (p >.05). In addition, effect sizes (Cohen, 1973) were low.
Discussion

The results indicate that the adoption of SRI may be influenced by both regulations and by following the example of other investors (herding). Moreover, the two groups of investors, those that already have adopted SRI and those who remain conventional investors, are susceptible in different ways to the two factors. While SRI investors are more likely to be influenced by the examples of others, non-SRI investors are more strongly influenced by market regulations and uniform criteria of SRI in the investment community.

The results of a previous study ("Author", 2008) showed that SRI investors, as compared to non-SRI investors, have a stronger belief in market benefits of SRI, perceive that there is a norm in their organization supporting SRI and have a stronger intention to increase their SRI share. At the same time they also perceive a greater risk associated with SRI. This may make them more sensitive to the behaviour of other financial actors. Since there are no objective measures to reduce uncertainty and potential financial risks, the behaviour of similar investors may serve as a proxy to uncertainty reduction. Non-SRI investors, on the other hand, are less interested in SRI in the first place and hence less prone to be influenced by others’. Instead, they are more likely to adhere to agreed-upon rules and market regulations.

Thus, there seems to be a parallel between those investors that heard due to an interest in short-term returns (see Froot et al., 1992;; Guyatt, 2006), an interest that is assumed to counteract SRI, and investors that are susceptible to herding in the domain of SRI. This suggest that an interest in a particular investment domain, paired with outcome uncertainty, promotes heard behaviour. Future studies may examine this proposal.

We also examined whether SRI investors and non-SRI investors differed in their investment horizon, used different techniques to analyze information, and valued information in different ways. Contrary to previous research (Guyatte, 2006) that has emphasized the importance of short-term investment horizon as a major obstacle to SRI, it was found that investment horizon did not differ between SRI and non-SRI investors. Neither did we find support for the claim (Froot et al., 1992) that SRI investors to a larger extent use fundamental analysis and are less concerned with information about historical stock price movements (technical analysis) than non-SRI investors. Other factors may serve as more important impediments to SRI. For instance, “author” (2009) found that beliefs about the market benefits and drawbacks of SRI mainly determine the interest in SRI among investment institutions.

It is important to emphasize that our conclusions depend exclusively on the investors´ own perceptions. This is only a first step that can provide some guidance for future research, which ideally should investigate effects of the actual implementation of regulations as well as what happens in the investment community if non-SRI investors decide to adopt SRI.
References


Table 1

*Number of Institutions and Respondents Categorised by Industry Classification*

<table>
<thead>
<tr>
<th>Industry</th>
<th>Respondents</th>
<th>Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public pension fund</td>
<td>15</td>
<td>4</td>
</tr>
<tr>
<td>Private pension fund</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Mutual fund company</td>
<td>41</td>
<td>10</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>60</td>
<td>19</td>
</tr>
</tbody>
</table>
Table 2
*Potential Drivers of Adoption of SRI*

| An increasing number of institutional investors adopt a SRI practice |
| Leading institutional investors adopt a SRI practice |
| An increasing number of financial analysts promote SRI |
| SRI investing proves to be as profitable as non-SRI investing |
| A majority of beneficiaries demand SRI funds |
| Private investors will not be taxed on their interest and dividend payments from green investment funds |
| Mandatory CSR reporting by larger companies |
| An obligation to state a policy on ethical investment |
| Uniform criteria of SRI are established in the investment community |
## Table 3

**Means (Standard Deviations) of Potential Drivers of SRI by Investor Group**

<table>
<thead>
<tr>
<th>Driver</th>
<th>Non-SRI (n = 31)</th>
<th>SRI (n = 29)</th>
<th>t</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1. Increasing number of institutional investors</td>
<td>3.97 (0.66)</td>
<td>4.36 (0.67)</td>
<td>-2.29*</td>
</tr>
<tr>
<td>#2. Leading institutional investors</td>
<td>4.13 (0.72)</td>
<td>4.21 (0.67)</td>
<td>-0.48</td>
</tr>
<tr>
<td>#3. Increasing number of financial analysts</td>
<td>3.81 (0.48)</td>
<td>4.00 (0.54)</td>
<td>-1.48</td>
</tr>
<tr>
<td>#4. SRI as profitable as non-SRI</td>
<td>3.77 (0.67)</td>
<td>3.89 (0.72)</td>
<td>-0.66</td>
</tr>
<tr>
<td>#5. Majority of beneficiaries demand SRI</td>
<td>4.29 (0.78)</td>
<td>4.57 (0.62)</td>
<td>-1.53</td>
</tr>
<tr>
<td>#6. Tax reduction for private investors</td>
<td>4.28 (0.82)</td>
<td>4.18 (0.80)</td>
<td>0.38</td>
</tr>
<tr>
<td>#7. Mandatory SRI reporting by larger companies</td>
<td>3.61 (0.56)</td>
<td>3.50 (0.57)</td>
<td>0.77</td>
</tr>
<tr>
<td>#8. Obligation to state a policy</td>
<td>3.90 (0.65)</td>
<td>3.68 (0.66)</td>
<td>1.33</td>
</tr>
<tr>
<td>#9. Uniform criteria of SRI</td>
<td>4.13 (0.56)</td>
<td>3.53 (0.98)</td>
<td>2.92**</td>
</tr>
</tbody>
</table>

*p < .05. **p < .01
Table 4
Means (standard deviations) and effect size (d) on ratings regarding measures on investment style, comparing non-SRI investors with SRI investors.

<table>
<thead>
<tr>
<th>Question</th>
<th>Investor group</th>
<th>Non-SRI (n = 31)</th>
<th>SRI (n = 29)</th>
<th>t</th>
<th>d</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stated investment horizon</td>
<td></td>
<td>5.23 (0.99)</td>
<td>5.11 (1.04)</td>
<td>.43</td>
<td>.06</td>
</tr>
<tr>
<td>To what extent do you act as active investor</td>
<td></td>
<td>4.38 (1.24)</td>
<td>4.66 (0.86)</td>
<td>-.98</td>
<td>.13</td>
</tr>
<tr>
<td>To what extent do you use fundamental analysis</td>
<td></td>
<td>4.33 (0.80)</td>
<td>4.15 (0.79)</td>
<td>.87</td>
<td>.11</td>
</tr>
</tbody>
</table>

*p < .05