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Economies of Traditional Investment and Socially Responsible Investment

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Abstract

Socially Responsible Investing (SRI) or social investment is one of the most important approaches and concepts that influence the way investors choose funds for their social cause and returns. Sometimes it seeks to avoid companies that are engaged in producing harmful products and practices. There are also some approaches that focus completely on companies engaged in eco-friendly and social causes. In this paper, we discuss different types of socially responsible investments and study that how it is better than traditional investments. This study uses secondary data to gather all the information that investors need to know before making any decision. However, further research is needed to find out how to choose companies that are actually socially responsible to help investors make informed decisions.

Keywords – socially responsible investing, traditional investment, investors, social causes, environmental responsibilities

Research Methodology

The research paper based on secondary data collected.

The Objective of Research:

The main objectives of the research presented are as follows.

i) To study the types of social investments.

ii) To study the pros and cons of socially responsible investment.

Data Collection

Data has collected from newspaper, books, magazines, reports, and websites.

Introduction

Traditional investment is a broad term in finance which consists of investing money in traditional assets like real estate, bonds, shares, etc. for capital gain and earnings from interest and dividends. Investment in gold, fixed deposits and several other age-old investments are losing interest of millennial investors. New age customers seem to be slow to invest in the stock market. According to Transamerica Center for Retirement Studies, around 75% of millennials started saving for their retirement at earlier age than their predecessors.

Also called social investment, socially responsible investment (SRI) considers the nature of business and conducts of the company. Common grounds for SRI include socially conscious investment. One can make socially responsible investments in companies having noble social causes or through an exchange-traded fund (ETF) or socially conscious mutual fund. Socially responsible investments also include avoiding companies engaged in selling or producing tobacco, gambling, alcohol, or any addictive substances and seeking companies engaged in environmental causes, social justice, and alternative energy or innovative efforts.

Socially responsible investment usually goes hand in hand with social and political climates. Investors should understand this risk as investment may suffer due to fallout of social value if it is based on a social cause. Due to this reason, usually professional investors consider socially responsible investment through Environmental, Social and Governance (ESG) factors. This approach puts emphasis on the management practices of the company and whether they focus on community improvement and sustainability. This approach is also proven to improve returns. However, investment on a social value alone doesn’ t always mean success.

Environmental, Social and Governance (ESG) are the important non-financial factors socially responsible investors consider as part of analysis to identify growth opportunities and material risks. ESG factors are not mandatory to be a part of financial reporting. These days, companies are widely disclosing these factors in their sustainability report or annual report.

A company may not stand the test of every factor. It is up to the investor as what matters most to them. Investment firms should have priorities in ESG criteria. For example, a company may avoid companies which are engaged in nuclear power or coal mining. They may also avoid companies infamous for their controversies in corporate governance, employee discrimination, etc.

Social investors consider screening to implement the right approach for their investments. It consists of some filters to choose the right companies or industries that should be or shouldn' t be added in the given portfolio. These criteria might include values, ethics, and preference of investors. For example, they may exclude companies that emit greenhouse gases from their portfolio or add companies that emit the lowest amount of gases.

These days, social investors use three types of screening approaches to achieve social goals with their investments –

Negative Screening – Here, the focus of social investors is to avoid companies engaged in producing harmful products or practices, such as tobacco, beer, gambling, weapons, alcohol, coal mining, etc. These screens eliminate securities from consideration of investment on the basis of environmental or social criteria.

Positive Screening – An investor invests in companies with approved practices. For example, a company which really cares about the workforce or environment will surely invest in green and noble causes. It means an investor chooses only those companies that can adhere to sustainable and constructive practices, such as –

2 Conserving energy
3 Constructing a recycling program
4 Investing in energy-efficient building materials and equipment
5 Enforcing eco-friendly policies like empowering employees to turn off the lights when not in use.

Community Screening – It is another important factor an investor considers before investing in a socially responsible company. This way, they focus on companies that invest in improving local communities. For example, projects that create opportunities for the under-privileged and invest in resources that are easily available for the community.

Literature Reviews

Mariacristina Rossi et. al (2017) analyze the given preferences and actual behavior for social investments. For doing this, they have conducted a survey to know the willingness for socially responsible investments and demand for such products. They propose socially responsible investment products in two sets – one with clear return penalty and other with proper compensation related to lower return. The study concludes that social investors are more inclined towards completely social products rather than compensation. Experienced people and people with higher academic qualification and women have great interest in social responsible investment. The analysis has found that women accept special offers more often but it is not so evident for the given preferences. The authors present evidence that some ethical investment products may be less or more effective for private investors. This study further investigates the latent demand for investments that have social aspects given in the subscription. The study investigates the financial product' s potential with a social dimension added in it. This research is based on a survey of Dutch population in which questions on choices for SRI products and actual SRI are asked.

Types of social investments

Socially responsible investment is usually recommended for those who are personally conscious about where their money is going and always want it to get into noble causes. Socially responsible investments have two sides – investment in companies with ethical practices and avoiding companies that may not have ethical products, services, or practices. Here are some of the types of socially responsible investments –

Environmental, Social and Governance (ESG) funds

These types of funds are usually focused on industries involved in manufacturing ethical products or engaged in ethical practices, while socially responsible funds are focused on avoiding industries not doing so. There is a noticeable difference between both scenarios. Just because a company is excluded from the fund engaged in manufacturing harmful products, it doesn' t mean other companies don' t follow unethical practices. This way, ERG funds are focused on companies functioning in completely ethical ways.

Socially Responsible Investment Funds

There are different categories of these funds. These are the most traditional and common funds as they avoid the companies engaged in controversial practices like tobacco, firearms, gambling, alcohol, etc.

The pros and cons of socially responsible investment

Socially responsible investment is considered when an investor either chooses all or nothing. Either portfolio can be completely " socially responsible" or there would be no focus at all.

Here are some of the pros of SRI strategies –

6 **Sticking to the values** – Many people attempt to try so many things at the same time and get confused at the end. So, it is important to be clear about certain core values and stick to them. This way, socially responsible investment helps investors to invest their money only where they intended to. By sticking to core values, investors can focus on other important financial aspects in their lives, such as owning a home, college savings, payroll savings, etc. The key here is picking some socially responsible funds and sticking with them.

7 **Ethical companies will be rewarded** – Socially responsible investment, though conducted on a small scale, ultimately focuses on companies that are doing right and avoids those acting unethically. Investors can support companies in making more ethical decisions in the most profitable way possible.

However, socially responsible investing is not all about solar panels and eco-friendly resources. There are also some drawbacks of SRI options –

8 **Ethics may sometimes be proved costly** – When someone limits their investments and pays more to companies engaged in ethical and social causes, they may not pay attention to their returns. The financial side usually suffers when social responsibilities come forward, at least in some cases. Here, investors need to do their research and choose stocks that don' t go against their ethics, without going out of the way.

9 **Most of the attractive investment options may be overlooked –** Continuing the above point, if an investor focuses completely on SRI funds and stocks, they might miss out several profitable investments, knowingly or unknowingly. Suppose an investor comes across a startup that has created innovative solutions and products to generate job opportunities and improve lives, but it is poor in social causes, an investor may miss a lot by getting this amazing opportunity out of their hands.

Conclusion

Socially responsible investment or ethical investment is a strategy which considers both environmental/social benefits and financial returns. It aims to bring positive change. Hence, it has become the most talked-about topic these days because investors are now encouraging corporate practices that are socially and ecologically responsible for human rights, consumer protection, eco-friendly behavior, and other noble causes. Some Socially Responsible Investments also avoid companies engaged in negative practices and products like tobacco, alcohol, gambling, fast food, weapons, military weapons, etc. Hence, this study has attempted to fill the research gap between traditional forms of investment versus socially responsible funds. There is still lack of research on the said topic. This paper suggests a further research path for investors and academicians in this field.

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