WORLD ORGANIZATION OF APPLIED SCIENCES JOURNALS
International Journal of Financial Accountability, Economics, Management, and Auditing
ISSN (2788-7189)
Int. J. Fin. Acc. Eco. Man. Aud. 3, No. 4 (July-2021)
https://doi.org/10.52502/ijfaema.v3i4.111

Market Conditions for Impact Investments as a Subsidiary of the Social Finance Model

Oxana Wieland

Business Department, University of Minnesota, Crookston, USA

Abstract: In this paper, the author presents an overview of the development of socially oriented impact investing in country-specific markets as a development of the social finance model. This analysis focuses on socially responsible investing (SRI) or impact investing, which has experienced continuous growth in certain countries, including European (UK, particular Scandinavian) and US markets. The equity of social impact mutual fund markets has grown both in the number of funds and in the differentiation of the securities under the social finance model.
Despite the fact that socially responsible investments or impact investments still lack a uniform definition under social finance, it mainly refers to investments that emphasize social/ecological/ethical value over monetary return. In the academic literature, it is not clear whether the behavior of impact investors will be sustainable toward the social finance paradigm, as their investment decision about the monetary return should be motivated by their economic behavior. The author analyzes the economic conditions of the capital market that provide long-term institutional support for socially oriented investments.

Keywords: Social finance model, capital markets, impact investments, market conditions, economic behaviour.

1. INTRODUCTION

Numerous studies have established that impact investing has developed rapidly throughout the last decade while typical investing has stagnated. Socially responsible investing may be defined as an investment process in which a voluntary and conscious selection of investment criteria and investment methods is used to show the investor's responsibility for the consequences of their investments for society, the environment, and the sustainable development thereof as well as their personal views and convictions in regard to socially significant issues and sociocultural values (Benson & Brailsford, 2006).
It is becoming a common practice in investing and finance to consider social, ethical, and environmental issues. Impact investing is typically undertaken through investments screening, shareholder advocacy, and engagements with corporations, venturing in the community, and providing capital to social enterprises. Although big financiers carry out most impact investments, retail investors comprise a small segment of the aggregate impact investments and are involved in socially responsible investments (SRI) funds (McWilliams & Siegel, 2001). Investors following the social finance paradigm attempt to advocate for social, environmental, ethical, and governance issues in the process of social impact investment. Consequently, SRI constitutes varied stakeholder interests ranging from institutional (workers unions), societal (NGOs, transnational institutions, governments, academics) to commercial (organizational and capitalist investors) investment banks.

The increased changes in the diversification of the social impact-oriented market throughout time are aligned with the transformation in the qualitative scope of the investments (ESG factors). For instance, the early days of social impact investing were marked by negative screens, whereas today it is mostly on pro-active affirmative screens and the participation of shareholders.

Additionally, before the 1990s, socially responsible investments were predominantly carried out by retail investors, whereas today most of the impact investments are done by institutional investors.

Numerous consumers of the social finance markets and investors are looking closely today at markets conditions in the wake of the transnational financial crisis of 2007–2009. This close examination is in line with the augmented attention to transparencies and accountability in the markets. Nonetheless, the parameters of impact investments are clear. For example, financial assets that have been exchanged in capital markets historically were in indirect association with the conduct of the institutions that initially discharged the assets. Impact investing influences investors' compensation through the direct effect (expected outcome). Thus, claims that investors who look into non-financial concerns (social impact orientation) require an adequate institutional mechanism in the entity affected. The financial returns may vary from those in standard investing compares to socially oriented investing as demonstrated by different empirical data (Bengtson, 2018). The inconsistency is widely pointed out in social finance-oriented literature.

The social finance model promotes a certain kind of economic behavior that can be considered a stimulant for impact investors. In other words, social finance is unequivocally linked to social, ecological, and ethical considerations, whereas impact investing is connected to financiers' mechanism to execute the principles of social finance. Therefore, impact investing has been subsequently linked to social finance choices on capital markets. The capital markets' agents practically implement social finance principles while making impact investment choices.

According to Carlsen (2012), it will cost an investor up to one percent in return on an investment annually if the investor should choose to invest according to an SRI strategy. However, the investor is participating in changing the financial paradigm. In a similar scheme, Der Speigel (2009) stated and showed that ethical investment had outperformed the rest of the market because of the demand for pollution-reducing technologies (Scott, 2009). This started the environmentally themed mutual funds innovations (green energy funds) currently leading in the market.

The social finance model provides a prosperous outcome that has an enormous impact on individual investors as well. For example, if an investor wants to act ethically, then they might contemplate between achieving a superior return or "global good." From the early 1970s, the academic world has sought answers to questions on whether an investor is worse-off by making an investment in a socially oriented portfolio relative to a current collection. The result of the relative social impact performance is mixed. Consequently, some papers indicate outperformance, some same performance, and some underperformance (Brief, 2016).

2. DIVERSIFIED STRUCTURE FOR FINANCIAL INSTRUMENTS

Many comparative studies have been conducted to investigate markets in different countries. Markets in the framework of developed countries (European and US) are characterized by a diversified structure for financial instruments and becoming more complex as the market develops.

In the market for impact investments, practically the entire range of financial instruments for the capital market (such as corporate and state/municipal bonds), money market instruments and securities in investment funds (such as mutual funds and closed-end funds, index funds (ETF), money market funds), venture funds, hedge funds, variable annuities, and derivatives is used. The asset structure for investors in the market for impact investments is dominated by stocks (see Figure 1), which is due both to the structure of the capital in the United States and the United Kingdom, and to the historically stronger positions of shares as a tool for influencing companies.

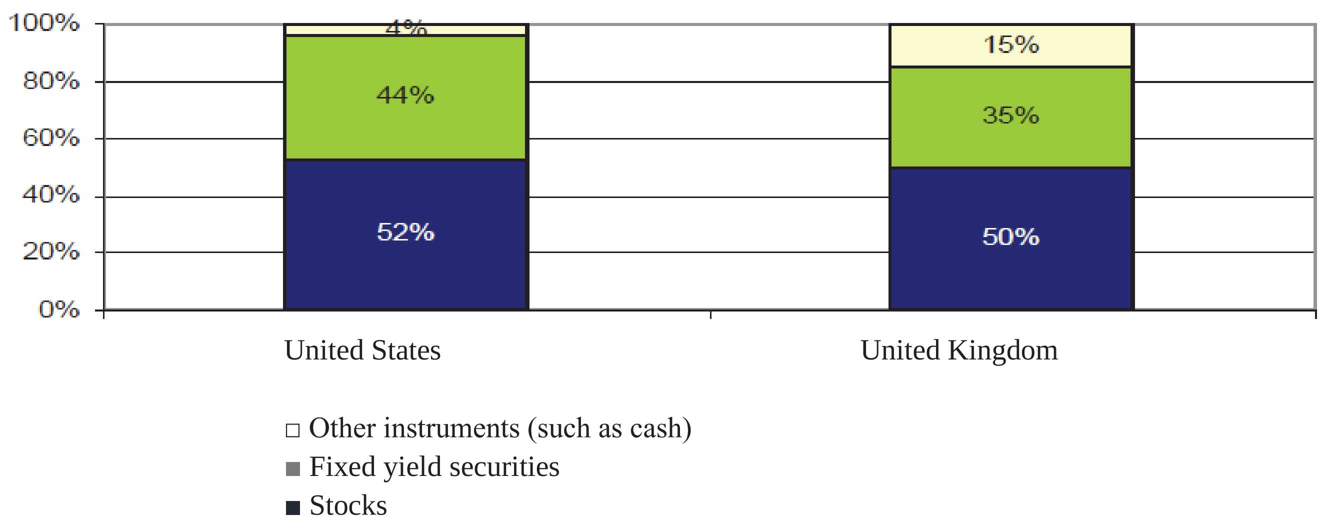

Figure 1. Asset structure in the market for social impact investments by type of financial instrument

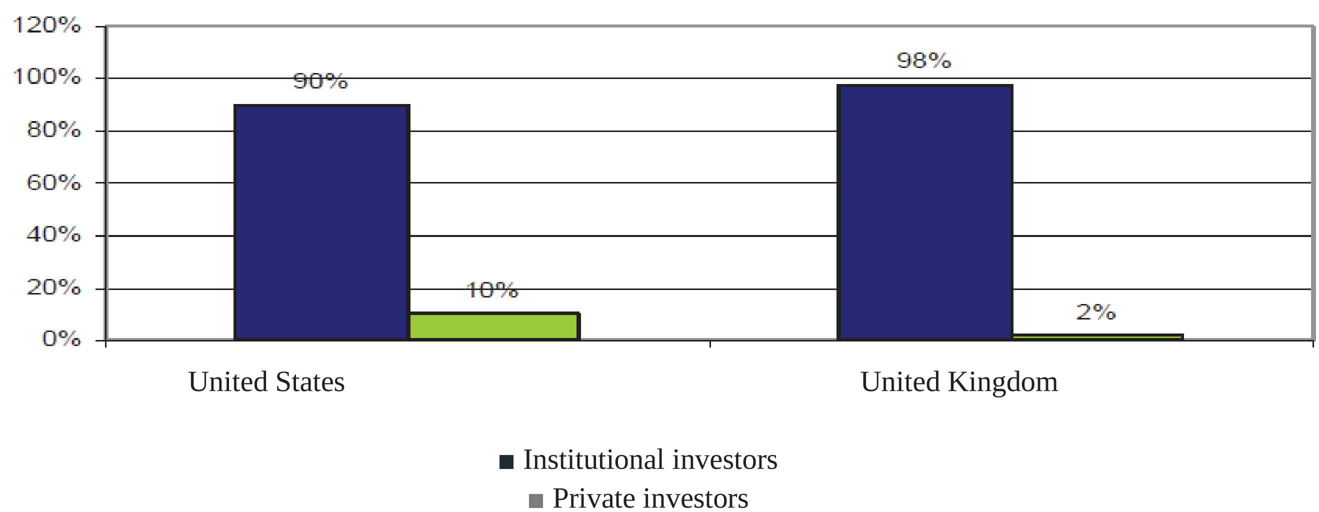

Figure 2. Asset structure in the market for social impact investors by type of investor

Source: USA - United States Social Investment Forum; United Kingdom - 2018 European SRI Study

At the same time, the proportion of bonds in the market for impact investments may be rather high and for traditional investments significantly lower.

The high level of development of the securities market provides investors in the market with a large selection of securities of ***companies in various industries*** as shown by the industry breakdown for fund indexes in the market for SRI, e.g., the Dow Jones Sustainability Index United States (DJSI United States) and the Domini Social Index 400 (DSI 400). The main issuers (first and fifth place in the index) are companies in the IT sector, consumer sector (goods and services), healthcare, the financial sector, and heavy industry.

Despite the fact that impact investments have a direct connection with casual finance directly, it seems essential to determine comparatively what universally drives social finance models in different nations and whether these forces are similar to those propelling impact investments (Sparkes, 2008).

Nevertheless, these investigations do not research comparatively to determine whether the elements play any part; thus, the absence of an ideal model of social finance that can be used as a standard to explain why countries are at different levels of the social impact markets developments. This study outlines the factors affecting impact investments development to explain the different levels among countries.

TABLE 1. Country-specific properties of the market for impact investments development

Factors affecting the market	Parameters of the market for impact investments development
Socioeconomic conditions	Economic and political stability: a high standard of living of the population has created a level of development of society and business such that the population, institutions, and corporations are starting to do impact investments voluntarily and/or in accordance with the social finance paradigm.
Standard of life	A significant number of individual and institutional investors interested in impact investments and of non-profit organizations dealing with the development of socially responsible investments—the market for EGS is a sufficiently high proportion of the capital market (10–20 percent of the assets).
Well-diversified and continually innovative financial instruments	A diversified structure for financial instruments in the market for impact investments, including but not limited to stocks, bonds, mutual funds, structured products, venture investment, and real estate.
Market liquidity and capitalization	A wide range of issuers in the market. A diversified structure for issuers, including, but not limited to consumer goods and services, the financing sector, industry, the utility sector, telecommunications, IT, and the health industry.
Capital market development	Investors' portfolios in the capital market are dominated by mutual funds. At the same time, the proportion of bonds is sufficiently high (significantly higher than for traditional investments), which is due to the high proportion of institutional investors, who are aiming at a more stable return and low risk.
Informational transparency	A developed infrastructure for the market for SRI and the presence of specialized information/analysis agencies that support organizations and regulatory initiatives. A significant amount of

Factors affecting the market	Parameters of the market for impact investments development
	information on SRI issues disclosed by market participants, voting policies for funds, the use of SRI criteria and methods, and the non-financial aspects of the companies' activities.
Social impact-oriented economic behavior among private investors	A degree of trust and willingness of private investors using financial market tools (EGS consideration). Private investors are important market participants who determine the trends in capital market development; however, their holdings are lower when compared to institutional investors. Market participants' cooperation methods have become widespread.
Institutional structure of the capital market	A developed institutional structure for financial intermediaries in the market for impact investments, such as banks, investment companies and funds, and management companies.
Institutional investors in the securities market (e.g., pension funds)	Domination of institutional investors in assets in the market though they are widely diversified. A high/growing proportion of state pension funds in the market for SRI.
Social finance paradigm popularity among market participants	For investors in the market for SRI, the financial results of investment play an important role that is on a level with non-financial factors, so the first-order mission for market participants is effective asset management.
Methods for socially responsible investing ideas popularization	Important criteria for individual investors are, first of all, ethical ones (negative criteria are tobacco, alcohol, gambling, and arms production) along with social and environmental criteria: preventing armed conflicts, protecting the environment, making investments, compliance with labor laws, and quality of products/services. Institutional investors use the negative selection method to a lesser degree; their priorities are positive social and environmental criteria along with criteria associated with corporate governance.
Religious consideration	Religious factors might be a dominant factor among SRI criteria and are used by religious investors and organizations in certain countries.

In the market for impact investing, the financial results of investments play as important a role as non-financial ones, but with a positive influence on society and the environment. This postulate is confirmed by the widespread use of fund indexes in the market for SRI, the continued attention paid by researchers to the results of activities of the socially responsible funds, and the fluctuations of social fund indexes compared to traditional indexes.

The most important criteria for private investors in the market are ethical ones associated with propaganda for a healthy lifestyle and a strong social opinion (tobacco, alcoholic products, gambling, military activity), concern with global problems (such as environmental protection), and human rights other than the basic ones (such as the rights to education, medical assistance, and legal defense).

At the same time, the highest priorities for institutional investors, in addition to the standard ethics criteria (tobacco products and alcohol), are social and environmental criteria, e.g., compliance with human rights, protection of the environment, equal opportunity, and issues of social significance at the global level, which reflects the orientation of institutional investors toward responsible economic behavior. This study attempts to develop a model that connects the social finance phenomenon to market conditions development.

3. Conclusion

This thesis gives an interesting perspective on the Scandinavian market. This is not just because the performance of SRI funds appears to be worse-off compared to their conventional counterparts, but knowing that the Scandinavian market is not the same as other socially responsible investment markets. Therefore, a different approach is needed to explore the actual performance of SRI mutual funds.

The importance of the market conditions provides a framework for socially oriented investments and indicates the existence of negative filters among purely monetary returns and social impact economic choices among investors that could yield an exciting field of future study.

References

[1] Allianz Global Investors, (2010). Doing Good by Investing Well? Pension Funds and Socially Responsible Investment: Results of an Expert Survey. International Pension Papers, pp. 1-20.

[2] Ballestero, E., Bravo, M., Pérez-Gladish, B., Arenas-Parra, M., & Pla-Santamaria, D. (2012). Socially responsible investment: A multicriteria approach to portfolio selection combining ethical and financial objectives. European Journal of Operational Research, 216(2), 487-494.

[3] Bauer, R., Derwall, J. & Otten, R., (2007). The Ethical Mutual Fund Performance Debate: New Evidence from Canada. Journal of Business Ethics, pp. 111-124.

[4] Bauer, R., Koedijk, K. & Otten, R., (2005). International evidence on ethical mutual fund performance and investment style. Journal of Banking & Finance, pp. 1751-1767.

[5] Baumann-Pauly, D., Wickert, C., Spence, L. J., & Scherer, A. G. (2013). Organizing corporate social responsibility in small and large firms: Size matters. Journal of Business Ethics, 115(4), 693-705.

[6] Bello, Z. Y., (2005). Socially Responsible Investing and Portfolio Diversification. The Journal of Financial Research, Issue 28, pp. 41-57.

[7] Bengtson, E.,(2018). A History of Scandinavian Socially Responsible Investing. Journal of Business Ethics, pp. 969-983.

[8] Benson, K. l., Brailsford, T. J. & E., H. J., (2006). Do Socially Responsible Fund Managers Really Invest Differently. Journal of Business Ethics, vol 65, pp. 337-357.

[9] Black, F., (1993). Beta and Return. Journal of Portfolio Management, Issue 20, pp. 8-18.

[10] Bodie, Z., Kane, A. & Marcus, A. J.,(2011). Investments and Portfolio Management: Global Edition. 9th ed. New York: McGraw-Hill.

[11] Bollen, N. P. B., (2007). Mutual Fund Attributes and Investor Behavior. The Journal of Financial and Quantitative Analysis, 42(3), pp. 683-708.

[12] Brief, A., Conduct, C., Policy, C. S. R., Bribery, A., Policy, C., Mix, P., P. A. (2016). Corporate Social Responsibility Issues.

[13] Carlsen, C., (2012). Etiske Investering. Børsen, 14 Maj, p. 6

[14] Cowton, C. J., & Sandberg, J. (2012). Socially responsible investment

[15] Danish SRI Study 2019. – Dansif, 2019. P. 1–56.

[16] European SRI Study 2019. – Eurosif, 2019. P. 1–40.

[17] Islamic Finance 2009. – IFSL Research, 2009. P. 1–8.

[18] Laurence, E. H. (2013). Socially Responsible Investment. In Encyclopedia of Corporate Social Responsibility (pp. 2258-2263). Springer Berlin Heidelberg.

[19] Lin, W. S., & Shih, Y. Y. (2016). A research framework of crowdfunding platform usage.

[20] McWilliams, A., & Siegel, D. (2001). Corporate social responsibility: A theory of the firm perspective. Academy of Management Review, 26(1), 117-127.

[21] Moon, J. (2014). Corporate social responsibility: A very short introduction. OUP Oxford.

[22] Pinsonneault, A., & Kraemer, K. (1993). Survey research methodology in management information systems: an assessment. Journal of Management Information Systems, 10(2), 75-105.

[23] Socially Responsible Investment among European Institutional Investors 2020 Report. – European Sustainable and Responsible Investment Forum. P. 1–48.

[24] Sparkes, R. (2018). Socially responsible investment. John Wiley & Sons, Inc.