

## Development of Investment Strategy Applying Corporate Social Responsibility

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### Abstract

**Purpose of the article:** Due to globalization processes and technological development, companies are having more influence on global society than ever. Therefore, business misconduct causes enormous harm to stakeholders, whereas ethical behavior is becoming an important issue. The goal of the following study is to verify and measure a positive effect from investments in social activities on financial attractiveness of companies in the form of its stock portfolio value growth.

**Methodology/methods:** In order to achieve the goal of the research, quantitative analysis is used by comparing performance of stock portfolio of companies having long-term investments in social activities with market index increment. The quantitative results are accompanied with the review of corporate social responsibility definition and some practical issues on governmental and corporation level.

**Scientific aim:** The conducted research contributes both to the scientific discussion about development of appropriate investment strategy in companies applying CSR principles as well as to the discussion of related terminology used in the field.

**Findings:** The research has shown that engagement in the CSR activities tends to have strong positive effect on companies' financial results and investors' financial performance. The research proves this fact by comparing value increment of CSR-portfolio (+35.99% gained from January 2015 to March 2017) with market index (+22.37% in the same period).

**Conclusions:** Regardless the positive result achieved in the study the authors have determined several gaps in the research, which will be discussed in the further studies on the field.

**Keywords:** corporate social responsibility, investment strategy

**JEL Classification:** M14

## Introduction

Currently, society's expectations for business have increased. In the context of globally high levels of uncertainty, negative reactions towards globalization process, caution regarding the activities of multinational corporations, there is increasing pressure on the business world to deliver not only added financial value to shareholders, but also considerable social value to society. Moreover, it should be considered that advances in information technology (e.g. the Internet) lead to quicker exposure of corporate misconduct in any field. In response to these changes, there has been a significant increase in interest for Corporate Social Responsibility (CSR) in the past few decades, and now it represents one of the most important topics for research, receiving not only academic attention, but also becoming an important issue for many organizations. Scientific research underlines that CSR is a concept in business ethics that is getting growing recognition in the globalized world. Based on a literature analysis, it can be stated that although the concept is

widely discussed in theory and practice, it is often intertwined with terms such as corporate sustainability, corporate sustainable development, corporate responsibility *etc.*, and does not have a general definition. The European Commission is defining CSR as a concept whereby companies voluntarily decide to contribute to a better society and a cleaner environment by integrating social and environmental concerns in their business operation and in their interactions with stakeholders. According to the Organization for Economical Cooperation and Development, CSR is defined as business's contribution to sustainable development, which is comparable to the concept of corporate sustainability that calls for the integration of economic and social issues in business management, and in this way a sustainable strategy development and use is ensured in the long term. In order to contribute to the ongoing discourse in the field, the authors suggest defining CSR as a concept on the crossing point of legal requirements and social expectations regarding economic, social, ethical, and environmental matters, as well as corporate go-



Figure 1. Concept of Corporate Social Responsibility. Source: Kuzmina, 2014b.

vernance standards in a company's strategy contributing to sustainable long term growth and added value (follow Figure 1).

The field of CSR has been growing exponentially. However, there are a few voices claiming that CSR has no place in modern business world, as general adoption of these norms by business would reduce welfare and de-stabilize the market economy (Tyrrell, 2006). The following authors have sketched out some points of view against CSR: Ostas (2001); Carroll, Buchholtz (2000); Fulcher (2004); Gallagher (2005); Barnett (2007); Renneboog *et al.* (2008); Zaharia, Dainora (2011); *etc.* Despite the widely held idea that social responsibility should begin and end with profit maximization, there is still a place for ethical and social norms in the business world. The following researches have provided arguments in favor of CSR: Villiers, van Staden (2006); Roberts, Dowling (2002); Jenkins (2006); Brammer *et al.* (2007); Schaper, Savery (2004); Okpara, Idowu (2013); Windsor (2013); *etc.*

Each representative of the business world can evaluate the above-mentioned arguments and make his or her own decisions about including CSR in the business strategy. Being aware of the strong negative view on the CSR concept it is necessary to underline that one of the most important argument supporting CSR is that such actions can possible improve company's financial performance, and from this point of view it is attracting attention from asset managers. Moreover, current global sustainable development challenges require action, while the financial sector is gradually more committed to increasing the number of investment products and services for economic agents working to meet these challenges. Furthermore, in the recent years the CRS concept and its importance were recognized also on the government level. As a result, thanks to the governments' initiative good-practice guidelines or even legislation were developed making pressure on the companies to follow CSR principles. The

following examples could be mentioned: first, UK Corporate Governance Code was published in 2010 and in 2016 renewed; its main principles include the necessity to pay attention not only to financial risks, but also to recognize health, safety, environmental and reputational issues. It is worth considering that UK Corporate Governance Code is being evaluated as good practice approach, being worth to follow. So that it encouraged several re-searchers to provide comparison to the approaches applied by other countries, searching for the most comfortable and efficient issues. Some examples could be found by Elshandidy, Neri (2014); Mueller (2016). Second, above mentioned European Commission is promoting their eight CSR principles on the European level encouraging companies to follow international guidelines. Further details how this process is implemented in different countries across the EU could be found by Hąbek, Wolniak (2013). Third, India was the first country in the world forcing companies to invest 2% of their net profit on social development annually, while the spectrum of activities/initiatives is pre-defined. Detailed description of main principles and their evolution could be found by Bhaduri, Selarka (2016).

Understanding the importance of the topic introduced above the current paper intends to close several gaps present in the research. First, the authors intends to clarify the different terms used in the academic and professional literature in connection with CSR concept, as this could lead to potential confusion and misinterpretation. The overview could contribute to the better understanding and awareness in the eyes of all the interested parties both in the academic research as well as in the business. Second, existing literature provides evidence about increase of companies' value if applying CSR standards (follow research by Ding *et al.* (2016); Rhou *et al.* (2016)), as well as investments in stocks (follow research by Renneboog *et al.* (2008); Galema *et al.* (2008)) or corporate

bonds (follow research by Kuzmina (2014a)) issued by companies committed to CSR standards (in particular during the economic down-turn period), but development of appropriate investment strategy is less discussed. Among the few research papers, one could mention published by Bilbao-Terol *et al.* (2016). The authors are developing a model based on goal programming that integrates the two cornerstones of the investor and their behavior on the market. The goal of the current paper is to develop stock investment strategy, as well as to prove the ability of the developed strategy to generate good financial performance in the middle period following “buy&hold” strategy, in this way contributing to the discussion about CSR issues.

### **1. Clarification of Terminology**

General impression that management as well as potential investors and shareholders should look beyond traditional financial metrics, but include CSR-related factors in the management, evaluation and in particular, in the investment process is widely recognized. Nevertheless, due to the fact that several groups that are led by different motivations and expectations are engaged in the process, the number of different terms used in the context is increasing, each highlighting specific direction, but with substantial correspondence to each other. Moreover, it is worth considering that the different interpretation of CSR is caused by the existence of eleven CSR-business behavioral models. Detailed explanation of these models could be found by Kanji, Agrawal (2016). It worth bearing in mind that out of the models mentioned in the article only a few were implemented in practice, so that the others are merely theoretical and have never been used. Currently, one could notice that model consolidation process is taking place. As a result, the CSR concept is getting clear and

well-defined outlines, moving towards unification. The goal of the current part of the article is to clarify the different terms used in the academic and professional literature in connection with CSR concept, as this could lead to potential confusion and misinterpretation. The overview would contribute to the better understanding and awareness in the eyes of all the interested parties both in the academic research as well as in the business (follow Table 1).

Broadly used is Socially Responsible Investing (SRI) or Ethical Investing (EI; mainly in UK) that is based among financial criteria on social criteria, for example by avoiding certain scandalous industries such as tobacco-co, or alcohol. Another term is ESG Investing – includes criteria to match investments through the three main categories of Environmental Issues, Social Issues and Corporate Governance Aspects. Recently the ESG investing has become equal to Sustainable Investing (SI), while sustainability can be achieved simultaneously on two levels: in the acting environment and in the world. Limited number of institutional investors describing their activities within CSR norms are using the term Corporate Social Investment (CSI) as well as Responsible Investment (RI), which refers mainly to the practice of investment funds using an approach that combines investors’ financial objectives with their commitment to social concepts like social justice, economic development, peace and others, as well as environmental matters. Sustainable and Responsible Investing (SRI) is used as an umbrella-term, having broader scope in comparison to the above-mentioned terms. Moreover, it is recognized by important organization as Eurosif (<http://www.eurosif.org>) – leading European association for the promotion and advancement of sustainable and responsible investment across Europe – contributing to the development of the approach. It is worth considering that the term is hardly used in the academic research and

Table 1. Terminology Used in the Field.

Terminology	Objective of Investment					Some Authors Contributing to the Research (Examples of Significant Market Players or Institutions, if exists)
	Financial Objective (is less emphasized even though it exists; refraining from chasing unfairly high profit)	Financial Objective (increase of shareholders and stakeholders value)	Commitment to Social and Environmental Issues (Willingness to Contribution and Development)	Commitment to Social and Environmental Issues (Avoiding particular Industries or “Sinners”)	Corporate Governance Issues	
Corporate Social Investment (CSI) = Responsible Investment (RI)	X		X			Haigh, Hazelton (2004); Scholtens (2014) (Mondi Group)
Socially Responsible Investing (SRI) = Ethical Investing (EI)		X		X		Bauer et al. (2006); Mollet, Ziegler (2014); Charfeddine et al. (2016); Revelli (2017)
ESG Investing = Sustainable Investing (SI)		X		X	X	Himick (2011); Halbritter, Dorfleitner (2015) (Barclays; Deutsche Bank)
Sustainable and Responsible Investing (SRI)		X	X	X	X	(Eurosif; Ussif; Societe Generale)

Source: Author's own study.

scientific literature. To summarize it is advisable to use the following terminology: SRI in order to describe investment under CSR principles and willingness of manager and/or investor to increase value in the long-term period.

## 2. Investment Strategy

Uncertainty in the financial market requires each investor to develop and follow individually adjusted investment strategy. Moreover, new issues like CSR and SRI should be considered both as challenges/risk factors as well as opportunities of additional return. So that the goal of the current part of the paper is to develop stock investment strategy for the European market, as well as to prove the ability of the developed strategy to generate good financial performance in the middle period following “buy&hold” strategy – above selected benchmark index. The strategy should incorporate SRI ideas following the modern trend, which could be formulated as following “the growing number of ‘green’ and ethical investment funds needs to find ‘green’ and ethical businesses to invest in” (follow: Corporate social responsibility – the UK Corporate Governance Code; retrieved from: <http://www.out-law.com/page-8221>) and also attributed to the institutional and private investors active on the European stock market. Additionally, current research suggests that the concept of CSR being used as a tool to attract investments through proper and guided reporting (Rundle-Thiele, 2008) increasing the interest of potential investors and make pressure on fund and portfolio managers. To sum up, SRI has different consequences for asset owners and asset/portfolio managers – while individual players are willing to make the world better place to live the companies are forced to uphold stable financial performance. As a result, asset/portfolio managers have to develop the appropriate strategy that would

allow attracting individual assets, but also providing necessary and stable financial performance. The authors propose the following investment selection approach recognizing the value of stock fundamental analysis and with regard to SRI. The selection approach is to be considered as a bottom-up valuation tool in search for European companies promising to provide positive results to the investors over middle-term period (from two to five years) and therefore to outperform the selected benchmark index – MSCI Europe.

The selection approach includes the following steps:

1. Stocks are underperforming the peer-group by at least 10% over the past four years but showing solid financial structure that could be determined through market capitalization, credit rating issued by Moody's and level of gearing. As this step is no different from the fundamental stock selection approach, it is less important to explain it in details.
2. The second criteria is indirectly connected to SRI – no change of company's CEO for at least four years (industry professionals' considered period to implement “new” strategy and achieve improved results). Moreover, scientific research (follow Kanji, Agrawal (2016)) proposes to identify the sustainability of CSR model through the mapping as vision and mission of the organization, while the CEO is responsible for the implementation of company's vision and mission in the development of the strategy, so that the necessity for implementation of CSR principles and acting in accordance with mentioned standards could be insured. Furthermore, it should be mentioned that CEO power leads to more CSR engagement (for details follow Jiraporn, Chintrakarn (2013)). So that the prove to include the second criteria in the selection process is given.
3. The final criteria is that selected company works in accordance with corporate go-

Table 2. Selected stocks as for January 2015.

Company's name	Country	Sector	Stock performance for the last 4 years	Sector performance for the last 4 years	Moody's credit rating	Financial gearing	CEO since	Commitment to Corporate Governance and CSR policies					
								Nr. of corporate affiliation	Good level of transparency regarding remuneration	Policy on bribery and corruption	Whistleblower program	CSR issue	
AEGON	the Netherlands	Insurance	40.29%	43.87%	A3	61%	2008	-	good	good	good	good	good
Deutsche Boerse	Germany	Financial Services	22.16%	53.95%	AA	50%	2005	3	good	good	good	good	good
E.On	Germany	Utilities	-34.20%	15.32%	A-	69%	2010	2	good	good	good	good	good
Galp Energia	Portugal	Oil and Gas	-29.28%	-16.06%	N/A	71%	2007	0	good	weak (1)	good	good	good
Koninklijke Philips	the Netherlands	Industrial Goods	12.73%	22.49%	A3	35%	2011	0	good	good	good	good	good
SAP	Germany	Technology	56.33%	64.24%	A3	28%	2010	2	good	good	good	good	good
Syngenta	Switzerland	Chemicals	14.07%	41.99%	A2	34%	2008	1	good	good	good	good	good
Unilever	the Netherlands	Financial Services	47.88%	49.73%	A1	79%	2009	1	good	good	good	good	good
WM Morrison	UK	Retail	-35.16%	27.29%	Baa2	65%	2010	0	good	good	good	good	good
Adecco	Switzerland	Industrial Goods	16.07%	22.49%	Baa2	58%	2009	0	good	weak (2)	good	good	good
Nestlé	Switzerland	Food and Beverage	32.18%	49.73%	Aa2	35%	2008	3	good	good	good	good	good
Saint-Gobain	France	Construction	4.96%	33.08%	BBB	67%	2007	2	good	weak (3)	good	good	good
Zurich Insurance	Switzerland	Financial Services	31.04%	43.87%	N/A	38%	2010	0	good	good	good	good	weak (4)

Source: Author's own study.

- (1) The company does not provide clear guidelines of what is or is not considered acceptable behavior.
- (2) The Code of Conduct prohibits use of gifts to influence officials. However, there are no clear guidelines on acceptable and unacceptable behavior.
- (3) There is no formal policy on bribery and corruption.
- (4) The Corporate Responsibility Working Group oversees CSR activities and reports directly to the group executive committee. Additionally, the company has a board level governance and nominations committee, responsible primarily for governance related issues. The company did not publish a CSR report.

vernance and CSR standards in order to act following the current trend mentioned above.

The following limitations to the investment strategy should be mentioned:

1. No transaction costs and taxes are assumed.
2. The investment portfolio is equally-distributed (100 stocks of each company were bought in January 2015 regardless the level of capitalization of each company).
3. The authors evaluated the commitment of the companies to the CSR and corporate governance standards, regardless the fact, whether these were one-time activities or long-term sustainable development (follow discussion by Kanji, Agrawal (2016)); moreover, the amount of company's investment in CSR and sustainable corporate governance is neither evaluated, nor determined due to the absence of mechanisms to evaluate the performance:

difficulties to determine the impact of CSR investment amount and company's financial results (follow Rundle-Thiele, 2008).

### 3. Investment Strategy Performance and Discussion of Results

In order to verify if the investment portfolio built according to the developed strategy could over-perform selected benchmark index historical investment portfolio has been constructed and tested on historical market data starting with January 2015 until March 2017. Table 2 provides main information and financial data used in the stock selection process, while the performance of the selected portfolio and benchmark index during the selected period is shown in the Figure 2 and in the Table 3.

Having checked portfolio's performance one could see that the research hypothesis

Table 3. Performance of Test Portfolio and Benchmark Index during January 2015 and March 2017.

	Performance of the Portfolio vs Benchmark Index				
	3 month	6 month	YTD	1Y	From inception
Created Portfolio	12.10%	6.05%	7.34%	38.18%	35.99%
Benchmark Index – MSCI Europe	9.22%	7.86%	1.48%	25.69%	25.69%

Source: Author's own study.

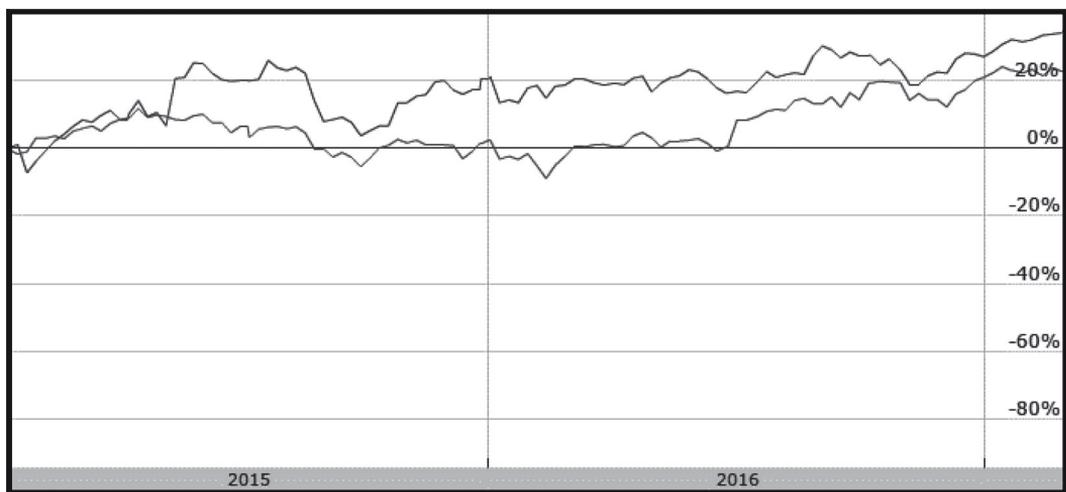


Figure 2. Performance of Test Portfolio and Benchmark Index during January 2015 and March 2017 (created portfolio – upper line; benchmark index – lower line). Source: created by authors in Google Finance.

was proven – developed investment strategy implementing the CSR concept allows to over-perform the market (described as MSCI Europe index) in the middle-term period – the performance of the created portfolio in the mentioned period was +35.99%, while the performance of the benchmark index is +22.37%. So that the second goal of the research – to develop stock investment strategy, as well as to prove the ability of the developed strategy to generate good financial performance in the middle period following “buy&hold” strategy – was achieved.

#### 4. Conclusion

The goal of the current research paper was to develop stock investment strategy for the European market, as well as to prove the ability of the developed strategy to generate good financial performance in the middle period following “buy&hold” strategy – above selected benchmark index. Moreover, the intention was meeting the following condition while creating investment portfolio – middle-term investments in companies managed under CSR requirements. Engagement in

the CSR activities tends to have strong positive effect on companies’ financial results and investors’ financial performance. The research proves this fact by comparing value increment of CSR – portfolio (+35.99% gained from January 2015 to March 2017) with market index (+22.37% in the same period). Authors find measurement of return on investments in single social activities as still non-covered topic that was not taken into consideration by current analysis as well. The same time observations of investors preferences indicates significant role of reporting standards and reporting manner in effect from investments in social activities meaning that even insignificant but smartly reported investment in social activities may enhance growth of stock value. Governmental program and legislation directed to CSR development should be considered as one of modern instruments of economy competitiveness improvement that forces even companies that are not interested in CSR actions at least to increase their international reputation. Authors are leaving a theme of „green” investments performance analysis as supreme case of CSR for the next research.

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