Responsible Investment as Market Driver for Sustainable Development

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Sustainability of Organizations and Social Responsibility Management - Financial Markets
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Motivation

If companies manage their impacts on society and the environment (Corporate Sustainability - CS), they will contribute to **sustainable development**.

**What is a ‘sustainable organization’?**

**CS** refers to "corporate activities that proactively seek to contribute to sustainability equilibria, including the economic, environmental, and social dimensions of today, as well as their inter-relations within and throughout the time dimension (i.e. the short-, long-, and longer-term), while addressing the company’s systems, i.e. operations and production, management and strategy, organisational systems, procurement and marketing, and assessment and communication; as well as with its stakeholders".

Financial system can be a key driver for corporate sustainability management, especially through socially responsible investments (SRI).
**Motivation**

**What is SRI (Sustainable investing)?**

- **Ethical Focus**
  - Positive Screening
  - Environmental, Social, & Corporate Governance (ESG) is considered

- **Negative screening**
  - Positive Screening
  - Environmental, Social, & Corporate Governance (ESG) is considered

- **SRI funds**
  - SR funds of the first generation
  - SR funds of the second generation
  - SR funds of the third generation
  - SR funds of the fourth generation
  - SR funds of the fifth generation

- **Sustainable Investing**
  - Best In Class
  - ESG is Sustainability


**Sustainable Investing** can be defined as “a long-term oriented investment approach, which integrates ESG factors in the research, analysis and selection process of securities within an investment portfolio. It combines fundamental analysis and engagement with an evaluation of ESG factors in order to better capture long term returns for investors, and to benefit society by influencing the behaviour of companies” (Eurosif, 2016).
SRI market has grown substantially over time and the investors’ need of accurate information—not only regarding financial performance but also about ESG aspects—has emerged.

Assessment frameworks to identify sustainable companies

SUSTAINABILITY RATING AGENCIES AND INDICES

- They offer the opportunity to translate CSP into operational terms and, consequently, to become a framework for the improvement of management practices towards sustainability.

- They influence the firms (Slager y Chapple, 2015) and investors.

Which kind of sustainable development should these assessment structures support?
Challenges and opportunities

There are some issues that should be taken into account in the CSP assessment within a strong sustainability context: i) Commensurability, ii) Market actors’ preferences and iii) Offsetting effect (Escrig et al., 2015*) and dynamism of corporate sustainability:

- **Commensurability**: The multidimensionality of CSP makes difficult to measure the several dimensions of CSP and to obtain robust overall CSP assessment of companies.

- **Market actors’ preferences**: The varying assessments that different stakeholders may give to each criterion are not included.

- **Offsetting effect**: Higher scores for one domain may hide very low scores in another domain → not consistent with a strong sustainability approach

- **Dynamism of corporate sustainability**: Improvement in CSP is a long process. It is necessary to wait more than one year before changes can be implemented.

The **objective** is to analyse the critical issues in relation to corporate sustainability assessment as has been promoted in the financial markets through the **assessment structures developed by socially responsible investment actors.**

The **aim** is to identify **how sustainability indices and rating agencies**, both of them belonging to the same market ecosystem, **assess sustainability in companies.**

The **challenge** is to discuss about the different **limitations** of these **SRI metrics**, and whether the different indices and rating agencies are consistent with a strong sustainability approach in the way they are measuring the sustainability of a company.

**Development of more accurate assessment frameworks**
Discussion

There are some issues that should be taken into account in the CSP assessment within a strong sustainability context: i) Commensurability, ii) Market actors’ preferences and iii) Offsetting effect (Escrig et al., 2015*) and dynamism of corporate sustainability:

✓ **Commensurability:** The multidimensionality of CSP makes difficult to measure the several dimensions of CSP and to obtain robust overall CSP assessment of companies.

**IDENTIFICATION OF MATERIAL ASPECTS**

León et al. (2016) provide an assessment framework of sustainability performance based on the integration of two MCDM (AHP & TOPSIS). This framework allows obtaining the useful information to make the scores reliable and comparable.

The contents of ESG domains and the market actors approach to corporate sustainability management are **dynamic** (Escrig et al., 2010, Fernández et al., 2015, Rivera et al., 2015).

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Discussion

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✓ Market actors’ preferences: The varying assessments that different stakeholders may give to each criterion are not included.

Solution Proposed in previous papers of the research team

1) IDENTIFICATION 2) INTEGRATION of market actors’ preferences

1) IDENTIFICATION market actors’ preferences (Escrig et al, 2013) and 2) INTEGRATION of different market actors’ preferences in the assessment framework, applying fuzzy TOPSIS methodologies (Escrig et al, 2013 and 2015 a,b)


Discussion

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Solution Proposed in previous papers of the research team

INTEGRATION OF EXPERT KNOWLEDGE

Integration of expert knowledge in the assessment framework, applying fuzzy logic based methodologies (Rivera and Muñoz, 2010; Escrig et al, 2014 and 2015b; Rivera et al 2016)


Findings


An example of fuzzy TOPSIS MCDM rankings vs. Asset4 rankings

<table>
<thead>
<tr>
<th>COMPANY</th>
<th>FUZZY TOPSIS DISTANCE</th>
<th>FUZZY TOPSIS RANK (I)</th>
<th>ASSET4 RANK (II)</th>
<th>DIF (II – I)</th>
<th>ECO ASSET4 SCORE</th>
<th>ENV ASSET4 SCORE</th>
<th>SOC ASSET4 SCORE</th>
<th>GOV ASSET4 SCORE</th>
</tr>
</thead>
<tbody>
<tr>
<td>PVH</td>
<td>0.634</td>
<td>1</td>
<td>0.919</td>
<td>0</td>
<td>0.8976</td>
<td>0.882</td>
<td>0.9664</td>
<td>0.93</td>
</tr>
<tr>
<td>DAVID JONES DEFERRED</td>
<td>0.600</td>
<td>2</td>
<td>0.818</td>
<td>3</td>
<td>0.886</td>
<td>0.722</td>
<td>0.7817</td>
<td>0.8837</td>
</tr>
<tr>
<td>GAP</td>
<td>0.590</td>
<td>3</td>
<td>0.834</td>
<td>1</td>
<td>0.9691</td>
<td>0.7049</td>
<td>0.7165</td>
<td>0.9441</td>
</tr>
<tr>
<td>GILDAN ACTIVEWEAR</td>
<td>0.573</td>
<td>4</td>
<td>0.868</td>
<td>-2</td>
<td>0.6985</td>
<td>0.9037</td>
<td>0.9415</td>
<td>0.9294</td>
</tr>
</tbody>
</table>

e.g. “If environmental performance is ‘low’ and social performance is ‘high’, then corporate sustainability performance is ‘low’
Discussion

There are some issues that should be taken into account in the CSP assessment within a strong sustainability context: i) Commensurability, ii) Market actors’ preferences and iii) Offsetting effect (Escrig et al., 2015*) and dynamism of corporate sustainability:

 ✓ **Dynamism of corporate sustainability**: Improvement in CSP is a long process. It is necessary to wait more than one year before changes can be implemented.

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**Solution developed in previous papers of the research team**

Fernández-Izquierdo et al. (2014) integrate the corporate social responsibility approach in the Enterprise Risk Management (ERM) Framework proposed by COSO in 2004. Specifically, this research provides a framework to integrate into the decision-making process financial and extra-financial aspects in a dynamic manner and with a long-term management horizon.

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Discussion


What is the expect result?

OBJECTIVES

...in order to achieve goals in economic, social, environmental and governance terms.

COMPONENTS

To explore how an organization may include FESG criteria in the eight components of ERM...

ENTITY UNIT

...at all levels of the organization...

Conclusions

Financial markets need SRI metrics that offer integrated solutions for overcoming current challenges related to the measurement of corporate sustainability performance.
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