DEFINING SOCIALLY RESPONSIBLE COMPANIES ACCORDING TO RETAIL INVESTORS' PREFERENCES

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Abstract. The impressive growth of the funds managed following socially responsible investment strategies is a phenomenon that has been analysed from different perspectives. One of the main factors determining such investment strategies, maybe the most important one, is the selection of socially responsable companies, that is, the differentiation between socially responsible and irresponsible companies. Generally, the selection process is performed applying negative screening or positive screening strategies. Negative screening considers irresponsible companies those involved in the production of weapons or alcoholic beverages, following religious criteria. The positive screening approach is much more complex and less transparent. Both methodologies have been critizied as they do not prevent companies performing a clearly irresponsible behaviour to be included in the socially responsable portfolio. Moreover, it is important to stress that the opinion of retail investors is not considered when defining the concept of "socially responsible company", that is, the opinion of the potential clients of the socially responsible financial products. In this paper we are interested in the opinion of these potential clients regarding negative screening criteria, because we exclude the possibility of retail investors applying complex positive screening approaches. Our results show that compliance with the legislation is a main criterion for potential retail investors. This is an important outcome, as legal compliance is actually not a necessary requisite and non-complying companies are usually included in socially responsible financial products. Regarding negative screening based on the activity sector of the companies, results are more controversial.

Keywords: sustainability; mutual funds; socially responsible investment; screening methodology; retail investors

1. Introduction

In the last two decades, the so-called socially responsible investement has reported a considerable increase. This trend remains strong at the present time. According to the Global Sustainable Investment Alliance (2018), sustainable investing assets in the five major markets (Australia and New Zealand, Canada, Europe, Japan and the United States) stood at $30.7 trillion at the start of 2018, which means a 34 percent increase since the last report in 2016.

As a result of this development, a number of firms have emerged that rank companies according to their sustainability and social behaviour and elaborate socially responsible stock indices (Kutay & Tektüfekçi, 2016). In fact, there is not a single international organization or agency responsible for defining and measuring the sustainable performance of companies. By contrast, many private companies and institutions undertake this task, applying their own definitions and methodologies (Espinós-Vañó, García, & Oliver, 2018).

One of the most controversial aspects regarding the social and sustainable performance of companies is how to define this behaviour (A. K. Chatterji, Levine, & Toffel, 2009; de Felice, 2015; Hellsten & Mallin, 2006; Ou, 2016; Schwartz, 2003; Silvestre, Antunes, & Filho, 2018). That is, it is necessary to define which activities must be carried out by those companies that want to be defined as "socially responsible". And it is also critical to define which activities prevent a company to be qualified as such. This is a fundamental aspect, as the sample of companies selected has a decisive impact on any subsequent outcome. This problem has also led to terminological issues, and different academic papers define "sustainable", "ethical", and "socially responsible companies" sometimes as synonimes, sometimes as different concepts.

The multiple definitions used, together with the different approaches employed by the firms and agencies specialized in the identification and selection of socially responsible companies, often generate striking results. In fact, it is not rare that companies which would never be calified as "socially responsible" by a common citizen or a retail investor are definied as such by social rating agencies and belong to socially responsible portfolios, to sustainable company rankings or sustainable stock indices. That means that it is usual to find companies performing activities that can be clearly defined as irresponsible and unsustainable which are constituents of socially responsible investment funds. Some studies show that most of the companies included in the Spanish sustainable stock index should not be defined as "socially responsible" if simple and clear negative screening criteria would be applied (Espinós Vañó & García, 2018). This fact could easily explain the high correlation between sustainable stock indices and their conventional benchmarks (Arribas, Espinós-Vañó, García, & Morales-Bañuelos, 2019), as the constituents of both sustainable and conventional indices are mainly the same.

The described situation makes us wonder what is wrong with the selection process applied by social rating agencies. There must be something wrong as there are huge differences between the perception of the ordinary people regarding what is meant by "socially responsible company" and the outcome of the selection process by the specialised firms (Arribas, Espinós-Vañó, García, & Tamosiuniene, 2019). This concern has been raised by several researchers, who question the way the concepts of "socially responsible", "sustainable" and "ethical" company are used by most social rating agencies and other actors in the financial markets (Baccaro & Mele, 2011; A. Chatterji & Levine, 2006; Gangi & Varrone, 2018; Windolph, 2011).

The proper definition of "socially responsible company" is a critical issue, because all the socially responsible financial sector leans on it. If the definition is too flexible, the outcome might be that almost all companies may be considered socially responsible. In this line, a number of studies do not find significant differences between conventional investment funds' portfolios and sustainable portfolios (Benson, Brailsford, & Humphrey, 2006; Bertrand & Lapointe, 2014; Humphrey & Warren, 2016; Leite & Cortez, 2014; Renneboog, Ter Horst, & Zhang, 2011; Revelli & Viviani, 2015; Utz & Wimmer, 2014; von Wallis & Klein, 2015). Furthermore, the definition of

"socially responsible company" affects all studies which compare the performance of socially responsible firms to conventional ones (Achim, Borlea, & Mare, 2016; Balcilar, Demirer, & Gupta, 2017; Bergmann, 2016; Gherghina & Vintilă, 2016; Maciková, Smorada, Dorčák, Beug, & Markovič, 2018; Wei, Lu, & Kong, 2017).

In addition, it is important to understand how retail investors define the concept of "socially responsible company". This question is particularly important regarding the marketing of several financial products, like sustainable or ethical investment funds. If the definition and the screening methodology applied by the investment funds' managers is different from the one that would be applied by potencial clients, retail investors may be mislead by the adjectives "sustainable" or "ethical".

The aim of the present research is to examine the concept of "socially responsible company". The definitions applied by practitioners are compared with the perception of potential retail investors in order to verify whether they match or, conversely, they are not actually useful for retail investors concerned about companies' environmental and social performance.

The paper is structured as follows. First, we comment on the difficulty of defining the concept of "socially responsible company" and we describe the most common screening methodologies employed by socially responsible investment funds to select the companies in their portfolios. Next, we analise which are the most important criteria in the eyes of retail investors in order to define a company as "socially responsible". This analysis is undertaken on the basis of a survey conducted among students of the Faculty of Business Management and Administration in the Universitat Politécnica de Valencia, in Spain. The answers are then compared with the criteria actually applied by financial sustainability experts. Finally, the major findings of the research are reported.

2. The concept of socially responsible company

The first problem we face when assessing companies' behaviour is determining the scope of the analysis, that is, which dimensions of corporate behaviour must be included in the evaluation. Once the scope is defined, a rating is assigned to the companies and according to the rating obtained companies are defined or not as "ethical", "sustainable" or "socially responsible". It must be stressed that there is often confusion regarding these concepts, and there is a lack of consense as of their exact meaning. Normally, the difference is concerned with the scope of the analysis undertaken.

One of the ways of addressing the problem is starting with the concept of sustainability and sustainable development. The study which introduced these concepts was the so-called Brundtland Report, released by the World Commission on Environment and Development (World Commission for Environmental Development, 1987). This report defines sustainable development as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. The main problem of this definition is that it is very abstract and is not useful for operational purposes and it does not indicate which aspects of companies' activities must be noticed in order to manage firms' sustainability.

At present, some authors still identify the concept of "sustainability" exclusively in terms of company's environmental policy. Nevertheless, since Bansal (Bansal, 2005) most authors argue that firms' sustainability has a three-dimensional nature. Therefore, sustainable companies must be controlled for their economic, social and environmental performance. In turn, these three dimensions can be measured from different perspectives. Székely and Knirsch (2005) propose ten criteria that must be considered when analysing companies' sustainability. Among these criteria we find firm's ethical behaviour and sustainable job creation. In this way, the concepts of sustainability, social responsibility and ethical behaviour start merging (Montiel & Delgado-Ceballos, 2014). Currently, in the field of sustainable finance, usually following three dimensions are analysed: environmental, social and governance issues, the so-called ESG factors (Capelle-Blancard & Petit, 2017).

Some of the definions of "sustainable company" mention the importance of stakeholders, who are all those groups and individuals that are affected by the activity of a company (Freeman, 1984). A sustainable company should identify its stakeholders and consider their needs when defining and implementing its strategies (Hörisch, Freeman, & Schaltegger, 2014). This approach also implies analysing firm's activity from an economic, social and environmental angle. As a result, the range of the analysis becomes much wider, as firms have to consider the impact of their activities on external third parties. Therefore, companies defined as "sustainable" must perform ethically and be socially responsible. Including into the analysis stakeholders' preferences makes the importance of ethical performance even more evident. The first step towards ethical behaviour is legal compliance. Following some authors, not complying with the legislation should be understood as misconduct and bad ethics (Espinós-Vañó, 2016). For that reason, legal compliance should be employed as a preliminary screening criterion in the process of filtering for sustainable, socially responsible companies.

In practice, there are two main approaches to identify and select socially responsible companies: negative screening and positive screening (Arribas, Espinós-Vañó, García, & Tamosiuniene, 2019).

In the negative screening approach exclusion criteria are used. Companies which do not meet with the speficied standards and criteria are not elegible to be defined as "sustainable" or "socially responsible". Generally, criteria employed to perform negative screening are related with the activity sector of companies. In this line, it is common that ethical or sustainable mutual funds do not include in their portfolios companies which produce weapons, alcoholic beverages or tobacco. In the negative screening approach, the economic, social and environmental performance of companies is not analysed, just the economic activity of companies. Usually, religious criteria are employed to define which sectors must be defined as not complying with the ethical standards and therefore excluded from the investment portfolios. The reason is that religious American goups, like the Methodist Church and the Quakers were the pioneers in socially responsible investment (Guay et al., 2004). Following the Global Sustainable Investment Alliance (2018), negative screening is the largest sustainable investment strategy globally with 19,8 trillion assets under management.

One version of the negative screening approach is the so-called norms-based screening, which performs screening of investments against minimum standards of business practice based on international norms, such as those issued by the Organisation for Economic Co-operation and Development (OECD), the International Labour Organization (ILO), or the United Nations (UN). Sustainable investment funds applying this approach managed $4.7 trillion in assets in 2018 (Global Sustainable Investment Alliance, 2018). It must be underlined that this screening methodology simply assesses the adherence to specific guidelines or pacts issued by prestigious international organizations. This approach has been often critizied (Espinós Vañó & García, 2018) and it does not actually consider law compliance.

Positive screening, the systematic and explicit inclusion by investment managers of environmental, social and governance factors into the financial análisis and the investment decisión process, is the second-most prominent screening strategy, with $17.5 trillion assets under management (Global Sustainable Investment Alliance, 2018) Positive screening requires the assessment of multiple activities within the companies, which must be identified, measured and weighted in order to obtain a ranking. This ranking is used to select for the sustainable portfolio those companies which obtain the highest scores. This approach has attracted the attention of many academics because of its complexity, as a high number of variables must be measured and weighted in order to obtain a final, unique indicator, and different multicriteria approaches heve been proposed. (Escrig-Olmedo, Muñoz-Torres, Fernández-Izquierdo, & Rivera-Lirio, 2017; García-Melón, Pérez-Gladish, Gómez-Navarro, & Mendez-Rodriguez, 2016; Lamata, Liern, & Pérez-Gladish, 2018). Nevertheless, positive screening has been critizied because of the lack of standardization, lack of credibility of the information inputs, bias, tradeoffs, lack of transparency and complexity (Arribas, Espinós-Vañó, García, & Morales-Bañuelos, 2019; Windolph, 2011).

Furthermore, positive screening is not able to identify and exclude from the sample of companies in the sustainable portfolio those firms which clearly perform unsustainable, unethical activities. Even though the performance of negative activities may be included into the analyses, their negative impact is diluted among all other criteria and variables which are also analysed and weighted. This fact explains why it is possible to find companies which perform unsustainable activities and violate the legislation as constituents of portfolios which are supposed to be socially responsible, ethical and sustainable (Arribas, Espinós-Vañó, García, & Morales-Bañuelos, 2019).

The analyses of the screening methodologies applied to define and identify socially responsible companies reveal that the opinion of retail investors is never considered. Moreover, we could not find in the literature research any research relating the above described screening methodologies and retail investors' opinion. Most studies which are interested in retail investors focus on their characteristics and behaviour (Berry & Yeung, 2013; Diouf, Hebb, & Touré, 2016; Michelson, Wailes, Van Der Laan, & Frost, 2004; Pérez-Gladish, Benson, & Faff, 2012; Renneboog, Ter Horst, & Zhang, 2008; Renneboog et al., 2011; Wins & Zwergel, 2014), but they do not analyse how do socially responsible retail investors define the concept of "socially responsible company" or what should be, in their opinion, the goal of sustainable investors (Capelle-Blancard & Monjon, 2012). This is a very important gap that should be filled, because there should be a reasonable compliance between the product which is offered (the socially responsible investment fund) and want the client (the retail investor) expects.

The objective of our research os to understand how retail investors discern between socially responsible companies and those which are not. We will assume that retail investors do not have the knowledge, nor the information or the time required to apply the complex positive screening methodology. By contrast, the retail investors apply negative screening based on the information about the companies published in the media. Our study uses a questionnaire in order to examine whether the activity sector criteria amployed in the negative screening approach match the perception of retail investors. Furthermore, other simple and transparent screening criteria based on legislation compliance are examined.

2. Methodology

The information for this research was obtained through a questionnaire conducted on students at the Faculty for Business Management and Administration of the Universitat Politécnica de Valencia, Spain, for 4 successive years from 2015 until 2018. The questionnaire was administered to students at the thrird course of the grade of Business Management and Administration, who are future potencial clients (and managers) of socially responsible mutal funds. The questionnaire was answered in one computer room of the faculty during the normal lessons, with no time limit. The questionnaire was prepared using google forms.

The questionnaire is made up of 10 statements which were assessed using a Likert scale. It was compulsory to comment on all statements. The questionnaire consisted of two sections. The aim of the first section (questions 1 to 6), was to check students' opinion regarding the relationship between "legal compliance" and "socially responsible behaviour". The second section (questions 7 to 9) analyses the link between "activity sector" and "socially responsible behaviour"", in line with the traditional negative screening. Only three negative screening criteria were included, those which are supposed to be more controversial among the Spanish young population. Finally, there is one statement which measures to which extent students trust the opinions of social rating agencies. The ten statements are following:

1. A company which does not comply with national or international law regarding human rights cannot be defined as "socially responsible company".
2. A company which does not comply with national or international law regarding labour legislation cannot be defined as "socially responsible company".

3. A company which does not comply with national or international law regarding environmental legislation defined be calified as "socially responsible company".
4. A company which does not comply with national or international law regarding tax legislation cannot be defined as "socially responsible company".
5. A company which does not comply with national or international law regarding criminal legislation cannot be defined as "socially responsible company".
6. A company which does not comply with national or international law regarding consumer protection legislation cannot be defined as "socially responsible company".
7. A company which is defined as "socially responsible" cannot produce weapons.
8. A company which is defined as "socially responsible" cannot produce tobacco.
9. A company which is defined as "socially responsible" cannot produce alcoholic beverages.
10. A company which has a certification from a social rating agency to be "socially responsible", can be defined, in fact, as "socially responsible", without doubt.

The five-level Likert scale used to scale the responses is 1 "strongly disagree", 2 "disagree", "neither agree nor disagree", 4 "agree", 5 "strongly agree".
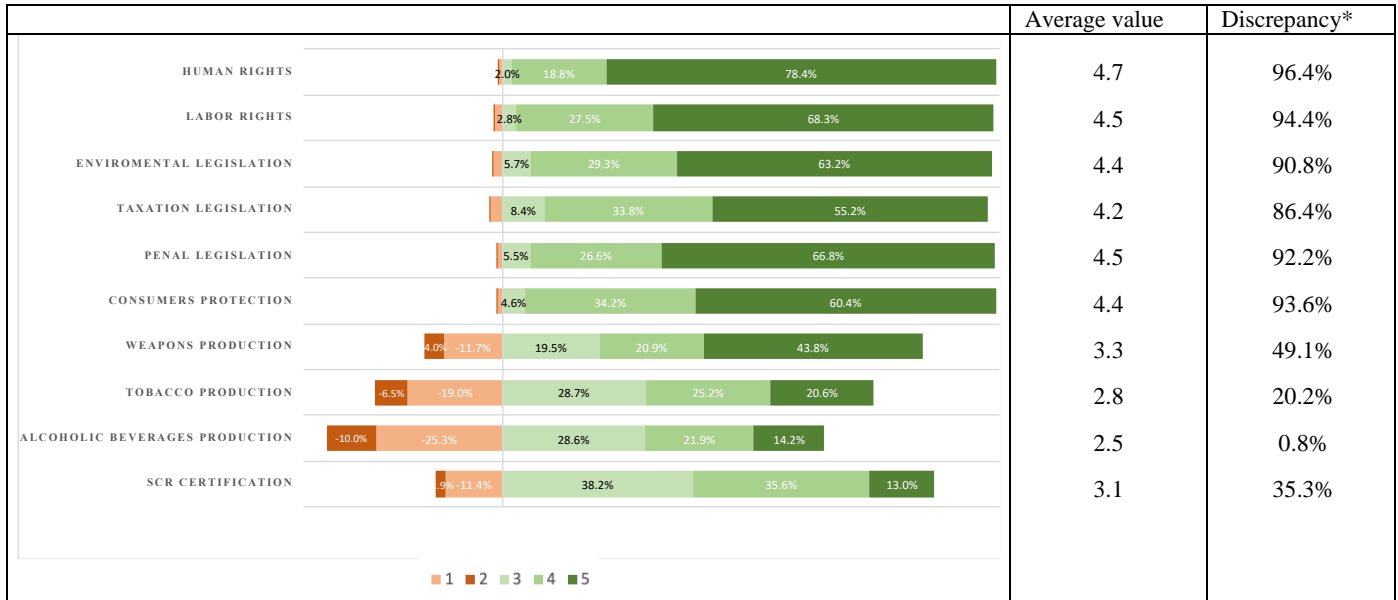
Sample size is 429, which is balanced between the four years of the study, includes 214 males y 215 females. By age, 221 respondents are younger than 21 years old and 208 are 21 years old or older.

3. Results

Figure 1 shows the summary of responses obtained for each item. Together with the graphical representation two values are shown: average value and discrepancy. The average value is the mean of the numerical values assigned to the answers obtain in each item. Values close to 5 stand for high level of agreement with the proposed statement, while values close to 1 show high disagreement. As sometimes the mean value may be not a good descriptive measure, the percentage of discrepancy was calculated as well. The discrepancy measures the difference between the percentage of confirmatory responses ("agree" and "strongly agree" in the Likert scale) and the percentage of non confirmatory responses ("disagree" and "strongly disagree" in the Likert scale). Doing this, it is easier to contrast contradictory opinions. High discrepancy values, near 100%, imply that most of the respondents do agree with the proposed statement. Values around 0% reveal that the statement is very controversial, having as many favourable opinions as opposing ones. Negative values close to -100% indicate that most of the respondents disagree with the proposed statement.

We start the analysis of the results discussing the responses obtained regarding the first section, which deals with the legal compliance criteria. Figure 1 shows that 89% or more of the respondents agree or strongly agree with the statement that those companies which do not comply with national and international legislation should not be defined as "socially responsible" (mean value higher than 4,2). This result is important, as it shows that for most of the potential investors in socially responsible mutual funds, legal compliance must be a requisite in order to incorporate a company into the portfolio. Therefore, such negative screening criteria should be implemented by social rating agencies and other sustainable investment experts.

Even though legal compliance is perceived as very important, there are some slight discrepancies regarding the importance of the different jurisdictions analised, that is, regarding the topic of the infringed legislation. Indeed, human rights violations are considered to be especially serious, followed by labor rights and criminal legislation infringements. They are followed by breaches of consumer protection legislation, environmental legislation and, finally, tax legislation (see Figure 1).

	Average value	Discrepancy*
HUMAN RIGHTS — 2.0% 18.8% 78.4%	4.7	96.4%
LABOR RIGHTS — 2.8% 27.5% 68.3%	4.5	94.4%
ENVIROMENTAL LEGISLATION — 5.7% 29.3% 63.2%	4.4	90.8%
TAXATION LEGISLATION — 8.4% 33.8% 55.2%	4.2	86.4%
PENAL LEGISLATION — 5.5% 26.6% 66.8%	4.5	92.2%
CONSUMERS PROTECTION — 4.6% 34.2% 60.4%	4.4	93.6%
WEAPONS PRODUCTION — 4.0% -11.7% 19.5% 20.9% 43.8%	3.3	49.1%
TOBACCO PRODUCTION — -6.5% -19.0% 28.7% 25.2% 20.6%	2.8	20.2%
ALCOHOLIC BEVERAGES PRODUCTION — -10.0% -25.3% 28.6% 21.9% 14.2%	2.5	0.8%
SCR CERTIFICATION — .9% -11.4% 38.2% 35.6% 13.0%	3.1	35.3%

■1 ■2 ■3 ■4 ■5

* The discrepancy measures the difference between the confirmatory responses ("agree" and "strongly agree" in the Likert scale) and the percentage of non-confirmatory responses ("disagree" and "strongly disagree" in the Likert scale))

Fig.1. Response distribution for the ten statements in the questionnaire, average value for the Likerts scale and discrepancy.

Source: The authors

In the second section, which deals with the activity sector, there is less consensus among respondents, as shown by the mean values and the discrepancy percentage in Figure 1. Looking at the mean values, it is possible to state that most respondents do not support applying the activity sector as a filter in the negative screening approach. This is an interesting outcome, because screening based on the activity sector is the largest sustainable investment strategy globally, as commented in the introduction. Nevertheless, our result shows that this is not an appropriate filter for Spanish retail investors.

Among the three sectors analysed, weapon production generates the utmost rejection, obtaining a discrepancy value of 49.1%, followed by tobacco production (20.2%). Regarding the production of alcoholic beverages, there is great disparity of opinions. Thera are as many respondents for and against applying this criterion as a filter to define socially responsible companies. As a result, the discrepancy value is almost 0%.

These results show that the social and religious context are probably very important when defining what is a socially responsible company. For example, in the case of alcoholic beverages production, religion can be a key factor that influences whether retail investors consider that producing firms must be always considered irresponsible. In the Spanish case, consumption of alcoholic beverages is usual. Spain is a main wine producer and wine is linked with the Spanish culture. Therefore, it is easy to understand that most respondents consider that it is possible that a company producing alcoholic beverages can still be defined as "socially responsible".

Regarding the last questionnaire item, results show that most respondents are not influenced at all by the opinions disclosured by social rating agencies. The mean value is 3.1 and the discrepancy percentage is 35.3%.

Next, we describe the results focusing on the profile of respondents: gender (male/female) and age (19 and 20 years vs. more than 20 years). Figures 2 and 3 show the discrepancy values for each item regarding gender and age, respectively.

Analysing the results according to the gender shows the different perception of males and females regarding the definition of "socially responsible" companies. As of legal compliance, women are stricter, that is, they agree more often that non-complying companies should not be defined as "socially responsible". The biggest difference between genders appears for non-compliance with the tax legislation (10 porcent points). In this case, men are by far more permissive, i.e., a higher percentage of men than of women see no ethical conflict when a company does not pay the required taxes. A similar situation appears regarding environmental legislation (8.6 percent points)

Differences in terms of gender become more obvious when the activity sector is applied as screening criterion. Regarding weapons production and production of alcoholic beverages, women are more likely to consider those activities as being inherently socially irresponsible (14 p.p. and 8.3 p.p. above men, respectively). In the case of tobacco production, it is the men who are more likely to consider that tobacco producing companies should not be considered as "socially responsible" companies.

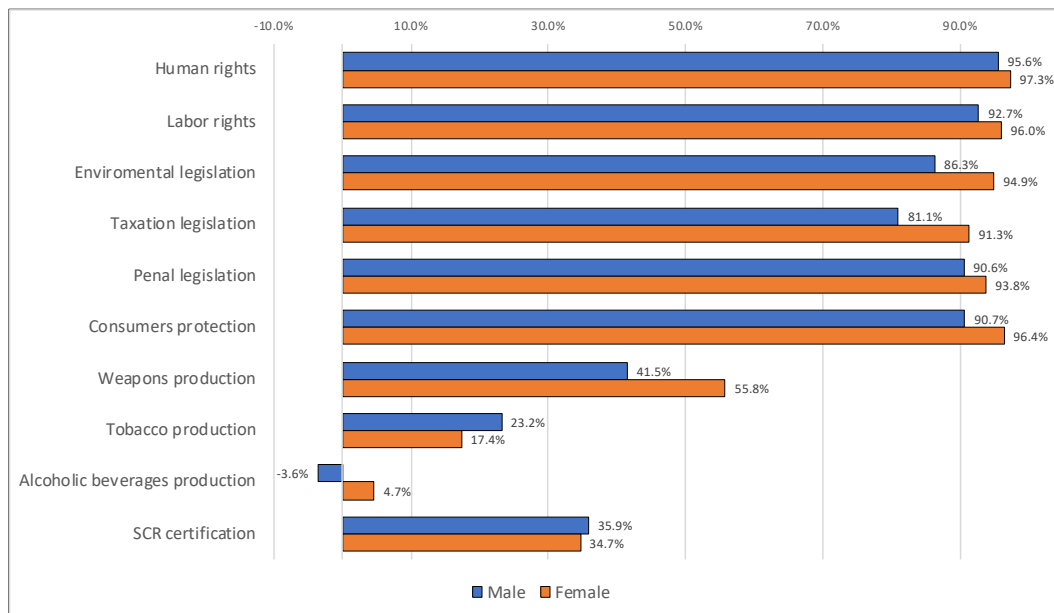Finally, both groups have a similar perception of the opinions issued by social rating agencies.

Fig.2. Discrepancy values for the 10 statments, gender.

Source: The authors

When the age of respondants is considered, there do not appear big differences between groups. Regarding law compliance, older students (21 years or more) are slightly less permissive regarding violations of labor rights and tax legislation. Younger students are more severe regarding environmental law compliance.

Regarding the activity sector, younger students agree more that companies in the weapons industry and in the alcoholic beverages industry should not be calified as "socially responsible", while older students are stricter regarding tobacco production.

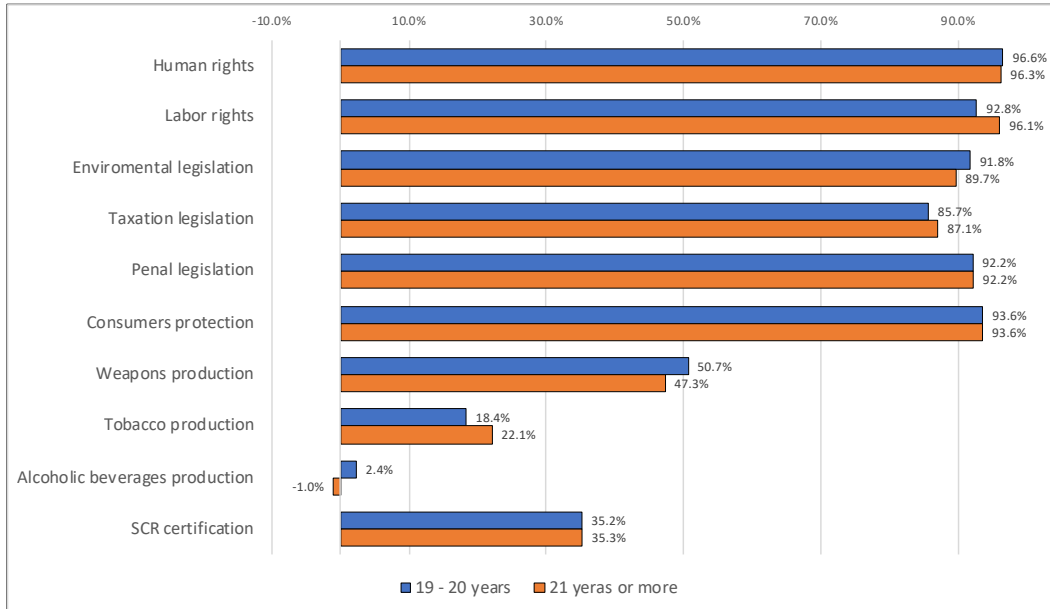Both groups have the same perception as for the opinions issued by social rating agencies.

Fig.3. Discrepancy values for the 10 statments, age.

Source: The authors

The results obtained show that, in the case of potential clients of socially responsible mutual funds in Spain, legal compliance is a key requisite to determine whether a company can be defined or not as "socially responsible". This finding contrasts with the screening filters actually applied by the so-called socially responsible investment funds, which do not use this exclusionary criterion. Regarding the positive screening approach, legal compliance assessment is just one of many other criteria. Therefore, this approach is not suitable to identify and label firms which do not comply with legality as "socially irresponsible" companies.

Moreover, directly defining companies in especific activity sectors as "socially irresponsible" is controversial. Therefore, we can conclude that using the activity sector of companies as screening criterion, as is commonly the case, does not match the perception of most Spanish socially responsible retail investors.

Conclusions

In the field of sustainable finance, defining the concept of "socially responsible", "sustainable" and "ethical" company is a key issue. Investment in socially responsible companies, management of sustainable portfolios, sustainable company rankings, ethical stock indices, performance comparison of sustainable firms and portfolios with their conventional peers etc. mainly relies on the definition of "socially responsible company".

At the present time, there is no a single definition of "socially responsible company". Many international organizations and private social rating agencies use their own definitions and methodologies, which are more or less complex.

Generally, socially responsible companies are identified applying negative screening or positive screening. The negative screening approach disregards those companies which are involved in specific activities which are considered to be harmful. It is a simple and transparent approach. Positive screening is much more complex, as it

is necessary to define, to assess and to weight a high number of variables. Moreover, this approach is not transparent and it does not ensure that companies with irresponsible behaviour are automatically disregarded.

It is remarkable that the different definitions of "socially responsible company" have not been subject to a more thorough study by academics. Furthermore, with the only exception of negative screening based on religious beliefs, the different screening methodologies do not consider the opinion of retail investors, who are the potential clients of socially responsible mutual funds. Definitions and methodologies are issued which completely ignore the opinion of the end customer. Given this situation, it is possible that no match exists between the screening approaches actually performed by professional investors and retail investors' perception. In fact, it is not uncommon that companies which are described as "socially responsible" by social rating agencies and other financial experts are frequently involved in scandals due to their socially irresponsible actions.

This paper has used the negative screening approach in order to define what is not a "socially responsible company". This approach has been chosen because it is simple and transparent. A questionnaire was conducted on more than 400 students of the grade of Business Management and Admisnitration in Spain in order to identify possible criteria to diffenciate between responsible and irresponsible companies. Law compliance and activity sector were the two proposed negative screening criteria. Results show that law compliance is a fundamental requisite for most respondents. That means that companies which violate the law should not be defined as "socially responsible" companies. This result is in contrast to reality, as this criterion is not applied as necessary and excluding. Another important outcome of the research is that using the activity sector as negative screening criterion is very controversial. Analysis regarding gender and age only show relevant differences in the case of gender.

Obviously, the results of the study must be assessed within its limitations. The main shortcoming is the sample used, which is not representative for the Spanish population. In addition, sociocultural factors may have great influence on the perception of what is a proper behaviour or a wrong one, so the sample should be expanded to cover more countries and cultures. Finally, the questionnaire is not exhaustive regarding legal topics nor activity sectors used in the traditional negative screening approach.

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