



MN5311 – RESPONSIBLE INVESTMENT

MODULE TYPE/SEMESTER: Option (20 credits), Semester 2

MODULE CO-ORDINATOR: Dr Kais Bouslah

MODULE LECTURERS: Dr Kais Bouslah and Professor Bert Scholtens

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OFFICE HOURS: Thursdays 3-4 pm

AIM: Responsible Investment (RI) forms a substantial portion of assets under professional management. RI has been generally associated with the integration of Environmental, Social and Governance (ESG) issues into investment-decision making as well as into ownership policies and practices. The aim of this module is to introduce students to the theory and practice of Responsible Investment (RI). Students will explore investments in a variety of RI strategies such as portfolio screening, shareholder advocacy/activism/engagement, and impact investing. The module also explores the carbon market and climate change investment. Furthermore, the module seeks to develop students' understanding and ability of how to evaluate the performance of RI strategies using appropriate techniques.

METHOD OF TEACHING AND LEARNING:

- a) Lectures: Thursdays, 11 am - 1 pm
- b) Tutorials: Thursdays, 2-3 pm, 4-5 pm

Note that tutorials will commence in Week 3 of the second semester.

COURSE OUTLINE:

- Topic 1:** Screening and portfolio selection
- Topic 2:** Shareholder Advocacy/Activism/Engagement
- Topic 3:** Direct (Impact) Investing
- Topic 4:** ESG Data: definition, identification and measurement
- Topic 5:** Performance analysis of Responsible Investment
- Topic 6:** Risk Management of ESG issues
- Topic 7:** Carbon Market and Climate change investment
- Topic 8:** Advanced Topics in Responsible investment

LEARNING OUTCOMES:

On completion of this module, students should be able to:

- Describe the responsible investment market and define the different responsible investment strategies.
- Understand portfolio screening and define its different strategies.
- Understand Shareholder Advocacy/Activism/Engagement and define its different strategies.
- Understand Direct (Impact/Community) Investing and critically evaluate its role in the economy.
- Appreciate the risk and return profile of responsible investment strategies.
- Understand and critically evaluate ESG Data.
- Evaluate the performance of responsible investment strategies.
- Define and critically evaluate risk management of ESG issues.
- Describe the carbon market and define carbon investment products.
- Critically evaluate the role of responsible investment in a more sustainable economy.

ASSESSMENT:

Coursework 1: One and a half hours **Class test** in **Week 6** (25%)

Date and time: Friday 3rd March 2017

Coursework 2: **Written essay** assignment (2500 words) to be submitted in **Week 10** (25%)

Submission deadline: Monday 10th April 2017, 12pm

Coursework 3: **Two-hour exam** (50%)

Written essay is to be submitted in accordance with guidance in the Student Handbook.

READING LIST:

Reading will be based on journal articles. The list below is indicative.

Hudson, J. (2006), "The Social Responsibility of the Investment Profession", p. 1-113. *Research Foundation Publications* of CFA Institute. Can be downloaded from: <http://www.cfapubs.org/toc/rf/2006/2006/3>

Benabou, R., and Tirole, J. (2010), "Individual and corporate social responsibility", *Economica*, 77, 1–19.

Clifford S. A. (2014), "My Top 10 Peeves", *Financial Analysts Journal*, 70, 1, 22-30.

Kotsantonis, S., Pinney, C., and Serafeim, G. (2016). "ESG Integration in Investment Management: Myths and Realities", *Journal of Applied Corporate Finance*, 28, 2, p.10-16.

Schramade, W. (2016). "Bridging Sustainability and Finance: The Value Driver Adjustment Approach", *Journal of Applied Corporate Finance*, 28, 2, p.17-28.

Screening and portfolio selection

Bauer, R., Koedijk, K., Otten, R., (2005), "International evidence on ethical mutual fund performance and investment style", *Journal of Banking and Finance*, 29, 1751–1767.

Bauer, R., Derwall, J., Otten, R., (2007), "The ethical mutual fund performance debate: new evidence from Canada", *Journal of Business Ethics*, 70, 111–124.

Derwall, J., Guenster, N., Bauer, R., Koedijk, K., (2005), "The eco-efficiency premium puzzle", *Financial Analysts Journal*, 61, 51–63.

Edmans, A. (2011), "Does the stock market fully value intangibles? Employee satisfaction and equity prices", *Journal of Financial Economics*, 101, 621-40.

Bollen, N., (2007), "Mutual fund attributes and investor behavior", *Journal of Financial and Quantitative Analysis*, 42, 683–708.

Galema, R., Plantinga, A., and Scholtens, B., (2008), "The stocks at stake: return and risk in socially responsible investment." *Journal of Banking & Finance*, 32, 2646–2654.

Gompers, P., Ishii, J., Metrick, A., (2003), "Corporate governance and equity prices", *Quarterly Journal of Economics*, 118, 107–155.

Geczy, C., Stambaugh, R., Levin, D. (2006), "Investing in socially responsible mutual funds", Working Paper, Wharton School.

Hamilton, S., Jo, H., and Statman, M. (1993), "Doing Well While Doing Good? The Investment Performance of Socially Responsible Mutual Funds", *Financial Analysts Journal*, 49, 62-66.

Kempf, A., Osthoff, P., (2007), "The effect of socially responsible investing on portfolio performance", *European Financial Management*, 13, 908–922.

Renneboog, L., Ter Horst, J., and Zhang, C. (2008), "The price of ethics and stakeholder governance: the performance of socially responsible mutual funds", *Journal of Corporate Finance*, 14, 302-322.

Renneboog, L., Ter Horst, J., Zhang, C. (2008), "Socially responsible investments: Institutional aspects, performance, and investor behavior", *Journal of Banking & Finance*, 32, 1723–1742.

Renneboog, L., Ter Horst, J., Zhang, C., (2011), "Is ethical money financially smart? Nonfinancial attributes and money flows of socially responsible investment funds", *Journal of Financial Intermediation*, 20, 562–588.

Roselle, P. (2016). "The Evolution of Integrating ESG Analysis into Wealth Management Decisions", *Journal of Applied Corporate Finance*, 28, 2, p.75-79.

Sauer, D.A., (1997), "The impact of social-responsibility screens on investment performance: evidence from the Domini 400 Social Index and Domini Equity Mutual Fund", *Review of Financial Economics*, 6, 137–149.

Schröder, M., (2007), "Is there a difference? The performance characteristics of SRI Equity Indices", *Journal of Business Finance and Accounting*, 34, 331–348.

Statman, M. (2006), "Socially Responsible Indexes: Composition, Performance, and Tracking Error", *Journal of Portfolio Management*, 32, 100-109.

Scholtens, B., (2005), "Style and Performance of Dutch Socially Responsible Investment Funds", *The Journal of Investing*, 14, 63-72.

Statman, M. (2000), "Socially Responsible Mutual Funds", *Financial Analysts Journal*, 56, 30-39.

Van Duuren, E., Plantinga, A., and Scholtens, B. (2015), "ESG Integration and the Investment Management Process: Fundamental Investing Reinvented", *Journal of Business Ethics*, DOI: 10.1007/s10551-015-2610-8.

Verheyden, T., Eccles, R., and Feiner, A. (2016). "ESG for All? The Impact of ESG Screening on Return, Risk, and Diversification", *Journal of Applied Corporate Finance*, 28, 2, p.47-55.

Shareholder Advocacy/Activism/Engagement

Barber, B. (2007), "Monitoring the monitor: Evaluating CalPERS' activism", *Journal of Investing*, 16, 66–80.

Bauer, R., Clark, G. L., and Viehs, M. (2013), "The geography of shareholder engagement: Evidence from a large British institutional investor", Working paper, Maastricht University.

Becht, M., Franks, J., Mayer, C., and Rossi, S. (2009), "Returns to shareholder activism: Evidence from a clinical study of the Hermes UK Focus Fund", *Review of Financial Studies*, 22, 3093–3129.

Black, B. S. (1998), "Shareholder activism and corporate governance in the United States", *The New Palgrave Dictionary of Economics and the Law*, 3, 459-465.

Brav, A., Jiang, W., Partnoy, F., and Thomas, R. (2008), "Hedge fund activism, corporate governance, and firm performance", *Journal of Finance*, 63, 1729–1775.

Brav, A., Jiang, W., and Kim, H. (2012), "The real effects of hedge fund activism: Productivity, risk, and product market competition", Working paper, Duke University.

Carleton, W. T., Nelson, J. M., and Weisbach, M. S. (1998), «The influence of institutions on corporate governance through private negotiations: Evidence from TIAA-CREF », *Journal of Finance*, 52, 1335–1362.

Dimson, E., Karakas, O., and Li, X. (2013), "Active Ownership", Available at SSRN: <http://ssrn.com/abstract=2154724>

Ertimur, Y., Ferri, F., and Muslu, V. (2011), "Shareholder activism and CEO pay", *Review of Financial Studies*, 24, 535–592.

Ferri, F., and Sandino, T. (2009), "The impact of shareholder activism on financial reporting and compensation: The case of employee stock options expensing", *The Accounting Review*, 84, 433–466.

Gillan, S., and Starks, L. (2000), "Corporate governance proposals and shareholder activism: The role of institutional investors", *Journal of Financial Economics*, 57, 275–305.

Gillan, S., and Starks, L. (2007), "The evolution of shareholder activism in the United States", *Journal of Applied Corporate Finance*, 19, 55–73.

Klein, A., and Zur, E. (2009), "Entrepreneurial shareholder activism: Hedge funds and other private investors", *Journal of Finance*, 64, 187–229.

Rojas, M., M'Zali, B., Turcotte, M-F., and Merrigan, P. (2009), "Bringing About Changes to Corporate Social Policy through Shareholder Activism: Filers, Issues, Targets, and Success", *Business and Society Review*, 114, 217–252.

Smith, M. P. (1996), "Shareholder activism by institutional investors: Evidence from CalPERS", *Journal of Finance*, 51, 227–252.

Direct (Impact) Investing

Armendáriz, B. and Morduch, J. (2005), *The economics of microfinance*. MIT Press, Cambridge.

Callaghan, I., Gonzalez, H., Maurice, D., and Novak, C. (2007), "Microfinance—On the Road to Capital Markets", *Journal of Applied Corporate Finance*, 19, p. 115-124.

Cull, R., Demirgüç-Kunt, A., and Morduch, J. (2009), "Microfinance meets the market", *Journal of Economic Perspectives*, 23, p.167–192.

Cull, R., Demirgüç-Kunt, A., and Morduch, J. (2014), "Banks and Microbanks", *Journal of Financial Services Research*, 46, p.1–53.

Galema, R., Lensink, R., and Mersland, R., (2012), "Do powerful CEOs determine microfinance performance?", *Journal of Management Studies*, 1–25.

Reed, L. (2015). "The State of the Microcredit Summit Campaign Report 2015".

Lützenkirchen, C., and Weistroffer, C. (2012), "Microfinance in evolution: An industry between crisis and advancement", Deutsche Bank AG, DB Research. September 13, 2012.

Mersland R., and Strøm, R. (2009), "Performance and governance in microfinance institutions", *Journal of Banking & Finance*, 33, p. 662–669.

Servin, R., Lensink, R., and Berg, M. (2012), "Ownership and technical efficiency of microfinance institutions: Empirical evidence from Latin America", *Journal of Banking & Finance*, 36, p. 2136–2144.

Strøm, R., D'Espallier, B., and Mersland, R. (2014), "Female leadership, performance, and governance in microfinance institutions", *Journal of Banking & Finance*, 42, p. 60-75.

ESG Data: definition, identification and measurement

Bendell, J. (2010), "World Review: July-September 2010", *The Journal of Corporate Citizenship*, 40, 6-25.

Eccles, R., and Youmans, T. (2016). "Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality", *Journal of Applied Corporate Finance*, 28, 2, p.39-46.

Graves, S. B., and Waddock, S. A. (1994), « Institutional owners and corporate social performance», *Academy of Management Journal*, 37, 1034-1046.

Griffin, J. J. and Mahon, J. F. (1997), «The Corporate Social Performance and Corporate Financial Performance Debate: Twenty-five years of incomparable research», *Business & Society*, 36, 5-31.

Herz, B., and Rogers, J. (2016). "Measuring What Matters: Industry Specificity Helps Companies and Investors Gain Traction on Sustainability", *Journal of Applied Corporate Finance*, 28, 2, p.34-38.

Hillman, A., and Keim, G. D. (2001), «Shareholder value, stakeholder management, and social issues: What's the bottom line? », *Strategic Management Journal*, 22, 125-139.

Ioannou, I., and Serafeim, G. (2012), "What drives corporate social performance? The role of nation-level institutions", *Journal of International Business Studies*, 1–31.

Jo, H., and Harjoto, M. A. (2012), «The Causal Effect of Corporate Governance on Corporate Social Responsibility», *Journal of Business Ethics*, 106, 53-72.

Johnson, R. D., and Greening, D. W. (1999), «The Effects of Corporate Governance and Institutional Ownership Types on Corporate Social Performance», *Academy of Management Journal*, 42, 564–576.

Kinder, P., and Domini, A. L. (1997), «Social screening: Paradigms old and new», *Journal of Investing*, 6, 12-19.

Mattingly, J. E., and Berman, S. L. (2006), «Measurement of Corporate Social Action: Discovering Taxonomy in the Kinder Lydenberg Domini Ratings Data», *Business & Society*, 45, 20-46.

Odell, J. and Ali, U. (2016). "ESG Investing in Emerging and Frontier Markets", *Journal of Applied Corporate Finance*, 28, 2, p.96-101.

Rehbein, K., Waddock, S. A., and Graves, S. B. (2004), «Understanding Shareholder Activism: Which Corporations are Targeted? », *Business & Society*, 43, 239-267.

Sharfman, M. P., Fernando, C. S. (2008), «Environmental risk management and the cost of capital», *Strategic Management Journal*, 29, 569-592.

Waddock, S. A., and Graves, S. B. (1997), «The Corporate Social Performance-Financial Performance Link», *Strategic Management Journal*, 18, 303-319.

Wood, D. J. (1991), "Corporate social performance revisited", *Academy of Management Review*, 16, 691-718.

Performance analysis of Responsible Investment

Cortez, M., Silva, F., and Areal, N.(2012), «Socially Responsible Investing in the Global Market: The performance of US and European funds», *International Journal of Finance and Economics*, 17, 254-271.

Eling, M., and Schuhmacher, F. (2007), «Does the choice of performance measure influence the evaluation of hedge funds?», *Journal of Banking & Finance*, 31, 2632-2647.

Risk Management of ESG issues

Bansal, P., & Clelland, L. (2004), «Talking trash: Legitimacy, impression management, and unsystematic risk in the context of the natural environment », *Academy of Management Journal*, 47, 93-103.

Barnea, A., & Rubin, A. (2010), «Corporate social responsibility as a conflict between shareholders », *Journal of Business Ethics*, 97, 71-86.

Bello, Z. Y. (2005), «Socially Responsible Investing and Portfolio Diversification », *Journal of Financial Research*, 28, 41-57.

Bouslah, K., Kryzanowski, L., & M'Zali, B. (2016), «Social Performance and Firm Risk: Impact of the Financial Crisis», *Journal of Business Ethics*, 1-27. DOI 10.1007/s10551-016-3017-x.

Bouslah, K., Kryzanowski, L., & M'Zali, B. (2013), «The impact of the dimensions of social performance on firm risk», *Journal of Banking & Finance*, 37, 1258-1273.

Cespa, G., & Cestone, G. (2007), « Corporate social responsibility and managerial entrenchment», *Journal of Economics and Management Strategy*, 16, 741-771.

El Ghouli, S., Guedhami, O., Kwok, C., & Mishra, D. (2011), «Does corporate social responsibility affect the cost of capital?», *Journal of Banking & Finance*, 35, 2388-2406.

Fama, E. F., & French, K. R. (2007), «Disagreement, tastes and asset prices », *Journal of Financial Economics*, 83, 667-689.

Godfrey, P. C. (2005), «The relationship between corporate philanthropy and shareholder wealth: A risk management perspective», *Academy of Management Review*, 30, 777-798.

Godfrey, P. C., Merrill, C. B., & Hansen, J. M. (2009), «The relationship between corporate social responsibility and shareholder value: An empirical test of the risk management hypothesis», *Strategic Management Journal*, 30, 425-445.

Goss, A., & Roberts, G. S. (2011), «The impact of corporate social responsibility on the cost of bank loans », *Journal of Banking & Finance*, 35, 1794–1810.

Heinkel, R., Kraus, A., & Zechner, J. (2001), «The effect of green investment on corporate behavior », *Journal of Financial and Quantitative Analysis*, 36, 431–449.

Hong, H., & Kacperczyk, M. (2009), «The price of sin: The effects of social norms on markets», *Journal of Financial Economics*, 93, 15–36.

Humphrey, J. E., and Lee, D.(2011), «Australian Socially Responsible Funds: Performance, Risk and Screening Intensity», *Journal of Business Ethics*, 102, 519–535.

Kim, Y., Li, H., and Li, S.(2014), «Corporate social responsibility and stock price crash risk », *Journal of Banking & Finance*, 43, 1–13.

Lee, D. D., & Faff, R. W. (2009), «Corporate sustainability performance and idiosyncratic risk: A global perspective », *The Financial Review*, 44, 213–237.

Lee, D., Humphrey, J., Benson, K., and Ahn, J. (2010), «Socially responsible investment fund performance: the impact of screening intensity», *Accounting and Finance*, 50, 351–370.

Luo, X., & Bhattacharya, C. B. (2009), «The debate over doing good: Corporate social performance, strategic marketing levers, and firm-idiosyncratic risk», *Journal of Marketing*, 73, 198–213.

Mackey, A., Mackey, T. B., & Barney, J. B. (2007), «Corporate social responsibility and firm performance: Investor preferences and corporate strategies», *Academy of Management Review*, 32, 817–835.

Merton, R. C. (1987), «A simple model of capital market equilibrium with incomplete information», *Journal of Finance*, 42, 483–510.

Oikonomou, I., Brooks, C., & Pavelin, S. (2012), «The impact of corporate social performance on financial risk and utility: A longitudinal analysis», *Financial Management*, 41, 483–515.

Sharfman, M. P., & Fernando, C. S. (2008), «Environmental risk management and the cost of capital», *Strategic Management Journal*, 29, 569–592.

Stulz, R. M. (2002). Risk management and derivatives. South-Western: Cengage Learning.

Carbon Market and Climate change investment

Andersson, M., Bolton, P., and Samama, F. (2016). "Governance and Climate Change: A Success Story in Mobilizing Investor Support for Corporate Responses to Climate Change", *Journal of Applied Corporate Finance*, 28, 2, p.29-33.

Campiglio, E. (2015), «Beyond carbon pricing: The role of banking and monetary policy in financing the transition to a low-carbon economy», *Ecological Economics*. <http://dx.doi.org/10.1016/j.ecolecon.2015.03.020>.

Chia, C-P., Goldberg, L. R., Owyong, D. T., Shepard, P., and Stoyanov, T. (2009), «Is There a Green Factor? *The Journal of Portfolio Management*, p. 34-40.

Kossoy, A., Peszko, G., Oppermann, K., Prytz, N., Klein, N., Blok, K., Lam, L., Wong, L., and Borkent, B. (2015), «State and Trends of Carbon Pricing 2015», World Bank, Washington, DC. Doi: 10.1596/978-1-4648-0725-1.

Litterman, R. (2011), «Pricing Climate Change Risk Appropriately», *Financial Analysts Journal*, p. 4-10.

Seung-soo, H. (2012), «From the Industrial Revolution to a green revolution», OECD Yearbook 2012, p.94-95.

Stern, N. (2007), *The Economics of Climate Change: The Stern Review*. Cambridge, UK: Cambridge University Press.

Stern, N. (2008), «The Economics of Climate Change», *American Economic Review: Papers & Proceedings*, 98, 1-37.

Advanced Topics in Responsible Investment

Alexander, F. (2016). "Delaware Public Benefit Corporations: Widening the Fiduciary Aperture to Broaden the Corporate Mission", *Journal of Applied Corporate Finance*, 28, 2, p.66-74.

Aktas, N., Bodt, E. d., Cousin, J-G. (2011), «Do financial markets care about SRI? Evidence from mergers and acquisitions», *Journal of Banking & Finance*, 35, 1753–1761.

Bereskin, F., and Hsu, P-H. (2016). "Corporate Philanthropy and Innovation: The Case of the Pharmaceutical Industry", *Journal of Applied Corporate Finance*, 28, 2, p.80-86.

Borgers, A., Derwall, J., Koedijk, K., and Horst, J-t. (2013), «Stakeholder relations and stock returns: On errors in investors' expectations and learning», *Journal of Empirical Finance*, 22, 159–175.

Choi, A. (2016). "Morgan Stanley Perspectives on Sustainable Investing: Acceleration and Integration", *Journal of Applied Corporate Finance*, 28, 2, p.62-65.

Deng, X., Kang, J and Low, B. S. (2013), «Corporate social responsibility and stakeholder value maximization: Evidence from mergers», *Journal of Financial Economics*, 110, p. 87–109.

Gao, F., Lisic, L. L., and Zhang, I. X. (2014), «Commitment to social good and insider trading», *Journal of Accounting and Economics*, 57, 149–175.

Goss, A. and Roberts, G. S. (2011), «The impact of corporate social responsibility on the cost of bank loans», *Journal of Banking & Finance*, 35, 1794–1810.

Hoi, C., Wu, Q. and Zhang, H. (2013), «Is corporate social responsibility (CSR) associated with tax avoidance? evidence from irresponsible CSR activities», *The Accounting Review*, 88, 2025-2059.

Huseynov, F., Klamm, B. (2012), «Tax avoidance, tax management and corporate social responsibility», *Journal of Corporate Finance*, 18, 804-827.

Jiraporn, P. Jiraporn, N., Boeprasert, A., and Chang, K. (2014), «Does Corporate Social Responsibility (CSR) Improve Credit Ratings? Evidence from Geographic Identification », *Financial Management*, 505 - 531.

Lydenberg, S. (2016). "Integrating Systemic Risk into Modern Portfolio Theory and Practice", *Journal of Applied Corporate Finance*, 28, 2, p.56-61.

Menz, K-M. (2010), «Corporate Social Responsibility: Is it Rewarded by the Corporate Bond Market? A Critical Note», *Journal of Business Ethics*, 96,117–134.

Pelosi, N., and Adamson, R. (2016). "Managing the “S” in ESG: The Case of Indigenous Peoples and Extractive Industries", *Journal of Applied Corporate Finance*, 28, 2, p.87-95.

Sikka, P. (2010), «Smoke and mirrors: Corporate social responsibility and tax avoidance», *Accounting Forum*, 34, 153-168.

Please note that supplementary readings will be provided in the class.