IF : 4.547 | IC Value 80.26

Volume-6, Issue-4, April - 2017 • ISSN No 2277 - 8160

Original Research Paper

Economics

# SRI funds: an overview in the European market

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**ABSTRACT** During the last decade a major attention towards an ethical finance is raised. The spread of financial instruments with sustainable and socially responsible implications is a phenomenon with ancient origins that started only recently to assume greater importance. Investors show a strong interest in the financial instruments that allow them to pursue not only economic efficiency but also to achieve solidarity and social responsibility. The aim of the paper is to discuss on the ethical funds and to offer an analysis of their trends in European markets.

**KEYWORDS :** Ethical Finance, Ethical funds, Socially Responsible Investment.

**Introduction**

The diffusion of financial instruments with ethical implications is a phenomenon with ancient origins that started in recent years, to take on a greater importance in Europe. Investors show a strong interest in the financial instruments that allow them to obtain not only an economic performance but also to achieve solidarity and social responsibility. The paper moves from the analysis of ethical funds in the European market and it concludes with a study on their trends.

**Criteria of SRI selection**

The heart of socially responsible finance is represented by the investment selection process to be included in a portfolio.

As part of the portfolio operating strategies, the literature identified two selection modes of the Sustainable and Responsible Investments (SRI) (Cory, 2001; Lewis, 2002): the screening and the engagement of the surveyed companies.

The portfolio screening consist, on the one hand, in the selection of the securities to be excluded from the financial portfolio (negative screening), on the other hand, in the choice of the securities to be included in the portfolio considered (positive screening) based on social, environmental and cultural criteria.

The engagement implies a commitment by the company to comply with practices based on corporate and social responsibility and to review so its activities in the light of social, environmental and cultural criteria.

The presence of numerous criteria of SRI selection makes of investors choices, and in general of all involved people, particularly cumbersome especially because of a need to collect specific information that are difficult, however, to adapt to a common investment process.

The problem is to provide a measuring and evaluation instrument of social performance of an enterprise, or of the ethics of a business, which is adaptable to the greater number of situations and allows comparing different contexts, at an acceptable cost both for traders and investors.

In this sense, a useful tool is represented by ethical rating awarded to companies, through which the assessment of investments securities is based on more or less rigorous and sophisticated ethical criteria.

Ethical rating adopted from traditional methods of rating systems the principles and assumptions expressing a synthetic judgment that is based on ethical criteria, i.e. on a valuation established not only on financial information but also on social, environmental and cultural data; in this way, the company's ability to create value is valuated not only for shares, but for all stakeholders (Calcaterra et al., 2002).

**Performance Measurements**

Regarding the performance of the SRI funds, two basic assumptions appear obvious.

The first is that an SRI fund is expected to cost more than a traditional because the screening activity could entail a less favorable cost structure than ordinary mutual funds.

The second is that an SRI fund should be less powerful than a traditional fund due to the constraints to the company management in the choice of the securities to be included in the portfolio.

In reality, these two assumptions are not always reflected in the empirical literature.

As regards to the first aspect the traditional mutual funds involve some costs to remunerate the asset management activities, as well as to cover organizational costs of the structure and the placement and distribution services.

The increase in cost that is imputed to SRI funds is justified in the increase in management fees. In fact, an ethical analysis, in addition to the traditional financial analysis, is also required in the assessment of titles. Therefore, these higher costs are mainly related to the need to resort to an ethics committee and external advisors, which must obviously be remunerated.

As regards the management fees, Young and Proffitt (2003) found that ethical products involve even lower costs than ordinary competitors putting in evidence, therefore, as the funds that use a higher number of selection schemes does not apply more onerous management fees to investors.

Vandone (2003) comes to the same conclusions, but raises some important differences in terms of operating costs according to the different categories of mutual funds. The management fee applied to SRI funds is higher than that applied to non-ethical funds in the case of balanced instruments, bonds and flexible, while it is lower in the case of the equity segment.

The other assumption concerns the penalization of profitability of ethical products because of the constraints imposed on the portfolio. Some studies have shown that disadvantage as the difference between the variance of an unconstrained portfolio and the variance of a purely ethical portfolio (Markowitz, 1952). The portfolio that arises from a management activity subject to a high number of constraints may be less profitable due to an increase in the overall risk in reason of a reduced diversification. The impact of the ethical screening is definitely not random and can create a risk not compensated, even in large portfolios (Dreman, Berry, 1995; Fama, French, 1992).

**An Overview Of The European Market**

Europe has a SRI market increasingly mature. In some European countries the SRI are no longer an "optional" choice of a minority of investors who are aware of their ethical values, but tend to be more and more exercised by traditional manager.

In recent years, the growth of SRI funds in Europe has been remarkable, increasing capacity to promote changes in corporate behavior through closer relationship between companies and fund management companies.

According to the latest available data, drawn from the survey on SRI in Europe made in 2014 by Vigeo, SRI funds increased from 159 in 1999 to 957 in 2014.

They have registered a strong increase during the 2008-10 period compared to a slowing in the following years (Table 1).

**Table 1 - SRI in Europe**

| | *1999* | *2001* | *2003* | *2004* | *2005* | *2006* | *2007* |
|---|---|---|---|---|---|---|---|
| *Number* | 159 | 280 | 313 | 354 | 375 | 388 | 437 |
| *Variation in %* | | 76.1 | 11.8 | 13.1 | 5.9 | 3.5 | 12.6 |
| | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* | *2014* |
| *Number* | 537 | 683 | 879 | 886 | 884 | 922 | 957 |
| *Variation in %* | 22.9 | 27.2 | 28.7 | 0.8 | -0.2 | 4.3 | 3.8 |

Among the European countries where ethical investments are more widespread and developed there are France (263), Belgium (214), Great Britain (95), Germany (90), and Switzerland (87). Denmark (17), Spain (16) and Italy (12), however, are the countries where the development of SRI is still insignificant.

An analysis of the total amount of assets managed by the SRI funds shows, in the last decade, a steady growth, with the exception of 2003, for an approximately 16 per cent decrease, and of 2008, for a limited variation the heritage remains stable despite the financial crisis. In particular, the total assets managed by ethical funds increased from a value of 11.074 million Euros in 1999 to a value of 127.015 million Euros in 2014.

A more detailed analysis on the categories of SRI funds in Europe shows a clear predominance of equity funds representing about 56 per cent of total assets in 2014, followed by bond funds with 29 per cent and balanced funds with only 15 per cent.

However, the breakdown by type of fund varies considerably among the different European countries, with the prevalence of equity funds in most cases - in particular, in Sweden (86 per cent) and Great Britain (74 per cent) - counterbalanced from countries where the presence of bond funds is stronger, as in Austria (69 per cent) and France (46 per cent).

The latest data made available in the Avanzi SRI Research report on ethical investment in Europe in 2014 put in evidence that on 957 European ethical funds, about 50 per cent is held by France and Belgium.

In terms of total assets under management, in 2014 France is more relevant, with 36 per cent of the European total assets, followed by Great Britain, with assets of around 17 per cent, and Switzerland, with assets amounting to about 19 per cent.

Further confirmation about the relevant position taken by some European countries may be drawn if the relative value of the total asset under management for SRI is observed. In 2014, France remains the leading country of sustainable finance in Europe with 45.6 billion euro of assets under management respecting socially responsible criteria, while Denmark is bringing up the rear with 1.7 billion euro in the same period of observation. France maintains the primacy in all the years, from a value of 41.3 billion euro in 2012 to a value of 45.6 billion Euros in 2014, with an increase of about 10.41 per cent. Great Britain and Switzerland presented also a rapid growth, respectively 56.62 per cent and 23.16 per cent from 2012 to 2014.

The lowest values were recorded by Spain and Denmark.

Finally, results of the research conducted by Avanzi SRI Research in 2013 and 2014 put in evidence a merit list (ranking) for the first 10 European funds (Table 2).

**Table 2 - Principal ethical funds in Europe**

| Ranking 2013 | Rankin g 2014 | Fund | Country |
|---|---|---|---|
| 1 | 1 | BNP Paribas Mois | France |
| 3 | 2 | Atout France | France |
| New | 3 | Ofi Trésor ISR A/I | France |
| New | 4 | BTP Trésorerie | France |
| 6 | 5 | Stewardship Pension Fund | Great Britain |
| 2 | 6 | Aviva Monétaire ISR | France |
| 4 | 7 | SNS Euro Mixfonds | Netherlands |
| New | 8 | Santander Responsabilidad Conservador FI Acc | Spain |
| 8 | 9 | EdR Tricolore Rendement | France |
| 7 | 10 | Atout Euroland | France |

The English BNP Paribas Mois fund maintained the top position in all the period.

**Conclusions**

A major attention towards an ethically oriented finance based on social investments and environmental benefits is raised. In the nineties the Sustainable and socially responsible instruments are developed in all Europe, becoming part of the range of mutual funds offered by financial intermediaries.

The motivation of investors to commit their savings in ethical mutual funds investments is not limited to just a desire to get a profit from an investment as high as possible, but regards the pursuit of the principles of solidarity and social, environmental and cultural responsibility.

These two motivations are considered when the performance of ethical funds is valuated opposed to that provided by mutual funds without ethical visions. However, classical performance indicators are not able to take account of this dual motivation since they assume, by definition, that the only thing to evaluate is the desired performance in the highest expected value with the minimum risk.

The European SRI Study, conducted by Eurosif in 2014, shows that all responsible investment strategies have grown at double-digit rates between 2011 and 2013, faster than the broad European investment market. Growth rates range from 22.6 per cent (Sustainability themed) to 132.0 per cent (Impact investing). This compares to an estimated 21.7 per cent for the broad European investment market.

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Volume-6, Issue-4, April - 2017 • ISSN No 2277 - 8160

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