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Exploring Sustainable Investment: In-Depth Analysis of Socially Responsible Investing (SRI) and ESG Strategies

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Abstract

Theoretical background: In recent years, there has been an increase in social and environmental awareness, which has forced companies to change their approach to investment. Large companies are burdened with responsibility for contemporary, global problems such as the depletion of natural resources, the ongoing process of environmental degradation and inequalities in living standards between poor and rich countries. Therefore, when making investments, companies must evaluate them not only in terms of financial returns, but also in terms of their social, ecological and ethical impact. Two key approaches to this new investment paradigm stand out: socially responsible investment (SRI) and ESG investment (a three-pronged view of

environmental, social and corporate governance). They focus on sustainable investments in order to achieve positive results for investors' portfolios as well as for society and the environment.
Purpose of the article: The following article examines both approaches, analysing their relevance, objectives, tools and economic and social impacts.
Research methods: For this purpose, specialist journals published between 2001 and 2023 were searched in the Web of Science database. A literature review of socially responsible investment and ESG investment shows that interest in these concepts has increased rapidly in recent years. In addition, reports available on the websites of selected companies were analyzed.
Main findings: The scientific impact on the studied concepts also makes it possible to determine future research directions. The literature contains results confirming that companies applying these approaches in their operations, achieve better results.

Introduction

Data on SRI and ESG are now much more readily available than they were just 10 years ago, making these strategies easier to implement and much more cost-effective (Townsend, 2020). Despite access to the reports of many companies (especially large companies, which are obliged to report), no detailed literature review has been carried out so far, to the knowledge of the authors, in the area of increasing interest in the studied topic. The authors analyse the topic from a scientific perspective, with a focus on future expansion of research, which can help to better understand the comprehensive economic and societal impacts of sustainable investment and provide more concrete information for policymakers, investors and businesses. The following sections will be presented: literature review in which the relevance of the topic to the current literature will be shown, research methods, results, discussions and conclusions.

Literature review

The issue of the article concerns the definition of unambiguous standards and definitions in the area of SRI and ESG and how they are perceived by companies and what consequences result from this. The research question asked is: Do companies that use sustainable investment practices (SRI) and ESG achieve benefits compared to those that do not invest sustainably?

The purpose of this article is to analyse the importance, objectives, tools and economic and social impact of socially responsible investment (SRI) and ESG investments. By analysing the scientific literature, the paper aims to better understand the benefits of these investments and identify areas that require further research.

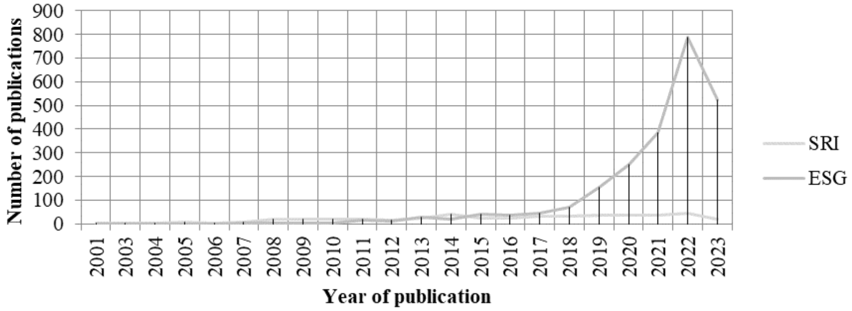

Figure 1. Number of SRI and ESG publications over the years

Source: Authors' own study based on (Web of Science data, 2023).

An analysis of the literature based on scientific articles in the Web of Science database indicates a sustained increase in interest in these concepts. The first article on SRI appeared in the database in 2001, and by 2022 there were as many as 46. As for ESG, the first article appeared in 2007, and in 2022 it reached its peak – a total of 525 articles were published on the subject. The results for 2023 are understated as the year is still ongoing.

While the growing number of publications on the subject (Figure 1) indicates a growing interest, more detailed analyses are needed on specific sectors, regions and company sizes. Research should focus on assessing the long-term financial performance of companies using these strategies, identifying key success factors.

The key issue is to understand the difference between SRI and ESG investing. There is some confusion in the literature about the terminology and scope of these approaches. These issues are crucial for the effective implementation of investment strategies and their impact on society and economy (Kłobukowska, 2019). The difference between ESG and SRI is shown in Figure 2.

Socially responsible investing is a type of investment based on ethical, social, and environmental criteria, driven by corporate social responsibility. It not only leads to investment returns but also contributes to the fulfillment of projects such as environmental protection, social integration, and poverty eradication. One of the largest socially responsible companies is Tesla, which, through its electric vehicles and research, endeavors to mitigate the effects of climate change (www4).

ESG represents a set of modern conduct standards. It involves planning the activities and development of an organization based on three pillars: environmental concerns, social responsibility, and corporate governance. It encompasses factors that influence the value and valuation of an organization, upon which non-financial ratings and assessments of the organization are created – influencing the value and valuation of companies. In ESG strategies, the key emphasis is on providing practical solutions tailored to the industry, company size and business risks (www5).

Figure 2. The difference between ESG and SRI

Source: (www3).

Research methods

Research methods were based on literature analysis and publicly available reports of selected companies. A literature review based on the Web of Science enabled the identification of trends in SRI and ESG studies (Figure 1). Among the articles analysed, 15 countries that stand out as leaders in research on the subject were identified. In the ranking of articles on SRI (Figure 3) and ESG (Figure 4), as many as 13 of them are repeated. Strong leaders in both areas are the United States of America, England and Australia.

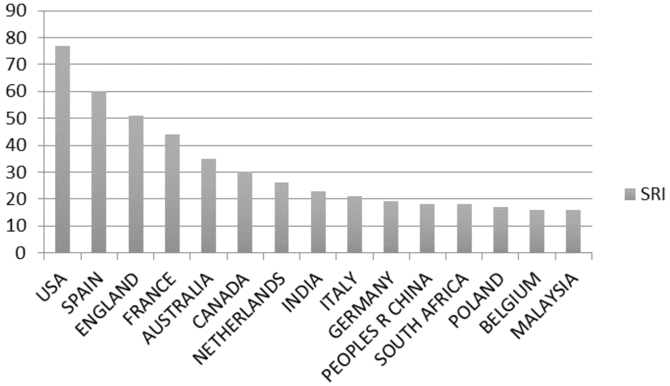

Figure 3. Number of SRI publications in selected 15 countries

Source: Authors' own study based on (Web of Science data, 2023).

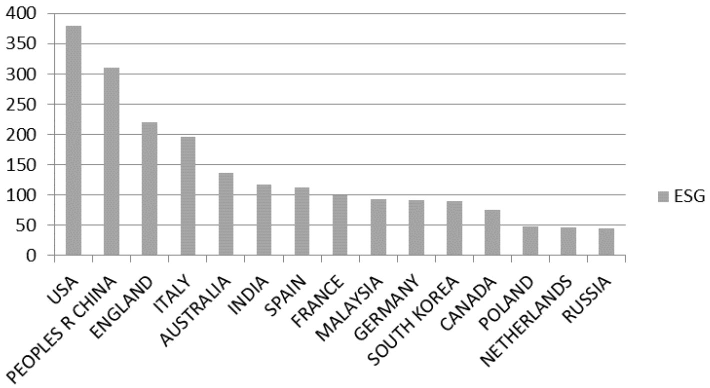

Figure 4. Number of ESG publications in selected 15 countries

Source: Authors' own study based on (Web of Science data, 2023).

Academic interest also reflects on results. The analysis of publicly available reports of selected companies allowed to identify the modern standard of applied strategies in the area of sustainable development or the desire to implement them (Figure 5), as well as their impact on the results received by these companies (Figure 6).

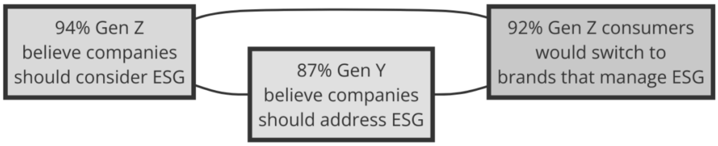

Figure 5. Selected results of the ESG perception survey

Source: (www14).

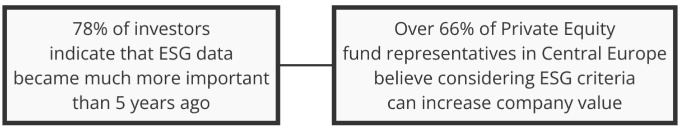

Figure 6. Selected results of the ESG perception survey

Source: (www14).

According to the latest data available, the United States had the largest share of the socially responsible investment market in 2020 (USD 17.08 trillion), accounting for 48.4% of the global market. Europe was the second largest market in terms of socially responsible investment (USD 12.02 trillion), accounting for 34% of the global market (Michalczuk & Konarzewska, 2022). Over the next two years (2020–2022), sustainable investments almost worldwide (Europe, Canada, Japan, Australia and New Zealand) reached USD 21.9 trillion (www11).

In Poland, a comprehensive survey conducted by the Warsaw Stock Exchange in July 2022 on the impact of non-financial factors on investment decisions showed that nearly 40% of respondents note the positive impact of ESG practices on corporate performance, while 81% of professional investors consider ESG entities to be less risky (www10).

Results

In recent years, we have seen a dynamic increase in social and environmental awareness, which prompts companies to revise and re-evaluate their investment strategies. The actions taken are evaluated in terms of financial benefits, but also in terms of social, environmental and ethical impact.

Companies base their strategies on the concept of corporate social responsibility (CSR), implementing numerous socially responsible innovations. Sustainable investment involves the choice of companies and the instruments they issue, in order to create an investment portfolio, taking into account their ethical practices and contribution to the well-being of society. Sustainable investments already comprise over 25% of the total value of global investment assets, with the largest assets managed according to this approach (Matczak et al., 2020).

Financial institutions and other investors are looking for forms of investment that comply with ESG (environmental, social and governance) criteria. The growth of socially responsible financial products is a response to the trend in which sustainable development is becoming a determinant of innovative solutions in both the corporate and financial sectors, as illustrated by the development of SRI (Kłobukowska, 2019).

The objectives of socially responsible investing and ESG investing can be reduced to a common foundation. This includes:

Sustainable development – emphasis on investing in companies engaged in sustainable development practices, protecting the environment, and reducing the negative impact on climate and ecosystems.

Ethical alignment – investing in accordance with ethical and moral values of investors, supporting companies aligned with convictions and avoiding those engaged in unethical or harmful activities to society and the environment.

Positive social impact – striving to generate positive social effects through investing in companies that support human rights, diversity, fair labor conditions, as well as social and philanthropic projects.

Responsible corporate governance – SRI and ESG promote companies that implement transparent and responsible management practices, prioritize shareholders' interests, mitigate conflicts of interest and ensure proper oversight of operations (www12; www1).

Socially responsible investing and ESG investment tools include a variety of financial instruments, such as green bonds, socially responsible shares, ESG index funds and sustainability certificates. Trading platforms increasingly offer ESG filters that allow investors to tailor their portfolios to their own sustainability criteria. Below are some of the tools used in SRI and ESG investing:

1. Negative selection criteria: The exclusion from the investment portfolio of companies or sectors engaged in controversial or unethical activities, such as arms production or coal mining.

2. Positive selection criteria: Investments are selected on the basis of positive factors such as good environmental practice, social innovation, support for local communities and gender equality.

3. Integrating ESG factors: Investors consider environmental, social and managerial factors when analyzing potential investments to assess risks and potential impacts on long-term financial performance.

4. Thematic investments: They focus on specific themes, such as renewable energy, clean technologies, health or education, that bring positive social or environmental change.

5. Impact investing: Investments focused on achieving specific social and environmental objectives, such as combating poverty or protecting water resources (Boffo & Patalano, 2020; www7).

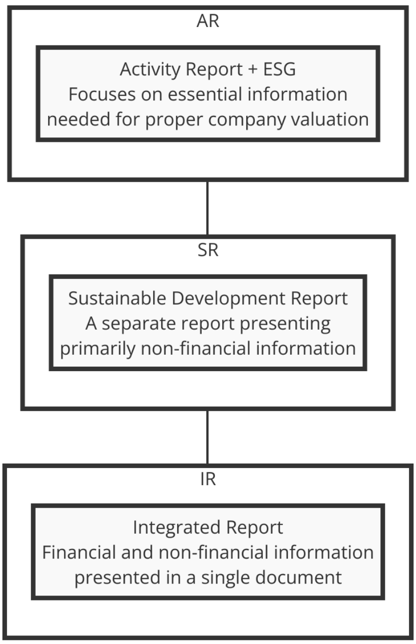

Figure 7. Selected reporting methods

Source: (www9).

It is also worth highlighting ESG reporting in this context. Companies are increasingly encouraged to publish information about their ESG practices, enabling investors to make a more accurate assessment and selection of investments aligned with their values. Furthermore, new legal regulations in this area are continually being developed, including the proposed European Union Corporate Sustainability Reporting Directive (CSRD) introduced in April 2021. According to the project, starting from 2023, all large enterprises in EU countries – both public and private companies (employing more than 250 employees, with a balance sheet total exceeding EUR 40 million or generating turnover of over EUR 20 million) – will be obliged to submit ESG reports. The proposed directive also stipulates that from 2026, all small and medium-sized companies listed on regulated markets will be subject to the obligation of ESG reporting (www12).

Companies can choose a reporting method that best suits their needs, provided it meets legal requirements. Figure 7 shows the options a company has to choose from. Overall, the goals and tools of SRI and ESG focus on creating a positive impact on society, the environment, and corporate governance through investments aligned with specified values and principles.

Discussions

Sustainable investing in the form of SRI and ESG has a significant impact on the economy and society. Firstly, it promotes corporate social responsibility, encouraging companies to adopt more sustainable practices and build a positive image. Companies that meet SRI and ESG criteria may gain greater trust from customers and investors, potentially leading to an increase in the company's value (www9). Companies' assessment of the application of ESG is shown in Figure 8.

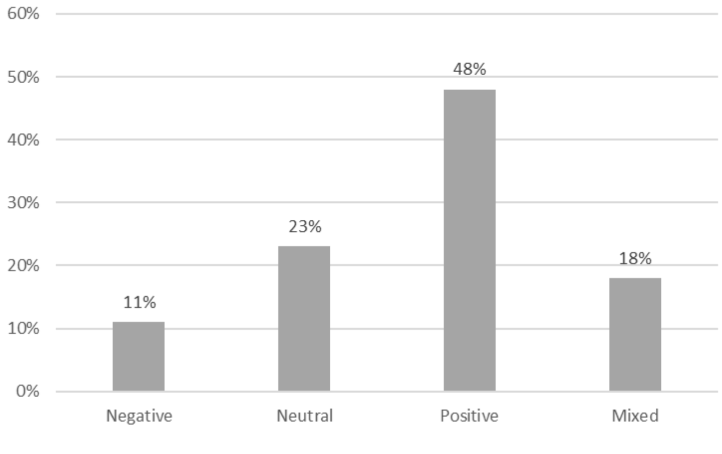

Figure 8. Impact of ESG on the financial results of companies

Source: (www2).

Secondly, ESG investments can influence long-term investment profitability. Companies that invest in sustainable practices are more resilient to risks related to environmental and social regulations and have a higher chance of achieving financial stability in the future. Recent experiences related to the COVID-19 pandemic confirmed that business models considering ESG factors are less susceptible to negative disruptions caused by factors like technology or regulations, providing them with a competitive advantage in the long term (www13).

Although the path to standardization seems straightforward – as evidenced by the fact that the percentage of S&P 500 companies reporting on their sustainable development activities, corporate social responsibility efforts, and ESG performance increased from just below 20% to 86% from 2011 to 2018 – the importance of ratings should not be underestimated. Institutional investors should continuously conduct research and select indicators that allow them to choose companies with lower risk levels, higher returns, and external demand (Figure 9) (www14).

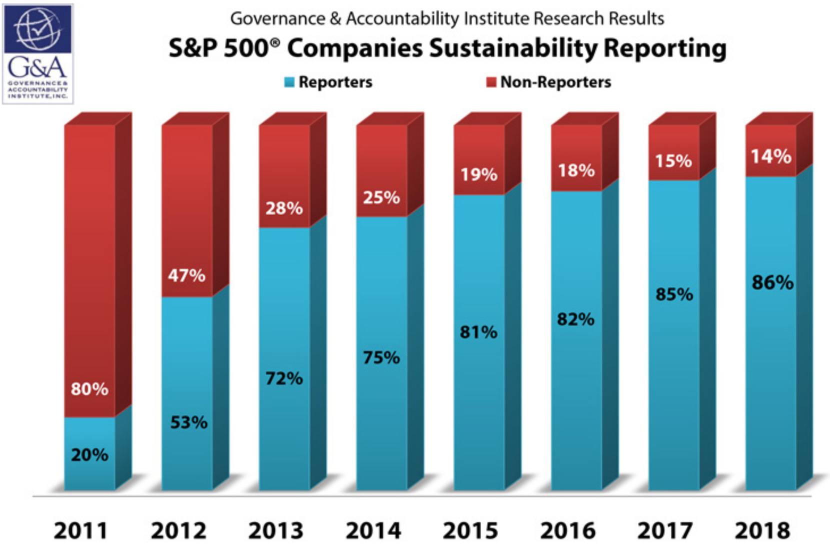

Figure 9. Percentage of S&P 500 companies reporting on their sustainable development activities

Source: (www8).

Neglecting ESG risk control can have negative consequences, and the costs of rectifying such issues may significantly surpass the costs of proactive actions. The role of the financial sector remains significant in driving this trend and contributing to the growing importance of ESG factors and sustainable development principles (www9), as illustrated in Figure 10.

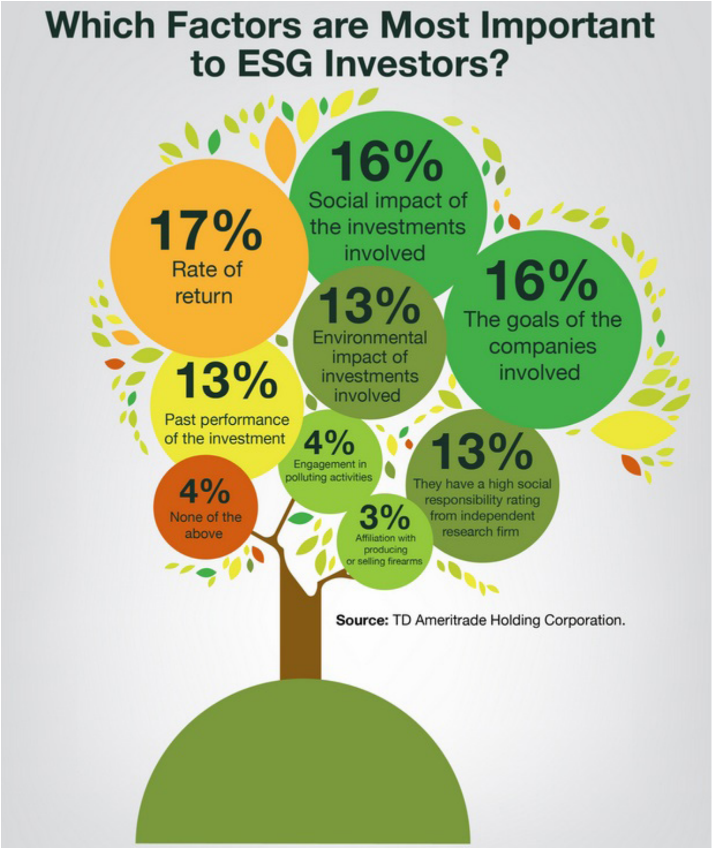

Figure 10. TD Ameritrade's Socially Responsible Investing Survey infographic

Source: (www6).

There is no specific structure of ESG factors for the selected company. ESG factors are often interrelated and difficult to classify. These ESG factors can often be measured (e.g. what is the turnover of employees in the company), but it is difficult to assign a monetary value to them (e.g. what is the cost of employee turnover in the company) – everything should be determined individually, depending on the parameters.

Conclusions

In summary, the statistics show that SRI and ESG investments represent an important step towards sustainable investment and are an important part of the market. This has to do not only with increasing social, environmental and regulatory demands, but also with the COVID-19 pandemic, the war in Ukraine, the coming climate crisis and inflation. Investors should understand that they should not focus on short-term profits, but rather formulate long-term goals (Michalczuk & Konarzewska, 2022).

Even in Poland, despite the growing awareness of sustainability among entrepreneurs, ESG factors are still seen more as a challenge than a business opportunity. This may be due to the lack of structural knowledge of entrepreneurs in this area, the small number of experts and the cost of their employment, as well as the lack of IT tools to facilitate reporting (*Realizacja Celów…*, 2023).

In response to the research question, SRI and ESG Investments can contribute to positive economic and social change by directing capital towards companies that strive to achieve financial success while respecting social and environmental values. They introduce additional company rating indicators that can help investors make more informed investment decisions. They also have the potential to influence business practices by promoting an ethical and sustainable approach to corporate activities.

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