

The evolution of responsible finance

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Lodon

The Microeconomics of Wellbeing and Sustainability

Recasting the Economic Process

Leonardo Becchetti | Luigino Bruni | Stefano Zamagni

The Microeconomics of Wellbeing and Sustainability: Recasting the Economic Process explores the civil economy tradition in economic thought. Gaining increasing consensus worldwide, this alternative—not heterodox—view of the economic process and agents explains how modern economics is placing increasing emphasis on the determinants of subjective wellbeing and environmental sustainability. With support from behavioral economics, this book makes a foundational contribution that will help users better understand and prepare for future economic challenges.

Key Features

- Marries criticism of the neo-classical model with empirical work on the possibilities of alternative frameworks for action
- Links new ideas (*homo reciprocans*, happiness, relational goods) to established microeconomic concepts (the market, perfect and imperfect competition, utility maximization)
- Devotes specific attention to relevant elements in economic history, explaining how we evolved to the current paradigm and to its challenge

About the Authors

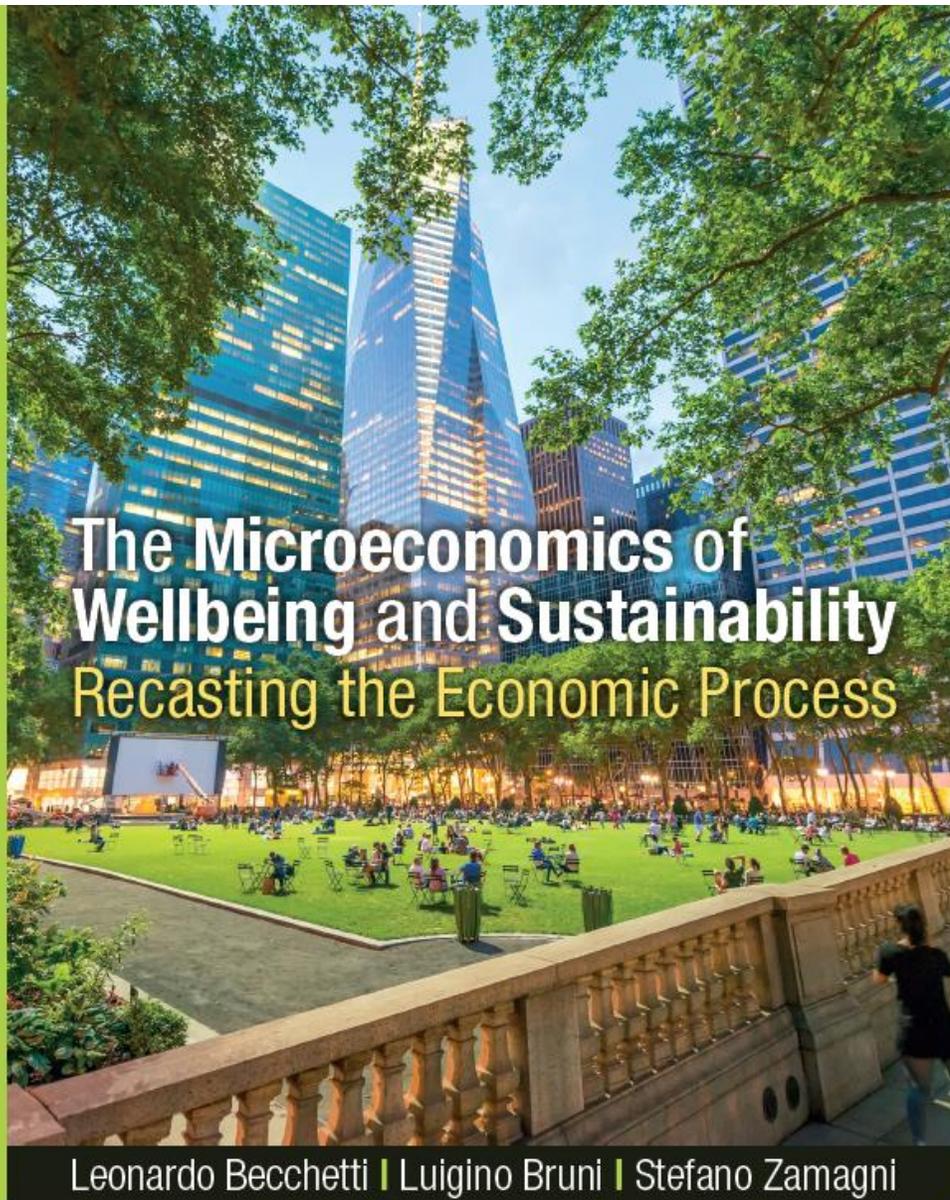
Leonardo Becchetti is professor of Economics and Director of the Master in Development Economics and International Cooperation at the University of Rome "Tor Vergata". He is among the first 100 authors in the RePEc world ranking for number of journal pages published and "betweenness", an indicator that measures the degree of proximity among registered authors in the world network. His main research topics are behavioural economics, social capital and social norms, economics of happiness, corporate social responsibility, growth and economic wellbeing.

Luigino Bruni is Professor of Economics at University LUMSA in Rome and Professor of Civil Economy at the University Institute Sophia (Lopplano). He is Editor-in-Chief of the International Review of Economics and a member of the editorial board of the Review of Social Economy and the International Journal of Happiness and Development. His research concentrates on topics related to ethics and philosophy in economics and more generally rational choice, trust, social capital, and evolutionary game theory.

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The Microeconomics of Wellbeing and Sustainability

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The civil economics approach

ECONOMICS

- Beyond homo economicus (behavioral economics, reciprocity, trust)
- Beyond profit maximisation (corporate social responsibility, hybrids)
- Beyond «value = GDP» (multidimensional wellbeing, generativity, happiness, «human sustainability»)

POLITICAL ECONOMY

- From a two-hand (market, institutions) to a four-hand (market, institutions, active citizenship voting with the wallet, responsible business) approach...**responsible investment funds play a crucial role**

3 main arguments to convince people about a new civil economy paradigm in one slide _ Abstract

- Men is a **sense searcher** before being an **utility maximiser**, poverty of sense is a mortality risk factor (Becchetti et al., 2017). **Generativity** is the best way to create sense in individual life and make them flourish. Creating condition for generativity of every member of the society is the goal of Civil Economics
- Homo economicus is a “social” idiot (life is made of social dilemmas whose features are asymmetric information, non overlapping competences, incomplete contracts). Homo economicus rationality is an inferior form of rationality in a life made of social dilemmas.
- Why social progress along this line is so difficult ? The most powerful and important dimension of freedom is freedom-of (since it leads to higher generativity) and it can be conquered with training..hence the enjoyment of what we say is not immediate but we must give the taste of it(Scitovsky, comfort and stimulus goods, Aristoteles vs Hobbes)

World Happiness Report

- 7 factors explain 75% of differences in life satisfaction among countries
 - Education
 - Income
 - Health
 - Freedom of initiative
 - Absence of corruption
 - Quality of relational life
 - Gratuitousness
-
- ...beyond millions of data one principal component...

Two of the best definitions of generativity as source of life satisfaction and life sense

- Work hard for your own interest, no man could do otherwise, as he would be less human by not doing so: but do not work for the misery of others and, if possible, work out how to make them happy. **The more you are self-interested, the more you must be virtuous if you are not fool. Is a natural law that you cannot make your own happiness without making that of other human beings”]** (Genovesi, *Autobiografia e lettere*, p. 449).(Genovesi, *Autobiografia e lettere*, p. 449)
- *“Those only are happy, I thought, who have their minds fixed on some object other than their own happiness, on the happiness of others, on the improvement of mankind, even on some art or pursuit, followed not as a means, but as itself an ideal end. Aiming thus at something else, they find happiness by the way”* (John Stuart Mill, 1893: p.117)

The principal component of life satisfaction of human beings (who are sense searchers before being utility maximisers) is generativity

Erikson (1993)

generativity consists in the sequence of four verbs: to desire, to give birth, to accompany, to let it go.

Generativity stands to functionings and capabilities as Aristotelean «act» to Aristotelean «power»

Functionings are “states of being and doing” that relate to individual wellbeing (ie., being educated, healthy) and, as such, they are not identified in the goods that can be used as means to enable them.

Capabilities are instead the set of functionings that an individual has access to. In this respect, while generativity in power relates to those capabilities and functionings that make generativity acts possible, generativity in act implies the use of capabilities and functionings for actions that are generative, ie. that are likely to affect positively lives of other human beings.



The vote with the wallet potential

- Not the Nash equilibrium in the multiplayer prisoner's dilemma played by homines economici....
- But the optimal strategy played by generative individuals maximising happiness and richness of sense of life
- 4 limits
- Awareness
- Information
- Coordination of choices
- Price

- The enormous growth of vote with the wallet in finance is because 4 limits overcome

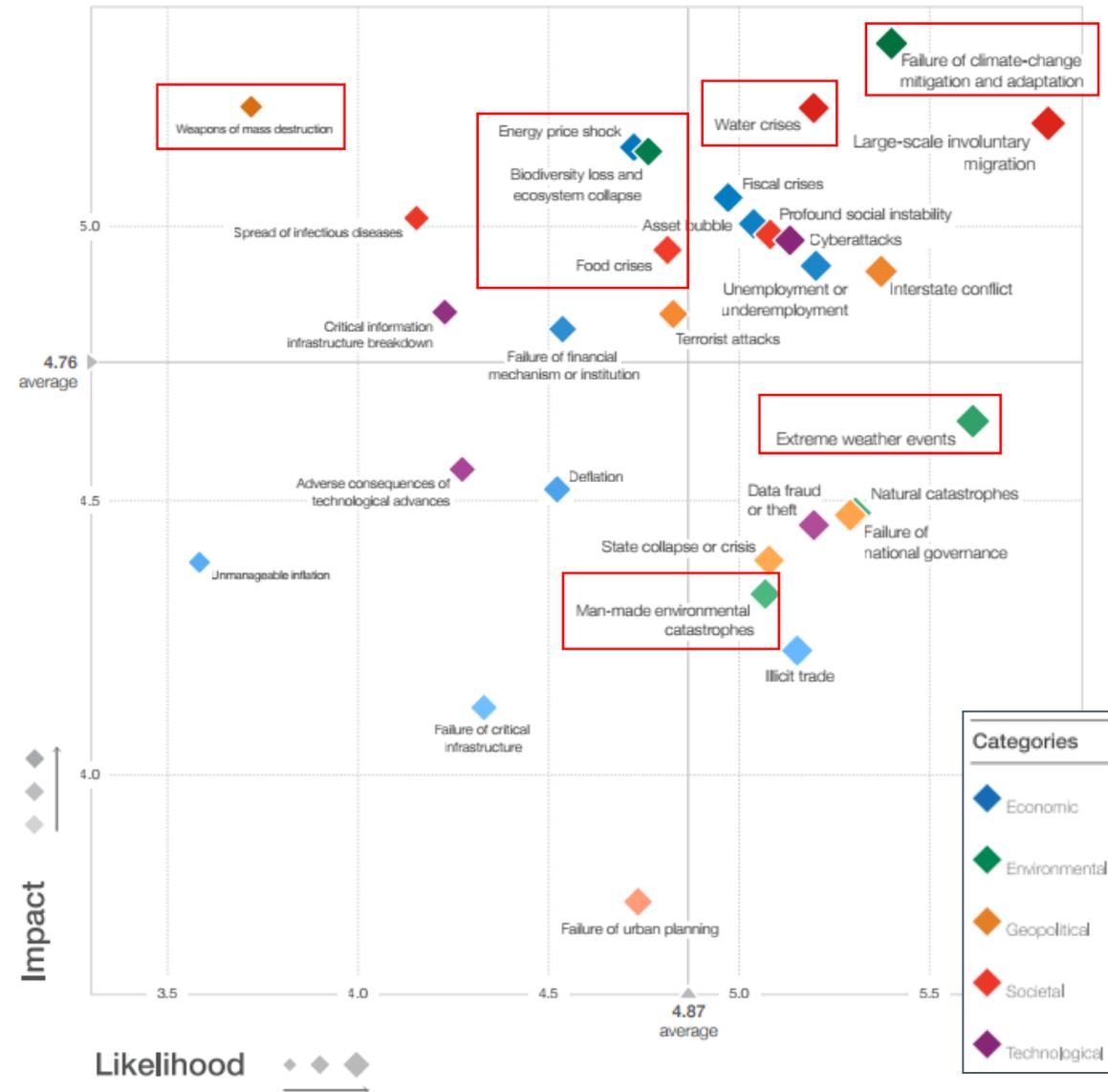
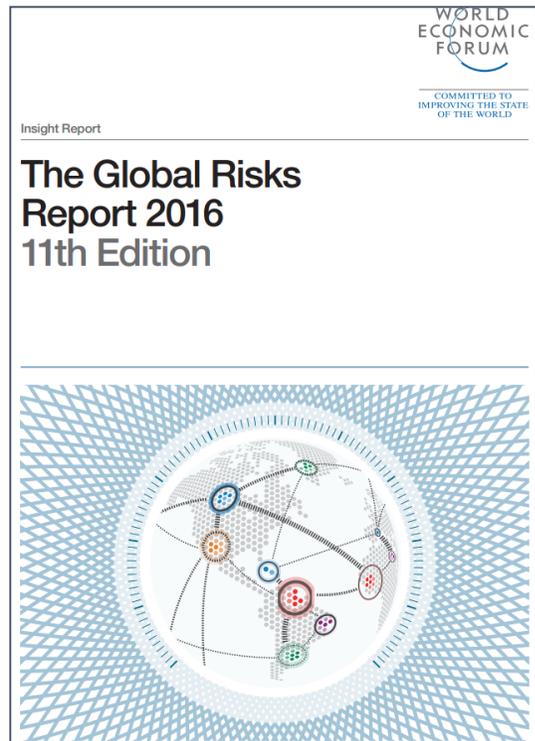
2. A pioneer in sustainable finance

Since 18 years in
the SRI market...

..now the big
players come in...



Investment funds are aware that ESG risk is growing in importance.....



Larry Fink «A sense of purpose»..

The 2018 letter of the founder and CEO of BlackRock to the world multinationals

- *Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders.*
- *It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth.*
- *It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives.*
- *And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.*

An example of stakeholder risk materialised...

Voestalpine invested in environmental sustainability while Ilva did not...who is today market leader ?



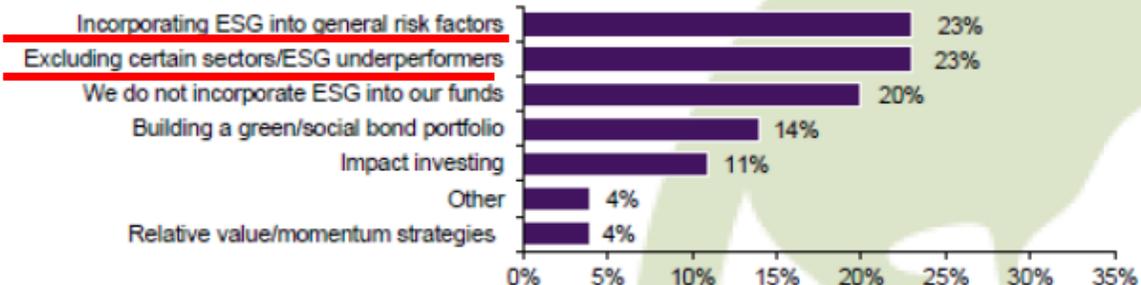
Investment fund manager are aware of stakeholder risk and make pressure on companies: an example

- From Financial Times, OCTOBER 28, 2016
- “Aggressive tax avoidance raises risks for investors
Regulatory pressure has increased the financial implications of tax planning”
- For years, executives have defended these tax arrangements on the basis that they are legal. [Some have even argued](#) that they have a responsibility to shareholders to minimise tax liabilities
- Nordea Asset Management, the €300bn Nordic fund house, has written to a number of companies, including Alphabet and Apple, to warn that pressure from regulators and governments has increased overall risk for investors.
- The pressure for concrete regulatory changes will no doubt continue to raise regulatory risk for companies who prioritise aggressive tax practices in their financial strategies. The risks related to aggressive tax practices have raised investor uncertainty

ESG trading strategies

- Predominance of 'light green' trading strategies
 - ESG as part of risk factors
 - Exclusion of certain sectors/ESG underperformers
- Highlights importance for issuers to 1) clearly state their environmental risk management policies and 2) manage their ESG ratings
- 'Dark green' strategies growing in importance, with 25% of funds focusing on environmental/social impact

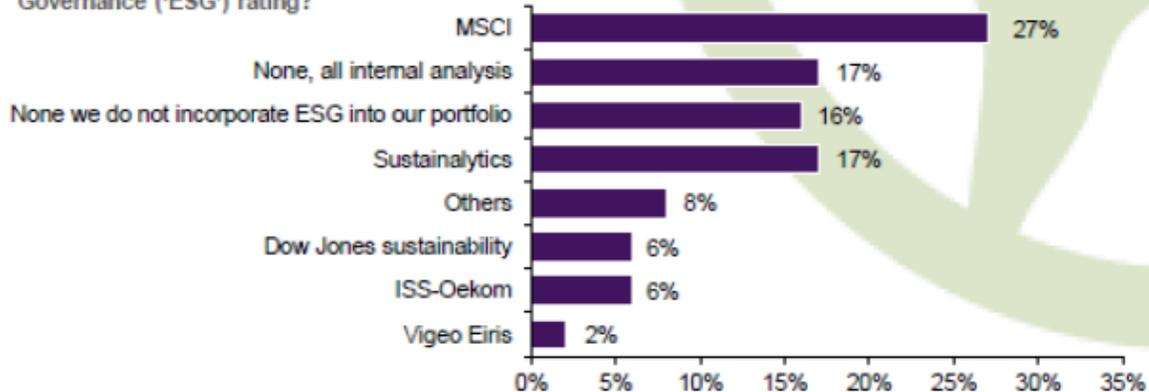
How do your funds incorporate ESG into their mandate?



ESG agency selection

- 84% of investors actively incorporate sustainability into their investment decision – The large majority of them employ an external agency for this, with MSCI and Sustainalytics the most popular. 17% of respondents purely rely on their internal models, being either large accounts or purely ethical funds

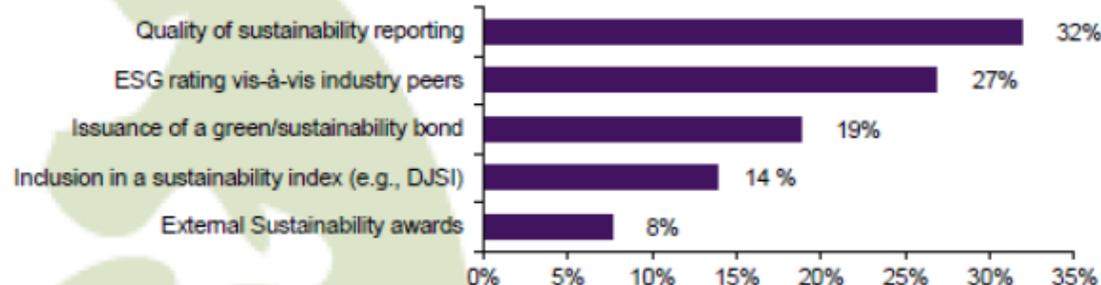
Which sustainability agencies do you rely on when assessing a bond issuer's environmental, social and Governance ('ESG') rating?



Preferred corporate sustainability actions

- In line with results of September survey, investors prefer issuer-wide actions to improve sustainability (e.g., reporting, ESG rating) over project-specific actions – such as a green bond issuance
- Message of the market hence is – make sure your house is in order before engaging in a green-labelled financing exercise

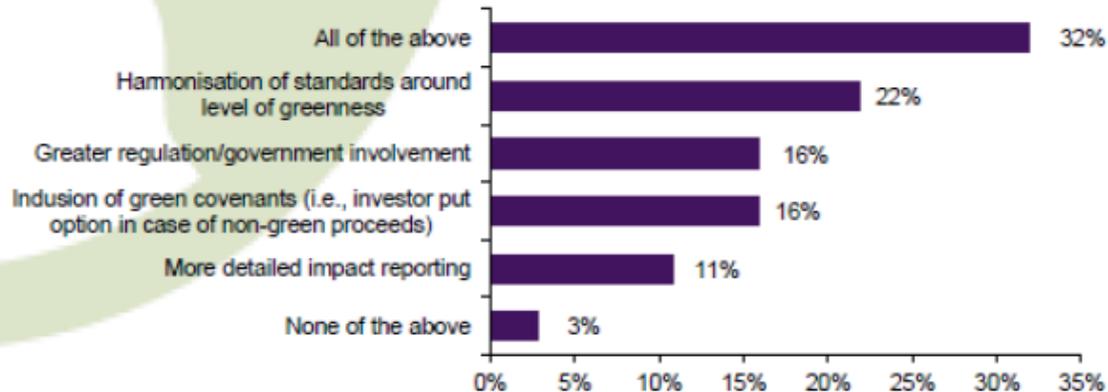
What two actions best underscore a bond issuer's commitment to sustainability?



Green bond structuring

- Further standardisation demanded by investors, frustrated by the lack of a clear taxonomy of green
- Moving to a more professionally structured product: Around half of investors feel that greater regulation/government involvement and inclusion of green-specific covenants would be beneficial

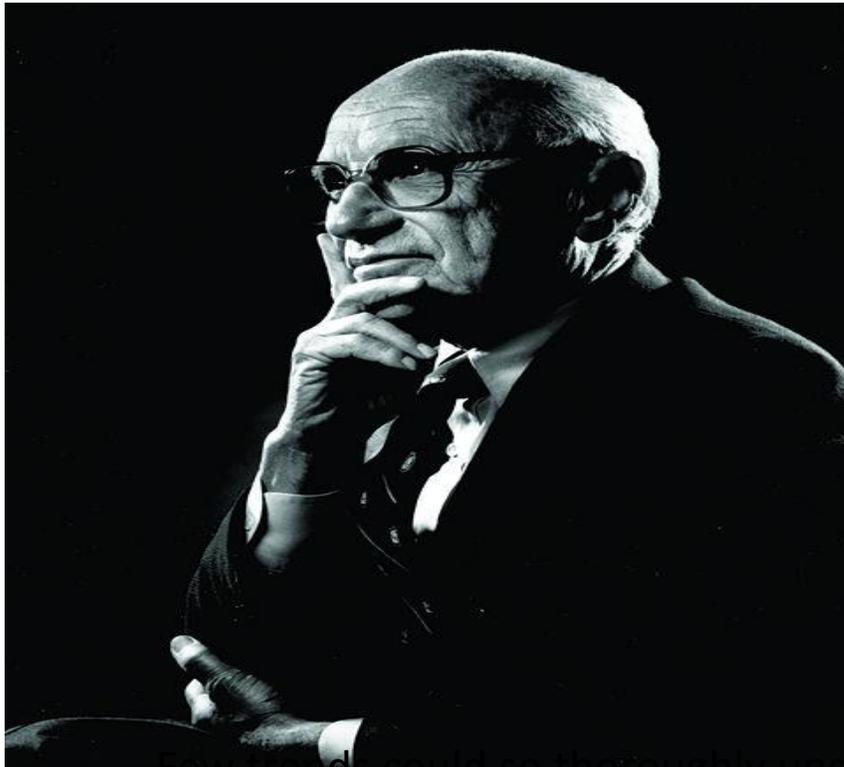
Which of the following developments do you think would be beneficial for the green bond asset class?



Is Social Responsibility Useful?

Some say no – at least to CSR

Friedman



- Few trends could so thoroughly undermine our free society as the acceptance by corporate officials of a social responsibility other than...

Others say yes - Samuelson



- ...a large corporation these days not only may engage in social responsibility, it had damn well better try to do so.

Friedman's (old pre-globalisation) view

Forces of market competition transform individual and corporate self-interested behavior into an efficient and socially optimal outcome, while the state intervenes with taxes and regulation to address the problem of externalities and public goods and redistributes income and wealth according to the dominating social standards.

Why Friedman is deeply wrong

- GLOBALISATION ARGUMENT: in globally integrated economies in which production is delocalized, with institutions and rules are kept highly heterogeneous amongst nations, regulatory arbitrage and race to the bottom have made the role of CSR progressively more important.
- STRUCTURAL ARGUMENT: regulatory capture by lobbies, inefficiency and high transaction costs limit the scope of state intervention and create room for the emergence of corporate social responsibility as a rational response of concerned consumers who ask (in their own self-interest) corporations to comply with stricter social and environmental norms.
- HAPPINESS ARGUMENT: the corporation is the place where we workers live most of their life. Therefore they cannot separate their humanity from their job

- IS CSR is a "win-win" strategy ?
- Let us investigate the relationship between CSR and corporate performance under different dimensions.

Is CSR economically sustainable in the competitive globalized scenario ?

- 1) CSR is not a free lunch: most CSR criteria entail higher costs since they transfer income from shareholders to other stakeholders
- Some exceptions: cap to managers' wage, product quality
- ...such costs may be however offset by five potential benefits ...

First potential gain: the impact on workers' productivity (1)

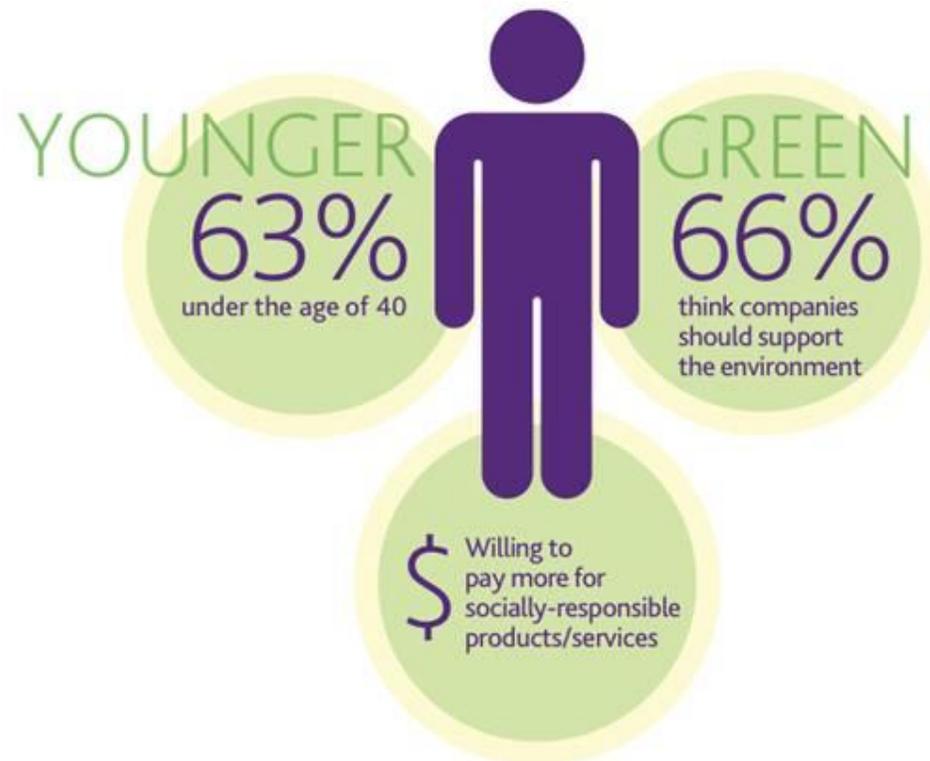
- A) Efficiency wages (or the productivity-wage nexus upside down): higher workers remuneration reduces shirking, and turnover and triggers gift exchange phenomena (Stiglitz-Shapiro, 1982; Salop, 1979; Malcomson, 1981; Akerlof, 1982)
- B) CSR makes corporate goals closer to workers ideals thereby triggering intrinsic motivations (Deci and Ryan, 2000). The extreme corporate dreams: volunteers are so intrinsically motivated to «work for nothing» (Freeman, 1997)

First potential gain: the impact on workers' productivity (2)

- Edmans (2009) documents that top firms in terms of employee satisfaction in the United States earn a risk adjusted abnormal return (four-factor alpha) of 4 percent per year from 1984 to 2005
- EU (Social Business Enterprise): social firm halved workers' absenteeism rates

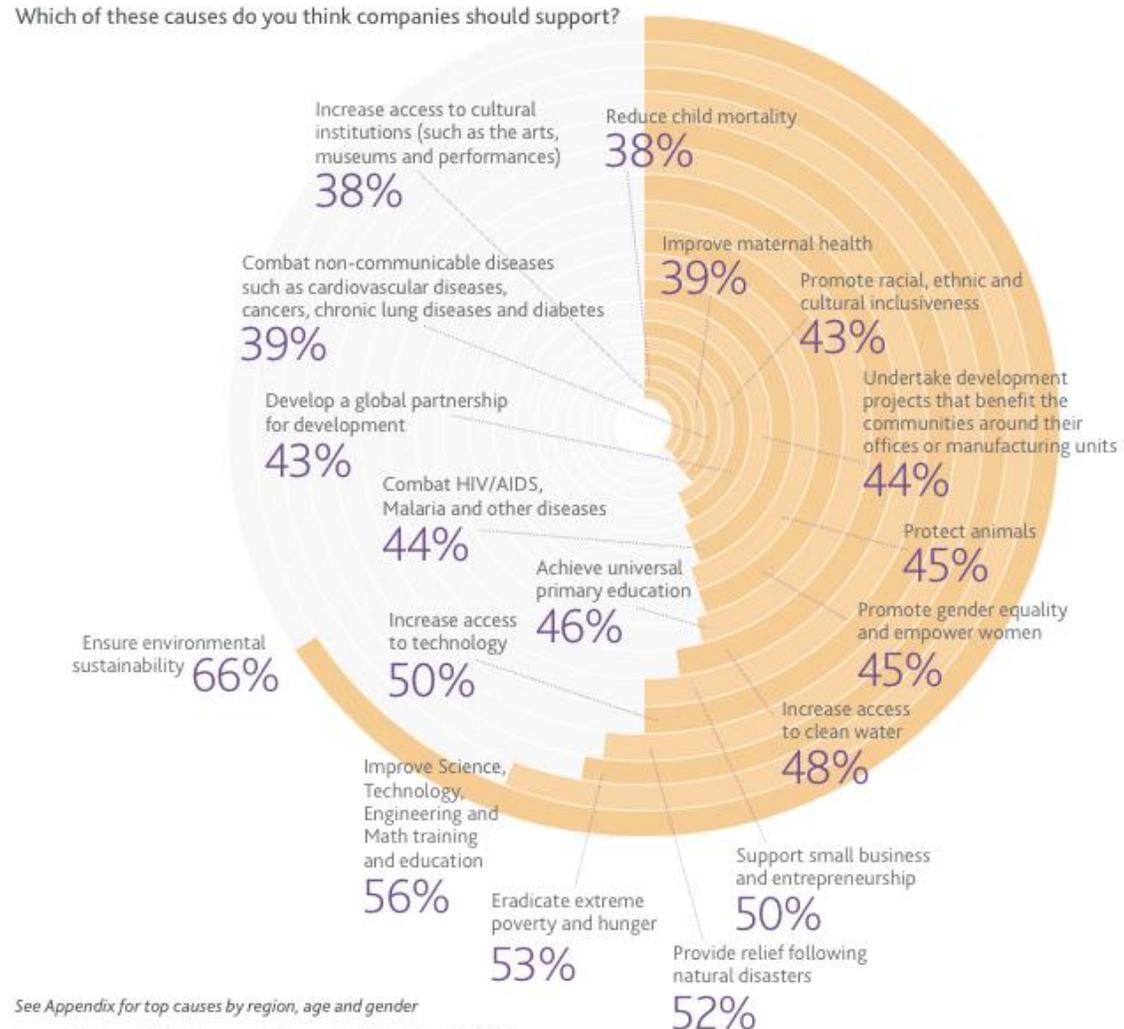
Second potential gain: support from socially responsible consumers «voting with the wallet»

- Nielsen Survey: 28.000 interviews in 56 countries – 46 percent of consumers vote with the wallet



The second gain: the «vote with the wallet» breakdown

Food for thought: why plants matter almost twice more than human being ?
(66% environmental sustainability; 38% child mortality)



See Appendix for top causes by region, age and gender

Source: Nielsen Global Survey of Corporate Citizenship, Q3 2011
Socially-conscious consumers defined as those who expressed willingness to pay extra for products and services from companies that have implemented programs to give back to society.

Third potential gain: minimisation of transaction costs with stakeholders

CSR minimises transaction costs with stakeholders (consumers, local communities, suppliers) (Freeman, 1984)

In this sense CSR may reduce «ethical risk» which is becoming an increasingly relevant risk factor taken into account in risk management theory and practice

Every year listed US companies spend millions of dollars to settle conflicts with stakeholders (especially when class actions work)

Goss and Roberts (2011): non CSR firms impose costs on the society. The society understands this and may impose penalties on firms who did it in the past

The fourth potential gain

CSR is a signal on corporate reputation and product quality under asymmetric information

Minor (2009) shows on a sample of 184 events that product recall generate significantly less negative abnormal returns (3 percent gain) for firms with higher social rating. The rationale is that recalls are more likely to be interpreted as accident not depending on corporate negligence (and with lower consequences on future unobserved product quality)

Considering the median market value of sample firms (23 billions) the net CSR gain per event is 600 million dollars

The fifth potential gain

- Environmental responsibility may lead to substantial profits when it:
 - i) anticipate future restrictive environmental regulation;
 - ii) triggers innovation in terms of energy saving processes



What do we know about the CSR-performance nexus (1)

- ❖ **Positive link:** i) employee morale and productivity more than compensate costs (Soloman and Hansen, 1985); ii) CSR and financial performance (Pava and Krausz, 1996 and Preston and O'Bannon, 1997); iii) corporate performance and good stakeholders relationships (Stanwick and Stanwick, 1998; Verschoor, 1998); iv) CSR and growth in sales and returns on sales (Ruf et al., 2001).
- ❖ On the **negative side**, we have contributions of Preston and O'Bannon (1997) Freedman and Jaggi (1982), Ingram and Frazier (1983) and Waddock and Graves (1997).
- ❖ **No directions** results are those of McWilliams and Siegel (2001) Anderson and Frankle (1980), Freedman and Jaggi (1986) and Aupperle, Carroll and Hatfield (1985).
- ❖ Most of these studies **do not take into account** the *endogeneity* and *stationarity* of the time series and panel data.

What do we know about the CSR-performance nexus (2)

- ❖ A more recent paper, Barnea and Rubin (2005) refines the empirical methodology and show that the decision to invest in CSR is negatively related to insiders' ownership. CSR is good for shareholders' value up to a given level, but insiders may have an interest to overinvest in it to improve their reputation and they are more likely to do so when their ownership share is lower.
- ❖ Recent papers highlight the increasing diffusion of ethically managed funds and provide theoretical framework and empirical analyses of their relative performance.
- ❖ Bauer, Koedijk and Otten (2002) on active strategies of ethical and traditional investment funds.
- ❖ Geczy, Stambaugh and Levin (2003) calculate the cost of imposing socially responsible investment constraints in terms of risk adjusted returns.
- ❖ Low CSR firms pay 8-18 basis points more from banks (Goss and Roberts, 2011)
- ❖ Nofsinger and Varsma (2011) CSR reduces downside risk. It is therefore preferred by investors who are loss averse (willing to give up some upside performance to reduce downside losses)

Our research...what did we learned

- Becchetti L.,Ciciretti R., Giovannelli A., 2013, Corporate Social Responsibility and earnings forecasting unbiasedness, *Journal of Banking and Finance*, [Vol. 37, \(9\)](#), pp. 3654-3668.
- Becchetti L. Ciciretti N. Kobeissi R. Hasan I., (2012) 2009, Corporate Social Responsibility and Shareholder's Value *Journal of Business Research*, vol.65 (11), pages 1628-1635,
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- Becchetti L. Ciciretti R. Hasan I., 2015, Corporate Social Responsibility, Stakeholder Risk, and Idiosyncratic Volatility, *Journal of Corporate Finance*,[Vol. 35](#), pp. 297-309
- Becchetti L., Ciciretti R., Dalo, A., 2018, Fishing the Corporate Social Responsibility Risk Factors, *Journal of Financial Stability*, Vol. 37, pp. 25-48,

Ethical versus conventional investment fund performance

Becchetti, Ciciretti, Dalò, Herzel "Socially Responsible and Conventional Investment Funds: Performance Comparison and the Global Financial Crisis", in Applied Economics, 2015

We investigate the performance of Socially Responsible Funds (SRFs) and Conventional Funds (CFs) in different market (geographical area and class size) segments during the 1992-2012 period.

From an unbalanced sample of more than 22,000 funds, we define a matched sample using a beta-distance measure to match any SRF with the “nearest neighbor” CF in terms of sensitivity to risk factors.

Using this matching approach and a recursive analysis, we identify several switch points in the lead/lag relationship between the two investment styles over time in different market segments.

A relevant finding of our analysis is that SRFs played an “insurance role” outperforming CFs during the 2007 global financial crisis.

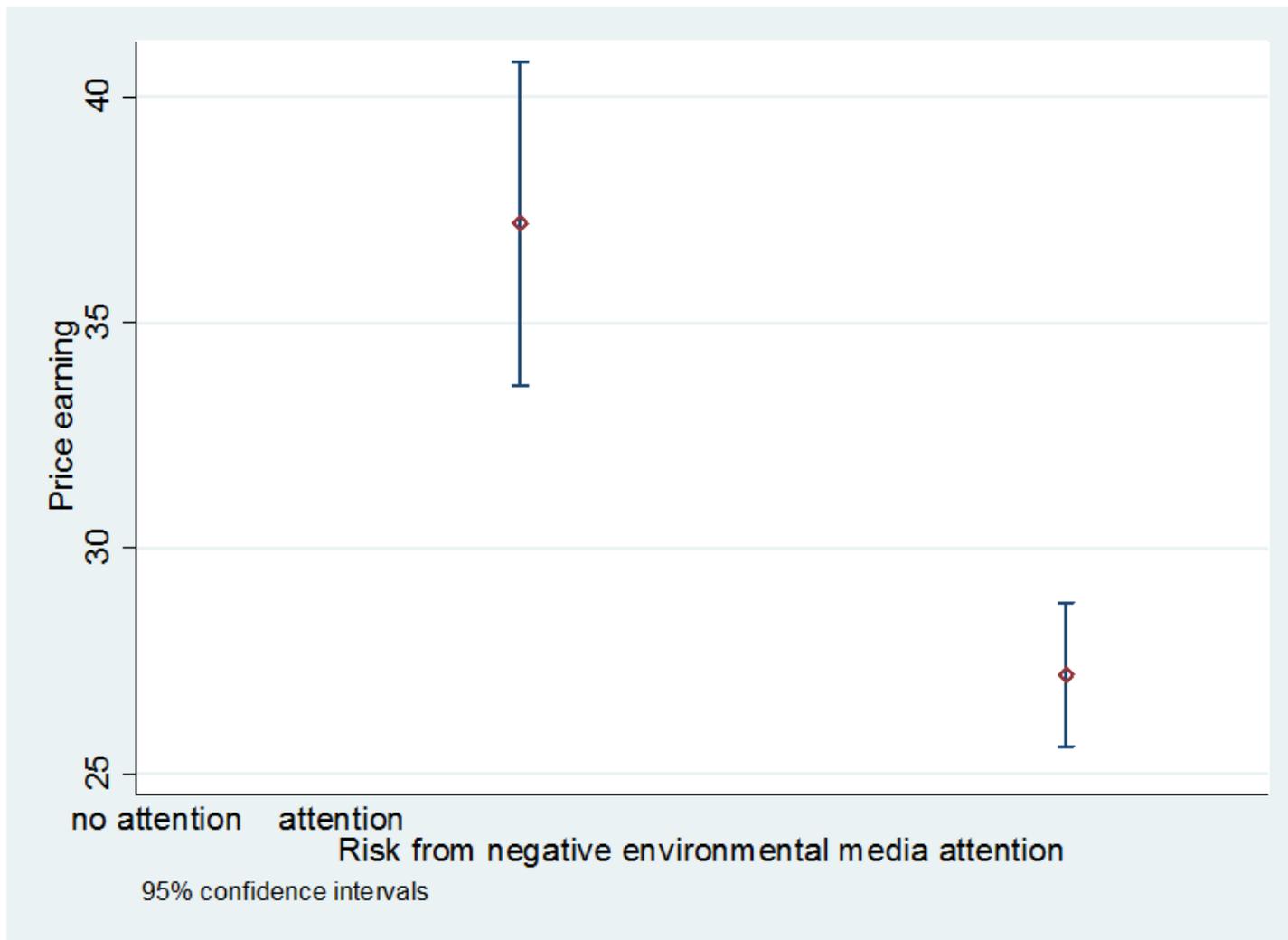
There is no significant systematic difference in performance between responsible and conventional funds...observed differences are random and depends on the ability of fund manager



The birth of reputational risk indexes

- RepRisk is the main provider of information on corporate reputational risk for financial intermediaries, insurance providers and institutions. The data are provided through the Wharton Research Data Services (WRDS) and are used in the construction of the Dow Jones Sustainability Index (DJSI), the Carbon Disclosure Project (CDP) and by FTSE Russell when reviewing and selecting companies for the FTSE4Good Index Series.
- RepRisk daily screens with a sophisticated algorithm not only the traditional media such as international and local newspapers, but also those social medias that are becoming increasingly relevant in more recent times such as online news and news-wires, blogs, social media and the world wide web, going through over 80,000 media and stakeholder sources every day in 15 different languages
- The reputational “RepRisk” Index (from now on “RRI”) focuses on company’s exposure to business conduct risks related to the environmental, social and governance (ESG) corporate social responsibility domains

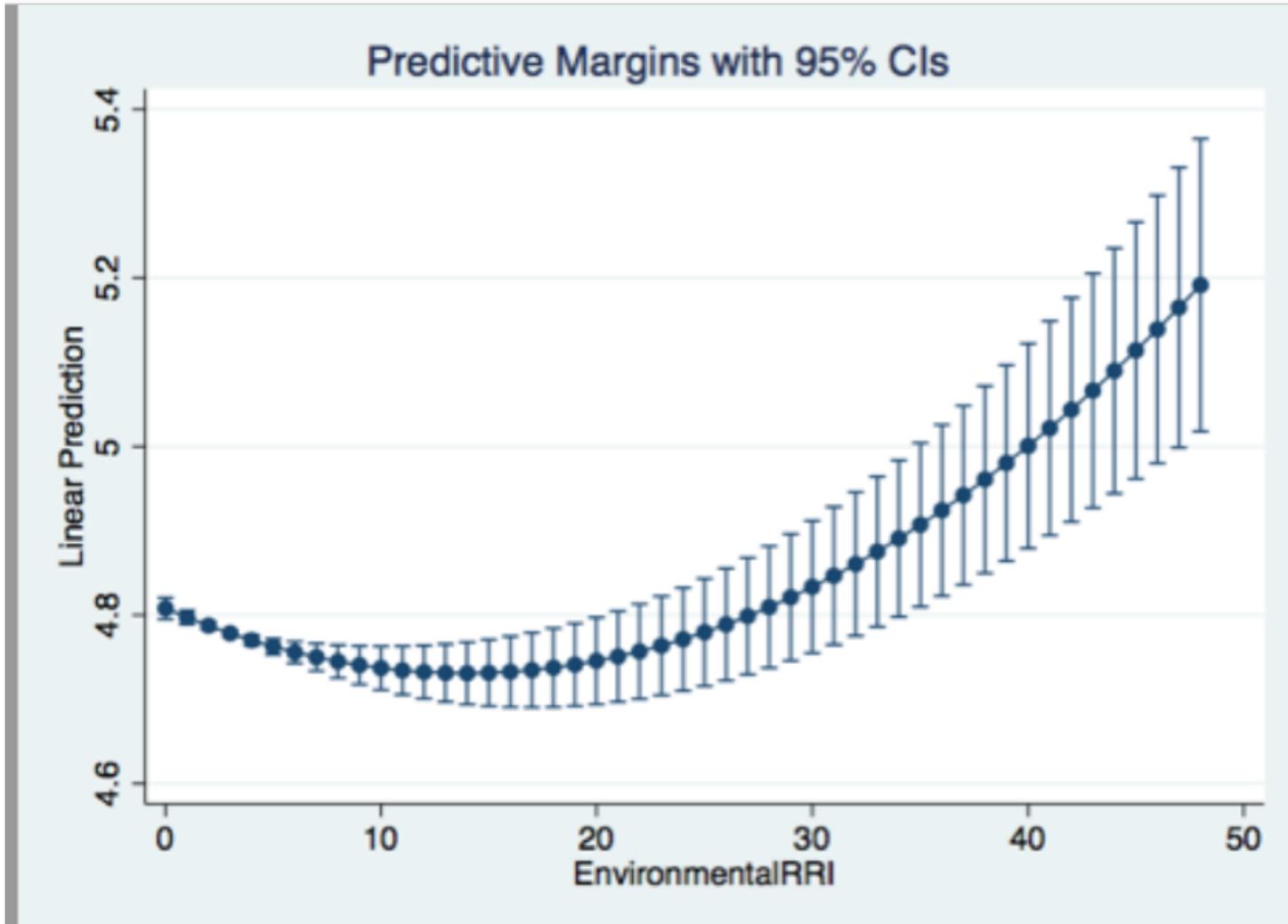
Price/earnings and environmental reputation



Becchetti, Hasan, Manfredonia (2019)

Legend: average price-earning ratio for the 2007-2016 period with monthly data for companies with zero environmental RepRisk indicator (on the left) and with top 20% environmental RepRisk indicator (on the right)
26700 observations

Cost of loans and environmental reputation



We analyze the effect of CSR (corporate social responsibility) related negative media attention on loan contracting.

We find a positive and significant effect on the all-in spread undrawn, on the all-in spread drawn and on their ratio. The effect is stronger in countries with higher attention to CSR.

Our findings support the hypothesis that lenders charge higher costs on loans and on the option to drawdown credit lines on borrowers with higher negative media attention on CSR, anticipating that they are more exposed to stakeholder risk.

Media disclosure of negative Corporate Social Responsibility news and bank loan contracting

- Leonardo Becchetti
- *University of Rome Tor Vergata and SOAS University of London*
-
- Iftexhar Hasan
- *Fordham University, Bank of Finland and University of Sydney*
-
- Stefano Manfredonia
- *University of Rome Tor Vergata*

We investigate the effects of (traditional and new social) media disclosure of negative “Corporate Social Responsibility” (CSR) news on firm debt contracting.

We find that negative media attention has a significant and positive effect on bank loan costs.

The effect is smaller in presence of prior lending relationships between the lead arranger and the borrower, while stronger if misconducts concern borrowers with prior signals of high CSR reputation (such as the signature of the United Nation Global Compact).

Our findings support the hypothesis that lenders charge higher costs on loans to borrowers with higher negative media attention on CSR, anticipating that they are more exposed to stakeholder risk.

Future directions of research

- Development of the fiscal responsibility domain
- The difference between impact of pure expert based indexes (KLD MSCI) and hybrid expert evaluated media reputation indexes (Reprisk)



*«ogni persona
ha
un'obbligazione
naturale e
insita di
studiarsi a
procacciare la
propria felicità»
Antonio
Genovesi*

FELICITÀ, BENESSERE E BENE COMUNE

World Happiness Report

7 fattori spiegano 75% delle differenze di felicità

- Reddito
- Salute
- Istruzione
- Libertà di iniziativa
- Assenza di corruzione
- Qualità vita relazioni
- Gratuità

- Fatigate per il vostro interesse, niuno uomo potrebbe operare altrimenti, che per la sua felicità sarebbe un uomo meno uomo: ma non vogliate fare l'altrui miseria, e se potete e quando potete studiatevi di far gli altri felici. Quanto più si opera per interesse, tanto più, purchè non si sia pazzi, si debb'esser virtuosi. È legge dell'universo che non si può far la nostra felicità senza far quella degli altri"" (Genovesi, *Autobiografia e lettere*, p. 449)
- *Sono felici solamente quelli che si pongono obietti diversi dalla loro felicità personale: cioè la felicità degli altri, il progresso dell'umanità, perfino qualche arte, o occupazione perseguiti non come mezzi, ma come fini ideali in se stessi. Aspirando in tal modo a qualche altra cosa, trovano la felicità lungo la strada."* (John Stuart Mill).

Cosa vuol dire
welfare
generativo ?

La risposta finale alla ricerca di senso è la
generatività (desiderare, far nascere,
accompagnare, lasciar andare)

Generatività Biologica: mettere al mondo figli

Generatività parentale: partecipazione a crescita ed educazione figli

Generatività sociale: lavorare per costruire capitale sociale e il tessuto della società civile

Generatività politica: lavorare per costruire soluzioni per il paese

Generatività nell'economia civile: favorire una creazione di valore economico socialmente ed economicamente sostenibile

Generatività culturale: lavorare per produrre idee guida che possano favorire la generatività

Generatività spirituale: aiutare le persone nella ricerca di senso, nel percorso di fede e nella connessione con la dimensione dell'Assoluto



	Vecchio paradigma	Paradigma economia civile
Individui	Massimizzatori di utilità	Cercatori di senso
	Miopemente autointeressati, idioti sociali, incapaci di risolvere dilemmi sociali generando superadditività	Abbinano preferenze sociali ad autointeresse, capaci di risolvere dilemmi sociali generando superadditività
Imprese	Massimizzatrici di profitto	Creatrici di valore aggiunto per gli stakeholders
	Povere nella produzione di senso e di impatto sociale	Ricche nella produzione di senso e di impatto sociale
Valore	PII	BES o stock beni spirituali, relazionali, economici, ambientali di cui una comunità può godere su un territorio

	Vecchio paradigma	Paradigma economia civile
Dinamica della politica economica	A due mani: mercato e stato risolvono i divari tra risultato sociale migliore possibile e risultato senza intervento	A quattro mani: cittadini attivi e imprese responsabili coadiuvano stato e mercato nel colmare i divari tra risultato sociale migliore possibile e risultato senza intervento
Fine della politica economica	Colmare divari su variabili oggettive (PIL, occupazione)	Colmare gap di generatività e povertà di senso (tra risultato sociale migliore possibile e risultato senza intervento) creando le condizioni migliori per il raggiungimento dell'ottimo (concetto che coincide con quello di bene comune)
Generatività della politica economica	Scarsa xchè tutto demandato a pianificatori benevolenti. Cittadini e imprese non partecipano e dunque non hanno occasioni di generatività	Piena xchè offre occasioni di ricchezza di senso e di generatività a cittadini e imprese

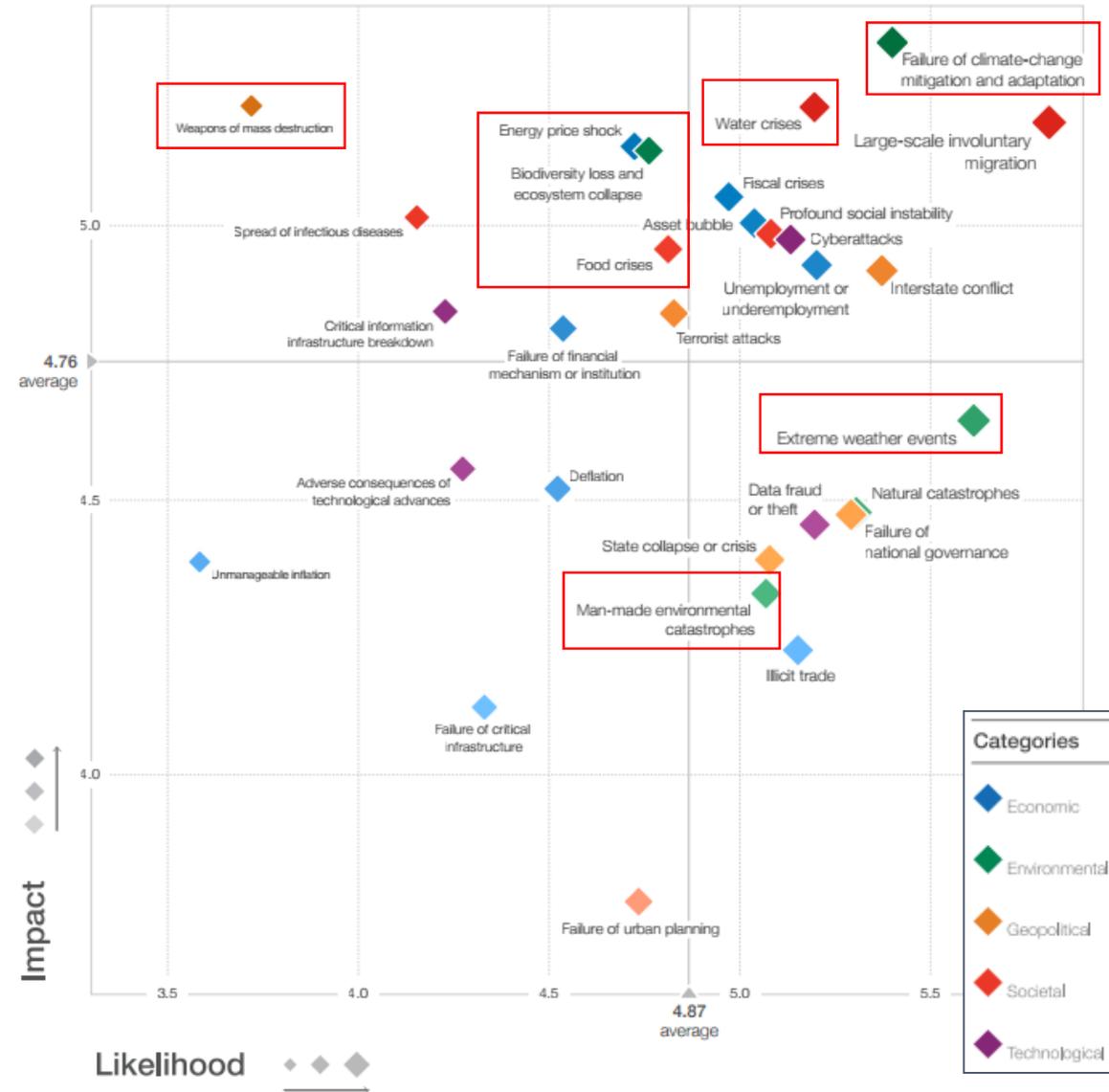
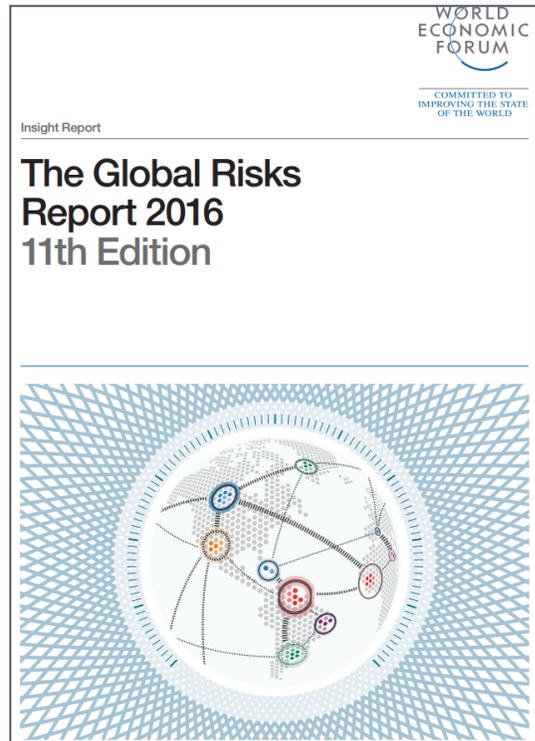
2. Pionieri

- Da 18 anni nel mercato SRI
- Disponiamo di un **ruolo da protagonista nel mercato italiano dell'SRI** → 24%*
- **Pionieri** nell'attività di azionariato attivo → da sempre, partecipiamo fisicamente alle assemblee italiane
- Antesignani sul tema → ciò che oggi tutti dicono, **noi lo diciamo da anni**



I rischi ESG diventano sempre più rilevanti

Molti dei rischi emergenti e considerati rilevanti dalla comunità economica internazionale sono legati al tema della sostenibilità ambientale



Larry Fink «A sense of purpose»..

Lettera del CEO di BlackRock alle maggiori multinazionali del mondo

- *Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders.*
- *It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth.*
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- *And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.*