# The Rise of Socially Responsible Investing in the US

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On my honor as a University student, I have neither given nor received unauthorized aid on this assignment as defined by the Honor Guidelines for Thesis-Related Assignments.

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**The Rise of Socially Responsible Investing in the US**

Is there such a thing as “ethical investing”? In early biblical times, Jewish law laid down principles for ethical management of public funds (Meir, 2012). Milton Friedman famously argued that the sole responsibility of any business is to return value to its shareholders and that social responsibilities lie with citizens and their elected representatives (Friedman, 1970). The recent proliferation of socially responsible investing (SRI) principles and environment, social justice and governance (ESG) policies indicates, however, that many businesses claim extensive responsibilities apart from profit. According to Gallup polls, nearly half of surveyed US investors were interested in ESG-related investing, and 70 percent of employed respondents say they would include sustainable investing funds in their 401(k) if given the option (Saad, 2022). Interest in ESG is also high among companies. One of the largest worldwide investment management firms finds that desires to meet investor needs and wants, to do good in the world, and to improve financial performance were the biggest reasons for adopting ESG policies (Capital Group, 2022). The World Bank reported that the US had the largest market capitalization worldwide in 2020, when American companies’ shares were collectively valued at $44 trillion (World Bank, 2023). Given investors’ interest in SRI, participants in the world’s largest domestic market have had to integrate ESG into their strategies while ensuring that their actions at least appear to be consistent with their values. How has the American investment sector shaped the standards for ESG and SRI to suit its needs and ideals?

To some, investment is a way to make money. If a company of interest conducts itself legally, then its present and anticipated profitability is therefore the only investment consideration, and other values such as social impact are a distraction. However, increasing proportions of both the investment sector and the public say that companies have duties to global

society and the environment (Saad, 2022). Among SRI investors, common goals include mitigating climate change and its effects, and reducing material and economic inequalities on a local or global scale. ESG and SRI have widespread effects both within and outside the investment sector. These impacts can include the public perception of investors, companies, and the investment sector, and many say ESG and SRI can also have positive economic impacts. While critics of SRI fault it for misdefining a corporation's responsibilities to include ESG, defenders argue that adopting these values benefits companies, investors, and the public alike. Because ESG ideas have proliferated in business, many investors have adopted SRI standards; in turn, SRI standards promote the adoption of corporate ESG policies. Investors who shun at least the appearance of SRI risk being left behind. Whether investors who espouse SRI do so from principled conviction or from pragmatic calculation is therefore impossible to determine.

**Review of Research**

There has been extensive research into ESG, SRI and ethical investing. For example, Monahan (2002) concluded that SRI represents a contrast in a field dominated by the avoidance of ethics in pursuit of profit. According to Monahan, prudent investors are principled egoists who are governed by self-interest but who recognize that their interests are not isolated from others' interests. Wallace (2019) contends that companies have responsibilities apart from profit maximization, and that socially responsible funds repay investors and society. He traces SRI to the "moral capitalism" of the 19th century and considers the ESG landscape from political, economic, and other social points of view. Waddock and Graves (1997) found that ESG initiatives cause companies no harm and argued that a company's social performance and its financial performance reinforce each other. They admit that companies can benefit from a mere

appearance of commitment to social values, with little or no actual commitment. While these studies go into great depth about SRI and its place in the modern US investment sector, none of them directly address how or why ESG and SRI have become as prominent as they are.

There has also been a lot of research about the "true" meaning of SRI. Sandberg et al. (2009) say that there are many differing understandings of SRI, and that ideological differences, stakeholder values and market forces cause each company and investor to develop their own definition for SRI. Mackenzie and Lewis (1999) contend that while most investors have ethical concerns, not many are prepared to sacrifice financial requirements to address them. Berry and Yeung (2013) argue that investors can be classified based on their attitude towards responsible investing. For each group, they recommend investment approaches that best suit those investors' and the sector's desire for SRI. Puaschunder (2016) says that SRI has the potential to avert economic market downfalls, and that it has flourished in the eye of socio-economic deficiencies. She also proposes that socially responsible funds are more crisis-stable, and that they are less volatile to cyclic changes in the market. Kitzmueller and Shimshack (2012) contend that economic costs and benefits of Corporate Social Responsibility (CSR) remain largely unknown.

**ESG and SRI contribute positively to economic indicators**

Participation in SRI has a positive impact on a company's economic indicators in multiple ways. According to McKinsey, a global management consulting firm, a sound ESG proposition is remunerative, yielding returns in equity and risk reduction (Henisz et al., 2019). It argues that disregard of non-investor stakeholders is "the essence of short-termism, and measurably and overwhelmingly harmful to most shareholders' economic interests." The report takes the example of sports retailer Dick's Sporting Goods whose 2018 decision to restrict gun

sales reduced its revenue by 2%, but the company's stock climbed 14% because the company "remained stubbornly committed to its sense of purpose," and therefore retained investor interest. While this example does not directly prove that ESG and SRI are beneficial to performance, it points out that there are factors beyond raw economic performance that impact investor interest, and therefore stock price. The leaders of companies already recognize this. in 2019, Larry Fink, the CEO of global asset management firm BlackRock, wrote in his annual letter to CEOs that a company's purpose is "not the sole pursuit of profits but the animating force for achieving them" (Fink, 2019). He says that profits and purpose are inextricably linked because profits are essential for any company to serve all its stakeholders, and sustained long-term profitability can only be achieved when a company "truly understands and expresses its purpose." In terms of ESG, a company's "purpose" manifests itself in corporate governance, so companies with strong corporate governance metrics might have stronger financial performances.

Adoption of ESG and SRI policies can also lead to other changes within a company that enhance its financial performance. Mazyar Mortazavi is the CEO of TAS, an "unconventional impact company that uses real estate as a tool to drive profit and purpose" (TAS, 2023). In a 2023 article, he recognizes that ESG is "not easy to implement from an operational or financial point of view," and that the process "must be seen as an iterative one, where incremental wins help motivate progress." To achieve this, company leaders must "approach this through a lens of innovation, recognizing that teams need to be motivated." He also argues that companies committing to ESG are inherently "setting a culture of transparency," and that this creates trust within and outside the company. ESG policies can also indirectly reduce costs. A panel from KPMG, a global consultancy, spoke at the World Economic Forum's 2022 annual meeting, noting that ESG-friendly businesses, such as those that have reduced their energy consumption,

are less affected by volatile prices for energy and fossil fuels. They liken ESG investing to a "lever for delivering value in a volatile world" (Bernau, Botha & Mincey, 2022). They also underline the need for transparency in the reporting process, noting that "it can be hard to distinguish between those companies that genuinely embrace sustainability and those that are merely greenwashing." It appears that although pretending to participate in SRI is enough to generate positive impacts, properly implementing ESG policies can have positive impacts way beyond the company's economic performance or reputation.

**Who should make decisions about social impact?**

Business decisions made by companies, especially large companies, may have negative social and environmental impacts. There is disagreement within the investment sector about who should be responsible for offsetting these negative impacts.

Many believe that decisions about which social causes to support must be made strictly at the individual level. Therefore, for an individual to truly have a choice, their investment choices must not dictate their social impact. The Heritage Foundation, a conservative think tank, dismisses ESG as "woke virtue-signaling" (Tyrrell, 2021). It argues that ESG standards compromise individuals' right to support or oppose social causes as they prefer. It also contends that ESG is an example of "overstepping bounds and expanding the political realm into the farthest reaches of society." The State Financial Officers Foundation (SFOF) is a nonprofit consisting of financial officers from US state and federal governments whose aim is to drive fiscally sound public policy from an "unapologetically free-market perspective." When the Standard & Poor (S&P) global rating firm began publishing ESG indicators as part of its state credit reports, members of the SFOF wrote to S&P on behalf of multiple states arguing that S&P

was attempting to overlook sound financial management in favor of political priorities, and that this was “inconsistent with the fundamentals of sound financial planning and evaluation” (Little et al., 2022). By including a politically charged indicator that (according to the SFOF) was completely independent of financial performance, S&P was attempting to trick investors.

Another group believes that companies are responsible for social justice, and that each company must hold itself to a high moral standard and act accordingly. Amazon Employees for Climate Justice, a coalition of Amazon employees who are fighting for the company to take up more social and climate justice initiatives, wrote an open letter to founder Jeff Bezos stating that “in our mission to become ‘Earth’s most customer-centric company,’ we believe our climate impact must be a top consideration in everything we do” (AECJ, 2019). They say that Amazon “has the resources and scale to spark the world’s imagination and redefine what is possible and necessary to address the climate crisis,” and that Amazon’s leadership must take climate action to fulfill the company’s core value of customer obsession. A survey conducted by PriceWaterhouseCoopers, a global accounting firm, found that 83% of surveyed global consumers thought that companies should be “actively shaping ESG best practices,” and 86% of employees prefer to work for companies that “care about the same issues they do” (PwC, 2021).

Yet another group contends that social and climate justice is a collective issue, and must be dealt with at the regional, national, or even international level. The Insured Retirement Institute (IRI), which represents the retirement income industry, commended the non-enforcement of a 2020 rule that would have greatly limited ESG-focused investing by portraying firms that include ESG factors in financial evaluations as “at risk” (IRI, 2021). On its end, the U.S. Securities and Exchange Commission (SEC) has begun to develop ESG standards, proposing regulation of disclosures and ensuring transparency (SEC, 2022). If implemented, the

standards would require funds claiming to achieve an ESG impact to specify their goals and to evaluate the results. In a letter to the SEC, the Securities Industry and Financial Markets Association (SIFMA), a coalition of investment banks and asset managers, commended the SEC's focus on "ensuring funds and managers provide adequate disclosures to support their claims about the role of ESG factors in their investment decisions" (Keljo, 2022). The letter supported the SEC's decision to refrain from defining ESG, stating that "ESG investing is rapidly evolving, and a prescriptive definition of ESG may limit market innovation and lead to a mismatch between regulatory definitions and investor expectations." Supporters of government oversight over ESG feel that by letting the people (through the government) lay out expectations for ESG and SRI, companies can satisfy their social responsibilities by simply adhering to those guidelines. This is similar to the approach suggested in Friedman's famous 1970 article, where he argues that a corporation engaging in social responsibility is simply "spending his stockholders, customers' or employees' money" (Friedman, 1970). Social responsibility is something that benefits the people, so the people should decide how to go about it.

**Public perception of ESG and SRI; Reputation has a value**

Companies often place a high value on their reputation because it often has a direct impact on their financial performance. Since ESG and SRI can have social impacts, and because most companies publish periodic ESG reports, a company's ESG impact has become deeply tied with its reputation. Federated Hermes, a Pittsburgh-based investment management firm, argues that the rise of ESG investing has "further increased the impact of reputation on firms' value by increasing the importance of corporate sustainability," and warns that failing to implement a good sustainability strategy will "not only prevent a firm from optimizing long-term value but

can also destroy value, by damaging reputation, supplier and investor relations, staff motivation and retention and customer trust" (Federated Hermes, 2021). They point out that traditional risk management strategies are not adequate to manage reputational risk in the 21st century because companies have significantly less control over their public perceptions thanks to the rise of social media, and that companies need to "mitigate reputational risk by incorporating its possible effects into key business decisions." Tunheim, a public relations firm, asserts that ESG frameworks are "creating effective ways to develop and distinguish one brand from another in terms of commitments to sustainability," and that the public, especially Millennials and Gen Z, want to do business with "good" companies (Tunheim, 2023). They note that ESG can be a "fantastic opportunity for brands to truly distinguish themselves," but that brands must be ready to prove that their actions are consistent with their values. The public cares about companies' ESG impact now more than ever, and companies would be causing themselves harm if they do not prove that they are "good."

Participating in SRI certainly has a positive effect on a company's reputation, but its real-world impact remains unclear. The fact that there is no single definition for ESG and no common set of guidelines to abide by means that even if a company publishes ESG reports, it can be hard to deduce the results of its ESG actions. The Bank of New York Mellon (BNY Mellon), an investment bank, mentions that anxiety about greenwashing, a practice where a company's claims to be environmentally friendly do not reflect reality, is high because companies can "cherry-pick impacts to show only what is good" (Smith, 2020). They note that opinions of rating firms and data vendors can vary widely, leading to inconsistent ratings that are hard to interpret. The article also mentions concerns about the longevity of ESG, and states that the entire ESG movement risks becoming a "momentary marketing fad" without universal ESG

standards. An article in The Hill by the founder of a financial consultancy echoed these thoughts, saying that “there are the practical difficulties in determining what constitutes a high-scoring ESG company” (Shinder, 2021). The article also mentions the “the internal tension among the E, S and G” and talks about each of those individual factors, especially governance, are slippery slopes in themselves. The CEO of asset management firm Candriam stated at the 2023 World Economic Forum Annual Meeting that “Outdated interpretations of what is materially important in relation to an investment manager’s fiduciary duty have further obscured the purpose of ESG,” and that “too many people now attach heavy baggage to their expectations of the ESG acronym, blurring its practical function in business and investment” (Abou-Jaoudé, 2023). In the craze for socially sustainable investment, the lack of consensus has led to confusion and misunderstanding. Combined with anti-ESG sentiments from companies involved in “unsustainable” areas such as fossil fuel and the politicization of climate change in the US, this has led to doubts being cast on the usefulness of ESG.

While participating in ESG and SRI is beneficial to companies’ reputations, they must continue to ensure that their sustainability efforts do not detract from their bottom lines. When Emmanuel Faber was appointed as CEO of global food megacorporation Danone, he set out to create an “enterprise à mission” (Walt, 2021), a company whose purpose was “far broader than profits and growth.” Faber joined the B Corp movement in 2019, whose aim is to “mobilize the … community towards collective action to address society's critical challenges” (B Lab, 2023). In 2019, Danone began reporting its earnings per share after adjusting for carbon emissions, the first company to do so worldwide (Handley & Meredith, 2020). In his interview with journalist Vivienne Walt, Faber said he was “putting our money where our mouth was,” and that Danone had fulfilled its goal of maintaining growth but reducing carbon emissions six years earlier than

planned. However, Danone's market performance could not keep up with its rivals Unilever and Nestlé. This lag in performance was exacerbated by the pandemic, and Faber was removed from his position by Danone's shareholders. While Faber had made Danone into one of the world's most sustainable megacorporations, he had failed to sufficiently reward stakeholders, causing them to lose interest even though the public held Danone in high regard. Faber said in his interview that "ESG has been sort of an easy path for CEOs and boards that wanted to look good," and that he thinks the greenwashing, a practice where a company's sustainability efforts are exaggerated in order to persuade the public, is "penalizing the people that are doing the real stuff, because they can't prove that" (Walt, 2021).

**Conclusion**

Given the modern public's interest in social impact and climate change, it is unsurprising that ESG and SRI are very popular in the investment sector today, to the extent that those who do not say they practice SRI are in danger of falling behind. Companies and investors may have adopted ESG policies because of investor pressure, government regulation or several other reasons, including the fear of falling behind. While doubts about the efficacy of ESG and debates regarding its necessity remain widespread, it has made companies conscious of their public images. In many ways, ESG and SRI represent the application of the 21st century values of public accountability, climate consciousness and social justice onto the centuries-old yet constantly evolving investment sector. Given this, the decades-old debate about whether companies have a purpose besides profit warrants a reexamination through a modern lens. ESG appears to be here to stay, regardless of its believers or its effects.

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