2008 Russell Ackoff Fellowship application

Applicant:

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Title of project:

Explaining socially responsible investing: Toward a unifying framework of the investment decision process
Overview of the research project

Over the past two decades the phenomenon of socially responsible investing (SRI), i.e. the inclusion of social criteria in the selection of investments (Sparkes & Cowton, 2004), has increasingly become a topic of interest for academics and participants in the marketplace (Social Investment Forum, 2006). Despite this interest the understanding of the motives, psychology and decision-making of socially responsible investors is incomplete and largely limited to descriptive accounts (Anand & Cowton, 1992; Cullis, Lewis, & Winnett, 1992; Lewis & Mackenzie, 2000a, b; Mackenzie & Lewis, 1999; Rosen, Sandler, & Shani, 1991) or studies comparing the characteristics of investors who invest in SRI and those that do not (Lewis, 2001; McLachlan & Gardner, 2004; Tippet & Leung, 2001). To date there is only a scantily developed theoretical basis for understanding SRI and little knowledge about the individual and contextual variables that predict an investor's decision. Currently only a couple of studies have developed and tested hypotheses about investor behavior (McLachlan et al., 2004; Webley, Lewis, & Mackenzie, 2001). Thus the question of “why do some investors practice SRI and others don’t?” is still largely unanswered.

Many of the current economics- and finance-based evaluations of SR investor behavior are portraying the decision to apply social criteria to investment choices as irrational behavior that lacks economic foundations and is not efficacious (Boatright, 1999; Haigh & Hazelton, 2004; Hudson, 2005; Schepers & Sethi, 2003; Statman, 2000). However, this traditional perspective of the individual in the marketplace – the homo economicus – has been found to be insufficient to understand the behaviors seen among market participants (Etzioni, 1988). Therefore, this research will apply a social psychological perspective in the examination of SRI.

The main aim of this research is to develop and test a unifying framework of the decision process behind SRI. The most suitable theoretical background for this work is therefore the literature on judgment and decision-making, which describes two main cognitive mechanisms that are part of decision-making tasks (Pitz & Sachs, 1984). The first step in the decision process is the activation of a decision frame or schema for understanding the decision situation (Johnson-Laird, 1981). The second step is the integration of the various outcomes associated with a decision and the decision maker’s preferences (Pitz et al., 1984). These two stages will structure the development of the decision model behind SR investment choices.

Since the type of decision frame applied to a decision situation affects the decision outcome (see for example Cellar & Barrett, 1987; Lord, Foti, & DeVader, 1984; Lord & Kernan, 1987; Walsh, 1995), the decision frames that investors are applying to the investment situation are a central variable in the decision model. The themes reflected in the SRI and investing literature point to two general cognitive frames investors have of the investment decision. In the first frame investing is a type of decision that is functional in nature and mainly contains financial knowledge elements, which Lewis for example has called “normal” (Lewis, 2001, pg. 332). In the second frame investing is an expressive decision that extends the investor’s identity and social beliefs into the investment choice. For example, one investor in Lewis’ focus-group study said that investing “[…] is part of me and therefore it should follow the same sort of principles that I want to in the rest of my life.” (Lewis, 2001, pg. 337) This type of mental model is
similar to ones described in the ethical consumerism and symbolic consumption literature (see for example Grubb & Grathwohl, 1967; Hogg & Michell, 1996; Kleine, Kleine, & Kernan, 1993; McCracken, 1988).

Furthermore, decision frames influence how information about a decision situation is processed and evaluated (Walsh, 1995, pg. 281). Therefore the decision model will consider the effect decision frames have on the way investors make the trade-offs between the various outcomes associated with their decision options. In addition to the two basic elements described above, the model will also include other individual and contextual variables that interact with or present boundary conditions for the decision process (Figure 1 in the appendix depicts the decision model).

Of particular interest in this analysis is the connection between an investor’s expectations and beliefs about acceptable corporate conduct and her investment decision. According to agency theory, management has a fiduciary duty to act in the best interest of the owners of the corporation, which is commonly assumed to be the maximization of profit or shareholder value. The SRI phenomenon has demonstrated that some investors not only care about the return that their investments generate but also how these returns are generated. In other words, “acting in the best interest” of the SR shareholders would mean having to broaden the fiduciary mandate beyond profit-maximization. However, only ten percent of investors engage in SRI. One could therefore argue that only these ten percent of investors care about the way companies conduct themselves in society but the majority of regular investors do not (since they do not act on these beliefs). This conclusion is inconsistent with findings from surveys of consumers that show significantly more widespread concerns about proper corporate conduct than is reflected in consumers’ purchasing behavior. It is therefore important to establish to what extent expectations about corporate conduct influence the decision of investors in order to move the discussion beyond the increasingly inadequate notion of profit maximization.

The empirical test of the SRI decision model will draw on data from a large-scale field survey of investors from the StudyResponse subject pool assembled by the University of Syracuse. This survey will assess the decision frame that investors actually use and how these frames interact with the other individual and contextual variables in the decision process to provide a picture of the decision process structure. In pre-tests several instruments have been developed to measure the variables in the model. A decision frame scale will assess which decision frame investors use, an identity scale will assess whether investing affects the investor’s self-image, and a CSR expectation scale will assess how high the investors expectations are about corporate social responsibility. Structural Equation Modeling will be sued to analyze the survey data.

Name of supporting faculty member:

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Figure 1: The social cognition investment decision model
Appendix 2

References


