Considerations Regarding the Social Responsibility of Stock Market’s Actors

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Abstract

The social responsibility is a new concept that guides the activity of transnational corporations, small and medium enterprises, but also shapes the behavior of portfolio investors and stock exchanges. In this article, we analyzed the activity of stock market’s actors in order to promote social responsibility and sustainable development principles and their role in the outbreak of international financial crisis.

Key words: social responsibility, exchanges, portfolio investors

JEL Classification: D21, G11

Introduction

Increasing economic and social interdependence, at national and international level, between economic agents is causing numerous effects or influence over others generically called externalities, which can be positive or negative. Because corporations generate social and environmental problems, increasing unemployment due to more efficient use of technology, labor migration, depopulation and overpopulation of some areas, environmental pollution, use of non-renewable resources, many corporations promote certain social actions to compensate for these shortcomings created to the detriment of the society, local community and the environment.

Stakeholders like consumers, supplies or financial market actors track social involvement of companies: banks, shareholders and potential investors. Thus, banks are assessing companies seeking loans in terms of criteria for corporate social responsibilities. More and more portfolio investors have become socially responsible and their securities are selected on the basis of social, environmental and governance aspects. In some countries, even public authorities encourage capital market’s players to become socially responsible through various legal provisions such as the obligation to publish certain information on their social involvement (Britain, France etc.). In addition, the concept of social responsibility is promoted, in various ways, by stock exchanges.
**Dimensions of Social Responsibility of Stock Exchanges**

The exchanges play an important role in the economy, providing mobilization of financial resources, concentration in time and space of demand and supply of goods or financial assets, formation of fair prices through the confrontation of supply and demand, providing comprehensive information needed by economic agents.

The activity of exchanges has evolved over time, but in the last 50 years, we have witnessed major changes in the organization and functioning of commodity and stock exchange in the world. Strong competition between banking and stock market, fierce competition between exchanges led to the intensification of financial innovation that resulted in the emergence and development of new products such as exchange-traded derivative contracts on weather, ETFs and sophisticated financial assets, difficult to assess which ultimately proved toxic, as they have contributed to the destabilization of international financial system and even the world economy.

The business strategy of exchanges has changed and with it the form of their organization. Thus, we assist at the demutualization of stock exchanges, which change from non-profit associations established by brokers, to joint stock companies that aim to get profit. The transformation into joint stock companies has many consequences such as autolisting of their own actions. This process of demutualization is accompanied by increased international mergers and acquisitions, which results in the set up of large transnational companies or groups such as New York Stock Exchange - Euronext and Chicago Mercantile Exchange Group (created by the merger of Chicago Mercantile Exchange and Chicago Board of Trade).

As corporations, stock exchanges have thus a social responsibility to the environment in which they operate. However, taking in account the organization of the stock exchange’s activity and self-regulatory power, stock exchanges have an important role in promoting corporate social responsibility (CSR) among listed companies and portfolio investors aware of their social involvement. The demutualization can be an impediment to promoting ESG (environment, social and governance) criteria by stock exchanges to listed companies, given the need to maximize profits and to efficiently use the available financial resources.

In addition, the development of information and communication technology and globalization can lead to an intensification of competition between exchanges in attracting companies to be listed, but also a reconfiguration of the sources of financing used by companies. The imposition of strict sustainable practices by a stock exchange can cause a company to focus on another stock exchange, to give up an initial public offering (IPO) and become a closed (private) company, or to use other sources of funding, less the share issue: bank loan or the bond loan.

More and more corporations have initiated, proactively or in response to pressure from investors, consumers or public authorities, responsible and sustainable practices aimed at environmental, labor and corporate governance to minimize risk and to support the long-term sustainable development. These companies report, in a personal manner, their efforts and results, which makes it quite difficult to achieve international comparisons of corporate social performance. For this reason, stock exchanges are promoters of the standards of social involvement and tools for measuring social performance of listed companies. These efforts are supported in particular by the World Federation of Exchanges (WFE), as well as the United Nations and its specialized agencies.

Thus, United Nation Principles for Responsible Investments (UNPRI), UNCTAD and the UN Global Compact launched the "Sustainable Stock Exchange" initiative1 in order to improve relations between investors, stock exchanges, capital market authorities and companies listed in

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1 [http://www.unpri.org/sustainablestockexchanges/indexSSE.php](http://www.unpri.org/sustainablestockexchanges/indexSSE.php)
the promotion of ESG issues and socially responsible investment. In this regard, they held two international conferences attended by over 100 representatives of major actors on the capital market.

In 2010, the World Federation of Exchanges (WFE) conducted a survey among the 30 largest exchanges in the world to assess the efforts made in promoting CSR practices among companies listed. The results showed the following\(^2\):

- Some exchanges have developed and/or adopted guidelines/principles of CSR\(^3\) and corporate governance principles\(^4\);
- Fewer exchanges plan to change the criteria for listed companies by introducing additional elements of ESG, the most exchanges like to recommend some good practice rather than to impose conditions for listing;
- Some exchanges have more listing segments, each segment having established corporate governance criteria, each company is free to choose one segment or another, but once a company elected a listing segment, established standards are compulsory (the example, BM & FBOVESPA);
- Most respondent exchanges launched or plan to launch sustainability-related investment indices; for example, the London Stock Exchange Group (with FTSE indices sustainable, most created since 2001), NASDAQ OMX and NYSE Euronext\(^5\) stand;
- A number of exchanges that have answered the survey have a segment and have created a specialized exchange for carbon transactions, in this respect, we remark NYSE that together with Caisse des Depots et Consignation sets up Bluenext exchange, established in 2007; Deutsche Börse Group, which together with the European Energy Exchange and Eurex provide a trading platform where different certificates created under the Kyoto Protocol or under the European Emissions Trading Scheme are sold and bought;
- The exchanges are involved in actions aimed at assisting the community to which they belong and at the development aid by initiating measures such as conferences, support for education and research, support for charities, etc. For example, the Tokyo Stock Exchange offers training programs for the staff of exchanges from developing countries; the National Stock Exchange of India organized the Forum for Responsible Investment in India in 2009, while the Stock Exchange of Thailand has set up the Institute of CSR to encourage and support corporate social involvement.
- Exchanges are considering, for the future, various actions for sustainable development of the capital market: development of ESG codes or guidelines on CSR for listed companies, the launch of sustainability indices etc;


\(^3\) For example, the Taiwan Stock Exchange has developed CSR Best Practice Principles to include ESG criteria, principles that are recommendatory in character but listed companies are required to publish information on their CSR activities in the annual report.

\(^4\) The Johannesburg Stock Exchange adopted the King Code of Corporate Governance, developed in 1994, because South Africa is trying to promote corporate governance principles after the abolishment of apartheid. King code was improved and King II version (2002) appeared and puts great emphasis on the role of internal auditors; King III version (2010) which recommends an integrated reporting and agrees with the approach GRI reporting CSR activities. http://findarticles.com/p/articles/mi_m4153/is_4_60/ai_106863373/?tag=mantle_skin:content http://www.massmart.co.za/pdf/king_code_of_governance_for_sa_2009.pdf

\(^5\) NYSE Arca launched the first sustainable named Cleantech Index and created in 1999.
Regarding the involvement of the capital market’s authorities, the measures initiated by them under the form of legislation to reduce the risk of fraud and to promote principles of corporate governance can have negative consequences for the listed companies. Many researchers point to the effects of Sarbanes-Oxley (SOX) law enacted in 2002 in the U.S. By this law, there were substantial changes to the management of reporting responsibilities and the scope and nature of the auditor's responsibilities, the ultimate goal being a better protection of small shareholders. In addition, until the promulgation of this law, the corporate governance was "regulated" by the market (i.e. the major U.S. exchanges), but financial scandals like Enron and WorldCom have shown weakness of financial markets in this area. Some researchers believe that this law is an example of the sudden acute regulatory syndrome, following a panic situation similar to that, which led to the adoption of U.S. securities law after the Great Depression of the ‘30s. An exaggerated, inefficient and unnecessary reaction 6.

Some experts believe that this law has limited positive effects on corporate governance and more, there are negative effects regarding the additional costs of monitoring and reporting 7. The result was the delisting of many companies: 200 companies in 2003 opted for delisting and transformation in closed (unlisted) companies, and in 2004, a total of 114 companies have become private companies (of which 44 were mentioned as the reason, the costs of implementing SOX Act) 8.

In addition to universal exchanges, where both fungible goods and financial assets are traded, there are more and more specialized exchanges such as those where carbon is trading (in the form of certificates) or more recently, social exchanges. These exchanges have a social mission as it provides the funding of social enterprises that want to finance various impact investment that generate social and financial benefits. At these exchanges, the main assets traded are shares, bonds and environment certificates such as carbon certificates.

In 2009, such an exchange was set up in Asia - Asia Impact Investment Exchange - that actually is a trading platform that allows private social enterprises to have access to funds to finance impact investment projects 9. The activity of this exchange is developing in the following two directions:

- Partners Impact Platform that allows social enterprises to meet with investors;
- Impact exchange that will be launched in 2012 and will operate as an authorized exchange which will deal mainly with stocks and bonds issued by non-profit organizations and companies with social mission.

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9 http://www.asiaiix.com/
In 2010, in Germany, a social platform, called PHINEO was created by Deutsche Börse in collaboration with Bertelsman Foundation, which aims to improve access to finance for non-profit organizations and social enterprises.\(^{10}\)

**Box 1. The impact investment**

The impact investments are investments that create a positive social or environmental impact in addition to generated profits, being oriented to the economic pyramid’s base (the term of economic pyramid’s base starts from the idea of Franklin Roosevelt which launched the concept of bottom of pyramid – BoP; the World Resources Institute defined BoP as people who earn less than U.S. $ 3,000 per year). Therefore, these investments are aimed at improving the living conditions of poor or vulnerable people or have positive effects on the environment. Unlike socially responsible investments, these investments have a proactive role because they generate positive effects on the environment or society.

The main businesses that finance such investments are:

- development financial institutions like International Finance Corporation and European Bank for Reconstruction and Development;
- foundations such as the Omidyar Network in the U.S. and Esme Fairbairn Foundation in the UK;
- major financial institutions and commercial banks such as JP Morgan, Citigroup, Prudential, Africa's Standard Bank, Triodos Bank, Charity Bank;
- investment banks such as PGGM in Holland, TIAA-CREF Root Capital in the USA;
- companies such as General Mills, Starbucks and Danone, which are expanding their commercial activities through impact investment or use these investments to identify new markets;
- local development finance institutions such as Southern Bancorp and Carver Federal Savings Bank in the USA.

Financing instruments used are traditional ones such as shares, bonds, but there are innovative products such as Social Impact Bonds already launched in the UK, and financial performance evaluation is done traditionally. Measuring social and environmental impact is more difficult, but there are some concerns in this regard: Global Investing Impact Rating System (GIIRS) or Impact and Investment Reporting Standards.


A new social exchange is to be created by the Johannesburg Stock Exchange and will be called South African Social Stock Exchange\(^{11}\). Besides the usual listing standards covering aspects of economic profitability and corporate governance, this exchange will require proactive conditions regarding the implication of the companies in social and environmental problems. The companies operating in areas such as tobacco will be eliminated and companies activating in sectors such as clean technology, education, health and agriculture will be preferred.

In Great Britain as well, by the end of this year, a social exchange will be established in London, which will be authorized by the Financial Services Authority and will function as a common stock exchange, but here only companies that have social and environmental objectives will be listed. In a first phase, the initiator of the exchange - Rockefeller Foundation -


\(^{11}\) http://www.sassx.com/AboutUs.aspx
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hopes that in the first five years there will be listed around 200 social companies from the developed countries, because these companies are more mature. The large corporations that have notable social performance are not considered, but smaller companies that have specialized in providing goods or services with social purposes will be listed.

**Socially Responsible Investors and UN Global Compact**

The social responsibility should guide not only the activity of the great transnational corporations, but also the work of portfolio investors. Socially responsible investments made on the capital market have their origins in religious movements. Thus, the Methodist Church began to invest over a hundred years ago on the capital market, with some selection criteria of securities not only based on economic indicators, but also on ethical aspects, eliminating the securities issued by companies that operate in certain areas such as the production of alcohol, weapons, tobacco, pornography and gambling.

Over time, certain events have encouraged the development of socially responsible investment markets. Thus, in the U.S. in 1971, an investment fund - Pax World Fund - was created in order to avoid investment associated with war in Vietnam, and the apartheid regime from South Africa accelerated the promotion of ethical investment in the 80s of last century.

In addition to initiatives developed by the portfolio investors, a catalyst in boosting socially responsible investment is United Nations. At the beginning of this millennium, the United Nations Environment Programme Finance Initiative (UNEPFI) and UN Global Compact had the idea of involving the world's largest international investors to develop the Principles for Responsible Investment. The initiator of these principles was the UN Secretary at that time - Kofi Annan, and the launch of these principles took place in 2006.

In 2009, over 550 institutional investors were signatories to these principles and the value of assets managed by these investors is over 18 billion USD. The success of these principles is demonstrated not only the number of signatories, but also their importance. Thus, among the signatories are the Norwegian Government Pension Fund - Global, APG, Public Employees' Retirement System from California, the California State Teachers' Retirement System, New York State Teachers' Retirement System, Government Employees Pension Fund of South Africa. Among the signatories of these principles are also investment funds owned by universities from developed countries: Régime de Retraite de l'Université de Montréal, University of Dayton Davis Center for Portfolio Management's Flyer Investments from USA or Universities Superannuation Scheme from Great Britain.

The Principles of Responsible Investment (PRI) are based on the idea that ESG (environmental, social and governance) aspects can affect the performance of investment and consideration of these issues lead to risk reduction and achievement of higher yields.

The analysis of these principles allows the outlining of four specific activities of responsible investment practices: investment screening, commitment as shareholders, proxy voting and economically targeted investment, mission or community investment.

**Investment screening** involves the use of positive and negative criteria that determines the acceptance or rejection of securities. Thus, negative screening is excluding securities issued by

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companies in certain areas (gambling, tobacco, weapons or nuclear weapons) or countries (for example, Columbia and Brown University eliminates securities belonging to companies that support the actions of Sudanese government from Darfur). Positive screening involves the selection the investments made in certain sectors such as renewable energy and sustainable exploitation of forests. Most times, this type of screening is based on an integrated ‘triple bottom line’ according to which the investors select securities issued by companies that in their activity take into account certain aspects of the environment, society and corporate governance. The most popular selection method is “best in class” – the investors select the securities issued by companies that promote best practice in a particular field, but taking into account the criteria for diversification portfolio and risk.

**Commitment as shareholders.** This commitment is an investment strategy through which responsible institutional investors trying to establish a dialogue with companies whose securities they hold in portfolio, which resulted in improved performance of the companies in the long-term.

**Proxy voting.** By participating and exercising their right to vote, investors bring their concerns in corporate social responsibility to the attention of managers and managers can be sanctioned if they do not take into account the ESG issues in their activity. Most institutional investors such as investment funds, pension funds, insurance companies and banks have the necessary expertise and specialized departments to base the voting policy for each company to which they are shareholders.

**Economically targeted investment, community investment and mission investment.** These investments are based not only on traditional financial objectives, but also on non-financial objectives, which take into consideration certain aspects of the environment, society and corporate governance. Mission investments are made to align financial investments of the institution with the mission of organization. This investment provides additional placement mechanisms to institutional investors and increases the financial resources other than philanthropic activities, but have the disadvantage that may have lower rates of return than traditional investments. Community investment involves the supply with financial resources of communities not served at the best standards by financial markets. For example, universities can be involved in financing community projects since they are important sources of cultural and intellectual development. Thus, in 1995, Ohio State University launched an initiative for community investment in urban development area around the university campus. These investments were financed both from its own funds and from funds raised by issuing bonds. In this way, the reputation of university increases and, in future, additional donations could be available.

Recently, the experts consider that the objective of investment in the community expands and incorporates those activities that have led to a model called social finance. Social finance focuses on social enterprises' investment that provides certain social environmental or economic outcomes. Social finance takes two forms: providing donations to support social enterprises and investments in organizations that have social and environmental objectives and results.

In conclusion, not only companies and public authorities have become aware of their social responsibility but also portfolio investors who can direct the available funds not only based on economic criteria but also on considerations related to the environment, society and governance aspects. There has been created a new capital market segment, namely the socially responsible investment (SRI) market.
Conclusions

Social responsibility (SR) is a topic of interest not only for transnational corporations and SMEs, but also for capital market’s actors: stock exchanges, listed companies, capital market authorities, portfolio investors and consulting firms.

Social responsibility of capital market’s actors must be analyzed on two segments of this market: the primary and secondary market and it must be assessed differently taking into account the different roles of the two components.

In the case of the primary market, carriers of SR are strictly related to real economy – the companies are financed by launching initial public offerings (IPO) which have many direct effects, such as increased employment in the issuing company as a result of investments made or indirect, upstream or downstream effects such as snowball effects or effects that diminish at different rates up to annihilation.

IPO provides conditions and prerequisites for the profitable growth of companies that create the necessary and sufficient financial resources to ensure incentives to employees in the form of vouchers, prize pools, tickets for holiday, shows and books and the award of sponsorship for local communities that aim at improving the citizens’ living conditions.

Financing through IPO provides the extension of the number of stakeholders and their stronger involvement in corporate life, including the social responsibility segment, given that in the area of stakeholders, unions and NGOs manifest more strongly in dealing with issues such as pollution or providing working conditions conducive to promoting an adequate health state of workforce.

The increase of social capital is a key factor for building SR potentialities given that owner-employee relationship is perceived and implemented through various forms of attracting employees at social capital such as:

- allocating a share of profit to employees, provided that they become shareholders in the company;
- providing them with the opportunity to participate in the capital of the company by converting a percentage of salary into shares.

These means of incentives to attract the employees do not assume abstruse purposes, as a way to avoid showing hostile actions against employers, but they offer some form of complementary income for more intense involvement in company’s life.

Therefore, the primary capital market is a factor that contributes to the consolidation of CSR taking into account the real economic needs and the efficient allocation criteria of available capital. We believe that this is a crucial factor to promote effective policies in the CSR with sustainable effects because it does not have a predominantly speculative character.

The secondary capital market can play, up to a certain level, a favorable role in the manifestation of social responsibility of firms and investors. The moment that the instruments of the secondary capital market gain, par excellence, speculative character, the question arises if they are the ingredients of a good functioning capital market any longer or, on the contrary, they have become disruptive or parasitic elements. It is about some toxic derivatives arising not from the need to address the problems or the needs of the real economy, but from the need of certain higher levels to get some profit at all costs. Consciously or not, they are interested in higher profits in the short term without taking into account the economic and social impact on the medium and long term, and especially their so-called toxicity from the point of view of those who must pay for the effects of the financial crisis. In fact, the effects of such crises are borne
by the whole mass of taxpayers, out of which the low-income persons feel the strongest impact, in the negative sense.

This is why the theory of sustainable development embedded in growing proportion the so-called vector of business ethics, which, unfortunately, for much of the capital market players is:

- a utopian problem or incompatible with efficiency and profitability criteria, companies declaring their self cynical pursuit of profit at any cost, regardless of the negative externalities they create;
- a problem that they agree to consider, but which subsequently is taken into account much less or even totally neglected.

Re-circulation of securities, which actually turned into electronic documents, so far removed from reality, but seductive in terms of their earning potential, is a factor of delusion for decision-makers due to the attractiveness of gains expectations. Even though there are a number of procedures, rules of prudential, risk management, they have significance rather on theoretical and methodological level, because the compliance, sooner or later, becomes a matter of generation and use of seemingly legitimate means (double accounting or fraud of internal control systems that have generated big financial scandals involving large transnational corporations or banks).

The issue of the theoretical, methodological and pragmatic approaches of business ethics is not concluded, but it is rather increasingly raised in the meetings and summits of G20, the OECD and the UN, where, at least verbally, attention is drawn on business ethics as a requirement of compliance and implementation of social responsibility. The main areas of interest are transparency, the activity of rating agencies and of control and supervision institutions of financial markets, given the negative role played by these entities in the international financial crisis.

Sizing the speculative behavior of investors shall be realized in accordance with the requirements of social responsibility of their actions and decisions on the time horizon: short, medium and long term so that, any myopic decision for enrichment in the short run, in the detriment of economic-financial balances of financial welfare, sustainability and real competitiveness of national economies can be reduced or removed.

During the crisis, foreign portfolio investors have shown highly volatile, trying by all means either to use certain circumstances on short-term to the detriment of favorable economic developments in the medium and long term, or to leave the national economic corporations shaken by the crisis.

Corporate governance through its legal institutional framework is an incentive for decision makers at the firm level in terms of increased responsibilities and obligations to society, locally, nationally and internationally as a condition for increasing entrepreneurial capacity and the competitiveness of their respective companies. In this context, particular importance has gained the running of principal-agent relationship. Proposed solutions by agent theory have aimed at the optimizing of the relationship between owners and managers, taking into account not only the interests of both parties concerned, but also those of employees who directly or indirectly intervene in sizing and performance of this relationship.

Efforts made by capital market actors have resulted in the adoption of legal regulations (SOX Act in the U.S.), additional listing criteria, codes or principles of corporate governance, new financial products, sustainable indexes or new dedicated segments or exchanges (for example, social exchanges) which are traded financial instruments which have ESG components or social enterprises are financed. The figures show the growth of socially responsible investment (SRI) market despite the financial crisis and the increasing involvement of exchanges or even investors from developing countries.
Thus, the social responsibility of capital market actors is to avoid and to signal economic expansion of nominal economy beyond its natural size, taking into account the objective correlation in time and in space between real and nominal economy. Any removal of the nominal economy and financial systems of the real economy, in order to achieve gains arising from speculative re-circulation of securities, providing overly large and unjustified revenues for certain components of leadership (in the unfavorable sense of the term) is a counterproductive and selfish approach that sooner or later will be invalidated by reality, leading to financial crisis, with the toxic effect of contagion.

Lack of social responsibility of decision makers from the financial sector, regardless of the decision hierarchy, have manifested in the perpetuation and maintenance of unjustifiably high salaries for managerial staff, which is discordant with their contribution to social welfare. On the contrary, such a discrepancy in the revenues, that has nothing in common with the idea of healthy money manufacturing, shows:

- the delay of the international financial system’s reforms,
- the lack of transparency, oversight and fair financial reporting;
- the selfishness to satisfy their own individual or group interests that pushed beyond endurance and socio-economic and financial balances ends to stock crashes, overnight impoverishment of billionaires whose money actually do not have counterparts in the real economy validation of the social demand.

Unfortunately, experience regarding the economic and financial crises has shown so far that those who actually triggered the crisis and should be held responsible, in fact bear few effects of the crisis, the bill of negative economic and social effects being paid by the population.

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Considerații privind responsabilitatea socială a actorilor pieței bursiere

**Rezumat**

Responsabilitatea socială este un concept nou care ghidează activitatea corporațiilor transnaționale, a întreprinderilor mici și mijlocii, dar modeleză și comportamentul investorilor de portofoliu și a burselor de valori. În acest articol am analizat activitatea actorilor pieței bursiere în promovarea principiilor responsabilității sociale și dezvoltării durabile, precum și rolul lor în declanșarea crizei financiare internaționale.