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EXPLORING SOCIALLY RESPONSIBLE INVESTMENT IN PAKISTAN

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Key Points:

- Socially responsible investment or investing (SRI) is an umbrella term for investments and investment strategies that consider the attempt to create positive social change, minimise environmental damage, and incorporate religious or ethical beliefs.
- A socially-oriented investor makes environment, social and corporate governance (ESG) metrics an integral component of the investing process.
- SRI and Corporate Social Responsibility (CSR) can be considered "the two sides of the same coin". CSR is the corporate answer to SRI and a firm's solution to ESG concerns raised by shareholders.
- Social screening, community investing, and shareholder activism are major SRI strategies.
- Though a relatively new trend, the increased state guidelines regarding the SRI strategies have increased the need for SRI products in Pakistan.
- Apart from the SECP and PSX's requirements, SRI is quite closely associated with the Islamic code of business conduct.
- Lack of information, transparency and due diligence, and higher risk perception towards SRI comprise the major impediments to the investment strategy in the country.
- SRI can become more widespread in Pakistan by mentoring younger investors, increasing transparency, suitable registrations and governance mechanisms, and allowing access to relevant information. Also, as MNCs are diligent in abiding by CSR and imposing it on their contractual partners, increased local-MNC partnerships can increase the room for SRI as a consequence.

I. SOCIALLY RESPONSIBLE INVESTMENT

Today, it is impossible to deny or undervalue the increasing significance of social and environmental matters, primarily in the corporate setting. The undesirable consequences of commerce are on a constant rise and bother an increasing number of entities among firms, buyers, civil sector, states, global organisations, media agencies, and investors.[1] "Socially responsible investment or investing (SRI) is an umbrella term for investments and investment strategies that have taken into consideration the attempt to create positive social change, minimise environmental damage, and incorporate religious or ethical beliefs."[2]

SRI is also called "ethical investing, responsible investing, green investing, impact investing or sustainable investing".[3] While traditional investment concentrates on monetary risk and returns from investment, SRI considers other aims or limitations.

[1] Enrique Ballestero, Blanca Pérez-Gladish, Ana Garcia-Bernabeu (eds.) *Socially Responsible Investment: A Multi-Criteria Decision Making Approach* (New York: Springer International Publishing, 2015): 3.

[2] Hung-Gay Fung, Sheryl A. Law, Jot Yau, *Socially responsible investment in a global environment* (Cheltenham: Edward Elgar, 2010): 1.

[3] Ballestero, Pérez-Gladish, Garcia-Bernabeu (eds.) *Socially Responsible Investment,* 5.

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SRI is concerned with not only the amount of monetary return but also the nature of the source of that return.[4]

The significance of SRI as an investment strategy is well-encapsulated by the idea purported by Mackey et al. that at times investors might "have interests besides simply maximising their wealth when they make their investment decisions... they may want the firms they invest in to pursue socially responsible activities, even if these activities reduce the present value of the cash flows generated by these firms." [5]

A. Environmental Social and Governance (ESG) Factors for SRI

A wide array of matters concerns the investors, ranging from everyday faith-related matters to certain ESG concerns emerging as a result of particular events. For instance, the increased stress on societal problems associated with the apartheid in South Africa.[6]

ESG stands for a broad range of environmental, social, or corporate governance aspects pertaining to the operation of a firm, which may be kept in mind during the process of investment. For instance, environmental factors may consist of the way a business accounts for its carbon emissions, social factors may comprise labour policy, and governance factors may include the extent to which the board members of a corporation can act independently of the firm administration.[7] Also, corporations face a mounting insistence from investors for adopting procedures based on ESG metrics and implementing sustainability approaches.[8] [9] Thus, business firms are under increasing internal and external pressure to participate in social responsibility initiatives and attain wider societal objectives.[10] [11]

In essence, a socially-oriented investor makes ESG metrics an integral component of the investing process. In contrast, traditional or majority investors normally only contemplate these issues when they have an explicit impact on the value of the stock.[12]

B. Corporate Social Responsibility

SRI and Corporate Social Responsibility (CSR) can be thought of as "the two sides of the same coin". CSR is the corporate answer to SRI. CSR is a firm's solution to ESG concerns raised by shareholders. For SRI investors, social responsibility is as valuable as monetary return, whereas a firm's management considers CSR as a means to bring its owners or stakeholders in line with these values.[13] Nowadays, CSR has emerged as a vital component of majority corporate governance codes across the globe. It is hard to determine what exactly characterises the word "social responsibility" of companies.[14] CSR depicts the manner in which a corporation considers a variety of elements or investors as a constituent of its business plan. The majority of businesses concentrate on conventional financial gauges for their output. However, corporations with a marked CSR initiative also weigh the effect of their activities on a broad set of social and environmental aspects. In this way, CSR and ESG have some semblance as potential "measures of performance". As for the link between CSR and SRI, SRI strategies are employed for improving the CSR output of businesses. [15]

Likewise, three main SRI strategies furnish a useful guideline for the SRI choices open to the majority of individual investors.[16]

C. SRI Strategies

a. Social Screening: One of the most popular means of employing the SRI strategy includes social screens.[17] Screening choices for an SRI portfolio can be grouped as negative and positive. Negative screening is one of the primary methods of selecting investments and is based on exclusion.[18] Such screening eliminates businesses that are contributing to socially irresponsible conduct, including items and services of addiction, for instance,

[4] C.J. Cowton, J. Sandberg, "Socially Responsible Investment," Editor(s): Ruth Chadwick, *Encyclopedia of Applied Ethics* (Second Edition), (Academic Press, 2012): 142-151, https://doi.org/10.1016/B978-0-12-373932-2.00086-7.

[5] Alison Mackey, Tyson B. Mackey, and Jay B. Barney. 2007. Corporate social responsibility and firm performance: Investor preferences and corporate strategies. *Academy of Management Review* 32: 818.

[6] Scott J. Budde, *CFA, Compelling Returns: A practical guide to socially responsible investing*, (John Wiley & Sons, Inc., Hoboken, New Jersey, 2008): xii.

[7] Ibid., 3.

[8] Patricia Crifo, Rodolphe Durand, and Jean-Pascal Gond, "Encouraging Investors to Enable Corporate Sustainability Transitions: The Case of Responsible Investment in France," *Organization & Environment* 32 (2009): 125–44.

[9] Asad Shafiq, Muhammad Usman Ahmed, and Farzad Mahmoodi, "Impact of supply chain analytics and customer pressure for ethical conduct on socially responsible practices and performance: An exploratory study," *International Journal of Production Economics* 225, 107571, (July 2020).

[10] Gunther Capelle-Blancard and Aurélien Petit, "Every Little Helps? ESG News and Stock Market Reaction," *Journal of Business Ethics* 157 (2019): 543–65. Joshua I. Weinstein, "The Market in Plato's Republic," Classical Philology 104 (2009): 440.

[11] Marc Orlitzky, "Corporate social responsibility, noise, and stock market volatility," *Academy of Management Perspectives* 27 (2013): 238–54.

[12] Ibid., 5.

[13] Fung, Law and Yau, *Socially responsible investment in a global environment,* 2.

[14] Richard Janda and Joseph Wilson, "CSR, Contracting and Socially Responsible Investment : Opportunities for Pakistani Firms," *East Asian Bureau of Economic Research, Finance Working Papers* 22266, (2006): 2, https://eaber.org/wp-content/uploads/2011/05/LUMS_Janda_2006.pdf Accessed November 5, 2021.

[15] Budde, *Compelling Returns,* 3.

[16] Ibid., 2-3.

[17] Ibid.

[18] Fung, Law and Yau, *Socially responsible investment in a global environment,* 28.

alcohol, gambling; detrimental products for the environment, for example, nuclear power, pollutants; humanitarian lapses, for instance, discriminatory behaviour; and defence items like weapons, mines et cetera.[19]

Thus, in negative screening, firms are omitted on the basis of a specific set of benchmarks. Based on those criteria, sometimes investors straightforwardly eliminate complete areas from the investment portfolio. There can be a broad omission of the "sin" stocks. Sin stocks are from the common stock firms that have primary business in liquor, firearms, and tobacco items. On the other hand, considering the aim of the portfolio, some investors may remove firms individually.[20] Positive screening actively includes businesses that are according to the benchmark set by the investment portfolio's goals. Employing a positive screen to include corporations is considered a comparatively more demanding strategy than straightforward negative screening.[21] SRI portfolios enlist businesses with outstanding governance, societal regard, and attention to environmental concerns through positive screening. Also, depending on the investor, particular areas are focused upon in SRI portfolios. These specifications can vary from faith-based requisites like Islamic investing, ethical beliefs, or concerns like "cleantech" and biofuel.[22]

b. Community or Proactive Investing When funds are channelled to firms or ventures, working for some positive social or environmental effect, like facilitating cheap accommodation, the strategy is called community or proactive investing. For instance, an investor may designate a portion of their savings to a deposit certificate in a nearby bank that stresses loaning and monetary facilities in neglected communities.[23]

c. Shareholder Activism Shareholder activism takes place when the holders of the stock try to affect the conduct of firms. Employing this strategy usually includes campaigning for shareholder resolutions and balloting at yearly consultations. It is undertaken to back particular ESG motives and may at times be somewhat hostile. It can occur via communicating to the firm straightforwardly or by casting votes to approve or reject particular pitches which need balloting of the shareholders or directors. However, it is mostly adopted when engaging the firm is no more a feasible route.[24]

II. SOCIALLY RESPONSIBLE INVESTMENT IN PAKISTAN

In case of Pakistan, the SRI is a gradually budding trend. There is a huge number of multinational corporations (MNCs) existing in the country that have made substantial CSR undertakings. Therefore, the indigenous firms that seek to conduct business with MNCs frequently have to encounter CSR tests as well.[25] From the viewpoint of those investors that lean towards SRI, the matters of concern have increased over the years. The introduction of names like ESG represents the way SRI strategies have expanded with the time to incorporate environmental affairs and issues related to business governance.[26]

III. FRAMEWORKS FACILITATING SRI IN PAKISTAN

The rising number of state guidelines regarding the SRI strategies of social screening, community investing, and shareholder activism have increased the need for SRI products in the country.[27] Likewise, the growing sway of the purported SRI funds indicates that the businesses in Pakistan have a substantial reason to observe CSR criteria in order to turn them into suitable SRI instruments.[28] Following are a few frameworks that facilitate the SRI trend in the country.

A. Code of Corporate Governance for Listed Companies

The Securities and Exchange Commission of Pakistan (SECP) gave out the Listed Companies (Code of Corporate Governance) Regulations, 2019 ("2019 Code") on September 25, 2019.[29]

As per the Code of Corporate Governance regulations, a firm's board of directors should guarantee that a thorough dated account of details of the significant policies with their relevant dates is upheld. The code enlists some of the central policies whose specifics need

[19] Julia M. Puaschunder, "On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)," *Consilience: The Journal of Sustainable Development* 16, no. 1 (2016): 42.

[20] Fung, Law and Yau, *Socially responsible investment in a global environment,* 25, 28.

[21] Ibid., 28.

[22] Ibid., 25.

[23] Budde, *Compelling Returns,* 2.

[24] Fung, Law and Yau, *Socially responsible investment in a global environment,* 30.

[25] Janda and Wilson, "CSR, Contracting and Socially Responsible Investment ," 1.

[26] Budde, *Compelling Returns,* xii.

[27] Ibid., 2.

[28] Janda and Wilson, "CSR, Contracting and Socially Responsible Investment ," 1.

[29] Afferguson & Co., "The Listed Companies (Code of Corporate Governance) Regulations, 2019: A new governance regime," *PWC* October 17, 2019, https://www.pwc.com.pk/en/assets/document/AFF%27s%20document%20on%20the%20Listed%20Companies%20(Code%20of%20Corporate%20Governance)%20Regulations,%202019.pdf Accessed November 16, 2021.

to be kept, such as environmental, social and governance policies, corporate social responsibility programs and other humanitarian actions, charitable contributions, and further areas of societal assistance.[30]

The code requires the chief executive officer of a corporation to bring forward important matters for the board to be informed and consider and decide upon them accordingly. For example, accounting for the implementation of the Corporate Social Responsibility (Voluntary) Guidelines, 2013 or whichever monitory guideline, as related.[31]

B. Stock listing requirements/ Reporting awards

According to the International Finance Corporation (IFC), ESG factors are progressively more on the stock listing requirements. In its Annual Reporting Awards, Pakistan State Exchange (PSX) has documented the significance of accounting for non-financial matters. It is granting points for reporting on gender representation and businesses that account for a minimum of two sustainable development goals.[32]

C. SECP's CSR Voluntary Guidelines

The SECP's CSR voluntary guidelines are meant to endorse creating a framework for CSR programs by all businesses. Firms are urged to try and collaborate with the investors for executing a clear and socially responsible plan of action.[33] CSR policy is required to explicitly define the significant domains where the CSR initiatives are presently being administered and also those areas where new initiatives are about to begin. The domains can largely encompass: community investment, governance, product responsibility, work-life balance, safety, and climate change. [34]

D. Shariah

There are profound religious and ethical roots associated with the social screening of investments. All widely practised faiths in the world have some points of view pertaining to forbidden actions and/or conscientious corporate procedures.[35] SRI is quite closely associated with the Islamic code of business conduct. Therefore, the religious practice also allows people in Pakistan to lean towards making socially responsible investments. An investor having a strong affiliation with the Islamic faith is very likely to adopt SRI portfolios. Also, as compliance with Shariah and concern for societal and ethical matters is vital for such investors, they might not consider risk highly. Straightaway deal breakers for them are the stocks that are repugnant to Shariah. Therefore, it directly affects the decisions of Muslim investors, which make up the majority of investors in the country.[36]

IV. ROADBLOCKS TO SRI IN PAKISTAN

SRI still have a very long way to go in Pakistan. Some of the major impediments in the course of such investments in the country are as follows:

A. Lack of Information

SRI is a comparatively newer and unorthodox market choice. [37] That is why there is not as much understanding and knowledge about it in the country.[38] Some of the SRI instruments are not thoroughly comprehended by either businesses or investors. [39]

B. Risk Perception among Investors

Risk perception means the way investors perceive the risks related to monetary assets on the basis of their apprehensions and knowledge.[40] Consequently, investors with a thorough understanding of the different investment instruments are better able to perceive risk precisely than those who do not have much experience or

[30] "Code of Corporate Governance," *Pakistan Stock Exchange* (2019): 4-5, https://www.psx.com.pk/psx/themes/psx/uploads/SRO_1163(I)2019-ListedCompanies(CodeofCorporateGovernance)Regulations_2019.pdf Accessed November 11, 2021.

[31] Ibid., 6-7.

[32] Nazish Shekha, "Attracting Investment by disseminating ESG disclosures," *CERB,* July 2020, https://cerb.pbc.org.pk/article-attracting-investment-by-disseminating-esg-disclosures/ . Accessed November 10, 2021.

[33] "CSR VolutaryGuidelines 2013," *Securities and Exchange Commission of Pakistan*, (2013) https://www.secp.gov.pk/document/csr-guidelines/?wpdmdl=18351&refresh=618cbe67419a31636613735 Accessed November 11, 2021

[34] Ibid., 4.

[35] Budde, *Compelling Returns,* 43.

[36] S. Murtaza,H.M. Rana, F. Noor, M. Sahdat, and J. Khan, "Risk perception of socially responsible investors in muslim countries," *European Scientific Journal, ESJ* 9, no. 31, (2013): 407. https://doi.org/10.19044/esj.2013.v9n31p%p https://eujournal.org/index.php/esj/article/view/2074/1985. Accessed November 9, 2021.

[37] Julia M. Puaschunder, "On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)," *Consilience: The Journal of Sustainable Development* 16, 1 (2016): 39.

[38] Ghazanfar Ali , Faiza Hashmi , Tamkinut Rizvi, "Personality Influences Socially Responsible Investment (SRI): the Role of Religiosity," *Pollster Journal of Academic Research* 4, no. 1, (2017): 22, http://pollsterpub.com/images/4.1.2.pdf Accessed November 5, 2021.

[39] "The landscape of impact investing in Pakistan: Understanding the current status, trends, opportunities, and challenges in BANGLADESH, INDIA, MYANMAR, NEPAL, PAKISTAN, and SRI LANKA," *GIIN,* (2015): 131, https://thegiin.org/assets/documents/pub/South%20Asia%20Landscape%20Study%202015/1_Full%20South%20Asia%20Report.pdf. Accessed November 10, 2021.

[40] M. Ahmad, and S.Z.A Shah, "Overconfidence heuristic-driven bias in investment decision-making and performance: mediating effects of risk perception and moderating effects of financial literacy" *J. Econ. Admin. Sci.* 36 (2020): 178–209. doi: 10.1108/JEAS-07-2020-0116.

knowledge.[41] As SRI is a relatively newer domain, there is a higher risk perception given the lack of knowledge. [42] [43]

C. Vague ESG Screens

Although firms are more and more conscious about clearing a particular screening method or not, the indications from ESG screens are not always clear. The signals from screening are often diffused. For instance, a corporation might not clear a specific screening method due to the overall evaluation of many aspects, including negative and positive. Still, the firm might only consider the general result of clearing or failing a screening and might not find the reason or motivation to alter its conduct in one of the aspects of the screening which it did not clear. Altering behaviour in that particular factor will eventually allow the firm to pass the screening the next time around.[44]

D. Need for Transparency and Due Diligence

In the case of Pakistan, a major roadblock in carrying out SRI investments is to cross the intermediary steps of screening and due diligence in order to transform prospects into investable contracts. There is a scarcity of such companies in the country that possess the thorough monetary systems and operations necessary to make them ready for investment. They have twin or multiple arrays of accounts. Likewise, in a majority of firms, there is a dearth of transparency, suitable registrations, and appropriate business governance mechanisms. Besides, a major apprehension exists regarding the political linkages and corporate procedures of firm owners in a scenario where corrupt practices are commonplace.[45]

Moreover, carrying out official due diligence is an arduous task for local investors. For instance, it is quite challenging to travel to remote locations for assessing value chains. As for foreign investors, due diligence requires them to travel to Pakistan, which could be a matter of concern for a lot of people considering the security and political scenario. [46]

V. RECOMMENDATIONS

SRI seems to have a potentially growing market in Asia.[47] Pakistan can further facilitate such investments in the following ways.

A. Focusing on Millennial Investors

Research suggests that most of the individual investors that make socially responsible investments are likely to be younger.[48] As there is a greater susceptibility among the younger population to incline towards SRI, it is significant to focus on the country's millennial investors. As potential investors with a lack of experience will have a higher risk perception, it is crucial to train them to tackle or regulate situations with higher risk.

B. Incubation

As for new enterprises designed around SRI, there is a need to train them regarding the necessary socially responsible regulations. In such a scenario, incubation is a good plan of action. It will allow training as well as interaction with funding opportunities.

In countries like Pakistan, SRI is driven chiefly via microfinance, community investing and venture development.[49] In this regard, training, mentoring, and advisory services are of utmost importance.

C. Increasing Transparency

Pakistani firms usually struggle in drawing foreign investment as disclosures related to ESG are not thorough, thus making the investors reluctant. The state should also enforce a clearer set of directions on the indicators and data that companies need to furnish. Investors want to be cognisant of the way firms invest on their part. A socially-oriented investor, whether local or foreign, considers ESG metrics an integral component of the investing process. Therefore, companies need to ensure that the ESG reporting is exhaustive enough to retain and satisfy existing investors and invite more investors.

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[41] Wangzhou Kaixin, Khan Mahnoor, Hussain Sajjad, Ishfaq Muhammad, and Farooqi Rabia, "Effect of Regret Aversion and Information Cascade on Investment Decisions in the Real Estate Sector: The Mediating Role of Risk Perception and the Moderating Effect of Financial Literacy," *Frontiers in Psychology* 12, (2021), https://www.frontiersin.org/article/10.3389/fpsyg.2021.736753, DOI=10.3389/fpsyg.2021.736753.

[42] Puaschunder, "On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)," 39.

[43] Ghazanfar Ali , Faiza Hashmi , Tamkinut Rizvi, "Personality Influences Socially Responsible Investment (SRI): the Role of Religiosity," *Pollster Journal of Academic Research* 4, no. 1, (2017): 22, http://pollsterpub.com/images/4.1.2.pdf Accessed November 5, 2021.

[44] Budde, *Compelling Returns,* 40.

[45] "The landscape of impact investing in Pakistan: Understanding the current status, trends, opportunities, and challenges in BANGLADESH, INDIA, MYANMAR, NEPAL, PAKISTAN, and SRI LANKA," *GIIN,* (2015): 122, https://thegiin.org/assets/documents/pub/South%20Asia%20Landscape%20Study%202015/1_Full%20South%20Asia%20Report.pdf. Accessed November 10, 2021.

[46] Ibid.

[47] Puaschunder, "On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)," 52.

[48] Murtaza,Rana, Noor, Sahdat, and Khan, "Risk perception of socially responsible investors in muslim countries," 403.

[49] Puaschunder, "On the emergence, current state, and future perspectives of Socially Responsible Investment (SRI)," 51-52.

D. Differentiating ESG Metrics and CSR

More and more corporations in Pakistan are now delving into CSR initiatives. Any charitable step that is taken by the firm also comes within the ambit of CSR. Such companies in Pakistan need to maintain transparency by ensuring thorough records of their CSR programs as it will draw a more significant number of SRI investors to them. However, from the purview of SRI, there is a need to be conscious of ESG and CSR as separate entities.

Nascent socially responsible firms ought to be aware of the different reporting that the two may entail. Firstly, CSR remains a more qualitative way of making firms answerable for their societal obligations, while ESG ensures a rather quantitative reckoning of the socially responsible behaviour of the company. Secondly, CSR disclosures remain voluntary in Pakistan. On the other hand, ESG disclosures have been made mandatory. Therefore, in order to ensure a regular flow of foreign investments to the socially responsible firm, reporting on ESG metrics needs to be consistent and regular.

From the standpoint of the local investor, they need to look out for the ESG reporting of the firm as SECP's "comply or explain" clause in the Companies (Corporate Social Responsibility) general order is a definite way to ensure compliance with social responsibility metrics. The CSR voluntary reporting is on top of it.

E. Unravelling the Complexity of SRI Products/Instruments

It is important to ensure more balanced and thorough dialogue on SRI in order to straighten out the complicated aspects of SRI. A better understanding of the investment will allow lessening those losses which emerge due to the obscure nature of this multi-shareholder scenario.

F. Working with MNCs

Since various MNCs are present in Pakistan, they have directly, and indirectly implications for CSR practised in the country. While working on their own, the local enterprises may abuse the scenario and implement the least possible reporting benchmark thus compromising the quality of the SRI disclosure. However, MNCs are very vigilant in executing CSR. They also require the companies they work with to keep up with CSR requirements. Therefore, by facilitating more MNCs to take local businesses on board, CSR and as a result, SRI trend is going to increase in the country. Though CSR reporting is voluntary, local firms will guarantee timely disclosures to ensure continued collaboration with MNCs.

G. Improving SRI Reporting Regulations

Enforcing a uniform set SRI reporting rules is an arduous task leaving leeway for evading firms. Obligatory ESG reporting rules need to be further improved as, unlike monetary data, ESG data is multifaceted. It may also vary according to different industries.