RISK PERCEPTION OF SOCIALLY RESPONSIBLE INVESTORS IN MUSLIM COUNTRIES

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Abstract

From the evidence that socially responsible investment is an emerging concept in Muslim countries, we have developed a socio-demographic behavior based model. We have shown the direct effect of social factors (religion and family influence) and indirect effect of demographic factors (age, education and income) on investment choices through risk perception. Investors may be experienced in investment market but particularly in SRI investments of Muslim countries they will be new entrants. We have developed hypotheses from literature in our study regarding this concept of new entrants. In Pakistan, SRI investment is not prevailing but opportunities do exist. Pakistani firms can take the initiative by attracting SRI investments if firms develop more sophisticated CSR.

Keywords: Socially responsible investors, muslim countries, investment choices, risk perception, behavioral finance

Introduction:

Within the field of personal investment, the socially responsible investment is considered a rapidly emerging phenomenon. Previously the only aim of the business was considered to maximize profits (Abbarno, 2001). Socially Responsible Investment (SRI) is progressively becoming a significant part of financial markets in many countries. For instance in the United States, it is projected that 11% or more of all holdings are held in SRI funds (Social Investment Forum (SIF) 2003). However, for the last few years the concept of socially responsible investment has been expanding in different countries like Malaysia, Indonesia and India (Muslim majority country) (Conroy, 2001).

According to Brooks (1989) socially responsible investors are those which ensure that all their investments have ethical dimensions. Therefore, they are other-centered rather than self-centered. As far as, recently Greene (2001) studied that socially responsible investors are usually younger in age and they are highly educated. These younger investors paid many investments towards environmental issues so they select those companies who also have much concern about these issues. The public perception about socially responsible investors is that they need to return to their society, in a sense of social responsibility that has given them by their stakeholders. Stakeholders should invest outside their home country because opportunities will be limited in one country, especially a small country such as Pakistan. This will make sustainable investment more international than conventional investments. Second it is not only a question that where should opportunities are located; investors should have all information about geographical and demographic factors which are available in Muslim countries.

In Muslim countries especially in Malaysia and Indonesia, socially responsible investing is the emerging concept. The SRI Kehati index has been established recently in 2009 in Indonesia. The investors may hesitate to invest in this special type of investment. Previously it was not a very common phenomenon. This is the reason that we have chosen the "risk perception" as a mediating variable between demographic variables, social factors and investment choices of socially responsible investors. Risk perception is an individual's estimation that how much the situation is risky? In addition, if the risk is involved then how that risk will be controlled? While investing in an emerging investment (SRI), risk perception of the investors may be high. The younger investors tend to be more socially responsible (Rosen et al 1991). They perceive risk in SRI more different than the old investors do. Although old investors are more experienced but their risk perception would be entirely different in making investment decisions. However, in taking the case of only Muslim countries, these results may be opposite. Old-age investors may be new in this ethical and social investment. As they are not much concern about social and ethical values, they may prefer more diversified portfolios in which the stocks of ethically bad companies may exist.

As SRI is new in Muslim countries, the risk may be higher than the conventional investment market. Greene (2001) found that socially responsible investors are mostly highly educated. They are having a greater concern for ecological issues, which actually reflects on their ways of selecting between companies and funds and their ways of investments. Highly educated investors are more concern about social and ethical values so they prefer SRI more while making their investment choices. Whether high risk is involved or not, they may willingly go for it. Uneducated or less educated investors in Muslim countries may be more experienced but they are new entrants in the socially responsible investment market and they give less importance to social and ethical issues (Geoffrey, 2005).

Socially responsible investors have higher levels of income than conventional investors (Tippet and Leung, 2001; Rosen et al, 1991). Our study is not a comparative one. We are more concern about the income level of investors. As SRI is the emerging/new concept in some Muslim countries, the number of socially responsible investors may be less as compared to European countries. Level of income may have some effects on the investment choices of socially responsible investors this is the reason we have taken it as an independent variable.

Another important variable in our study is social factors. Our focus is on religion and family as social factors. There is a direct relationship between these social factors and investment choices. In the past decade, the Islamic finance industry has been developed immensely. It has grown twenty percent annually since 2003 (research from State Street Corporation). It has been suggested that the risk-adjusted returns of portfolios tended to be higher which contains both SRI and Shariah standards (Irfan, 2009). Investors who are religiously affiliated are more likely to invest in SRI funds. It is the case with another variable i.e. family. It is an important perspective because family members may influence the investor's decision-making while making their portfolios.

Most of the previous research focused in European countries, no significant literature was found in the role of socially responsible investors in Muslim countries. This study is primarily focused on the impact of these ethical investors in Muslim countries. The main key variable is the risk perception of these types of investors regarding their age, education and income level. Another important variable is the influence of social factors on the investment choices of socially responsible investors. These types of investors are not fully diversified because their portfolios contain only the stocks of those companies, which are ethically good. So according to this, their investment choices would be different from the conventional investors.

The remaining paper has been organized as; Section 2 illustrates the literature review. Section 3 shows the proposed model whereas section 4 is about discussion and practical insinuation of the study and section 5 give details about limitations and further research. Section 6 describes the conclusion of the study.

Literature Review

The concept of socially responsible investment was initiated during 1920s in the United Kingdom when the Methodist Church started shunning the sinful stocks in its investment strategy. But proper and world's first socially responsible mutual fund was introduced in 1971 (Pax World Fund) which was US based. Socially responsible investment is a broad topic. Socially responsible investors are supposed to be those investors who invest in the stock of those companies, that encourage human rights, environmental laws, diversity and consumers' rights. It is also believed that some of the SRI investors do not like to invest in the stocks of businesses, which are involved in alcohol, tobacco, weapons, and gambling. Socially responsible investment has gained much importance in the countries like USA, UK, Canada, Australia, Singapore and some other developed nations. Whereas, it is still a new or emerging concept in Muslim countries. There has been a lack of research on specifically SRI in Muslim countries.

Most of the researches have been conducted on the demographic factors of socially responsible investors in the past. One of those factors is age. It is found in the researches that socially responsible investors tend to be younger (Rosen et al, 1991). Junkus and Berry founded the same results in 2010. However, the results of the few researchers were inconsistent with the above results. For instance Geoffrey Williams in 2005 showed in his results that age factors does not matter in socially responsible investment. He argued that both young and old age investors invest in socially responsible investments readily. There were many comparative studies conducted between two types of investors; Conventional investor and socially responsible investor. McLachlan and Gardner (2004) suggested that there is no age difference between both types of investors.

Another important demographic factor is education. It is a general perception that socially responsible investors are more likely to be more educated. This is also supported by the previous researches. Junkus and Berry in 2010 projected that the socially responsible investors are better educated. According to them educated people will prefer in investing the socially responsible investment. While the results of study conducted by McLachan and Gardner (2004) shows that not only highly educated, but less educated people may also invest in socially responsible investments. The idea was that investors that are more educated might be more influenced by the issues of social responsibility when they invest. Besides that, most of the studies showed that SRI investors are highly educated. Income level is also the important variable, which can affect the investment choices of the socially responsible investors. Studies demonstrated that the SRI investors tend to be wealthier (Tippet and Leung, 2001). The investors with a high level of household income will tend to invest in socially responsible investment. On the other hand, McLachlan and Gardner (2004) argued that the income level does not have an impact on socially responsible investments. In fact, investors may pay a price when making their SRI portfolios, as they are more concerned about social objectives rather than wealth maximization (Renneboog et al, 2007).

Social factors also influence the socially responsible investors. One of the social factors, which have been taken in our study, is the religion. Their religious background some time influences SRI investors. Like most of the Muslims hesitate to invest in the businesses which are involved in the liquors. That is the reason why SRI is gaining popularity in the Muslims countries. Countries include Malaysia, Indonesia and India (country with Muslim majority). Religions and faiths can also play an important role in investment decision making of the SRI investors. (S. Brammer et al, 2007). The concept of Islamic mutual funds in a context of social responsibility has been explored (Forte and Miglietta, 2007). Irfan in 2009 suggested in his study that by merging the standards of Shariah investments with the principles of SRI, returns from equity investments might have optimistic impact. On the other hand, family matters can also influence the investment decision making of the socially responsible investors. Due to the family obligations, a socially responsible investor will not invest in the business, which his family dislikes.

Risk perception of the socially responsible investors is a mediating variable in this paper. There has been a very little research on this area. Some research has been done on the risk and return of the socially responsible investment in the western countries like USA and Canada. But research on this issue has not been done in Muslim countries. In a few of the Muslim countries like Malaysia and Indonesia, SRI indexes have been made. Therefore, SR investors in these countries will perceive the SRI investment as risky according to their age, education and income level. Usually SRI investments have low risk, and they provide high returns (Kreander et al 2005; Mallin et al 1995).

In most of the studies, the demographic and social characteristics of socially responsible investors compare with the conventional or non-ethical investments. While this study shows the relationship of demographic and social characteristics with investment choices of the SR investors; with risk perception as a mediating variable. The investment choices of the socially responsible investor differ from the conventional investors. Socially responsible investors are more perfect in their decision-making because of a strong desire of high quality and the presence of high standards among these investors (McLachlan and Gardener, 2004).

While most of the researches have been conducted in the non-Muslim countries like USA, UK, Canada, Australia etc. However, there has been a very little research in the Muslim countries. Abdullah et al (2010) has done some work to investigate the socially responsible investment behavior within the context of Malaysia. Damini Gupta (2011) has also done one related study within the context of India. She examined that whether an investor in India can improve the performance of his portfolio by investing in the SRI investments?

Looking at the literature, which has mostly focused non-Muslim countries; it can be assumed that there is an opportunity for the investors of the Muslim countries to invest in SRI investments. There is a lot of significance between Shariah index and SRI index. Unfortunately, there has been a very limited research on SRI within the context of Muslim countries.

Proposed Model

In our study investment choices of socially responsible investors' typically in Muslim countries has been taken as a dependent variable. There are mainly two independent variables; demographic factors and other social factors. Demographic factors, which have been considered in this study, are age, education and income level of socially responsible investors. We are living in a society so there are many factors, which influence the decision-making of investors. However, we have focused on two important social factors that are; religion and family. Risk perception has been taken as a mediator between dependent and demographic variables.

As we mentioned before that social factors have a direct influence on investment choices of socially responsible investors because any investor who is having a strong influence of their family to invest in ethical funds would go for SRI funds without perceiving any risk about it. An investor, who is strongly followed the principles of Islam, will prefer the stocks of those companies, which are involved in businesses according to Shariah standards. Demographic factors may influence through a mediating variable 'risk perception'.

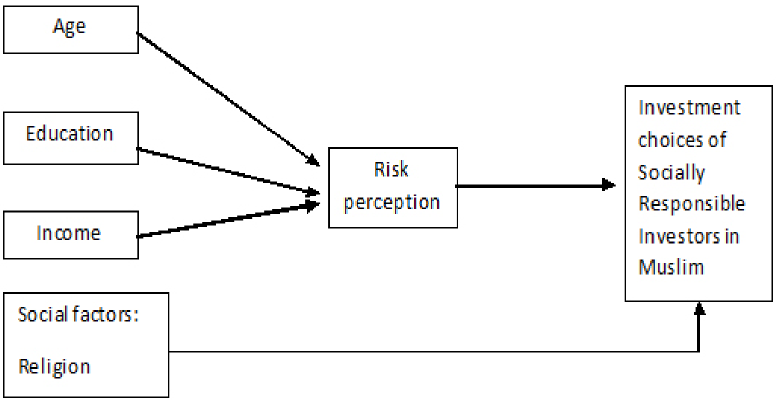

Figure 1: Socio-demographic based investment behavior model of SRI's inMuslim countries

Then the hypotheses, which need to be checked, are;

Young investors tend to be more socially responsible Greene (2001). In Muslim countries where investors are new entrants in this socially responsible investment market, the young investors may perceive less about risk. On the other side, older investors may be experienced but they are also new entrants in this type of investment. They are less concerned about social and ethical issues so they perceive high about risk while investing in socially responsible funds.

H1: Young investors tend to be more socially responsible so they perceive less about risk; old age investors tend to be less socially responsible so they perceive high about risk.

Education is the significant factor that affects investment decision-making of socially responsible investors while making their portfolios. Socially responsible investors tend to be highly educated (Geoffrey, 2005; Junkus and Berry, 2010). According to their higher education, they are willing to invest in socially responsible funds while perceiving less about risk. On the other side, less educated investors may be experiencing one but in this emerging investment type, they perceive high about risk as according to Greene, (2001) less educated investors tend to be less socially responsible. Then the hypothesis becomes;

H2: Highly educated investor tend to be more socially responsible so they perceive less about risk; less educated investor tend to be less socially responsible so they perceive high about risk.

In this study, we are not concerned about the wealth condition of socially responsible investors as projected by Tippet and Leung, 2001 that these types of investors are wealthier. Investors may pay a price when making their SRI portfolios, as they are more concerned about social values rather than wealth maximization (Renneboog et al, 2007). If the investors' income level is high then he/she may perceive less about risk while making their SRI portfolios because he/she may cover the financial cost. An investor having low income may perceive high about the risk involved in this emerging investment type in typically Muslim countries.

H3: Investors with high income have less risk perception; investors with low income have a high-risk perception.

Investors' risk perception depends upon many factors including the personality, attitudes and beliefs of investors. However, we have only considered the effects of demographic factors of investors in Muslim countries. Young investors are normally more socially responsible. Therefore, their risk perception will be low about SRI. They are eager to invest in SRI portfolios. Less educated investors are not much concerned about environmental issues. They think more, before investing in SRI portfolios. Their risk perception will be high and they may not keen about investment in SRI portfolios. Investors' who are having a high level of income, may easily cover their financial cost and prefer more to invest in the emerging investment type in Muslim countries. Their risk perception will be low. It is opposite in the case of low-income investor. So the hypothesis becomes;

H4: Risk perception and investment choices of socially responsible investors in Muslim countries are negatively correlated.

There are many social factors including religion, ethnicity, family, physical attributes etc. However, in this study our focus is on mainly two social factors; family and religion. An investor, who is strongly affiliated with religion (i.e. Islam), will prefer more to invest in Socially Responsible Investment Portfolios. They may not perceive risk highly because Shariah, social and ethical issues may be more important for them. They certainly will not go for such portfolios, which contain stocks against Shariah. As according to Irfan (2009) SRI is very much related to the Shariah of Islam. So, this factor directly influences their investment choices.

H5: Stronger the affiliation of investor with Islam, more socially responsible he will be.

Another social factor that we are exploring in this study is family of investor. There is a particular culture and traditions of every family. The norms and values of this culture influence the behavior of the investor. An investor, who is having a strong family influence to just invest in socially responsible portfolios, will definitely go for SRI. On the other hand, if the culture of the family has not so influenced, the investor may not make their portfolios less diversified. In case of family, there are certain other factors as well. For instance, economic status of the family of investor or education level as well. These all factors strongly influence the decision-making behavior of investor.

H6: Investor's family influence and investment choices of socially responsible investor in Muslim countries are positively correlated with each other.

Discussion And Practical Implications

The main purpose of our study is to build-up a model of social and demographic based investment behavior model of socially responsible investors in Muslim countries. We have taken a main variable "investment choices of socially responsible investors in Muslim countries" and two independent variables (demographic and social) check their effects on the dependent variable. Most previous researches have been conducted in Europe and USA in which mostly were comparative studies of socially responsible and conventional investors. Typically, in Pakistan not even, a single study has been conducted on a behavior of socially responsible investors because this concept is not practiced in Pakistan but still there are many opportunities. Our main aim is to educate the investors of Pakistan about SRI investments by making hypotheses of behavior of such investors and through literature about the progress of SRI's in European countries.

The SRI concept is very much common in Europe and United States but it is still not popular in Muslim countries. Europe is at the top in endorsing SRI through new principles. CSR and SRI are now becoming closely linked with each other. Only few Muslim countries have been adopted this emerging concept like Malaysia, Indonesia and India (Muslim majority country). Indonesia has established their own SRI index named SRI Kehati Index. Until now in Pakistan, this concept not even started. In fact, there are many opportunities, which are available to the investors. There is no such domestic firm in Pakistan, which gets benefit from foreign investment through foreign-based SRI funds, and there is no Pakistani SRI investment fund which exists. As mentioned earlier that CSR and SRI are now almost linked with each other so there are many firms in Pakistan, which are engaged in CSR. These firms should develop sophisticated CSR in order to attract SRI investments.

As according to Hayes (2001) young investors are more socially responsible so the young investors should take initiative towards SRI investments. They should start making their portfolios which are ethically and socially worthy. Education is another significant factor. Highly educated investors tend to be more socially responsible (Greene, 2005). Proper and relevant education must be provided to the investors on an individual basis. Before taking initiatives in attracting SRI's, purpose-based guidance must be provided to the individuals. When investors are having more knowledge about the financial markets, they do perform much better.

The Securities and Exchange Commission of Pakistan can play a prime role in promoting and taking SRI initiative. This could make Pakistan a positive reputable country to invest and do business. Some Pakistani firms are trying to take initiatives for promoting labor standards, environmental sustainability and social responsibility. There is still a hope that Pakistani firms will participate in foreign SRI funds. Non-existence of this involvement is another fence to the growth of Pakistan's economy.

Limitations And Future Research

In this study, we have developed the model of socially responsible investors' behavior and hypotheses related to the model. Not a single hypothesis have been tested so researchers are encouraged to test the hypotheses. It is recommended that to test these hypotheses, structured interviews can be taken. Questionnaires can be made to distribute among the socially responsible investors of Muslim countries in evaluating their investing behavior in terms of socio-demographic factors.

We are living in a huge society, so there are many other social factors like economic status or political system of a country, which may have an influence on the behavior of investors. In our study, these variables have been omitted so in future the effect of these variables can be tested. We have generated our model in a country (Pakistan) where this SRI concept has not yet been developed. Our purpose is to guide the investors of Pakistan to look at the opportunities and growth of this SRI investment. They can take initiatives by promoting sophisticated CSR in a country, which ultimately attract foreign SRI funds. Researchers can apply this model in another Muslim country where SRI is in practice.

Conclusion

Socially responsible investment (SRI) is now becoming an important part of financial markets in some Muslim countries. However, it is still not developed in countries like Pakistan. In this study, our main aim is to develop a behavioral model of socially responsible investors to provide direction to the investors of Pakistan so that they may get the idea. Generally, we have taken two independent variables; demographic (age, education and income level) and Social factors (religion and family influence). The demographic factor affects the investment choices of socially responsible investors through a mediating variable i.e. risk perception. Where as social factors affect directly the investment choices of investors. As according to previous researches, young investors are more socially responsible this may be the reason that they would prefer to invest in SRI with a less risk perception. Education is another demographic variable. As highly educated individuals are more concerned about environmental and ethical issues so they are assumed to have less risk perception while investing in SRI. Individuals with higher income would have less risk perception because they may cope up with the financial cost. More religiously affiliated individuals are assumed more social. Their portfolios would not contain the stocks of those companies, which are involved in businesses which are against the Shariah principles. They may give more preference to invest in SRI funds. Family's strong sway may force an investor to invest in SRI funds. The model of our study may apply to other Muslim countries. Firms in Pakistan must take initiatives to attract SRI funds and knowledge must be given to the investors. Further studies may find the reasons behind the lacking of this investment in Muslim countries. The attitude of investor towards SRI funds can also be examined.

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