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Social identification and investment decisions

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A B S T R A C T

This paper investigates the role of social identification in investment decisions. Social identity is an aspect of self-image based on in-group preferences and a perception of belonging to a social group. We collected survey data from retail clients of the only two banks in the Netherlands that exclusively offer socially responsible investment products and savings accounts. Our data show that almost half of the clients invest exclusively at these banks, whereas the other half also holds at least one conventional investment account. Clients vary widely in the extent to which they identify themselves with socially responsible investments (SRI). Investors with a strong social identification allocate substantially more of their wealth to these banks, both in terms of euros invested and in terms of percentage of their total portfolio invested. Social identification also mediates the effect of expected returns on SRI. Our results further show that social identification is stronger among highly educated, younger and low-wealth investors.

1. Introduction

Investors possibly gain non-financial utility from investments and savings at a bank that shares their personal values and thus enables them to identify with the bank. An important example is socially responsible investments (SRI) that could be driven by an individuals' social identity of being a responsible person. SRI is growing significantly in the United States (US SIF, 2014) and in Europe (EUROSIF, 2014). In the United States alone, $6.57 trillion of professional assets under management were SRI at the start of 2014 (US SIF, 2014). SRI mutual funds not only select companies on the basis of risk–return trade-offs, but also consider factors such as environmental policies and human rights. They often exclude investments in companies that deal with weapons, alcohol, tobacco, and gambling. Another example of how social identification could matter in financial markets is Islamic finance. Here, investors with a strong religious identity likely look for investments that fit their social values. Our paper focuses on SRI, but its conclusions might have broader implications for how social identity matters in financial markets. For instance, Islamic mutual funds pay close attention to social responsibility (e.g., Abdelsalam et al., 2014).

According to traditional models in finance, investors would only hold SRI funds if they provide at least the same risk–return trade-off as other investments. The papers of Derwall et al. (2005), Kempf and Osthoff (2007), and Edmans (2011) document that companies that score well on social-responsibility criteria such as eco-efficiency and employee satisfaction can

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financially outperform other companies. Investors might therefore be attracted to socially responsible banks because of financial reasons.

However, Riedl and Smeets (2014) show that many investors hold socially responsible mutual funds even if they expect returns to be lower and risk to be the same compared to conventional investments. The willingness of investors to hold SRI funds from which they expect lower returns can be ascribed to their social preferences. Other papers also show that investors do not just focus on returns and risk of their investments. Hong and Kostovetsky (2012) show that mutual fund managers who donate to the Democratic Party select stocks that score higher on social responsibility than the stocks that fund managers who support the Republicans select. Hong and Kacperczyk (2009) find that many institutional investors shy away from investments in so-called "sin" stocks, although these stocks actually provide positive abnormal returns.

This paper hypothesizes that social identification plays an important role in investment decisions of retail investors. Social identity is the portion of an individual's self-concept derived from perceived membership in a relevant social group (Tajfel and Turner, 1979). Social identification affects many economic decisions and outcomes such as gender discrimination in the workplace, social exclusion, and poverty (Akerlof and Kranton, 2000, 2005). To our knowledge, this paper is the first to investigate the role of social identification in investment decisions.

To this end, we administered a survey with retail investors of two socially responsible banks. The special nature of the banks creates an opportunity to study the effects of social identification. We measure clients' social identification and risk and return expectations, and we collect information on their overall investment portfolio. Both banks have been socially responsible from the start and provide two main types of services to retail investors. They offer in-house-developed SRI mutual funds based on criteria such as environmental performance, human rights, and employee satisfaction. Second, clients of these banks can open socially responsible savings accounts. These accounts differ from conventional savings accounts to the extent that the majority of the savings should be lent to companies that meet certain social-responsibility criteria. Because of this explicit focus on social responsibility, investors with strong social preferences likely see a fit between their own social values and the values at the banks.

Because we only have data on socially responsible investors, this paper cannot investigate the decision to open an investment or savings account at a socially responsible bank. Rather, we investigate whether social identification matters once an individual already is a client at a socially responsible bank. Our survey data show that clients differ substantially in terms of social identification and in terms of expectations on the performance and risk of mutual funds of these banks. As a result, clients allocate different fractions of their wealth to the socially responsible banks.

Our main result is that social identification plays a large role in investment decisions. First, we document an economically and statistically significant positive relation between social identification and the percentage of a client's total portfolio invested at the socially responsible bank. Second, social identification is also positively related to the absolute amount invested. Third, we find that investors with strong social identification hold a smaller number of investment accounts and savings accounts at competing banks or brokers. Moreover, we find that social identification mediates the effect of return expectations on allocations to the socially responsible banks in our sample.

Our paper mainly contributes to two streams of literature. First, we contribute to the literature on SRI. Several papers have conducted experiments or surveys on SRI with students, and find that non-financial considerations influence investment decisions (Pasewark and Riley, 2010; Glac, 2009; Barreda-Tarrazona et al., 2011). Surveys conducted among investors also confirm the importance of social factors in investments (Webley et al., 2001; Nilsson, 2008; Heimann et al., 2011). Others use administrative data and find that political or social preferences influence investment decisions (Bollen, 2007; Riedl and Smeets, 2014; Hood et al., 2014; Di Giuli and Kostovetsky, 2014). The current paper contributes to this literature by studying the clientele of two explicitly socially responsible banks and by showing that social identification is an important factor explaining the prevalence of SRI.

Second, previous work shows that social identity affects economic outcomes (e.g., Akerlof and Kranton, 2000, 2005; Bénabou and Tirole, 2011), but its relation to investments has received little attention. Our paper differs from previous studies by showing that social identity influences investment decisions. Social identification likely also influences investment decisions in contexts other than SRI. For instance, Pool et al. (2012) find that mutual fund managers are more likely to invest in their home states. Cohen (2009) shows that employees often invest a large fraction of their wealth in their employer's stock. Social identification might be an important driver of these and other observed investment patterns.

2. Background

Statman (2004) argues that investors want more than just a good return and low risk; they look for expressive benefits. We argue that investors get non-financial utility if investments fit their (desired) social identity. Social identity is an important concept in social psychology and organization (Tajfel and Turner, 1979; Mael and Ashfort, 1992), in marketing (Homburg et al., 2009), and plays a role in many economic decisions. Akerlof and Kranton (2000, 2005) develop a model in which identification enters directly into the utility function. People draw benefits from a behavior that contributes to a positive identity. Charness et al. (2007) argue that people "consult" their identity when making decisions. Identity can also be culturally determined. Khamis et al. (2012) find that disadvantaged caste groups in India spend more on visible consumption goods than the social groups with a higher status.

In many cases, people also choose their identity (Akerlof and Kranton, 2000, 2005). For example, they choose memberships of specific clubs and universities. Similarly, people can create a prosocial identity by investing in a socially responsible way.