Cleansing your conscience: The effects of guilt on Socially Responsible Investment decisions.

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Short Abstract

This paper explores the effects of incidental guilt on Socially Responsible Investment (SRI) decisions of retail investors. Moral emotions and guilt motivate prosocial behaviours. However, not much is known about the relationship between guilt and ethical investment. Do investors who feel guilty invest in ethical investments in order to clear their conscience? If so, are guilty investors willing to sacrifice their profits in order to restore their moral selves? Based on data from an online quasi-experiment among a sample of US retail investors, we find that individuals who experience incidental guilt choose to invest more ethically than those in a neutral state. We find that even after controlling for morality and individual attitudes towards social responsibility, incidental guilt is still a significant predictor for ethical decision-making. We show that when presented with a trade-off between social responsibility and favourable risk/return characteristics, guilty individuals tend to make more ethical choices than non-guilty ones. Our research sheds new light on the impact of moral emotions on prosocial behaviour in the context of financial decision-making. We provide new evidence for the substantial effect that guilt can have on sustainable investing.

Keywords: retail investors, socially responsible investment, morality, psychological motives, guilt, emotions.

J.E.L. Classifications: G11, M14, A13, D91, C25

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Extended Abstract

Introduction and Contributions

Socially responsible investment (SRI) is an investment style that incorporates moral considerations such as social, ethical, governance and environmental concerns into financial decision-making process. SRI is gaining momentum among institutional and retail investors (Sandberg et al., 2009). A number of scholars have explored what motivates retail investors to invest in SRI and whether it involves deviating from the core principle of a rational individual, profit maximization. Bollen (2007) found that ethical investors are willing to accept significant underperformance of SRI funds, which means that, apart from risk and return aspirations, moral judgement has a strong impact on investment decisions. According to Kohlberg & Gilligan (1971), emotional responses are a fundamental element of moral judgement formation. Hence, our study explores whether and how moral emotions impact the decision of retail investors to invest in SRI. Specifically, we investigate whether incidental guilt influences the willingness to invest in ethical funds. Guilt is one of the most prosocial moral emotions and there is an extensive number of studies that investigate the impact of guilt on prosocial behaviors (e.g. Tangney and Dearing, 2003). However, little is known about the effect of guilt on investment decisions and SRI. To our knowledge, this is the first study which explores the role of guilt in the context of sustainable investments.

Cotte et al. (2005) specified that when feeling guilty, individuals are likely to seek ways to eliminate the experienced feeling due to the strong negative nature of the emotion. One of the ways to do so is by attempting to balance a negative act with a positive one, which makes the feeling of guilt a powerful motivator for pro-social deeds (Zhong & Liljenquist, 2006). In line with this theory, findings show that guilt has a positive impact on cooperation, charitable giving, and proenvironmental behavior (Harth et al., 2013; De Hooge et al., 2011; Basil & Weber, 2006). Hence, we hypothesize that investors who experience guilt will invest in a more sustainable manner in comparison to non-guilty ones to cleanse their conscience.

In addition, we examine whether guilty investors are more willing to give up returns in order to invest in SRI. The moral dilemma between morality and profitability has previously been explored in the literature. Findings suggest that individuals are willing to give up certain amounts of return in order to invest ethically (Gutsche and Ziegler,
2019; Berry and Yeung, 2010; Glac, 2010; Barreda-Tarazona et al., 2011). However, there are no studies on the effect that moral incidental emotions could have on the trade-off between profitability and ethical investment. Our study aims to fill this gap by exploring whether guilty investors would give up more favorable risk/return investment characteristics for investing responsibly in comparison to their non-guilty counterparts. Our research contributes to the literature in different ways. Firstly, our results extend research on moral emotions and especially guilt and pro-social behavior (Haidt, 2003, De Hooge et al., 2011) to the SRI investment decision-making process. Additionally, we contribute to the stream of literature that explores how emotions and momentous states influence financial decision-making (Lerner et al., 2004; Lo et al., 2005; Fenton-O’Creevy et al., 2011). We also provide new insights into to what extent retail investors are willing to sacrifice attractive investments in order to invest on SRI. Our findings are important for industry professionals, financial advisors and policymakers and indicate that moral emotions are a key driver of ethical investments.

Data and Methodology
Our methodology is based on an extensive online experiment that was carried out via Amazon MTurk in November 2019 among a representative sample of US retail investors. Our dataset consists of 403 participants, who were randomly allocated into induction and control groups. Participants were rewarded in line with the standard procedures, while the study complied with the University’s Ethics policies. A guilt induction in a form of autobiographical recall was performed on the induction group, while control group had a task to describe their regular Tuesday morning. This was followed by an investment-based Discrete Choice Experiment (DCE), where participants were presented with various combinations of investment attributes including risk, return and sustainability. The task consisted of a set of 10 stated preference questions, and participants were asked to select which of the funds, Funds A, B and C, they would like to invest in. Each fund in each question had its own level of risk: low, medium or high; return: 5%, 10% or 15%; and sustainability rating, namely green, yellow or red.

We also control for individuals’ demographic information, financial literacy, morality, perceived consumer effectiveness (PCE), risk tolerance, social responsibility, financial knowledge and experience as well as perceptions regarding responsible investments’ risk and return in comparison to conventional funds. Our investment task allows us to
understand whether guilt indeed directs participants towards more sustainable choices, and to compare the average percentages of expected return that guilty and non-guilty participants were willing to give up to invest ethically. We explore whether guilt can explain the variation in Socially Responsible decision making by using regression models. The dependent variable is the average number of times a green fund is chosen - out of 10 - and limited by the number of DCE items. For this reason, we implemented ordered probit regressions as a basis for our models.

Results and Conclusions
Our results provide evidence that, on average, guilty participants make significantly more sustainable choices that non-guilty investors. Moreover, individuals who received the guilt induction, were willing to give up more returns in order to invest ethically than those who did not. Controlling for additional variables, we show that incidental guilt has an effect on SRI choices of individuals across different morality and social responsibility levels indicating that the feeling of guilt does not only affect those who are more prone to feeling so and have higher morality, but also investors with low morality and social responsibility. When morality and social responsibility are included in our model, morality and social responsibility are significant predictors of sustainability choices. However, guilt still significantly explains the variation of SRI investment preferences.

Additionally, our findings on personality traits and demographic information of retail investors show that individuals who are more risk tolerant, financially literate and those who have a stronger belief that their actions contribute to solving environmental, social and governance (ESG) issues make more sustainable SRI choices. Most of these relationships are in line with previous studies that explored the heterogeneity of SRI investors as well as personality traits of investors (e.g. Nilsson, 2008; Martenson, 2005; Straughan and Roberts, 1999).

Our findings shed new light on how everyday emotions impact decision-making process of retail investors highlighting that they can be important motivators of SRI.
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