

Ethical Investment: Money with Values

By Wayne Visser

Ethical investment – also called social investment, socially responsible investment and green investment – is an international trend which refers broadly to the conscious use of investments to achieve social, ethical and environmental performance objectives, over and above the usual financial returns. The relevance of the ethical investment movement lies in its potential to deliver good financial returns while also helping to deliver on the countries social objectives, like empowerment, good labour practices, and environmentally sustainable development for instance.

Apartheid as a Catalyst

The phenomenon can be traced back to the beginnings of the corporate social responsibility movement in the United States in the 1930s, although it only really became visible in the 1970s. At this time, church and university groups set up the first funds, such as the Pax World Fund, to avoid investment which supported the Vietnam War and the Apartheid regime in South Africa. Since the political transformation of South Africa is widely regarded as one of the great motivators and success stories of ethical investment, this background is worth recalling.

Many would argue that it all began in 1970. South Africa had just been ejected from the United Nations for its apartheid policies, and Reverend Leon Sullivan proposed that this be reinforced by the adoption of a set of minimum standards by US companies with South African operations. These standards, formalised as the Sullivan Principles in 1977, included clauses on non-segregation of facilities on racial grounds, affirmative action for blacks, and social upliftment for underprivileged employees. Various civil rights, labour and religious groups took it upon themselves to monitor and report on companies' adherence to these principles.

In 1982, Connecticut became the first US legislature to require all its investments to be screened against the Sullivan Principles, setting the precedent for similar action by other bodies. Then, as the South African regime toughened its stance on apartheid, complete disinvestment began. As a result of increasing stakeholder pressure and led by Citibank and Chase Manhattan Bank, 135 US industrial companies pulled out of the country between 1985 and 1987. Over the same period, the level of US Funds screened for South African links rose from less than \$100 million to nearly \$400 million.

Similar ethical investment forces were at work in the UK over the same time. Lobby organisations like Christian Concern for South Africa, End Loans to South Africa, and the Anti-Apartheid Movement, put tremendous pressure on the major UK banks (Midlands, Standard Chartered and Barclays) to withdraw from South Africa. There were also campaigns against users of South African gold and suppliers of oil to South Africa (especially Royal Dutch Shell). These were given added weight by the emergence of screened ethical unit trust and investment funds with avoidance criteria for oppressive regimes chiefly targeting South Africa. By 1985, South Africa was forced to default on its foreign loans, and in 1986 the US passed the Comprehensive Anti-Apartheid Act, with the European Community following suite shortly after to consolidate international financial sanctions.

Types of Ethical Investment

There are basically two types of ethical investment: shareholder activism and screened investments.

Shareholder activism is where groups of shareholders campaign for changes to what they perceive as the unethical practices of the companies they have a technical stake in, often by using the annual general meeting as a platform for their awareness and lobbying tactics. In the USA, assets of \$922 billion are held by investors who play an active role in shareholder advocacy on social responsibility issues, compared to \$736 billion in 1997. This category is defined as investors who have sponsored or co-sponsored resolutions on social issues in the last three years.

Screened investments typically include avoidance of investments in areas such as oppressive regimes, armaments, animal exploitation, tobacco, gambling and alcohol production. The converse might include deliberate support of investments in companies with a good record in environmental awareness, employee welfare, or community involvement. But this is an evolving field which has grown to embrace over 300 different criteria, with gun control and biotechnology among the more recent issues to be factored in. This category of ethical investment has seen the largest growth of all.

Growth of Ethical Investment

A special feature on socially responsible investing in Tomorrow Magazine in 2001 showed that, after growing steadily throughout the 1970s and 1980s, ethical investment took off like a rocket in the 1990s. In the US, ethical investment funds grew 82% between 1997 and 1999, about twice the overall growth rate, and reached a total of \$2.2 trillion, some 13 percent of all funds under management. There are now around 200 ethical mutual funds in the US.

The growth picture in Canada has been similar, though the totals are smaller – growth of more than 75 percent between 1998 and 2000, about twice the rate of growth of the overall market, leading to a total investment of \$32 billion. The UK market doubled every three years in the 1990s, reaching almost \$5.9 billion in 2001.

From a start only four years ago, France now has 35 ethical investment funds with assets of more than \$840 million. Across the rest of Europe, 20 new funds have been started every year since 1995, reaching a total of almost 300 in 2001, worth an estimated \$2.5 billion. In Asia, less than \$2.5 billion is invested in ethical funds, but interest has spread from Australia to Japan, Hong Kong and Singapore.

Ethical Investment Indexes

While there are now a plethora of ethical investment funds globally, several indexes serve to illustrate how ethical investments gone mainstream, including the Business in Environment (BiE) Index, the Dow Jones Sustainability Group Index and the Tomorrow Top 30 Index.

The Business in Environment (BiE) Index

The Business in Environment (BiE) Index of Corporate Environmental Engagement is used to measure companies' awareness of the environmental issues relevant to their business and the need to have appropriate management processes in place. The index surveys the FTSE 350 listed companies plus the top 25 UK companies by turnover not listed on the FTSE.

BiE measures and ranks how well companies are doing on ten key environmental management parameters, including: policy, board members, targets, objectives, environmental management systems, audits, stakeholder communication, employee training and development, supplier focused initiatives and environmental stewardship. In addition, companies are invited to complete the performance measurement section of BiE, which includes questions on: energy consumption, transport, greenhouse gas emissions, waste, water consumption and environmental compliance.

The Dow Jones Sustainability Group Index

The Dow Jones Sustainability Group Index (DJSI) was launched in 1999 and, by the end of December 2000 had a market capitalisation of the exceeded \$5 trillion. The DJSI family includes one global index, three regional indexes – covering North America, Europe and Asia Pacific – and one country index covering the United States.

Companies are selected and scored for the DJSI using eight economic criteria (including risk and crisis management, strategic planning and corporate governance), seven environmental criteria (including environmental performance, environmental charters, environmental policy and environmental, health & safety reporting), and eleven social criteria (including stakeholder involvement, social policy, standards for suppliers and remuneration). In addition, there are industry specific criteria (such as research and development, eco-design, hazardous substances and

community programs). Each of the five broad regional indexes has four additional narrow, specialised sustainability indexes that exclude investments in alcohol, gambling and tobacco.

Tomorrow Index

Tomorrow magazine has teamed up with Credit Suisse to rank the 30 companies which appear most frequently in the portfolios of the 200 of the world's funds which call themselves socially or environmentally responsible. At the beginning of 2000, the top five companies were, perhaps surprisingly: Cisco Systems, Intel, Microsoft, IBM and Merck. The dominance of the technology and telecoms companies echoes the top 25 holdings of the two prominent US social investment indexes, the Domini Social Equity Index and Citizens Index.

Screened Investments in South Africa

As the demise of the old government structures became evident, the focus of the ethical investment movement began to shift toward designing a framework for the emerging post-apartheid South Africa. Today, many of the former funds which excluded South African companies from their portfolio now deliberately include them subject to various ethical criteria.

The UK Ethical Investment Research Service, for example, evaluates 28 ethical funds based on their avoidance of investment in UK companies with South African operations that pay wages below a calculated minimum living level, and/or have less than certain percentages of black Africans in their workforce.

Within South Africa, the South African Council of Churches was among the first to look seriously at ethical investment, although they have yet to translate this into practice. Nevertheless, ethical investment has begun to find its niche among South African financial institutions. BusinessMap lists 16 South African socially responsible funds in existence at the beginning of 2000. BusinessMap monitors these funds, using a Social Impact Rating methodology, to attempt to verify to what extent they are achieving their noble objectives. The most recent addition to this list is the Earth Equity Fund, launched by Fraters Asset Management in 2001. Each of these funds tends to have its own unique characteristics. For example:

- GCAM's Community Growth Fund focuses on worker participation, with criteria including black partnership stakes, training, affirmative action, environment, and occupational health and safety;
- Southern Life's Futuregrowth funds have a national development emphasis, linking its investments to the Reconstruction and Development Programme, especially major infrastructure projects and black empowerment deals; and
- Fraters' Earth Equity Fund have a comprehensive approach to assessing triple bottom line (social, environmental and economic) performance using a specialised research organisation called Corporate Footprint.

The Community Growth Fund (CGF), the first to be launched in 1992, is worth examining in more detail to illustrate the role of these vehicles in promoting sustainable development. The CGF, 50% owned by trade unions, has grown its portfolio of assets to over R700 million.

From an initial investment universe of only 20 companies in 1992, CGF now has over 80 organisations which meet their standards. The criteria, which are applied to companies by the Labour Research Service, are equally weighted and disqualify any company which scores below 50 percent. The criteria are as follows: create jobs through innovation and expansion plans; training of workers to enhance skills; economic and social empowerment; equity through affirmative action in the workplace; good conditions of employment; promote sound environmental practices; apply high health and safety standards; and demonstrate open and effective corporate governance.

Commentary in one of CGF's Annual Reports is illustrative of their approach. For example, the reasons for rejecting Iscor were cited as follows: "Appalling relations with the union, doubts about the effectiveness and 'tokenism' of their affirmative action policy, an ineffectual retraining programme, environmental problems, and the re-deployment of white managers as consultants at

higher cost." Positive aspects were "a reduction in injury and fatalities, full-time shop stewards and improved conditions of employment."

Corporate assessments like this by the new ethical investment watchdogs are a tool in the hands of the public to further the sustainable development agenda. And after the key role of the ethical investment in South Africa's political miracle, could it now be the financial vehicle through which a desperately needed socio-economic miracle is brought to life?

Does Ethical Investment Pay?

In a recent survey of the UK ethical fund, NM Conscious Fund, it was revealed that 87 percent of the unit owners had bought on the strength of the ethical approach of the fund, while only 7 percent had done so on the grounds of investment performance. In other words, these investors were prepared to sacrifice their level of financial returns for 'social returns'. But is this really necessary? Do ethical funds under-perform?

While financial theorists argue that by limiting the diversity of investment choice, ethical screens compromise potential returns, in practice very few analysts have been able to show under-performance except for some of the exclusive green funds. Most (among them Fortune magazine) conclude that the ethical funds either reflect the average for mutual funds, or significantly outperform the market.

For example, an analysis of the US Domini Social Index of 400 ethically screened companies shows it to marginally but consistently outperformed the Standard & Poors 500 Index between 1986 and 1992.

In 1999, the 20 largest socially responsible funds averaged returns of 5 percent above the benchmark S&P 500 index, according to Credit Suisse. And the Dow Jones' Group Sustainability Index has also outperformed the market in its two years of existence.

According to Russell Sparkes, author of the book *The Ethical Investor*, the explanation for this phenomenon can be found in a number of possible effects:

- The smaller companies effect - that responsible investors are forced to avoid large conglomerates, and concentrate on smaller companies which over time grow faster;
- The anticipation effect - that exclusion of certain companies on grounds of moral or environmental repugnance anticipates later legal action and financial problems;
- The information effect - that properly done ethical/green investment needs a higher level of knowledge about the companies invested in than normal investment managers possess; and
- The positive selection effect - that the positive criteria used by such funds help them target well-run companies.

It is important not to lose sight of the wood for the trees however. What are the real returns of ethical funds? Their true value is in directing money towards the fulfilment of social and environmental goals which usually get under-funded in the marketplace. Their returns may not be short term financial profits and may not directly benefit the individuals making the investment. Instead, their legacy may be a better world for future generations to live in.

In addition, ethical investment may be an important system of checks and balances to counter the unrestrained might of the large, influential companies of the world. It may be the very vehicle we need to keep business accountable and responsible; to ensure that they don't sell off the quality of life of our unborn children in the name of 'mammon'.

Article reference

Visser, W. (1997) Ethical Investment: Money With Values. *Money Values* online column.

~ *Ethical Investment: Money with Values* ~
Wayne Visser, *Money Values*, 1997

Part of the WAYNE VISSER ARTICLES Series

Copyright 1997 Wayne Visser