What is a socially responsible or ethical investment?

When an investment is ethical (or socially responsible)?
Terminology

- Ethical
- Socially responsible
- Social
- Green
- Alternative
- Targeted
- ... investing or investment

A definition

“Ethical investment” or “socially responsible investment” is broadly defined as the integration of personal values, social considerations and economic factors into the investment decision”

(Michelson et al., 2004, p. 1)
Another definition

In a broad sense ethical investment is “the exercise of ethical and social criteria in the selection and management of investment portfolios, generally consisting of company shares (stocks)”.

(Cowton, 1994)

“Ethical investment refer to a set of approaches which include social or ethical goals in addition to more conventional financial criteria in decisions over whether to hold a particular investment”

(Cowton, 1999, p. 99)

“There’s nothing wrong with making money but it’s how you make the money that counts” (Murray, 2003)

“In ethical investment we are interested in how a company makes its money, not just how much”

(Cowton, 1999, p.99)
Selection and management

TO HOLD

= To buy
To sell
To maintain
To manage
...

Ethical investors

- Individuals - private investors
- Groups
- Institutions
- Public investors
- ...
- Religious organization
- Pension funds
- University (foundations)
- ...

- Financial and non financial institutions
- Managing their own or someone else money
Development of SRI

The *prima facie* ethical case for SRI is that investment should not be immune from ethical scrutiny, for there is nothing special about investment in general that warrants its exclusion from the ethical considerations that are brought to bear on other areas of life


Ethics and investments

Any individual or group which truly cares about ethical, moral, religious or political principles should in theory at least want to invest their money in accordance with their principles” (Miller, 1992, p. 248).

→ approving of an immoral action is immoral
→ making profit from it indicate acquiescence …
A brief history

- Religions (Jewish, Christian and Islamic laws)

- Social, political and environmental movements (e.g.: apartheid in South Africa)

Two investor motivations

• “Feel good” investors
  → Feel the need to put their money aligned with their personal values and priorities

• “Social change” investors
  → Feel the need to support and encourage improvements in quality of life (or in corporate behaviour)
Three strategies

Screening

is the practice of including or excluding companies (or States) based on social and/or environmental criteria.

Engagement (or shareholder activism)

involves SRI who take an active role as owners (shareholders). These efforts include dialoguing with companies, filing, co-filing and voting resolutions.

Community investing

provides capital and other services to communities underserved by traditional financial services institutions.

Screening

Screening is the practice of excluding or including companies from investment portfolios based on a range of social and environmental criteria.

(Michelson et al., 2003)

- Negative screening = “never if”
- Positive screening = “only if”
Negative screening = avoidance

WHAT?
- Tobacco
- Alcohol
- Gambling
- Military contracting
- Pornography
- GMO
- Etc.

HOW?
- Treatment of employees
- Advertising practices
- Environmental concerns
  Etc.

WHERE?

Common negative screens

- Armaments and nuclear weapons
- Alcohol
- Hazardous substances (such as pesticides, chlorine)
- Environmentally damaging practices
- Poor employment practices
- Animal exploitation (e.g. fur industry, factory farming)
- Activities, processes or products that have a major impact on climate change (e.g. automobile, oil and gas industry, road building, etc.)
- Ozone-depleting substances
- Nuclear energy
- Gambling
- Animal testing
- Genetic engineering
- Tobacco
- Oppressive regimes
- Pornography
- …

A.A. 2012-2013

Silvana Signori – University of Bergamo
Positive screening = supporting

**WHAT ?**
- Healthy food
- Green energy
- Organic producing
- Pollution control equipment
- Etc.

**HOW ?**
- Treatment of employees
- Advertising practices
- Environmental concerns
- Etc.

→ Stakeholder analysis

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**Common positive screens (1)**

| Human Resources | Integration of human resources issues into corporate strategy, Promotion of labour relations, Encouraging employee participation, Career development, Training and development, Quality of remuneration systems, Improvement of health and safety conditions, Respect and management of working hrs. |

Source: Vigeo

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A.A. 2012-2013
Silvana Signori – University of Bergamo
<table>
<thead>
<tr>
<th>Environment</th>
<th>Customers and Suppliers</th>
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<td>Environmental strategy and eco-design,</td>
<td>Product safety,</td>
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<td>Pollution prevention and control (soil, accident),</td>
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<td>Protection of biodiversity,</td>
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<td>Management of local pollution,</td>
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<td>Management of environmental impacts from transportation,</td>
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<td>Management of environmental impacts from the use and disposal of products/services.</td>
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</tbody>
</table>

Source: Vigeo A.A. 2012-2013

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Human Rights

- Respect for human rights standards and prevention of violations,
- Respect for freedom of association and the right to collective bargaining,
- Elimination of child labour and abolition of forced labour,
- Non-discrimination.

Community involvement

- Promotion of social and economic development,
- Societal impacts of company’s products and services,
- Contribution to general interest causes.

Corporate Governance

- Board of Directors,
- Audit & Internal Controls,
- Shareholders’ rights,
- Directors & Key Executives remuneration.

Source: Vigeo
Negative and positive screening

1) Negative + positive selection

2) Trade off between good and bad features

The application of screening

- Not static
- Extension
- Primary and secondary involvement
- Significance/threshold
- Best-in-class or best-in-industry approach
**Best-in-class approach**

A best-in-class or best-in-industry approach allows to compare companies within the same industry sector (usually a “critical” sector) and ranked against each other, not against those outside the industry.

- To seek good financial returns
- To improve the overall social performance of firms in particular sectors (chemical, mining, automobile, etc.)

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**The question of information**

Information is vital for the successful implementation of ethical investment criteria. **Sources**: corporate annual reports (financial and ethical/social reporting), press releases, newspaper articles, statistics, etc.

- Reliability, availability and cost
  → social rating agencies
The need of transparency

Ethical investment as a process...
The identity of specific criteria might become less important than “… the way in which issues are identified and considered, the degree of information obtained, (and) the action that is taken in response” (Taylor, 2001, p. 59 quoted in Michelson et al., 2004, p. 4).

Engagement or shareholder activism

Engagement can be defined as “influencing corporate policy by virtue of the position as investor and the associated rights”

(Hummels et al., 2004)

⇒ Exit vs voice (Hirschman, 1970)
How do you do it?

Private methods
- Raising questions or discussion of social issues in routine meetings between institutional investors and company management.
- Writing to company management about issues of concern.
- Arranging special meetings to discuss such matters.
- Writing to other shareholders to express concerns.
- Joining with other like-minded investors to undertake some or all of the above.
- Informing other investors on the dialogue as to build up pressure.

More public mechanisms
- Attendance at annual general meetings to ask questions.
- Proposing shareholder resolutions.
- Exercising voting rights, e.g. on the adoption of the report and accounts or the re-election of directors.
- Calling an extraordinary general meeting.
- Issuing press briefings.

Source: Just Pensions, a guide for trustees and fund managers, May 2001

Soft and hard engagement

Comunication
Dialoguing
Support
Filing resolution
Voting

Soft engagement

Shareholder activism

Hard engagement
Shareholder resolutions

Shareholders in a publicly traded company may introduce shareholder resolutions, or proposals, to the company management to be voted on in the next annual proxy vote. These resolutions may pertain to company policies and procedures, issues of corporate governance, or other issues of social responsibility or environmental concern. Shareholder resolutions are a powerful way for shareowners to encourage corporate responsibility and discourage company practices that are unsustainable or unethical. (www.ussif.org)

Who may file a resolution?

The U.S. Securities and Exchange Commission (SEC) recognizes that generally any shareowner holding at least $2,000 in stock, for a minimum of one year prior to the company’s annual submission deadline, may introduce a shareholder resolution. However, for maximum efficacy it is recommended that individuals come together to form a shareholder coalition in order to increase the impact of their proposal. Often, a shareholder resolution will fail to win a majority of votes, but still succeed in persuading management decisions because the resolution was favored by a significant number of shareholders. (www.ussif.org)
What is a Proxy Voting?

Shareholders, as owners of a publicly traded company, have the right to weigh in on important issues by participating in proxy voting. Shareholders affect change in management’s policies and procedures through participation in the company’s annual general meeting either in person, or more commonly, by proxy voting remotely, via mail, phone, or online. Proxy voting is the primary means by which shareholders are able to direct company management to act in a socially responsible manner. (www.ussif.org)

Proxy Voting (2)

Prior to the annual meeting, every shareholder in a company receives proxy resolutions (or proxy statements) and voting materials, via mail or email. These materials inform investors of issues for consideration at the annual meeting each year. It is important to review all materials, read the resolutions presented by other shareholders, and vote your proxy ballots in accordance with your values and what you believe will improve the company's bottom line. (www.ussif.org)
Shareholder resolution process

Focus on …

- Shareholder activism vs shareholder advocacy (advocacy campaigns)
- Coalitions (e.g.: ICCR – the Interfaith Center for Corporate Responsibility)
- Transparency
Community investing

Community Investing consists on providing capital and other services to communities (but also sectors, people, etc.) that are underserved by traditional financial services institutions.
How does community investing work?

Community investing institutions use investor capital to finance or guarantee loans to individuals and organizations that have historically been denied access to capital by traditional financial institutions.

…. follows

The community investing institution typically provides training and other types of support and expertise to ensure the success of the loan and its returns for investors.

(www.ussif.org)
What does community investing do?

Community Investing projects are small and local, and work by lending individuals and local groups the capital they need to improve their own communities in a socially positive and environmentally sustainable way. They focus on affordable housing, small business creation, development of community facilities, and the empowerment of women and minorities. (www.ussif.org)
Markowitz Right
Markets are pretty efficient, and investors owning a subset of the market portfolio must therefore incur a diversification cost.

Markowitz Wrong
Investors owning a subset of the market portfolio do not necessarily incur a diversification cost.

Moskowitz Right
A portfolio of socially responsible companies should outperform a portfolio of less-responsible firms.

Moskowitz Wrong
No Contradiction: Financial markets are efficient enough that SRI portfolios incur a diversification cost, but inefficient enough for this cost to be offset by an SRI anomaly.

Moskowitz Wrong
A firm's social record has no bearing on its stock performance.

Contradiction: The fact that SRI portfolios do not appear to underperform market benchmarks remains unexplained.

No Contradiction: SRI portfolios have the same performance as unscreened portfolios because screening introduces no unaddressable diversification costs and there are no tradeable information effects.

Effects due to the investor's ethical selection

- Diversification
- Geographic and/or sectorial diversification
- Markets and/or investment sectors
- Segmentation
- Small cap growth

Performance

- Information costs
- Information
- Forecast
- Risk adjustment
- Timing
- Fund dimension
- Learning
- Fund Management ability

Effects due to managerial criteria
Ethical or traditional benchmark?

One major challenge is to choose an appropriate 'benchmark' portfolio against which to judge performance. A general stock market index might seem to be a good yardstick, but ethical funds tend not to be invested in many of the larger companies because they are likely to contravene at least one negative criterion.

(Cowton 1991)

Trade-off ethics/profit
Ethical complexity

- Lack of homogeneity
  - Pluralistic society
  - In criteria adopted by SRI
  - In the application of the criteria
- The need for transparency

- Eurosif transparency guidelines
- etc.

From margin to mainstream?

- Institutional investors’ economic and social power
- Government legislation
- Ethical indexes (Dow Jones sustainability indexes, FTSE4Good, Ethibel, etc.)
Bibliography


To know more…

Websites suggested:
- [www.uissf.org](http://www.uissf.org) - The Forum for Sustainable and Responsible Investing
- [www.eurosif.org](http://www.eurosif.org)
- [www.iccr.org](http://www.iccr.org)
- …