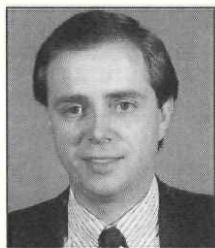


SOCIALLY RESPONSIBLE INVESTING

Is It Successful?

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Socially responsible investing (SRI) came to prominence in the 1970s when persons protesting apartheid in South Africa refused to invest there. Today, SRI is an integral part of the investment culture. Its proponents see SRI as a way to promote practices of which they approve (such as concern for the environment) and discourage those of which they do not (such as nuclear weapon manufacture). However, more time and studies are needed to tell whether SRI is generally a successful way for investors to affect corporations and society in general.

WHAT IS SRI?

SRI appears to have as many definitions as it has proponents and detractors. In a roundtable discussion in *Pension World*, John Schultz, former president of the Social Investment Forum, indicates that socially responsible investing "involves reallocating scarce financial resources among competing investment opportunities, with the objective of maximizing financial and social well-being for the investor and the underlying corporation."¹

Summary

Socially responsible investing (SRI) has been defined as "the integration of social or ethical criteria into the investment decision-making process." Based on the values they hold, investors distinguish socially responsible investments from those which are not by implementing social screens: nonfinancial criteria applied in the decision-making process.

Socially responsible investors typically follow one of three approaches to ethical investing: avoidance of businesses whose activities they do not support, a positive approach where they seek investments that will enhance the quality of life, and an activist approach where they attempt to

In a less positive look at SRI, Marcia Berss notes: "What is socially responsible to one person is irresponsible to someone else. . . . Some people regard building weapons as a threat to peace; others think that it is America's powerful weaponry that keeps the peace."²

Amy L. Domini, a principal in Kinder, Lydenberg, Domini & Company, succinctly defines SRI as "the integration of social or ethical criteria into the investment decision-making process."³

SRI SCREENS AND APPROACHES

Based on the values they hold, investors distinguish socially responsible investments from those which are not by implementing social screens: nonfinancial criteria applied in the investment decision-making process. The **Box** presents some of the more common screens used during the development of a socially responsible portfolio. Socially responsible investors use these or other screens in various combinations, typically following one of three approaches to ethical investing:

- **Avoidance:** Investors who follow this

influence the company's activities. In addition to individuals, many institutional investors are heavily involved with SRI.

Activist investors can judge their investments' performance by the success of their shareholder activities. Investors might also look at the societal effects of their investments. If investors are seeking to change the corporation or society, SRI has proven to be successful. Empirical studies have shown mixed results with respect to the financial performance of SRI, but the findings tend to show that SRI has minimal impact, either positively or negatively, on investment returns. Nevertheless, many factors indicate that SRI may be here to stay.

approach prefer not to benefit from business activities they do not support in other areas of their lives. With this strategy, the effect of screens is generally to eliminate companies from the universe of potential investments.

• *Positive approach:* The positive approach complements the avoidance approach. Under the positive approach, investors seek investments that will enhance the quality of life.

• *Activist approach:* Some ethical investors want to do more than avoid "bad" companies or invest in "good" ones. Activist investors attempt to influence the company's activities by voting their shares at annual stockholders' meetings or by sponsoring proxy resolutions to change some aspect of the company.

In addition to all the usual financial risks encountered by any investor, socially responsible investors also face the risk of their social aims being misapplied or ignored by their investment counsel. To ensure that social screens are being implemented as desired, socially responsible investors must regularly review the performance and activities of the investment managers who are responsible for implementing the stated social screens.

THE SOCIALLY RESPONSIBLE INVESTOR

In a general sense, socially responsible investors want their investments to be compatible with their personal values. Accordingly, what constitutes an ethical investment depends on the individual investor's views, since values and ethics are personal.⁴

A study published in 1991 noted that typical socially responsible investors "are younger and better educated compared to other investors. [They] most frequently identified environmental and labor relations issues when asked what determines socially responsible corporate behavior. Although they valued socially responsible behavior in companies they invested in, they were not willing to sacrifice financial returns to achieve it."⁵

What constitutes an ethical investment depends on the individual investor's views.

In addition to individuals, many institutional investors are heavily involved with SRI. Pension funds are taking an increasingly active role in SRI by using "economically targeted investing," a method of investing to achieve a market rate of return and, in addition, a benefit (social or economic) to the public at large.⁶ Also active in SRI are community development banks, regulated financial

institutions that make loans to people living, working, and doing business in low- or moderate-income communities to foster permanent, long-term economic development.⁷

MEASURING THE SUCCESS OF SRI

"Success" in SRI can take on many different meanings, but has three fundamental measures: results of investor activism, effects on society, and financial performance.

Results of Investor Activism When activism is the investment objective, its goals are usually not directly related to the financial return of the investment. Rather, activists are generally more concerned with using their rights as voting shareholders to effect some change within the target firm. Accordingly, success is likely to be assessed

COMMONLY APPLIED SOCIAL INVESTMENT SCREENS

- Military contracting
- Alcohol and tobacco
- Gambling
- Nuclear power
- Environmental record
- Product quality and attitude toward consumers
- Corporate citizenship
- Employee relations
- Cultural diversity

in a qualitative manner.

Since corporations operate on a one-share, one-vote system, individual shareholders generally have little influence on corporate resolution voting. Since the early 1960s, however, individuals and small organizations have used shareholder resolutions and participation at annual meetings as mechanisms to educate shareholders and the general public and to expose corporate wrongdoings.⁸

However, institutional investors (banks, pension plans, insurance companies, etc.) have enormous financial clout and have taken an increasingly active role in shaping the corporate policies of their holdings. Corporations cannot take the economic might of institutions lightly: By 1995 union pension funds alone will amount to more than \$3 trillion.⁹

Activist investors can judge the performance of their investments by the success of their shareholder activities. In the 1990s many social resolutions are receiving 10 percent to 25 percent of votes, and corporate governance resolutions are gaining 20 percent to 50 percent.¹⁰ Care must be taken, however, to ensure that the investors' fiduciary responsibilities are not breached in the name of shareholder activism.

Societal Effects As with the results of investor activism, this measure of SRI's success is difficult to assess. Investors can use any combination of the three SRI investment approaches discussed earlier to bring about societal change. Through *avoidance*, investors can boycott a company's products, equity instruments, or debt instruments in order to enlighten the general public about an area within the company that is in need of change. By using a *positive approach*, shareholders can support a corporation's activities by purchasing that firm's products or investment securities. Finally, they can use the *activist approach* (as discussed in the preceding section) to exert direct or indirect pressure on a corporation to make changes that are in the best interest of society.

The societal effects of responsible investing can be difficult to assess.

Financial Performance

This criterion for success is easier to quantify than the other two measures. Even so, quantitative measures are sometimes difficult to evaluate. Quantitative performance statistics can be calculated for any portfolio, regardless of the degree of its SRI ambitions. However, without some meaningful benchmark with which to compare the statistics, the facts and figures associated

with the portfolio are not of much use.¹¹

The difficulty in finding an adequate benchmark for comparison of SRI portfolio performance lies in the unique nature of the portfolios. As when comparing apples and oranges, one needs to know the difference between the two fruits, as well as the difference between a Granny Smith and a Golden Delicious.¹² In other words, the benchmark used for comparison of an SRI portfolio must closely resemble the portfolio for the comparison to be meaningful, and this is precisely the difficulty.

Much of the financial performance literature tends to be generated by groups or individuals that have a vested interest in depicting a positive or negative image of SRI's financial success. In the field of finance, the most independent and reliable analyses of topics are often those generated by academia. Unfortunately, empirical studies that address the financial performance of socially screened portfolios are relatively scarce. Writings on SRI in academic journals have focused primarily on the effects of divestment of South African holdings. In general, these studies indicate that the costs associated with divestment are significant and that the avoidance of specific securities may not necessarily improve an investor's financial situation.¹³

Two recent empirical studies have found inconsistent evidence regarding the impact of social and ethical investment screens on portfolio returns. One researcher found that, for the most part, ethical screening of securities has an insignificant impact on overall portfolio returns. Companies with good environmental records, policies of charitable giving, and an absence of

nuclear and defense work achieve higher-than-normal returns. However, companies that exhibit good performance on family issues earn lower-than-normal returns.¹⁴

A second study found inconsistent results during the test period. For 1991 the results indicated that investing in socially responsible firms would have earned higher returns than investing in socially undesirable securities. However, during 1992 and 1993 the socially undesirable securities outperformed the socially responsible securities.¹⁵

A report issued in 1993 by Good Money Publications compared the performance of social funds with overall mutual fund averages. In general, a majority of the socially screened funds underperformed the mutual fund industry averages.¹⁶

WHAT DOES IT ALL MEAN?

Is socially responsible investing successful? The answer to this question depends on the investors' objectives. If they are seeking to change the corporation or society, SRI has proven to be successful. Empirical studies have shown mixed results with respect to the financial performance of SRI, but the findings tend to show that SRI has minimal impact, either negatively or positively, on investment returns.

What does the future hold for SRI? Many factors indicate that SRI may be here to stay. The current administration in Washington, DC, has a decidedly "green" penchant, so future federal legislation may place a greater emphasis on environmental and societal concerns than in recent years. The aging generation of baby boomers is showing increasing attention to environmental and societal concerns. And many companies, both public and private, are recognizing that being a good corporate citizen can be a profitable exercise.

The bottom line on SRI is that the jury is still out. Until more high-quality, empirical studies have been performed, socially responsible investors will have to rely on their own evaluation of the relative merits and success of SRI. □

NOTES

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3. Peter D. Kinder, Steven D. Lydenberg, and Amy L. Domini, eds., *The Social Investment Almanac: A*

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9. M. Brause, "Issues to Consider in Social Investing," *Pension World*, June 1983, p. 29.
10. Timothy Smith, "Shareholder Activism," in Kinder et al., eds., p. 109.
11. Carsten Henningsen, "Measuring Performance of a Social Portfolio," in Kinder et al., eds., p. 282.
12. Henningsen, p. 283.
13. Eugene A. Swinnerton and Bernard Shinkel, "Socially Responsible Investing: Impact on Individual Securities, Portfolio Returns and Related Issues," unpublished paper, October 5, 1993.
14. J. David Diltz, "The Private Cost of Socially Responsible Investing," unpublished paper, College of Business Administration, University of Texas at Arlington, TX, July 1993, pp. 7-8.
15. Swinnerton and Shinkel, p. 23.
16. *Good Money's Social Funds Guide: 1993 Edition*, Good Money Publications, Worcester, VT, 1993, p. 87.

SRI'S RELATION TO CATHOLIC TEACHING

Over the past century, theologians, popes, and bishops have applied Catholic social teachings to modern social and economic conditions. Many values and principles emphasized in Church teachings have direct applicability to SRI*:

- Dignity of the human person
- Promotion of the common good
- The preferential option for the poor
- Stewardship
- Political participation
- Promotion of peace

*Elizabeth McMillan, *The Social Good: A Guide to Responsible Investing, Purchasing, and Banking*, Catholic Health Association, St. Louis, 1991, pp. 1-4; Michael J. Schultheis, Ed P. DeBerri, and Peter Henriot, *Our Best Kept Secret: The Rich Heritage of Catholic Social Teaching*, Center of Concern, Washington, DC, 1985.