

Socially Responsible Investing When Money Meets Ethics

Socially responsible investing could do what corporate social responsibility did to the corporate sector while investors find the joy of wealth creation by being socially responsible

It has been an incessant desire of the mankind to find a way of making decent returns on their investments and yet find honorable avenues to do so. This is specifically true when the basic needs of the investors are achieved and they want to graduate to the higher needs and wants. He/she invariably climbs up the “Maslow’s” pyramid and looks at satisfying the esteem needs and the needs for self actualization. This hypothesis is supported even in the tenets of almost all the major religions. This is the *raison d’être* of the Socially Responsible Investing (SRI) or Ethical Investing.

Though various sources refer to the late 17th century religious origin for SRI, one can refer to the events in the recent past as more concrete or relevant examples. These include people’s backlash on industries that profited from or colluded in continuing the Vietnam War in 1960s or activism against businesses, sympathetic to erstwhile oppressive regime in South Africa (till 1990s). The more

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recent upheavals include activities against companies involved in major oil sleeks in Alaska (Exxon Mobil and British Petroleum), protests against erstwhile Soviet Union for its role in Chernobyl disaster, businesses that caused alarming increases in global warming, companies that are irresponsibly polluting environment with chemical secretions (Monsanto), etc. On the home front, we are aware of various environmentally damaging initiatives that were resisted by

the general populace, protests against Union Carbide role in Bhopal Gas tragedy, etc.

Since 90s, SRI investors, specifically in the US and Europe, increasingly found viable investment avenues whose investment objective is to not only beat the popular benchmarks but also to be responsible in selecting the companies to accomplish this objective. The major modes of investment are through the mutual funds and separately managed funds (for HNIs) with Separately Managed Funds garnering the major slice. There is a perceivable dearth of similar products in Asia and other continents. This is specifically the case in the Indian context.

It is pertinent here to note that the initiatives currently under active consideration by Government of India like Financial and Technological Inclusions could well be the harbingers of such initiatives in India. One of the major positive effects of the SRI is in making funds and resources available to the Small to Medium Enterprises (SME) through the dedicated Community Investing and/or through micro financing initiatives. Venture capital, Bank loans and other funding opportunities are generally in-accessible to the SME segment. In fact, this is the segment that needs such resources the most. Thus the dedicated investment sources will immensely benefit such segments.

The primary advantage of SRI investment is it is a long-term investment source that is comparatively more stable and thereby usually strategic in nature. This will mitigate/allay fears of the capital seekers who will welcome such stable sources of capital. In India, we are well aware of esoteric interest charged by the “non-institutional and un-regulated” entities for micro financing needs of hawkers, vegetable and



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fruit vendors, etc. Through SRI, these people can benefit from low cost funding and long-term source of capital. Further, other economically and financially viable public good works, NGO projects, Health Care Initiatives, will also be the recipients of much sought after capital. Based on my previous experience as a Chief Relationship Manager, I am aware of the demand for similar investment avenues in India where many investors want to invest their hard earned income in ethical businesses but could not do so due to lack of information about the sources and products.

Power of Socially Responsible Investing

The power of responsible investing can be exercised in many ways but generally classified under two popular ways:

A) By the act of omission: Prohibit, restrain or reduce investments in businesses that cause damage to the environment – emit higher carbon emissions, collude with oppressive regimes, use unfair labour and trade practices, produce weapons of mass destruction like chemical and nuclear weapons or employ other practices damaging to the quality of life and environment.

B) By the act of commission: Invest in companies and institutions whose products, services and practices contribute to a more socially just and sustainable society, follow good corporate governance polices, conduct businesses in highly transparent and ethical manner, provide equal opportunities to the work force irrespective of race, gender and religious affiliations, serves neglected segments, etc.

Investment Methodology

Typically, the SRI uses three prominent methods or tools 1) Screening of investments - both positive and negative screens, 2) Shareholder Activism and 3) Investing in underserved markets.

Screening is the first step where the SRI fund manager scans through the investable universe with a goal of weeding out the businesses that are engaged in acts, products, services or activities that are generally acknowledged to be harmful to the humanity. Some of these activities involve: cultivation of tobacco, production of alcohol, development of weapons of mass destruction, indulge in activities that are harmful to the environment, etc. These investments may be altogether avoided or could still be considered, by some managers,

if the share of their undesirable activities fall within a set threshold, say 5% of total revenues. The level of aversion is generally declared in the objective section of the SRI funds. It is understood that the eligible investments could be a subset of popular indices like S&P500, Russell 3000, FTSE100, Nifty, etc. or could even be outside this list.

More importantly, a pro-active way of contributing to ethical investing could be through investments in businesses or industries that enhance societal welfare, improve environmental balance, serve underserved communities, invest in clean technologies, have good corporate governance standards, initiate proactive human rights policies, etc. Once the undesirable investments are weeded out, the eligible investable universe is ranked based on its proactive activities for selection. In this process, the screens used not only include socially/ethically responsible filters but also involve usual profitability measures. Finally, these investments could be further adjusted (leveraged/un-leveraged) to mimic general risk-return characteristics of the target benchmark.

Other pro-active methods of fostering socially desirable behavior from the businesses are to increase the shareholder activism and invest in underserved market segments. In the former case, the investors can directly influence the way businesses are conducted by actively exercising their voting rights. There are two possible ways, among many, how investors could make their voting count. One, by transferring their voting rights to a “Fiduciary/Trusted” concern that would use its discretion in exercising the voting rights. The voting should be transparent so that the investors could see how the entity acted on their behalf. They will have the rights to elect/de-elect the members that form this entity. Second, by investors exercising their voting rights by themselves. This may not be an ideal choice since the investors may not have the luxury of time and knowledge on their side on all the matters that are voted on.

Shareholders activism is generally high in the US and the Europe and is slowly catching up in the Asia Pacific and Japan. India needs such mechanism for the investors to exercise their rights. We can leverage our expertise in the IT sector to possibly start an online exchange where the like minded investors can deposit/transfer rights to an agreed entity to vote in a responsible manner. Thus this way, the businesses learn to appreciate the common

& majority sentiment and may regulate their un-desirable activities. One of the desirable offshoots of such activism is garnering media attention, and educating the public on social, environmental and labor issues.

Finally, dedicated investments into segments that traditionally underserved by the financial institutions could also have a great effect in alleviating the economic levels of

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these segments. Dedicated investing in underserved segments provides them access to credit, equity, capital, and basic banking products that these communities would otherwise lack. This is a typical end result of Financial Inclusion and Micro financing endeavors. Recently these initiatives were in News owing to the initiatives of the government and due to activities of Bangladesh born Nobel Laureate Muhammad Yunus.

Financial Planning and Socially Responsible Investing

Socially responsible activities are often seen as only philanthropic or altruistic acts that have very little economic rationale. This has been proved wrong, though not conclusively, by the performance history of SRI dedicated funds. In the West, there are registered Financial Planners who use SRI for their Financial Planning purposes. (www.socialinvest.org). The performances of SRI funds are comparable to their benchmarks performance. As of 2005, the longest-running SRI index, the Domini 400 performed competitively with respect to the S&P 500 index generating 11.87% total returns, versus the 11.31% generated by the benchmark. Additionally, an increasing number of studies (more than 20) demonstrated that SRI mutual fund performance comparable to that of non-SRI funds (source: www.sristudies.org).

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In the Western Countries, SRI investing has become part of the mainstream, and as a result, a number of conventional companies now offer SRI products to their clients. This is further supported by the fact that a growing number of

major U.S. fiduciaries are either screening their portfolios, engaging in shareholder advocacy, or directing assets to community investing, demonstrating that these three SRI strategies do not impede financial returns.

Socially responsible investors include individuals and also institutions, such as corporations, universities, hospitals, foundations, insurance companies, public and private pension funds, nonprofit organizations, and religious institutions. Institutional investors represent the largest and fastest growing segment of the SRI world.

Statistics and Trends in SRI

According to the Social Investment Forum's "2005 Report on Socially Responsible Investing Trends" the total assets under management using one or more of the three

core socially responsible investing strategies—screening, shareholder activism, and community investing estimated at \$2.29 trillion. This constitutes above 9.5% of the total investment of \$24 trillion. Nearly one out of every ten dollars under professional management in the United States involved in socially responsible investing. Most of the assets are in separate accounts, portfolios managed for institutional and individual clients.

As of 2005, there were 201 socially screened mutual fund products in the US, with assets of \$179 billion. By contrast, there were just 55 SRI funds in 1995 with \$12 billion in assets. SRI mutual funds span a range of investments, including domestic and international investments, and a growing range of products are available, including hedge funds and exchange traded funds.

SRI in Developing Countries

Investments and savings, when used judiciously, can help create a better world by building healthy communities, promoting economic equity, and fostering a clean environment. SRI is one such avenue that helps foster a better tomorrow. There is an unmet demand for such products in India. The important steps in launching these initiatives could be 1) Increasing awareness about SRI, 2) Forming benchmark indices that keeps track of socially responsible record of the businesses, 3) Investors pro-active participation thereby attaching premium to the ethical entities and 4) Launching of websites and portals that track SR Investments. Once these investment avenues are available, there will be greater appreciation of such offerings creating a huge appetite for these products. India, the home of world's spiritual and ethical endeavors, will be natural habitat for such products and could well be the leader in these initiatives.

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