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Ethical investment: whose ethics, which investment?

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Introduction

The title of this paper consciously invokes the spirit of Alasdair MacIntyre, whose claim of the alleged 'conceptual incommensurability' of much contemporary moral debate is the subject of such books as *After Virtue* (1985) and *Whose Justice? Which Rationality?* (1988). MacIntyre considers the apparent difficulty of moral discourse in a pluralistic society to be one of the characteristic questions of the age. Such a viewpoint has implications for business ethics generally, but it would seem to be particularly true for one area of business activity that explicitly describes itself as 'ethical', by which I mean that of 'ethical investment'. As a practitioner working in the field I have been surprised at the relatively low level of attention paid to this subject in the business ethics community. Surely here is an area characterised by at best loose terminology, at worst by a conceptual confusion that would benefit from the rigour of academic analysis. My aim in writing this paper is to set down some of my own thoughts on the matter in the hope that they may stimulate academic consideration and debate.

This issue is not some empty philosophical conundrum of little practical import. Ethical investment is one of the fastest growing areas of finance and, perhaps most importantly, new pension regulations mean that under the alternative name of 'socially responsible investment' (SRI) the issue now affects the majority of the population. Since 3 July 2000 all UK private sector pension funds have been legally obliged to consider socially responsible investment and voting rights as part of their overall investment policy. This has come about by a regulation issued under Section 35 of the 1995 Pensions Act, which creates a statutory obligation for all pension funds to have a Statement of Investment Principles (SIP). These statements must cover the types of investment, and the balance between investments, risk, return and realisations. The new regulation requires all trustees to add the following two considerations to their fund's SIP:

i) the extent (if at all) to which social, environmental or ethical considerations are taken into account by trustees in the selection, retention, and realisation of investments; and
ii) the policy (if any) directing the exercise of the rights (including voting rights) attaching to investments.

At first sight these clauses do not look particularly dramatic. It is important to stress that pension funds are not being forced to invest along SRI lines; the new rules simply oblige them to take social and environmental considerations into account and disclose their policy about this. It is worth repeating that the regulation is about consideration and disclosure, not about compulsion. However, it does seem likely that it will cause rapid growth in the proportion of pension funds which consider 'socially responsible investment' to be a normal part of their investment strategy (Sparkes 2000).

Academe (dare one suggest unusually?) has taken a practical lead. The success of the campaign led by *Ethics for USS* shows how effective pressure can be brought to bear on a large pension fund by scheme members. The Universities' Superannuation Scheme (USS) is one of the largest pension schemes in the UK, with £22bn in assets. *Ethics for USS* was set up in 1998 to persuade USS to adopt a comprehensive ethical and environmental investment policy. The campaign was supported by 3,500 individual members as well as by the Association of University Teachers, and seems to have been successful in achieving its aims. In September 2000 USS recruited two SRI advisers 'to assist with the formulation of socially responsible policies and to engage effectively with companies to promote socially responsible policies that will be of benefit to USS's membership'.

Yet the potential critic, as well as the potential pensioner, may well feel somewhat uneasy about all this. There is clearly a practical concern that the imposition of non-financial constraints on a pension fund could adversely affect its ability to fund pension liabilities. For reasons of space this paper will avoid the question of whether the adoption of SRI constraints must lead to lower financial returns. However, the consistent answer coming from research indicates that there need not be any performance penalty (Sparkes 1994, Mallin et al. 1995, Gregory et al. 1997, EIRIS 1999, WM Company 1999). The US data generates similar conclusions (Guerard 1997). Yet more fundamental is the theoretical issue that nobody involved in this process has actually defined what 'socially responsible investment', or 'ethical investment', might mean. It is striking that the new government regulations make no attempt to define what the required *social, environmental or ethical considerations* might be. (Discussions with the civil servants who advised ministers on the issue led to the understanding that this silence was deliberate.)

The absence of an agreed definition of SRI is a gap that surely needs to be addressed; this paper is my attempt at doing so. There are a number of conceptual issues that would benefit from clarification. I mentioned earlier that 'socially responsible investment' and 'ethical investment' are generally thought to be equivalent terms, but we may inquire whether this should be the case. It is worth noting that 'ethical investment' is the older phrase, which is slowly being replaced in general use by 'socially responsible investment'. In this article I will generally assume that ethical investment and socially responsible investment are synonymous, although I will later suggest a meaningful distinction that can be made between them.

Is 'green' investment a part of SRI, or is it something *sui generis*? Ethical investment is normally thought to be based upon the avoidance of certain activities. Whilst this may let the ethical investor sleep easy in his or her bed, in what sense is such avoidance 'ethical'? We might label such activity 'conscience investing', and in fact there was once a retail SRI fund called *Conscience*. Moreover, most investors invest through ethical unit trusts run on a profit-maximising basis by commercial fund management companies. While the investors' motives may be pure, a sceptic might question the extent to which such commercial activity may be labelled 'ethical'.

Writers, particularly in the US, often use the term 'social investment', i.e. investment with some kind of social component. Schematically we may say that social investing divides naturally into two main sub-classes: SRI and socially directed investment (SDI). Socially directed investment occurs when a subnormal return is voluntarily accepted for community development or other purposes. This is normally based upon a banking model rather than upon equity finance, and indeed is sometimes described as 'ethical banking'. The banking model works rather well in such targeted development, as savers in effect give the use of their capital (which can be guaranteed in banking), whilst waiving most or all of the interest due upon it. UK examples include Shared Interest in fair-trade financing, or Tridos Bank with its range of targeted deposit accounts to fund social projects. However, I think that SDI does need to be clearly distinguished from SRI for two reasons. Firstly, SRI is generally considered to be an equity-based activity, as one of its core aims is to use the power and influence of shareholders to positively affect corporate behaviour. SDI on the other hand is essentially a debt-based activity. Secondly, the essence of SDI is that SDI savers deliberately accept below market returns in order to help others; this is certainly not the intention in SRI.

The phenomenon of socially responsible investment has received a reasonable amount of comment by academics and others over its relatively short life (the last fifteen years). However, much of it now appears rather dated in the light of recent developments, in particular the switch in emphasis from ethical retail products to institutional investment along SRI lines. It may be helpful at this point to review the literature on the subject before moving on to my own analysis and conclusions.

A Historical Analysis

It is important to distinguish between the *activity* (attempts to use ethical principles in the construction of investment portfolios), and the *public awareness* of it (the self-conscious phenomena of SRI or ethical investment). Church investors have run investment portfolios subject to certain ethical constraints for many years, certainly since 1948 in the UK, and since 1926 in the US (Sparkes 1995a: Ch.7). However, such activity attracted little attention and does not seem to have been described by any kind of generic term. For example, when the Society of Friends or 'Quakers' discussed it in the late 1970s, the phrase 'responsible investment' was used (Society of Friends 1979). As the 1970s progressed the campaign against the apartheid regime in South Africa led to widespread concern within the churches that their funds should not be used to support the existing regime, and to broader awareness within society as a whole of such an approach.

In the UK it was only in the late 1970s and early 1980s, with the introduction of funds and services designed for the private individual, that the term *ethical investment* became widespread. The SRI screening service EIRIS was founded in 1983, and the UK's first 'ethical unit trust', Friends Provident Stewardship, was launched in 1984. A similar phenomenon occurred in the US around 1970. The first US retail SRI mutual fund was the Pax Fund, launched in 1971, and inspired as its name suggests by similar investor fears of profiting from the Vietnam War. (The term *socially responsible investment* has been the standard descriptive phrase in general use across the Atlantic.)

The first UK book on the subject was that of Ward (1986). Like the majority of commentators she made little attempt to analyse the term, considering it in terms of action: 'definitions... of exactly what is socially responsible and what is not will vary. Some people feel strongly about tobacco, some about armaments, and some about creating employment in the inner city. The common factor is that they all think that they should not simply hand over their money and sit back.' An American book of a similar date by Domini and Kinder (1984) also emphasises action as opposed to analysis: 'ethical investing takes this feeling that our finances are a reflection of ourselves and carries it to a logical conclusion.... (there are) three approaches to ethical investing: avoidance, the positive, and the activist approach.' In 1990 Craig Smith called ethical investment 'analogous to ethical purchase behaviour' (mostly in the form of consumer boycotts); 'ethical investors can operate by selling off investments or keeping them and using them to press for changes in the companies concerned'.

Cooper and Schlegelmilch (1993) noted the 'lack of consensus on the meaning of the term ethical investment' and 'that little academic research has focused on this topic.' They adopted Button's definition as a working hypothesis: 'putting your money into investments which will yield a financial return for you, but which do not support areas of business interest that you disapprove of, such as arms, tobacco, alcohol, apartheid, violation of human rights' (Button 1988). Like many writers before and since, Cooper and Schlegelmilch focused their own energies and attention on the marketing-driven nature of retail ethical unit trusts. While they produced a thorough analysis of the existing retail ethical investment universe, they did not discuss institutional SRI investors such as churches or charities.

Cowton (1994) produced a more focused definition. Ethical investment, he says, may be defined as the exercise of ethical and social criteria in the selection and management of investment portfolios, generally consisting of company shares (stocks). He contrasted this with standard depictions of investment decisions which concentrate solely on financial return. Taking the terms SRI and ethical investment 'to be equivalent', he went on to argue that ethical investors care not only about the size of their prospective financial return and the risk attached to it, but also its source – the nature of the company's goods or services, the location of its business or the manner in which it conducts its affairs. He continues this theme in Cowton (1998).

My own book *The Ethical Investor* (Sparkes 1995a) was written at the same time as Cowton (1994). (My own attempts at more detailed analysis (Sparkes 1998a and Sparkes 1998b) will be considered later.) I was unaware of his paper when I made the following statement in the book: 'it is probably time to clarify what is normally meant by "ethical investment". It does not mean a moral campaign to clean up the Stock Exchange, or raise the standards of those who work in the financial field. Ethical investment is straightforward, and simply means an investment philosophy that combines ethical or environmental goals with financial ones.'

The above quotations show the general vagueness and lack of analytical precision regarding this subject. Ward identifies some areas of concern such as tobacco or armaments. Domini and Kinder (1984), like Ward (1986), highlight 'feelings' as well as emphasising procedures: avoidance, positive encouragement, and activism. Craig Smith takes a different perspective, seeing ethical investment as a subclass of ethical purchase behaviour, with a methodology based upon selling shares or activism.

Button's definition, used by Cooper and Schlegelmilch, seems to me to show an advance in thinking, in its greater awareness of what I have always believed to be the defining characteristic of socially responsible investment – *its unique combination of financial and social objectives*. Button correctly observes the characteristic that savings are put into productive assets (investments) that produce a return, whilst steering clear (avoidance) of areas of disapproval. My own 1995 definition is similar in emphasis.

However, the most sophisticated analysis so far reviewed must be credited to Cowton (1994). He too focuses on the use of ethical and social criteria in the selection and management of investment portfolios (much more precise than the vague term 'investments'). He stresses that financial return is important, but so is its 'source'. Many writers have described ethical investment as the avoidance of certain activities, but Cowton is surely right in indicating that things are more complicated than that, i.e. activity, location, or manner of business. (This point is further developed in Cowton 1999.)

Ethical, Social, or Green?

I now want to take the argument a step further by a deeper analysis of the terms involved, starting with the word 'ethical'. 'Ethics' is a highly emotive term, and those who use it in pursuit of their business interests may expect a high degree of scrutiny, if not outright criticism. In fact it is surprising how little adverse comment has been made on the use of this term. The first to raise a critical eyebrow was Cowton (1994):

> 'At one level, ethical investment can be seen as just another product innovation that helps widen choice . . . The irony is that its occurrence can be explained in pure, profit-seeking capitalistic terms, as financial institutions seek to influence and exploit their environment in the interests of profitability. Thus individual investors, potentially at least, have their values met or satisfied by institutions/people who do not share these values at all, whose sole motive might be to make more money.'

Well said! Cowton is surely right to suggest that any ethics to be found in (retail) ethical investment derive from the investors, while the organisations which meet their needs do so on a profit-maximising basis. The charges on most ethical unit trusts are fairly high, in line with most other unit trusts. Unless these charges can be justified they risk the accusation of exploiting the goodwill of the ordinary person in the street. The additional ethical research required necessitates somewhat higher fees, but as this overhead is spread over the greater revenues of the larger funds it should become a relatively small cost item.

However, Cowton's criticisms are mild compared to the onslaught levelled by Anderson et al. (1996):

> 'the criteria (used) reflect the criteria demanded by investors . . . the investment companies have indeed satisfied a customer demand. But that does not

mean what they are doing has a right to be labelled "ethical" with the at least occasional implication that other investments are unethical.... This Report suggests that their own investments might variously be accurately labelled "investments reflecting investors' opinions", "investments reflecting fashionable causes", "scrupulous investments", "ethically simplistic investments"... the overall objection to ethical investment codes is their aggressive simplicity ...a simplicity which ill fits them for their ethical work... there is no reason why the various investment institutions should not continue to serve (their customers) and their preferences. The only objection this Report makes is that they should not describe what they are doing as "ethical" investment.'

Critics such as Anderson may well question what is 'ethical' about what they see as a negative form of investment based upon arbitrary exclusion criteria. In general retail SRI funds set out certain activities of concern to them: traditionally alcohol, tobacco, defence, gambling, with more recent additions such as the environment or pornography. Filter screens are then established to rule out unacceptable investments; typically a maximum percentage of a company's turnover, perhaps five or ten per cent. So using a 5% turnover exclusion limit, a company deriving 5% of sales from alcohol would be forbidden, but one with 4.9% of sales from alcohol would be acceptable. For deeper analysis of the ways the preferences and concerns of individuals are combined into the criteria used by SRI unit trusts see Anand and Cowton (1993) and Mackenzie and Lewis (1998). For many ethical unit trusts the screening is done by a third party, the ethical research service EIRIS, that generates 'an approved list'.

I considered the Anderson criticism in two papers published in 1998 (Sparkes 1998a and 1998b), concluding that there was considerable force in the above argument. To consider it we must briefly analyse the word 'ethics'. In popular usage 'ethics' is generally used as a substitute for 'moral', as opposed to its technical, philosophical sense denoting the subject of moral reasoning. To describe something as ethical conveys certain principles of altruism, of self-sacrifice, of a normative and systematic code of conduct. In other words, to describe behaviour as 'ethical' implies a desire to help others even at a cost to oneself. It also implies the existence of a set of consistent general principles that guide and influence behaviour.

It seems to me that the use of the word 'ethical' to describe retail SRI funds can be objected to on two grounds. Firstly, on the whole 'ethical' unit trusts do not have a generally agreed code of ethics, and indeed in a pluralistic society that asserts individual liberty it is hard to see how they could do so. If one fund favours investment in pharmaceutical shares as benefiting humanity, another will forbid it because of the role of animal testing. Of course ethics must be consistent, whereas here the ethical criteria across funds seem confused and at times contradictory. There is also the question of the peculiar nature of the 'ethics' themselves. Few people in modern British society would say that there is anything wrong with alcohol or gambling, and most would accept the need for the UK to possess military defence capability. Yet these are standard exclusion screens across the retail ethical unit trust universe.

The second objection to using 'ethical' as a descriptive term to describe retail SRI funds derives from concerns about the lack of any sign of altruism. This is the criticism hinted at by Cowton earlier, i.e. that such funds are run on a profit maximising basis, which seems logically incompatible with values such as seeking to assist others even as some cost to oneself. The point is that the ethics to be found in (retail) ethical investment derive from the underlying investors, whereas the organisations which meet their needs do so on a profit maximising basis. There is a related concern that the individual funds show little explicit ethical awareness, as their main objective appears to be to maximise investment returns within the constrained investment universe available to them. There is an increasing trend for ethical unit trusts to base purchase decisions on positive criteria, but I am unaware of any example of such investment being made at an expected financial cost.

To continue the question of appropriateness of such retail funds describing themselves as 'ethical', we may note that Cowton (1998) advocated certain heuristic principles, essentially investor integrity – 'consistent standards of behaviour are applied in all areas of life', and a broader one of responsibility towards others, what we might call 'stakeholding'. Cowton clearly saw that value-based institutions could assert ethical values, and that they ran the risk of being criticised for not doing so.

In Sparkes (1998b) I suggested that one way forward to resolve this problem would be to restrict the use of the term 'ethical investment' to investment carried out on behalf of values-based organisations such as churches and charities, with the term 'socially responsible investment' (SRI) used in all other cases. This would, of course, return the phrase to its original use to describe the way some churches (Anglican and Methodist) integrated ethical considerations into their investment decisions. Such church investors meet the usual meaning of the word 'ethics' as designating a systematic code of conduct, deriving from an accepted set of beliefs, which aims to regulate and change behaviour. They meet the criteria specified earlier for the word 'ethical' to be truly applicable: *altruism* – they are non-profit making bodies; *consistency* – they have detailed ethical codes and principles, and they possess *clear decision-making* bodies used to tackling (often complex and difficult) ethical dilemmas. They also meet the requirements of *transparency* and *disclosure*, as both publish annual reports summarising the main ethical problem areas discussed and decisions taken over the previous year.

However, I want to stress that that this suggested definition is not meant to be exclusive. It could also apply in the case of any non-government organisation (NGO) that holds some investments, as long as it is based around a coherent code of beliefs, such as environmentalism, social justice, or animal rights. (For instance, it seems pretty obvious that there is a 'green ethic' based upon sustainable development.) But clearly the basic motivation of the organisation must not be to make money, and it is worth noting that 'not-for profit' is an alternative definition often used for the voluntary or charitable sector. I suspect that some people will disagree with me on this, and feel that 'ethical investment' should apply to SRI as a whole. I do not wish to suggest that there is anything immoral about retail SRI funds, nor that they cannot be considered as interesting case studies in business ethics. In my opinion the retail SRI industry has, in general, done a good job in meeting the ethical demands of private investors, and also in bringing the idea of ethical investment to public attention. My point is simply that there is a qualitative difference between such SRI unit trusts and investment funds run on behalf of value based organisations such as churches and charities.

Mackenzie (1998) argues that a useful distinction can be made between what he calls 'market-led' SRI trusts, which simply aim to supply criteria that will maximise sales, and 'deliberative' trusts, which do possess ethical views of their own. This distinction is useful, but as the author accepts, even the 'deliberative' trusts take customer wishes into account. They do not publish their deliberations, and the basis on which their advisory committees take decisions remains hazy: we do not know whether decisions are based on an estimate of what the average customer wants, or on what the investment institution itself deems to be ethical, or on some other basis.

As mentioned earlier, I know of no example of such a fund making an investment purchase in expectation of below average returns. Nor do I know of any example of a retail SRI fund publicly stating that it was doing something likely to be unpopular with its clients on the grounds that it was the ethically correct thing to do. In contrast, the Methodist Church Advisory Committee did so, for example, by accepting investment in British Energy, a company that generates electrical power from nuclear energy, on the grounds that the effects were, on the whole, positive for the environment.

Another, quite distinct, question that sometimes arises is whether 'green investment' is in some way different from SRI. Clearly we must distinguish between investment in environmental activities on the basis of profit maximisation compared with that carried out to encourage sustainable development, with only the latter deserving the term 'green'. Although there was a brief period in the early 1990s when purely green investment funds were aggressively marketed on the back of the public's environmental enthusiasm at that time (the Green Party won 15% of the vote in the 1990 European elections), their popularity did not last. Financial performance was not particularly good, and the investing public wanted both ecological and social goals, so most green funds adopted social criteria. At the same time many existing SRI investors added sustainability objectives to the older 'ethical' criteria of avoidance of breweries, tobacco, defence, etc. inherited from the churches. Cowton (1994) describes this accurately.

> 'It remains the case that some investors are interested in environmentalism for value-based reasons, and a number of ethical investment products recognise that. Therefore, when I refer to ethical investment I take it to encompass green investment too, when that investment is being undertaken for other than purely commercial motives.'

Ethical Decision Making in Practice

Scruton, in Anderson (Ed.) (1996) was dismissive of any claim of ethical investment to be 'ethical'.

> 'For the most part "ethical" is another name for fashionable causes, and a way of pre-empting complex moral arguments in favour of a particular foregone conclusion. There is a real ethical *question*, for example, about the use of animals in testing pharmaceutical products. Are we to test these products on human beings? Use them without testing? Give up pharmaceutical research altogether? ... To assume that this complex ethical issue can be brought to a conclusion, simply by refusing to invest in firms which test drugs on animals, is to adopt a frivolous and self-indulgent response to a real moral problem.'

I would suggest that, at least in the case of Mackenzie's 'deliberative trusts', the existence of what is generally known as an advisory committee (or council of reference) refutes Scruton's criticism. These advisory committees receive detailed dossiers on a particular issue or company, to be used as the basis of detailed discussion on the ethical appropriateness of a particular holding. However, as was noted above, the basis on which such advisory committees take decisions remains hazy: they do not publish minutes of their deliberations, even in summary. In the absence of such published minutes, the use of their existence to refute Anderson's allegation of 'simplistic' reasoning is suggestive rather than conclusive.

However, one body that does publish a detailed record of its deliberations is the Joint Advisory Committee on the Ethics of Investment (Advisory Committee) of the Methodist Church. In Sparkes (1998b) I gave examples covering a period of years to show how this works in practice. This body advises the Central Finance Board (CFB) of the Methodist Church on the ethics of investment, and in my opinion it refutes the allegation that ethical investment decisions are necessarily random, fashionable, or arbitrary. In fact, for such an institution, the development of thinking in particular cases is very similar to the way case law codifies legal principles. The Advisory Committee possesses the two essential attributes for ethical decision making: a clear set of (Methodist) principles, and a forum for discussion to consider their application in practice.

The word 'ethics' also has the implication of normative suggestions or actions done with the intent to alter or constrain behaviour. The Committee possesses such a power in its ability to authorise the issuance of a press release stating that dis-investment has been made for ethical reasons in the case of a particular company. Such a press release was issued, for example, in November 1995 announcing the CFB's sale of its holding in the satellite broadcasting company BSkyB on account of its involvement with the Playboy Channel. The press release led to the appearance of a major article in the *Financial Times* on the subject, and it received widespread coverage in the financial press in the US and the Pacific. The Committee also produces a detailed annual report to the Methodist Conference that describes in detail the ethical concerns debated over the previous year.

Let me use the case of defence to illustrate the way considered ethical judgements are reached. Until the early 1980s the Advisory Committee's view of defence was fairly simple. Companies producing weapons were not acceptable, whereas there was no problem with suppliers of food or clothing to the military. Other factors taken into account when considering an individual company were the proportion of sales to the military, and the type of products manufactured, some being judged more offensive than others.

In 1988 a briefing paper was produced arguing that the issue was becoming more complicated, as an increasing proportion of modern military equipment consisted of electronic circuits. In general these were 'off-the peg' integrated circuit components designed for commercial use, but used or adapted for military applications. Thus a simple exclusion on the basis of turnover supplied to the Ministry of Defence could result in a ban on investment in electronics companies with little genuine involvement in defence. It was therefore accepted that it was necessary to 'sharpen up' the Committee's conceptual thinking in this area. It was agreed that the CFB should continue to avoid companies with a high level of exposure to the defence industry, and that the production of certain products would rule out investment in a particular company – landmines might be a case in point – no matter how small the proportion of turnover they accounted for.

However, it was also decided that there should not be a ban on investment in electronics companies just because their products *could* have military usage. The following conclusions were drawn to aid further discussion of military involvement by electronics companies.

- Suppliers of electronic equipment to the defence industry would only be excluded on ethical grounds when the proportion of defence sales became too high.
- Account would be taken of the end use of electronic products: for example offensive weapons, defensive (anti-missile weapons), or other use such as communications equipment.
- The extent to which the electronic sales were made exclusively for military purposes would be monitored.
- The non-defence businesses of a company would be taken into account, as would their effect on the community.

There was further discussion of defence matters in 1997. It was then decided to add two more guidelines for debate.

- A clear distinction was made between military products sold to the UK defence forces and their NATO allies on the one hand, and on the other hand products exported, particularly to 'oppressive regimes'.
- The strategic direction of a company would be monitored; for instance, was it management's intention to increase or reduce defence exposure over time?

Is Shareholder Activism the Same as SRI?

I mentioned earlier my belief that the heart of SRI is the combination of financial and social return. I now think that my earlier definition needs strengthening slightly, and will therefore rephrase it thus: *'the key distinguishing feature of socially responsible investment lies in its combination of social and environmental goals with the financial objective of achieving a return on invested capital approaching that of the market'*.

Some people may be surprised that the major change made to the definition lies in the additional weight given to financial objectives. The reason for doing so is my opinion that some commentators on SRI seem to over-emphasise the social and environmental considerations and neglect the financial ones. This also squares with market research showing that potential investors in SRI retail trusts are willing to accept a modest reduction in potential returns, but lose interest rapidly if the potential returns drop significantly below that of comparable 'non-ethical' investments. (Institutional SRI investors are under a legal fiduciary duty not to accept any reduction in likely returns, with a few specific exceptions for charitable funds.)

In this paper I have consistently argued that the essence of SRI is the attempt to combine social concerns with a reasonable financial return. If I am right about this, it is essential to distinguish SRI from 'shareholder activism' and from 'advocacy campaigns' where no financial gain is sought or desired. I think that there is quite a lot of confusion in general usage about the relative meanings of SRI, shareholder activism, and advocacy campaigns.

'Shareholder activism' is simply a technique – the usage of voting rights attached to ordinary shares to assert and achieve political, financial, or other objectives. In the US there are groups who use shareholder activism as a tool to force change on what they regard as underperforming companies, in the hope of instigating change that will lead to higher share prices. This is done for purely financial reasons, as such investors hope to profit from the stock market's recognition of a greater focus on shareholder value by such companies.

On the other hand, such shareholder activism can also be used by NGOs as part of their normal campaigning work; for example, to raise the public profile of issues seen as important, or perhaps to put the media spotlight on certain corporate activities. This is normally done by using the rights of share ownership to gain entry to a company's annual general meeting where critical questions can be asked of the senior executives. The main aim of such groups is to be able to complain in a public forum about a company's activities in a particular field, such as the environment, animal rights, or the welfare of indigenous peoples. Such activists are normally driven by a single-issue agenda that is perceived to be of overwhelming importance. This sort of activity is probably best described as *'advocacy campaigning'*. A typical example is given by Mackenzie (1997).

> 'Each year Partizans, a tiny but dogged London-based campaigning group, has launched a campaign against RTZ, the world's largest mining company. Partizans wants RTZ to act in a more environmentally responsible way, and to treat indigenous people with more respect. Partizans does not table resolutions, instead it asks difficult questions and seeks to attract press publicity for the causes it represents. *Occasionally it has stormed the podium in an effort to make the company and the press listen*' (my emphasis).

For such campaigning activists maintaining the value of the shares they have bought, normally for only a small sum, is not an object of concern. In fact it seems quite legitimate for them to want to cause financial harm to a company, perhaps by encouraging consumer boycotts, if that is seen as the most effective way to get their message across. On the other hand it is hard to conceive of any circumstance in which SRI fund managers would actually want to see the price of the shares they hold decline in value. It also seems true to say that confrontation and publicity are normally desired by campaigning groups, whereas quiet engagement via private discussion with company management is more characteristic of SRI.

The situation is the US is rather different, as differences in company law make it easy in the US to file 'social proxies' (non-financial resolutions) at a company's annual general meeting. Indeed the use of such social proxies is the most common form of socially responsible investment activity in the US, and there is much greater identity between SRI and shareholder activism there. In the UK the difficulty of filing shareholder resolutions critical of the management probably explains why shareholder activists feel constrained to embark on high-profile confrontational paths.

That said, it seems likely that in the future the UK will increasingly adopt the American model of shareholder activism. This is already starting to occur: the turning point was probably the 1997 Shell Annual General Meeting. Shell had already received immense negative publicity owing to its planned disposal of the Brent Spa oilfield platform, and concern over human rights abuses in Nigeria. In 1997 an NGO-led coalition was able to assemble enough support from local authority pension funds and church investors to file a resolution instructing the management to behave in a more socially and environmentally responsible way. While the resolution was rejected, within a year Shell management felt obliged to respond positively towards it. Other large UK based multinationals subject to SRI resolutions in recent years have included BP and Rio-Tinto.

My point is that there is a clear conceptual difference between an NGO buying a few shares in a company in order to publicise an issue, and perhaps the same NGO having a pension fund and issuing SRI guidelines to its investment managers over a wide range of potential issues. (There are other possible links between NGOs and SRI, such as cause-related marketing – see Sparkes (1995b).) The first point of distinction lies in the fact that socially responsible investors want a financial return from their investments, whereas it is immaterial for advocacy campaigns. Secondly, the objectives of the shareholder action are distinct. SRI shareholder activism seeks to improve corporate behaviour, whereas NGO advocacy campaigns may seek to close down a particular company on the basis that the whole basis of its operation is immoral, e.g. nuclear power (British Energy), mining (Rio Tinto), or animal testing (Huntingdon Laboratories).

On the other hand it is also true that shareholder activism to assert social and environmental goals is becoming a greater part of SRI, particularly for institutional investors who are bound by the legal objectives of getting the best return on their investment portfolios. In practice there is certainly a significant overlap between advocacy campaigns and the social objectives of SRI investors. The two groups may share the same concerns, and they may often work together to pressurise a certain company on a particular issue. The two types of activities may share the same means, i.e. the utilisation of the voting rights attached to ordinary shares to assert non-financial objectives, but the aims and objectives are quite different. My point is simply that the two types of activity are conceptually quite distinct. The following table will make this distinction clear.

Advocacy Campaign	**Socially Responsible Investment**
Single-issue focus	Multi-issue concerns
No financial concerns	Strong financial interest
Seeks confrontation	Seeks engagement
Seeks publicity	Avoids publicity

Stakeholding and Socially Responsible Investment

I want to conclude this paper by going back to the point I raised at the beginning, i.e. the recent imposition of a legal obligation upon pension schemes to consider social, ethical, and environmental considerations in their investment policy. I have argued earlier that value-based organisations such as charities are uniquely entitled to use the term 'ethical investment'. It seems fairly obvious that if, for example, the Cat's Protection League declines to invest in companies that test cosmetics on cats, it is being both morally consistent with its objectives, and 'commercially' sensible as not doing something that might offend its donors and other supporters. (This 'commercial' possibility is the legal basis for the ability of charities to have ethical investment policies even at some financial cost.) We can also see that the SRI unit trusts, even if not fulfilling generally accepted notions of ethics, are at least attempting to meet the ethical concerns of the underlying investors.

Yet the new pensions regulations give no reasons why pension funds should be subject to a legal obligation to consider SRI factors. Pension schemes are financial trusts with the sole function of producing a financial return sufficient to provide adequate funding for an individual's retirement. As far as I can see, no one has seriously argued why this constraint should be imposed. In this section I would like to develop some ideas I briefly touched upon in 1998 (Sparkes 1998b) that may provide an answer to this question. The first of these is that such SRI responsibilities are only a reasonable reflection of the legal privileges given to pension funds. These legal privileges include: tax relief on contributions; employers' contributions not treated as taxable income, and immunity from capital gains tax. It is arguable that pension funds should repay such a privileged status by acting in socially responsible ways.

At this point the concept of stakeholding may present an attractive solution to the problem. Cowton (1997) mentions in passing the idea that investors could be considered as 'stakeholders', but unfortunately doesn't develop the idea any further: 'this view is often reinforced by regarding stockholders, not as speculators or even investors, but as owners who have responsibilities which entail a degree of involvement.' In 1997 Lydenberg and Paul attempted to integrate stakeholder theory with socially responsible investment. They use a classic model: 'it is based on the premise that firms have both explicit and implicit contracts with those constituents which make the corporations responsible for honouring the resulting contracts, explicit and implicit.' They go on to use the example of financial theory, which states that the return shareholders receive from a quoted equity should be proportional to the risk involved. They argue that employees, suppliers, and local communities also share risks in the success or failure of a business so that they too should be compensated for the risk

The authors then use this idea to generate a new definition of a well-managed company:

> 'The well-managed company is one in which over time we observe increasingly levels of reward for stakeholders without risk increasing to unacceptable levels. Conversely, the poorly managed company incurs unacceptable high levels of risk for certain stakeholders; risks for which they do not receive appropriate levels of reward ... If managers are making decisions which they would accept as right if they were on the stakeholder end of the relationship, the level of risk may be regarded as acceptable. When one stakeholder benefits disproportionately, receiving disproportionately more rewards, and others receive disproportionately fewer rewards over time, we say we observe a lack of corporate social responsibility, poor social performance, and poor management.'

They go on to conclude:

> 'Increased awareness has developed among theorists that through SRI (socially responsible investing), corporate social performance is being monitored and evaluated using some of the basic principles of stakeholder theory ... SRI may be seen as an implementation of what stakeholder theory might prescribe, of theory put to practice ... Socially responsible investors aim to create and support a business environment where managers are mindful of the risks their operations impose on society, to avoid incalculable risks, and in the case of calculable risks to be as equitable as possible in minimising societal costs, along with compensating fairly for their imposition.'

I have quoted at some length from Lydenberg and Paul as they put forward what to me look original and interesting ideas that could justify the theoretical application of SRI to all financial institutions. In this paper I have stressed the importance of not forgetting the *investment* in socially responsible investment. Now in this context 'investment' normally refers to investment in equities, shares in limited companies quoted on a stock market. It seems to me that it is this word *limited* which is crucial in terms of a general justification of SRI for most investment funds. The point is that it denotes limited liability. In effect such a company is a legal entity of its own; while shareholders control it, they are not liable for damages for its actions. Limited liability also has the practical effect that in the absence of take-overs or bankruptcies, such companies live forever.

Lydenberg and Paul briefly mention that the risk profile of private and public companies may vary, but there is surely an agency problem here that the asymmetric nature of the risk to shareholders in such companies may encourage anti-social behaviour. This can perhaps be most clearly seen in the case of the environment, where a profit-maximising company has every incentive to externalise as many costs as possible if this adds to its own profitability. This agency problem was of course identified by Adam Smith in 1776, although in his lifetime it was a purely theoretical question as limited companies were banned by the (South Sea) Bubble Act of 1721, a prohibition not generally reversed until the Companies Act of 1862:

> 'This total exemption from trouble and risk, beyond a limited sum, encourages many people to become adventurers in joint stock companies, who would upon no account hazard their fortunes in a private partnership. ... The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot be well expected that they should watch over it with the same anxious vigilance with which the partners in a private partnership frequently watch over their own.'

To conclude, I therefore argue that the privilege of pension fund incorporation and tax relief, coupled with the privilege of limited liability enjoyed by quoted companies, are sufficient to justify the recent pension fund regulations regarding socially responsible investment. Limited liability is a great privilege that may encourage anti-social corporate behaviour, and one that all equity investors benefit from. There is a strong argument that limited liability has damaged corporate social responsibility, and it seems only logical to put the genie back into the bottle by requiring investors to consider and assert the values of corporate responsibility.

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