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Morals, money, ethical investing and economic psychology

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ABSTRACT

This paper reports on a questionnaire survey of 1146 ethical investors in the UK. Ethical investing usually means that certain companies are excluded from one's portfolio on non-economic grounds, e.g. because they manufacture armaments, test chemicals on live animals, or have poor pollution records. Is this an example where moral commitment rather than economics is driving economic decision making? Ethical investors were found to be neither cranks nor saints holding both ethical and not so ethical investments at the same time. A case is made that people are prepared to put their money where their morals are although there is no straightforward trade-off between principles and money. A broader analysis than that based on rational economic man is recommended: an economic psychology.

KEY WORDS

economic psychology ■ ethical investing ■ money ■ morals

Opportunities now exist, most notably in the USA and the UK, for people to invest money in ethically and socially responsible ways. As an individual investor, the normal procedure when making investment decisions is to contact an independent financial advisor (IFA) who provides information about the two key economic factors involved, namely, risk and return. Investors then select a portfolio which balances risk and return; a common example being one which combines relatively low risk and moderate returns with a smaller proportion of higher risk investments. There will be individual differences in preferences, but, within the discipline of economics, it is generally assumed that people will attempt to optimize their welfare, and be guided by self-interest, their existing 'reserve' of wealth, and their position in the life cycle: economists resort to 'preferences' only when all else (from among the economic variables) fails.

There is now a growing literature from among psychologists, sociologists, philosophers and within the economic discipline itself which recommends a richer and more comprehensive research approach, e.g. Earl, 1983; Elster, 1986; Lea et al., 1987; Etzioni, 1988; Lewis et al., 1995. Etzioni (1988) argues for a dual explanation for behaviour: people are motivated in the economic realm by self-interest (whether narrowly or broadly defined) and moral considerations as well. The person is assumed to be regularly engaged in a dilemmatic internal dialogue perpetrated by these mixed motives.

The writings of Etzioni and others are highly persuasive, where rich anecdotal evidence is used to great effect. What is required is an empirical example where models based on mixed motives (rather than on economic self-interest, narrowly defined) may be more appropriate and informative.

It is our contention that ethical investing provides such an empirical example and raises a number of questions that traditional economics, on its own, may not be able to answer (Lewis & Cullis, 1990; Cullis et al., 1992).

It is clear that ethical investing is growing. The first ethical unit trust, Friends Provident Stewardship, was launched in the UK in 1984; the Stewardship funds together now total around £750 million. Since 1984, about 30 additional ethical unit trusts have been set up in the UK, managed by 20 mainstream financial institutions. The history of 'social investing' in the USA is longer and the market share larger but the characteristics of the investments have much in common in both countries, i.e. they are based on exclusion on ethical grounds alone. As an example, companies may be excluded which manufacture armaments, or tobacco and alcohol products, or test their wares on live animals (Domini & Kinder, 1986; Mackenzie, 1997; Cowton, 1998; Lewis et al., 1998). There is also a small but growing movement to encourage ethical unit trusts to be more proactive in changing corporate

policy: at present, there is widespread support for the current practice of avoidance, accompanied by 'soft' engagement in the form of lobbying (Lewis & Mackenzie, forthcoming, 1999).

Reporting on a questionnaire study of 100 'ordinary' investors and simulations of hypothetical investment decisions, Lewis and Webley (1994) were able to show (using questionnaires and computer simulations) that people exhibiting 'green' attitudes revealed a greater enthusiasm for green ethical investments and those who would hypothetically ethically invest a windfall were highly price-elastic, reducing their ethical investment rapidly as comparative returns fell. This research is suggestive rather than conclusive as the questionnaires were completed by 'ordinary' investors not ethical investors and the simulations involved relatively 'unsophisticated' undergraduates. There are, however, opportunities to compare (in a limited way) the price elasticity of ethical investors with these preliminary samples.

Qualitative research, in the form of telephone interviews with ethical investors, has also been carried out by Mackenzie and Lewis (1999). This has suggested that ethical investors may combine 'unethical', 'neutral' and ethical investments in their portfolio, although a quantitative analysis of the relative proportions has not previously been undertaken.

Much of the previous work conducted on ethical investing in the UK has been completed for commercial purposes and is not readily available in the public domain. (An exception is the work of Anand and Cowton (1993) who collected, using questionnaires, the exclusion preferences of 125 ethical investors, identifying five consistent preference bundles.)

So who are these ethical investors? What proportion do they invest ethically? Are they a minority of cranks who can be dismissed as outliers? Or are they spearheading a shift in society beyond mere fad or fashion? Do they perceive ethical investments as producing poor returns, as more risky investments than 'mainstream' ones? Are preferences for ethical investments relatively price inelastic? Or, put another way, what price are these people prepared to put on their moral commitments? These are the main questions addressed in this current paper employing questionnaire data from 1146 UK ethical investors.

Method

The questionnaire

The questionnaire comprised 15 questions and was six pages in length. Four questions (with sub-sections) were specifically concerned with perceptions of the risk and return of ethical funds compared with ordinary ones, the general

make-up of participants' portfolios, their willingness to change their portfolios with varying rates of return and the demographic and social memberships of the respondents. These questions are reproduced in the Appendix. (The results from questions about motives for ethical investment and the favoured role of funds are reported on elsewhere: Lewis & Mackenzie, 1999).

Participants

Respondents were 1146 individual ethical investors recruited from two leading ethical unit trusts in the UK. The demographic characteristics of those respondents form part of the results.

Procedure

The two leading ethical unit trusts in the UK regularly send out literature to their investors detailing performance and so on. The funds helped the researchers by enclosing questionnaires and prepaid envelopes (addressed to the researchers) to a random sample in their mailings together with a letter encouraging participation. Names and addresses of investors were not made known to the authors, and no reminders were sent as the trusts concerned did not wish 'to bother' their customers unnecessarily. As an incentive, prospective respondents were told that each completed questionnaire would result in 50p being donated to charity: £573 was raised in this manner. The response rate was 32 percent, a figure broadly similar to the ones achieved by the trusts themselves in their market research. The wide geographical distribution of responses, the fact that the majority of ethical investors will have investments in these funds, and the close mirroring of the demographic features of our respondents compared to profiles held by the funds all point to cautious optimism when assessing the surveys' representativeness.

Results and discussion

Who are the ethical investors?

Of the 1146 respondents, the majority were over 45 (68.2 percent), and 20 percent were 65 or more. Fifty-four percent were male and 46 percent female. Twenty-five percent of the sample were retired, but, along with the rest of the respondents, were asked to describe their main occupation while at work. Thirty-one percent worked in the education sector, 14 percent in health; only 4 percent and 5 percent respectively were from the

manufacturing and retail sectors. Sixteen percent described themselves as members of the Labour Party, 7.7 percent Liberal Democrats; there were more ethical investors who were members of the Green Party (2.4 percent) than the Conservative Party (1.8 percent). Of the charities, the most popular for membership were the National Trust (36.6 percent), Amnesty International (31.1 percent) Oxfam (28.6 percent), Friends of the Earth (27.6 percent) and Greenpeace (26.4 percent). Religious allegiances were well represented by the Church of England (16.1 percent) and the Society of Friends (10.3 percent).

From this evidence, one cannot dismiss ethical investors as cranks or extremists as the demographic data show they are frequently middle-aged, middle-income professionals who take an active part in established political parties, religious and charitable institutions, and pressure groups. Nevertheless, this commitment is distinctive: they have already acted (and continue to act); ethical investing appears to be a natural and necessary part of the lifestyle these people have chosen to lead.

Do they believe that ethical investments are riskier and produce poorer returns?

The answer is presented in Table 1. Over 42 percent of ethical investors believe their ethical investments give a lower rate of return than ordinary investments and nearly 19 percent consider them riskier. From this evidence, it appears that substantial numbers already believe they are incurring costs by putting their money where their morals are. This, however, must be put in the context of some of the other figures in Table 1, notably that approximately 41 percent

Table 1 Perceptions of risk and return from among ethical investors

<i>RETURN</i>		<i>RISK</i>	
<i>In the long term, compared to ordinary investment funds, do you think ethical funds offer:</i>	<i>Percentage</i>	<i>In your view, compared to ordinary investment funds, are ethical funds:</i>	<i>Percentage</i>
A much lower rate of financial return	1.7	Much riskier than ordinary funds	0.3
A slightly lower rate of financial return	40.7	A little riskier	18.3
A similar rate of return	40.8	About the same	57.9
A slightly higher rate of return	12.9	A little less risky	18.8
A much higher rate of return	0.8	A lot less risky	2.3
(Missing)	(1.5)	(Missing)	(1.3)
(Don't know)	(1.7)	(Don't know)	(1.1)

believe the return to be similar and nearly 58 percent no less risky than any other investments. This perhaps reflects the current financial competitiveness of the largest ethical investment trusts rather than the willingness (or otherwise) of investors to take a loss alone.

What proportion do they invest ethically?

When assessing the average amount invested ethically, the mean, median and modal results are strikingly different: mean, 31 percent; median 21 percent; mode, 10 percent. This indicates positively skewed distribution with a long tail to the right. Eighty per cent of respondents have 'mixed' portfolios, i.e. ethical and non-ethical investments combined; 20 percent claim to have no non-ethical investments at all.

Are preferences relatively price inelastic?

The results are presented in Table 2. The majority stay with ethical where the return is 8 percent for an ethical compared with 10 percent for an ordinary unit trust (80.8 percent); their loyalty even remains where the comparative figures are 5 and 10 percent respectively (56.5 percent), although, in this latter case, 35.8 percent would reduce their ethical investments.

While 34.4 percent would be happy to leave things as they are, substantial numbers would increase their ethical investments if they outperformed ordinary investments by 2 percent (34.8 percent would increase a little, 26.3 percent substantially).

Table 2 Willingness to accept reduced (and increased) financial returns to invest ethically and non-ethically*

Comparative return (%)	Subsequent preference			
	Reduce my ethical investments (%)	Leave things as they are (%)	Increase ethical investment (%)	Don't know or missing (%)
Ethical 8	5.2	80.8	12.9	(1.2)
Ordinary 10				
Ethical 5	35.8	56.5	3.6	(4.1)
Ordinary 10				
Ethical 12	0.6	34.4	61.1	(4.0)
Ordinary 10				

*Simplified for clarity from five- to three-point scale

The results are not directly comparable to Lewis and Webley (1994), nevertheless it suggests that the behaviour of ethical investors is relatively inelastic for losses and elastic for gains, whereas it is symmetrically elastic for both gains and losses for non-ethical investors. (In Lewis and Webley's study over 50 percent of non-ethical investors hypothetically reduced their ethical investments where ethical return 8 percent compared with 10 percent for others.)

Interactions

The final stage of the results assessed, with the use of crosstabulations and the chi-squared statistic, the following:

- 1 Are beliefs about the financial performance of ethical funds related to the proportion invested ethically?
- 2 Are these beliefs about financial performance related to the willingness to sacrifice financial return?

For the purposes of the crosstabulations, risk and return were both reduced to three categories as follows:

For risk: 1 = a little riskier + much riskier
2 = about the same
3 = a little + a lot less risky

For return: 1 = a slightly + a much lower rate of return
2 = a similar rate of return
3 = a slightly higher + a much higher rate of return

The percentage held in ethical trusts was also recoded into three categories:

1 = 1–19 percent ethical holding
2 = 20–39 percent ethical holding
3 = 40 percent (or more) ethical holding

Reactions to the comparative performance of ethical trusts were similarly recoded:

1 = Reduce ethical investment substantially + reduce a little
2 = Leave things as they are
3 = Increase a little + substantially

(In the case where the ethical fund outperformed the ordinary one, the categories were reduced to two as only 0.6 percent said they would reduce their ethical investments under these circumstances.)

Eight crosstabulations were produced in all. Neither of the chi squares was statistically significant when comparing perceived risk and return with the proportion invested ethically.

Overall, when perceptions of financial performance and the willingness to sacrifice financial return were compared, there were no significant associations, with one exception: if one perceived, initially, that ethical funds underperformed, the good news of increased performance (ordinary 10 percent, ethical 12 percent) was greeted with more enthusiasm than would be expected by chance (see Table 3).

Taken together the results suggest, at the very least, that the economic costs of underperformance, do not, on their own, determine investment decisions. One would expect that the greatest incentives to reduce ethical investments, should they underperform, would be from among those with the highest stakes in them: there is no evidence whatsoever to support this claim in our data. A more plausible explanation, from the perspective of economic psychology, would be that the proportion invested ethically is a proxy for moral commitment. It would be possible to argue that people who are investing only a small proportion ethically can in some sense 'afford' to lose out. The same cannot be said of those investing larger proportions.

Table 3 The relationship between perceived underperformance of ethical funds and preferences where ethical funds out-perform ordinary investments

<i>Perceived performance of ethicals</i>	<i>Preference</i>		<i>(Row total)</i>
	<i>Invest about the same</i>	<i>Invest more</i>	
Less return	151 (170)*	322 (303)	473
About the same	184 (162)	266 (288)	450
More return	51 (54)	100 (97)	151
(Column total)	386	688	1074

*Values expected if there is no relationship
Chi squared = 8.41 df = 2 $p = .0149$

Conclusions

Ethical investors have already put their principles into practice in a number of ways; ethical investing is part of this favoured lifestyle. These individuals are neither cranks nor saints: they are commonly middle-income professionals mixing ethical investments with not so ethical ones. Substantial minorities currently think they are taking a loss by investing ethically and the majority would keep their portfolios much as they are now even if ethical investments were to give returns of only 5 percent compared with 10 percent for non-ethical investments. These preferences are unrelated to the proportion invested ethically which suggests there is no simple trade-off between principles and profit. This persistence cannot easily be dismissed merely as fashionable or faddish behaviour in the market-place. The accumulation of wealth is a moral and psychological issue for many (if not all) of us. It may be just as well for society that 'rational economic man' is a useful assumption for some forms of economic analysis rather than a universal reality.

Appendix

The questions reported on in this study took the following format.

Question 1

Many people invest both in ethical trusts and non-ethical ones. Whether or not you personally do this, we would like to hear your views about how these two different types of unit trust compare. Please tick the appropriate boxes for each question.

The questionnaire continues on page 188

<i>Risk</i> In your view, compared to ordinary investment funds, are ethical funds:		<i>Return</i> In the long term, compared to ordinary investment funds, do you think ethical funds offer:	
a) much riskier than ordinary funds		a) a much lower rate of financial return	
b) a little riskier		b) a slightly lower rate of financial return	
c) about the same		c) a similar rate of return	
d) a little less risky		d) a slightly higher rate of return	
e) a lot less risky		e) a much higher rate of return	

Question 2

Thinking about all your investments excluding pensions and life insurance funds, approximately what proportions fall into the following categories.

- a) Direct shareholdings
- b) Ordinary unit trusts, investments trusts, PEPs
- c) Ethical unit trusts, investment trusts, PEPs
- d) Bank, Building Society & Tessa accounts
- e) Other (please specify)

Total should add up to: 100%

Question 3

a) Imagine that over the next five years the best ethical fund only produced an 8 percent average financial return, whereas a typical ordinary unit trust produced a 10 percent average annual return. Assume everything else remains the same. Which of the following would you do? (Tick one box)

- | | | | | |
|---|--------------------------|--------------------------|--------------------------|---------------------------|
| Reduce my ethical investment (E1) substantially | Reduce E1 a little | Leave things as they are | Increase E1 a little | Increase E1 substantially |
| <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

b) Now imagine that the best ethical fund achieves only a 5 percent average annual return, whereas a typical ordinary unit trust produces a 10 percent annual return. Which of the following would you do?

Reduce my ethical investment (E1) substantially	Reduce E1 a little	Leave things as they are	Increase E1 a little	Increase E1 substantially
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

c) Now imagine that an average ethical fund achieves a 12 percent average annual return, whereas a typical ordinary unit trust produces only a 10 percent annual return. Which of the following would you do?

Reduce my ethical investment (E1) substantially	Reduce E1 a little	Leave things as they are	Increase E1 a little	Increase E1 substantially
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Question 4

About you

To which of the following organizations do you belong (please tick any that apply to you)

National Trust	<input type="checkbox"/>	Greenpeace	<input type="checkbox"/>	Friends of the Earth	<input type="checkbox"/>
WWF	<input type="checkbox"/>	RSPB	<input type="checkbox"/>	BUAV	<input type="checkbox"/>
Oxfam	<input type="checkbox"/>	WDM	<input type="checkbox"/>	Shared Interest	<input type="checkbox"/>
Amnesty International	<input type="checkbox"/>	Church of England	<input type="checkbox"/>	Catholic Church	<input type="checkbox"/>
Methodist Church	<input type="checkbox"/>	Society of Friends	<input type="checkbox"/>	Political Party please specify	<input type="checkbox"/>

Which daily newspaper do you read most often?

Your age? Please tick one box

Under 25 25–34 35–44 45–54 55–64 65+

Sex

Male Female

Occupation

Please state your occupation (if you are retired, please also state your previous main occupation)

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