

SOCIAL SCREENING: PARADIGMS OLD AND NEW

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Social investing is an inescapable part of our world, because individuals — and institutions — can never completely compartmentalize their concerns.

— “Editorial Comment” [1997, p. 2]

In the seventeenth century, the Quakers realized that their investments could put the lie to what they said they stood for. They could not reconcile investing in slaves, for example, with their belief in the equality of humankind before God. Thus, the Quakers were the first to apply a social screen to their investments.

Two hundred and fifty years later, investors decide whether to invest in companies selling imported shoes and apparel by the data they receive on the age, working conditions, and wages of their Asian and Latin workers. The impulse driving the screening remains the same, but the context has changed.

Investors still want their investments to reflect their principles. The change has come in what they wish to express. From simple assertions of repugnance toward war or tobacco, social screens have now evolved into proxies for sophisticated assessments of the relationships between corporations and the societies within which they operate. They have thus become tools of value for managers seeking insights into, say, the foresight of management on workplace issues.

This article presents a brief overview of the

evolution of social screening and suggests the shape of screening in the future.¹

THE DEFINITIONAL FRAMEWORK

A *screen* is a criterion applied to a universe of potential investments that helps winnow the candidates. Perhaps the most common financial screen for equities is a price-earnings ratio in a particular range. Only rarely does an investor have a single financial screen. More commonly, the investor applies several tests before making a decision to buy or sell.

A *social screen* is a non-financial criterion applied in the investment decision-making process. More specifically, a social screen is the expression of an investor's social, ethical, or religious concern in a form that permits an investment manager to apply it in the investment decision-making process with other screens.²

But where do these screens come from? What do they represent? Investment managers must pose these questions, if they wish to develop a relationship with their social clients, for investors rarely apply screens randomly or base them upon simplistic assertions. Instead, they usually rest on careful analyses of investors' objectives.

Frames of Reference

Properly used, the term, “paradigm,” refers to

a framework for analysis. For social screens, two basic paradigms exist. The first is self-referential, taking a stand on one or more issues with which an individual or institution wishes to act. The second is comprehensive, creating a context within which to evaluate the impact of corporations on society in a manner that permits implementation by an investment manager.

The self-referential paradigm and the comprehensive paradigm are both valid and, indeed, complement one another. As with all paradigms, the results of the analysis shift with new data.

The Self-Referential Paradigm. Social investing grew out of an impulse toward taking a stand on what one did not want to own. Originally, non-financial assets were the focus. Quakers in the seventeenth century would not own slaves; some Americans will not own a Mercedes because Daimler Benz used slave labor during World War II (see Bellon [1990]). It is but a short step from there to not owning conventional goods or not purchasing services to avoiding securities issued by companies that are in the business of providing those goods or services.

Some investors apply only screens of this type. Many more begin by applying screens of this type and then progress toward more comprehensive approaches to screening.

As institutional investors have begun entering the field, some have taken a different approach, which has been characterized as *mission-based investing*. An institution's *mission* — its purpose or calling

— drives its investment policies. Its investments, of course, should generate cash for its programs, but they should, at a minimum, be consistent with the institution's mission. Consistency leads to clarity, and clarity about one's mission extends one's reach and reinforces institutional integrity.

Defining social criteria in terms of institutional mission avoids abstract discussions about what is and what is not "socially responsible." While mission-based investing may seem to fit most closely with the self-referential paradigm, an institution such as a church or a university may have a quite comprehensive approach to social issues and therefore to screening.

The Comprehensive Paradigm. For some investors and mutual funds, their social screens state their concept of how corporations should interact with society. Working within the constraints of what an investment manager can implement, their object is at once to modify corporate behavior where necessary and to assert to the public what they believe to be the proper standards.

The screens for the Domini 400 Social Index and, therefore, for the Domini Social Equity Fund reflect a comprehensive view of the criteria to be applied to corporate behavior. (For obvious reasons, we will use them as examples here, but they are not unique. For instance, the Calvert Group's socially screened funds express a comprehensive view.)

It is tempting to treat screens as a philosophical system. But, they are not, nor could they ever be one. Instead, they are an attempt to reflect a person's

EXHIBIT 1 EXCLUSIONARY SCREENS

ALCOHOL	GAMBLING	TOBACCO
Substantial Involvement	Substantial Involvement	Substantial Involvement
Minor Involvement	Minor Involvement	Minor Involvement
MILITARY CONTRACTING	NUCLEAR POWER	
Substantial Involvement	Derives Electricity	
Minor Involvement	Design	
Major Supplies	Fuel Cycle/Key Parts	

For many social investors, the exclusionary screens are absolute. For others, however, there may be gradations, which these bellwethers attempt to accommodate.

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or an institution's philosophy in the investment context. Thus, they are tools for implementing a philosophy.

With mutual funds, the challenge to their managers lies in capturing the views of a sufficiently broad segment of the population, so that — assuming satisfactory performance — the fund attracts enough capital to justify its existence. In the case of the Domini Social Equity Fund, the screens represent what its founders believe to be the mainstream of social screening.

Types of Screens

A hospital that declines to own securities issued by tobacco companies has applied a social screen. Other screens of this type, which are called *exclusionary screens*, bar investment in alcoholic beverage manufacturers and companies in the nuclear power, gaming, and military weapons businesses. Exhibit 1 lists the main exclusionary screens.

When the area of concern is the environment, a different structure emerges. Few investors have clear-cut product or industry screens, although some do exclude all extraction companies, for instance. Most look rather for a pattern in a company's actions that indicates an overall attitude — positive or negative — toward the environment. For example, a single fine of, say, \$1 million may mean little in the context of an otherwise decent environmental record, while a number of \$50,000 fines imposed by several agencies in different states may reveal a pattern of carelessness and disregard.

Other screens of this type, which we call *qualitative screens*, fall into classifications such as community relations, product quality and safety, labor/employee relations, offshore operations and impact, and diversity. Exhibit 2 lists the principal qualitative screens.

Both the press and social investment's critics focus on the exclusionary screens. This leads to fundamental misunderstandings of investors' objectives and aspirations for screening. An example appears in a recent *Pensions & Investments* article by Michael Devaney, a professor at Southeast Missouri State University:

Rather than directly affecting product price, social investing attempts to influence the weighted average cost of capital and increase or decrease real investment opportunities. By denying funds to companies that generate negative externalities, social screens hope to

increase the weighted average cost of capital and decrease new investment (Devaney [1997, p. 38]).

Most investors apply screens out of a need for personal or institutional consistency. No one involved in SRI would argue that it has as its objective increasing a company's cost of capital.³ Even if this objective were attainable, few social investors would consider it as effective as the political action or lobbying that screening entails. Social screening and SRI generally reach an audience far beyond the capital markets.

Indeed, the essence of contemporary social screening is, first, the construction of frameworks within which to evaluate the relationship between a corporation and the societies in which it operates, and then the communication of a judgment both to the corporation and the world at large. An understanding of how these paradigms work requires an exploration of the screens themselves.

EXCLUSIONARY SCREENING: THE BURDEN OF HISTORY

The earliest social screens barred investments in military weapons, alcoholic beverages, tobacco products, and, as noted earlier, slaves. Rejection of alcohol and tobacco characterized nineteenth century Methodists and Baptists. By the mid-1920s, alcohol and tobacco screens were so common that one of the first U.S. mutual funds, The Pioneer Fund, imposed them.

While these screens arose out of religious convictions, by the early days of the twentieth century the alcohol and tobacco screens had evolved into secular dogma.⁴ By 1970 when a group of Methodists founded the Pax World Fund, so too had pacifism evolved.

This mixture of the religious and the secular has also characterized screens on nuclear power. No matter how it was dressed up, "the peaceful atom" of the Eisenhower years remained tied to weapons technology. General Electric, one of the main purveyors of nuclear power technology, was a major military contractor until the early 1990s. Late in the Vietnam era, nuclear power became associated with Dow Chemical Co., an early maker of Napalm. Dow drove the development of a nuclear power station in Midland, Michigan. Unshakeable opposition and implacable economics led to the conversion of the plant to conventional fuel. And then, there

EXHIBIT 2 QUALITATIVE SCREENS

SCREEN	STRENGTHS	CONCERNS
Community	Generous Giving Innovative Giving Support for Housing Support for Education	Negative Economic Impact Investment Controversies
Diversity	CEO Promotion Board of Directors Family Benefits Women/Minority Contracting Employment of the Disabled Progressive Gay/Lesbian Policies	Controversies Non-Representation
Employee Relations	Strong Union Relations Cash Profit Sharing Employee Involvement Strong Retirement Benefits	Poor Union Relations Safety Controversies Workforce Reductions Pension/Benefits Concern
Environment	Beneficial Products & Services Pollution Prevention Recycling Alternative Fuels Communications	Hazardous Waste Regulatory Problems Ozone Depleting Chemicals Substantial Emissions Agricultural Chemicals
Non-U.S. Operations	General Non-U.S. Operations Community	Burma Mexico General Non-U.S. Operations
Product	Quality R&D/Innovation Benefits to Economically Disadvantaged	Major Product Safety Product Safety Marketing/Contracting Controversies Antitrust Disputes
Other	Limited Compensation Ownership	High Compensation Tax Disputes Ownership

Qualitative screens depend on bellwethers, since it would be impossible to analyze the social records of even a small NYSE company with some sense of completeness.

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were the environmental concerns....

Opposition to gambling — or gaming, as many proponents now call it — has deep roots among evangelical Christians. Secular reformers had good reason to adopt the cause, too. Its association with other forms of vice and political corruption, as well as its costs to individuals, put it beyond the pale.

Gambling did not figure as a screen until the 1960s, because very few publicly traded companies had casinos or racetracks. Only in the 1980s did “leisure” come to mean “gambling.” At the same time, lotteries became the preferred means by which states increased their revenues.

Among Roman Catholics and some evangeli-

als, opposition to abortion and birth control are articles of faith linked to their concept of when life begins. They exclude primary care hospitals that offer abortion services, as well as manufacturers of abortifacients and birth control medications and devices. As Catholic institutions bring their portfolios into line with the National Conference of Catholic Bishops' 1992 investment guidelines, these life ethics screens will become common.⁵

Some critics have viewed exclusionary screens as litmus tests of "political correctness" or as examples of a new puritanism. As this brief summary indicates, there is little to support this view except opposition to the beliefs that exclusionary screens express.

A more cogent criticism is that those who do not own a company cannot influence its policies. With their franchise — the right to vote — as shareholders, theoretically corporate owners can influence policy in these areas. This argument presumes that every investor who opposes, say, the promotion of smoking to teens aspires to be a shareholder activist. In fact, it is enough not to want to profit from something one finds morally repugnant. And no one has made a compelling argument that one has an obligation to hold such investments.⁶

From the investment manager's standpoint, exclusionary screens have the virtue of definiteness. It is relatively easy to define such screens, and then identify companies in one's universe that fail a client's screens. A typical alcoholic beverages screen, for example, will simply bar investments in manufacturers of alcoholic beverages. Since few companies dabble in the brewing or distilling businesses, identifying the manufacturers from their Form 10Ks or annual reports is not difficult.⁷

Over the last thirty years, the list of exclusionary screens has been dynamic. Investors have developed new screens, such as gaming and life ethics, to address changes in society. More exclusionary screens will evolve with society. A brief look at how the South Africa screen emerged and developed will illuminate the process by which new exclusionary screens will emerge.

THE SOUTH AFRICA SCREEN: FROM THE PAST TO THE FUTURE

South Africa marked the transition from divesting sin to investing for positive social change. Over the twenty-five years between 1969 and 1994, South Africa catalyzed a change among social

investors from an inward-focused desire for consistency between one's values and one's investments to an outward-oriented expression of how society should work.

South Africa emerged as an investment issue in the late 1960s. Activists who had recognized the connection in the U.S. between *de facto* segregation and access to meaningful jobs had little trouble connecting apartheid and job classification by race in South Africa. To permit U.S. corporations to profit from practices in South Africa that would be unacceptable or illegal at home seemed, at best, inconsistent. As early as 1969, universities found themselves under pressure to rid their portfolios of companies in South Africa.

Opposition to a hard line on South Africa came from two sources. Conservatives and the in-country corporations often argued that so long as companies observed local standards, they were acting ethically. The more enlightened asserted that companies could influence South Africa for the good by staying and setting an example — a view that would later be termed, when applied to China and Burma, as "constructive engagement."

In 1974, the intervention of the Reverend Leon Sullivan (then a General Motors director) led to the articulation of standards to which companies with operations in South Africa would be held. At the same time, a system of ratings was devised to evaluate performance.

In short order, investors — both institutional and individual — began setting minimum performance requirements in terms of the Sullivan ratings. These ratings were of two types. One simply reflected whether the company had signed the Sullivan Principles, while the other required an evaluation of a signatory's progress in implementing the Principles.

Moving Toward Divestiture

Failure to subscribe became an exclusionary screen almost from the start.⁸ Progress by corporations toward the Sullivan goals sufficed for nearly ten years as a justification for keeping them in portfolios. Eventually, patience with constructive engagement waned in the face of South Africa's intransigence.⁹ By the mid-1980s, "divestiture" had become the watchword.

"Divestiture" had two meanings. First, it applied to corporate holdings in South Africa. Many believed that if U.S. companies left, the South African economy would suffer, thus forcing change. Second, divestiture applied to the portfolios of insti-

tutions that held stock in companies that declined to shed their South African holdings. By the time federal legislation effectively proscribed operations in South Africa in 1987, "divestiture" was the screen most commonly applied. Thus, over thirteen years, anti-apartheid screening had evolved (with American public opinion) from a system of gradations and options to an absolute, as on tobacco.

The South African paradigm seems likely to repeat itself, although no issue at this moment is an obvious candidate.

Evaluating Social Performance

Evaluating the performance of signatories requires something not seen before in social screening: a qualitative evaluation of a company's performance. It is a very different thing to determine whether a company is making progress toward the "nonsegregation of the races in all eating, comfort, locker room, and work facilities" than whether a company is in the gaming business.¹⁰

Complex questions should produce nuanced answers, not "making good progress," or "needs to become more active," as the Sullivan raters might respond. Such was the criticism then of the Sullivan ratings, and such is the criticism now of qualitative screens.¹¹

A somewhat contradictory but completely understandable complaint about screens of this sort is that they rest on data that are not comparable, as, say, the data used to calculate financial ratios are. When evaluating environmental impact, "good progress" by a surface mining company would amount to something quite different from "good progress" by a soft drink manufacturer.

In addition, the data on which a qualitative judgment will be based are necessarily partial. Companies with substantial operations in South Africa, such as General Motors or 3M, could not expect individualized appraisals of their operations. Instead, the Sullivan ratings rested on the companies' responses to bellwether questions from which the raters drew their conclusions.

QUALITATIVE SCREENS

Today's qualitative screens are the lineal descendants of South Africa screening. They may spring, in part, from a desire for personal or institutional consistency of purpose. Nonetheless, they represent an assertion of what the proper role of corporations in society should be.

The earliest of the non-South Africa qualitative screens is probably the environment. And, like the South Africa screen, it has evolved.

In the 1970s and early 1980s, environmental screening relied on lists such as Environmental Action's "Filthy Five" or the National Clean Air Coalition's list of the fifty top emitters of toxic pollutants (see Domini and Kinder [1984, pp. xv and 131]). Almost without exception, these lists focused on negatives. By their nature, they could not account for nuances, such as industry group, that would affect both their relative and absolute performance. They could not compensate for the implied comparison of, say, banks and chemical companies. And, most important, they could not reflect progress or excellence. Still, they were a starting point.

Environment, community, diversity, non-U.S. operations, and product screens share their origins in list-driven, negative screens. But, today's screens attempt to capture a more nuanced view of corporate performance — both positive and negative. By so doing, they express expectations and aspirations inconceivable in social investing before South Africa.

Qualitative Screens Today

Qualitative screens rely on *bellwethers*, indicators from which broad conclusions about a company may be drawn. Bellwethers should point to areas of strength in a company or to aspects of corporate performance that should concern the investor. In the employee relations area, a positive bellwether would be a history of strong relations with unions, while a negative would be a recent pattern of willful violations of health and safety regulations. As these indicate, bellwethers lack the virtue of list-driven screens — someone must make the judgment about the company's history; someone must evaluate the company's record.

Exhibit 2 lists bellwethers associated with a representative sample of contemporary qualitative screens. They share the common characteristic of being topics on which verifiable information is available from public and company sources. Each reflects a particular characteristic of the company from which a broader conclusion may be drawn. For instance, a company with a notable history of promoting women and minorities to line positions is likely to carry this attitude into its hiring throughout its operations.

Qualitative screens have become an essential part of many of the better known SRI mutual funds. Among those notable in this regard are the Calvert

Funds, the MMA Praxis funds (sponsored by the Mennonite Mutual Aid Association), and Security Benefit's Social Awareness Fund.

Tomorrow's Screens

Predicting the future of screening is not easy. A review of both our work and others' from the early 1980s and before is humbling in this regard. Still, it seems safe to predict that:

- The range of the current qualitative screens will expand.
- Global issues will become standard screens shortly.
- Unpredictable events will shape SRI's future.
- Conventional securities analysis will incorporate some of today's social screens.

No one has better captured the future of screening — and therefore of social investing — than a recent editorial in *Plan Sponsor*, which concludes: "Social investment is not corruption, or irresponsibility, or craziness. It is simply how the investment process works in a democratic setting" ("Editorial Comment" [1997, p. 2]).

Expanded Range of Screens. Nothing would appear more certain than that the range of qualitative screening will expand. Put differently, the range of bellwethers under each heading will grow, as it has over the last ten years.

Three areas in particular seem ready to expand. First, the environment. Both global warming and local concerns are extending the range of investor concerns. But given population pressures in urban and urbanizing areas, land use issues may be the next important screening area to emerge.

Second, as the reaction to the excesses of executive compensation and job exporting takes root, more attention will be paid to employee relations. The increasing interest in social investing by organized labor will accelerate this trend, despite labor's inability to impose screens on Taft-Hartley pension funds.

Finally, diversity will grow in importance, albeit gradually. The American workplace is changing both in terms of ethnicity and age. Questions of workplace justice will find their way into social screens. Already, a company lacking diversity in both top management and board of directors is exceptional enough to cause social investors to regard it with suspicion. As of early 1997, Cabletron, Shaw Industries, and Tele-Communications, Inc. fall into this group.

Non-U.S. Operations and Companies. The emerging qualitative screens will focus primarily on corporate activity outside the United States. Two interrelated phenomena are driving these screens. The first is the globalization of business. The second is the increasing popularity of mutual funds with global exposure.

The information available on both non-U.S. companies and non-U.S. operations of U.S. companies is both limited and of limited value. It is particularly hard to come by in the areas of immediate concern: the environment and labor relations. There will be increasing pressure on global organizations to impose reporting requirements and on nations to open at least their electronic borders. But it will be a long time before social investors have anything like the data on non-U.S. companies that they now get on U.S. firms, thanks to the Securities Acts.

The Unpredictable. Social investing in the U.S. and therefore social screening has not progressed in anything like a predictable fashion. Born of the peculiar confluence of movements in the late 1960s, SRI has no single parent or focus. For that reason, it is almost impossible to predict what screen will emerge or come to dominate.

From the perspective of 1969 with its Santa Barbara oil spill and anti-war riots, the importance of South Africa certainly was not apparent. Today's concerns about corporate social responsibility were more predictable given the excesses of the 1980s, but their depth was not.

Investment managers have learned to cope with social screening. They have become sensitive to the multiple bottom lines their clients now consider. They have learned to be flexible in the face of client concerns about social issues. The one safe prediction about the future of social screening is that investment managers will never be permitted to forget that lesson.

SOCIAL SCREENS BECOME MAINSTREAM

Perhaps the safest prediction today about the future of social screening is one that seemed impossible ten years ago. Some of today's social screens will be incorporated into conventional securities analysis.

With Exxon's environmental problems and Texaco's diversity problems, analysts are forcefully reminded that the criteria for fundamental analysis laid down by Graham and Dodd in the 1930s have to be expanded for the twenty-first century. A host of similar problems at other companies that only

meticulous readers of the business or legal press see day-to-day are persuading analysts to look farther afield.

In this change in focus, the securities industry is behind the very companies it analyzes. Last summer, when asked to comment on the Clinton Administration's vacillation on the threats of food shortages and plant and animal extinctions due to global warming, the Chairman and CEO of ALCOA, Paul H. O'Neill, said, "It's frightening that this is being handled like a regular political issue" ("Global Warming" [1997, p. 39]). Where companies go, analysts will surely follow.

ENDNOTES

The views expressed in this article are the authors' and do not necessarily reflect those of any organization with which they are affiliated.

¹For a comprehensive examination of this evolution, see Kinder, Lydenberg, and Domini [1992].

²Like all screens, social screens should indicate companies that should or should not be eligible for investment. They are not intended to indicate that a company is "socially responsible." Other evaluative frameworks are better suited to this determination.

³The notion that SRI has as its objective some effect on stock price or on the economics of a company is a persistent one among SRI's critics. For them, it has the dual virtues of being both understandable and ludicrous. Thus, they can ignore the more subtle and yet achievable objectives of positive social change that social investors do share.

⁴Although see Behr [1996, p. 26].

⁵"Socially Responsible Investment Guidelines" [1992]. It is important to note that this document deals with SRI generally. Whatever one's views on abortion, it is the finest concise statement on social investing so far written.

⁶"Why don't you keep your Philip Morris, and donate what you make to charity?" This argument merely presupposes that

the convenience of the manager outweighs the client's beliefs, a view few clients share.

⁷In the U.K., an alcoholic beverages screen can be considerably more difficult to implement than it is in the U.S. There, retail outlets carrying beer and wine would fail the screen. Apparently similar social screens can vary widely across cultural boundaries.

⁸Since this article focuses on screening, we have space only to acknowledge the critical role that shareholder activism played here.

⁹Long before apartheid ended, Mr. Sullivan disassociated himself from the Principles. He had given up hope that they would force change in South Africa.

¹⁰"1983 Sullivan Principles Ratings for Firms Doing Business in South Africa," as quoted in Domini and Kinder [1984, p. 230].

¹¹By the end of the Principles' usefulness, the task of rating had devolved onto Arthur D. Little & Co., Inc.

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