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The Alternative of Socially Responsible Investment

Stephanie Lynn Fox
Western Washington University

Honors Program

HONORS THESIS

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FOREWARD

When I graduate from Western in June, all official school records will list my dual degree in political science and a Fairhaven concentration. However, the substance of what I have been studying over the past three years deals with capitalism and free market economies. Not simply the economic system, but the growth of the global economy and the impact it has on worldwide social and political systems. While free market, capitalist economies seem to be highly efficient and profitable, there are massive and widespread negative effects that are not being taken account of, such as the increasing level of poverty, hunger and homelessness, environmental destruction, race and gender inequality and the exploitation of workers in lesser developed regions of our country and the world.

While I understand the profitable nature of capitalism, I believe that people, not numbers or money, are the important aspects of economic, social and political structures, and that it is possible for certain aspects the global economy to be simultaneously profitable and socially conscious. While a profitable and socially responsible capitalist system on a global scale may not be realistic, it is imperative for the future of the market economy to recognize its faults and weaknesses and make a serious effort to alleviate them.

Since I have spent three years studying, researching and examining the negative aspects of capitalism, my time and effort on this senior project is dedicated to exploring an alternative approach that is being taken to lessen the negative impact of the global economy.

While there are a variety of alternatives which exist throughout the world, such as grassroots trading organizations, lending groups and worker cooperatives that are targeted to the specific needs of the poorest populations of an area, I chose to focus on the strategy of social investment within the United States.

Following this course of action, banks and financial organizations are making it profitable to follow a social agenda, from reinvestment in community development to supporting socially and environmentally conscience corporate practices. Investors and stockholders are finally realizing the tremendous influence they have on important corporate decisions, and/or through their support of social action groups. Many organizations throughout the United States are making it possible for them to use that power in a positive manner to better their work places, communities, environment, and specific causes worldwide.

My research on the topic includes correspondence and analysis of information and materials various investment agencies have sent me, personal interviews with an investment banker, as well as critical studies and comparisons from various books, newspaper and magazine articles.

The format of the presentation of my results includes the paper attached which is a synopsis of my findings, a bibliography of resources and a notebook containing relevent resources, including informational packets sent to me by the various agencies.

<u>The Alternative of Socially Responsible Investment</u>

Free market, capitalist ideology is increasingly becoming the basis of the world economy. Over the past century the economic system of capitalism has proven to be highly effective and profitable, creating wealth and increasing productivity levels. However, the capitalist imperative to maximize profits is often accomplished at the expense of countless social and environmental factors. The ruling forces of capitalism that drive industry to be more efficient, more profitable, and expand to new markets, have left environmental degradation, cyclical poverty and hunger, as well as social strife in the wake of productivity. The social needs of many employees, including decent wages, job security, open hiring policies and support services are often lost in the quest for profit. Simultaneously, employees regularly become the scapegoats and suffer layoffs, lowered wages and/or benefits and increased work hours when production doesn't meet goals.

Take for example the case of Sadisah, a worker in a Nike contracted facility in Indonesia where she makes less than $1.03 per day producing $150.00 tennis shoes.[Ballinger 1992] Not only does her 63 hours of work per week calculated on her paycheck put her under the minimum physical need for subsistence, but perpetuates the environmental cost of Indonesian factory zones which pollute the ecosystem and promote crowded and unsanitary living conditions for workers. One must not forget the American jobs lost when Nike moved the plant overseas in order to save on wage costs.[Ballinger 1992] True, production costs are saved, but there is no way to measure the cost of wasted human potential and environmental degradation. While it is essential to the classical functioning of the capitalist system that a profit is realized, it is possible to bring capitalism to terms with a social agenda by making socially responsible business practices profitable. Infact, in 1992, according to the Social Investment Forum, an association of progressive investment institutions, over $500 billion in investment assets were beomg screened for ethical or social criteria, and few businesses want to cut themselves off from that volume of possible investors.[Ekins 1992]

The most important step in making socially based corporate practices a widespread reality is for investors and shareholders to realize the power they have over corporate decisions. When they make their desires known,

> Ethical investors can send corporations....... a message that their conduct is unacceptable either explicitly, by questioning this situation at annual meetings and through proxy votes, or by selling shares in these corporations and refusing to profit from these practices. [Judd 1990]

Lack of community and investor support makes it difficult, if not impossible for a company to conduct efficient business. Slowly, corporations are coming to understand this and many have begun to follow the "stakeholder" philosophy. Following this line of thinking, company policy must not just reflect the interests of the shareholders, but the "stakeholders" who are all effected by company policy. These groups include the shareholders, employees, consumers, the community and the environment.[Ekins 1992] This "stakeholder" ideology is proving effective in making corporations responsive to the needs of their community and employees. Aileen Hernandez, Chair of the Board of Working Assets, a socially responsible mutual fund, believes that "....the quality of a company's interaction with the community is one of the key factors in determining its long-term financial prospects." [Hernandez 1993]

Understandably this is a difficult ideological transition for a majority of the financial community, since it goes against orthodox business principles, the paradigm of rational choice and the rule of profit maximization which are so ingrained in the corporate and economic communities. For example, the South Shore Bank (see page 14) could not hire bankers for the first five years they conducted business in Chicago, since their business philosophy and loan policies, which place the poor and disadvantaged as primary customers, went against standard procedure. In effect, the loan officers were blinded by their knowledge and understanding of classical capitalist models.

What is being found, in contrast to popular economic standards, is that there is a rationality behind social investing. In effect, looking out for one's self interest can be in the best interest of all. As Jerome Dodson, the founder of The Parnassus Fund, a socially responsible mutual fund states,

> We found there is almost no difference in financial return between the socially responsible companies and the rest. You have to look a little harder, but there are more than enough to choose from.[Dodson 1993]

Financially, banks that re-invest in failing communities have, by traditional standards, excellent loan payback rates, and social mutual funds provide comparable dividends. Even more advantageous is the fact that investing in corporations with positive environmental and employee practices means less risk of excessive EPA fines or lawsuits. As one ethical investor put it, he "...sleeps better knowing it won't be his companies making the morning headlines for an environmental spill or equal employment lawsuit."[Judd 1990] Likewise, the marketing impact of "environmentally" or "socially responsible" products can be a boon to business. The new emphasis on recycling and the environment has made conscious corporate practices, including the contents and packaging, of products an important tool in increasing sales and marketability.

While the practice of social investing has hit the media spotlight, it is far from a new phenomenon. Its roots can actually be found early in this century with religious groups who "found it inconsistent to preach abstinence from certain activities and then invest in 'sin stocks'-companies whose primary businesses are gambling, tobacco sales, or alcohol manufacturing."[Judd 1990] In fact, churches set the tone for ethical investment and have guided the movement from the start.

In 1928 the Pioneer Fund was established as a focal point to assist with the social objectives of these many religious groups. Throughout the ensuing decades, especially in the 1960's and 1970's the range of issues expanded to include a broader range of worker safety, equal employment, the environment and anti war sentiments. Investors looking for a way to invest without directly supporting the Vietnam conflict helped create the Pax World Fund in 1970, the first fund to encompass a broad range of social criteria. People were finally able to invest and rest assured that there was no connection between their money and the conflict or weapons production in general. Two years later the Dreyfus Corporation followed with the Third Century Fund which likewise focused on the Vietnam conflict and provided comprehensive investment criteria.[Judd 1990]

It wasn't until the question of divestment from South Africa in the 1980's that the true possibilities of social investment were tested. Major investors used their financial leverage to pull entire corporations out of South Africa, students successfully petitioned for university divestment and workers united to keep their employers from investing pension fund monies in the region.[1] While the South Africa divestment movement caught the attention of many mainstream companies, others were skeptical, seeing divestment as irrational since it forced investors to ignore the chances at excellent returns.

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[1]In the late 1980's pension funds accounted for 2.3 trillion in assets.[Judd 1990]

While this "irrationality" has been the main point of contention between classical conservative and "ethical" investors, financial disasters such as the Exxon Valdez spill and Bhopal Chemical leak, have proven the ethical stance to be a valuable one. Exxon lost 20,000 customers within a few days of the Prince William Sound spill, and it has cost them billions more in court fees, clean up, fines, and additional lost customers. Regardless of the environmental factors that will be haunting the earth for centuries to come, these are financial footsteps that no other corporation, or investor for that matter, wants to follow.[Judd 1990]

Recognizing the growing importance of responsible business practices and a cry from the business community for assistance in setting guidelines and goals, Business for Social Responsibility (BSR) was created in 1992 to help guide companies in their quest to link corporate prosperity with socially responsible practices. Michael Leavett, the president of BSR, believes their goal is to make people recognize the link between profitable performance and responsible corporate practices. In his words, they see themselves as the

> ...premier American business organization defining, supporting, advocating and promoting responsible business policies and practices that benefit not only our companies, but also our employees and communities, our economy and environment. [Michael Leavett 1994]

Their proposition that "social responsibility makes good business sense" has attracted companies such as Reebok, Levi Strauss, Lotus Development, Time Warner, Starbucks and others who have come to recognize the myriad of positive results that come from conducting business in a responsible manner.[Grimes 1994]

Their services have proved highly effective for many businesses, due to the vast amount of criteria regarded as socially or ethically important. Due to the attention the media has lavished on the depleting Ozone layer, recycling, disappearing rain forests and disasters such as the Exxon Valdez, environmental issues are a major focus today.

Beyond ideological beliefs, new EPA regulations that require industries to clean up their act by reducing CFC, sulfur dioxide, nitrogen oxide and halon emissions are placing heavy financial burdens on companies that have a limited time to meet compliance.[Judd 1990] Corporations that have been following a sound environmental code for years may already meet new requirements and therefore will be in a better position to compete since resources aren't going to renovation or fines.

Likewise, court decisions that have found adverse health conditions resulting from toxic waste to be the liability of the company, not the insurer, are causing a few (though not enough) companies to think twice about disposal methods. Furthermore, the increasing cost of waste disposal makes workplace recycling a necessity.

Employment practices are another area of social scrutiny. This includes hiring and wage policies regarding women and minorities, employee treatment, benefits such as health care and childcare and the right to organize. Since over one half of all ethical investors are women, a good track record of hiring and/or promoting women and minorities into upper management is a popular trait for investors and investment companies to look for. Gannett news is an excellent example of this, since by 1990 over half of their upper corporate managers were women and six of the eighteen board members were women or minorities.[Judd 1990]

However, while screening companies for employee treatment and affirmative action, it is important to look at determinants other than simple statistics. Having a few women or minorities on the board of directors is not always an indicator of a sincere commitment to affirmative action. Likewise, the geographical location of a facility may influence workforce composition. For example, a company in the rural Midwest with 100 employees will have a different composition than a corporation based in New York city with 5,000 employees. Therefore, it is essential to look beyond the statistical breakdown of the company in question. The best companies tend to have a pattern of climbing to executive positions, not just a token one or two executives at the most visible levels. A system of mentors and networks readily open and available to women and minority employees, as well as other commitments such as child care, community reinvestment, job security, and worker safety are all indicators of employer commitment.

From the investor point of view, those work places that are willing to tackle current social issues are better equipped to deal with controversial issues that arise in the business community. Those workplaces that have an emphasis on employee relations and participatory corporate decisions create better employee performance, with less sick leave, increased productivity and innovation. This fosters not only better performance for the company as a whole, but also improves employee retention, which is economically essential and "rational." Fewer resources must be invested in hiring and training new employees, and the numbers of skilled workers in many fields are shrinking. The companies that can retain their skilled employees or invest in training employees will be in the best position to compete in the coming century.

Other regularly screened social criteria include non-affiliation with the tobacco, nuclear power and alcohol or firearm industries. Corporate policies and histories with unions, charitable contributions, the promotion of sustainable agriculture, non-discrimination for disability or sexual preference, HIV/AIDS support, and animal testing are all important factors as well.[Hernandez 1993]

While many businesses are striving to fit social criteria, the novice investor can get caught up in the rhetoric and confusing mass of information. In reality, deciding how to invest is a fairly simple process, even for a beginner. With any type of investment, the investor must narrow the field of search because of the limitless possibilities. Classical conservative investors may choose to narrow to one or two industries, or focus on companies that fit to a particular statistical listing. The socially conscious investor instead narrows decisions based on social criteria.

The first order of business to narrow the search is to decide what issues are most important to the investor. This is often an easy task since most ethical investors start as smart consumers with an eye for the environment and social needs during everyday life.[2]

Once an investor chooses the most important criteria, there are three simplified theories on how to invest consciously: either avoid the bad, buy the good, or change the bad to good. While the last option, changing the bad to good, may seem like the over shadowing purpose behind social investing, the first two approaches are both more common and more feasible. When taking one of these roles, there are a variety of investment options to choose from, including bonds, stocks, money market accounts, mutual funds and investment banks.

If the investor chooses to focus on stocks and bonds, it will take a good deal of research on the investors behalf to look up corporate policies and pinpoint a history of solid corporate

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[2]This includes curbside and office recycling, carpooling and attentiveness to the consumer goods bought.

growth. The two most common ways to pick stock are the fundamental and technical approaches. With a fundamental approach, the investor focuses on a thorough understanding of the company operations and inner workings. This information can be accessed from public records, company reports or brokerage houses.[3] Unlike the fundamental approach, the technical approach ignores business conditions or new products and instead focuses on predicting trends in the market.[Judd 1990]

Money market funds are another form of investment. While they give the investor more access to their money and guarantee returns, money market funds are heavy in Government issued bonds. Investing with Government bonds is something most ethical investment companies and individual ethical investors are leery of doing, or cannot do, because of a commitment to weapon, nuclear energy and/or alcohol and gambling free investment.

If money market accounts and stocks seems too daunting or time consuming to the new investor, mutual funds could be the answer. With mutual funds, a person is essentially buying stock in the investment company. The advantage to this approach is

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[3]One note of caution is that since brokerage houses make their money off of each share that is bought or sold, they often recommend frequent trading.

that not only does the company do the research for you, but your portfolio is automatically diversified and is managed by a professional. However, thoroughly researching the fund company is a necessity to assure you are making a sound investment. Funds can be found with either "load" which means paying on a commission basis, or "no load" which is paid through an annual management fee.

There are a variety of mutual funds that focus on specific issues and cater to a variety of special needs. The Women's Equity Mutual Fund is a company that screens its investment options based primarily on women's issues, such as equal employment, maternity leave and charitable contributions to women's health and social organizations. Working Assets Common Holdings on the other hand, screens for everything from health and the environment to affordable housing and international peace issues. Additionally, they will not invest in multi-nationals with more than 1/2 of their employees outside of the United States, since they believe this is a sign of taking unfair advantage of cheap labor. They have personally screened over 800 companies to come up with the list of approximately 200 they actually invest in.

Parnassus Fund, a San Francisco based mutual fund company, has been the most successful, as well as the most unconventional fund. The funds creator and president, Jerome Dodson, focuses on investing in companies that practice corporate social responsibility, recognize environmental protection as economically feasible and avoid tobacco, weapons manufacturing and nuclear energy. Dodson goes one step further though by going "against the established wisdom of Wallstreet."[Dodson 1994] He picks companies that not only meet the previous criteria but are out of favor with the market. This strategy has given clients a 37.7% annual rate of return on their investment, almost twice that of the Standard and Poors (S&P) 500 listing.[Fortune 1993]

Yet another type of investment opportunity is to support community development organizations. This can be done through deposits, savings plans, retirement accounts, shareholding or in some cases memberships. Community development organizations, such as investment banks, have been leaders in redeveloping failing communities. These organizations go against the established rules of business and investment to provide money and support to people in poverty stricken areas and, against all conservative predictions, still realize a profit. Many mutual funds such as Working Assets and Pax World Fund place emphasis on these projects since they value redevelopment, economic justice and affordable housing.

What these banks do is offer a commitment to failing communities by offering small loans to local businesses and residents to get local economies back on track, and returning a portion of profit to the community through block grants and community reinvestment. While these facilities exist throughout the United States and the world, the South Shore Bank in Chicago is the best example of pairing the profit motive with ethical business.

The South Shore community of Chicago was being rapidly abandoned in the mid 1970's due to poverty, violence and failing business. The four founding members of the South Shore Bank saw that community organizations were good at identifying the issues in the area that needed to be addressed, but lacked the capital to do anything about it. In the words of the co-founder and Board Chairman, Ronald Grzywinski,

> As bankers and community volunteers, we decided that the answer to rebuilding neighborhoods had to be some kind of business. It had to be self-sustaining; it had to have the independence of a capital base and the discipline of the profit motive. What we were imagining was a development bank-a bank that could be tough-minded about loans, qualify borrowers according to strict standards, satisfy the most demanding federal bank examiners, make a profit and still transform an inner-city neighborhood without driving out those who lived there.[Grzywinski 1991]

Previously the bank was a local lending institution that attempted to pull out of the area. They had lost over 50% of their deposits in four years and wanted to move the bank closer to urban Chicago. Through the dedication of Mr. Grzywinski and his co-founders who offered their innovative strategy and put their own families, savings and professional reputations on the line, they were able to locate the capital needed to take over the bank.

By seizing on the concept of a community as a living organism and a bank as serving that community, they convinced local residents to not only stay, but to invest in their homes, open businesses and bring their money back from the city bank branches and into the community. The South Shore Bank is responsible for financing the rehabilitation of 30% of the 25,000 apartments in the area, providing home and small business loans, as well as loans to local community organizations.[Grzywinski

1991] Deposits in the bank are steadily rising and the rate of loan failure is well below the national average even though more than 20% of the area residents live below the poverty level.[Grzywinski 1991] The neighborhood moved from the threat of bulldozers to a thriving community with increased property value, decreased crime rate, improved schools, and an increased annual income for long-time residents.

The efforts of these few bankers who went out on a limb, as well as the investors and residents who took out loans and invested in the bank saved an entire community from virtual collapse.

This example has produced spinoffs from Arkansas to Kansas and Michigan. The Southern Development Bancorporation is a subsidiary of the South Shore Bank and was formed in 1987 to focus on stimulating the economy in 32 rural counties of Arkansas.[Quint 1992] They focused on business and employment in these areas which suffered from layoffs and high unemployment. They are also constantly offering advice and financial support to banks in other communities who are attempting the same type of project.

Seattle has its own version of the South Shore Bank, the Cascadia Revolving Fund which invests in small local business ventures. Cascadia specifically focus on businesses owned by minorities and women who are unable to access credit through traditional sources. While investment in South Shore Bank is in the form of shareholding or deposits, Cascadia Fund offers memberships to support the organization, as well as investment options. Average investment is around $4000 and has a minimum one year commitment. To invest one simply pays a one-time $25.00 membership fee, then fills out the investment agreement, choosing any rate of interest they wish between 0% and the maximum interest rate Cascadia calculates from current market trends. Cascadia requests investors to pick the lowest rate possible, so that they can provide loans at a lower rate of interest.

Cascadia supports a variety of business ventures, including family farms, commercial fishermen and entrepreneurs. Cascadia goes beyond the role of lender and provides technical assistance to its borrowers such as legal consultation and business classes. Instead of the usual loan requirements of collateral and a good credit history, Cascadia requires that its borrowers have an exceptional knowledge in the proposed business, can justify the benefit of their enterprise for the community as a whole and have the determination to succeed.

While socially conscious investment may seem like the wave of the future, giving hope to the quest to highlight and counter the destructive forces of capitalism, caution is in order. Simple investment is not the only answer. For example, many companies may boast of their conscious practices, and appear credible, when in fact they are not. The Body Shop, a chain of natural beauty and cosmetic stores that tout their responsible business practices is one such example.

Despite claims to the contrary, their products are no more natural than any other cosmetics, contain petro-chemical ingredients and many have been animal tested. The company has also been cited for the illegal dumping of materials and has a bad record of employee and franchise relations. Their "Trade not Aid" program which is intended to promote trade with tribal groups instead of monetary handouts from international agencies, is the biggest failure of all. Money rarely reaches the artisans, but goes to local officials who help to set up the program.[4] In effect, The Body Shop uses these groups symbolically to attract customers and increase marketability.

Anita Roddick, the body shop's founder and executive director stated,

> Our environmental campaigning raised the profile of the company considerably, attracted a great deal of media attention and brought more potential customers into our shops....On that basis alone it could be justified as a sensible commercial decision.[Moberg 1994]

While a company can and should benefit from socially responsible practices, it is companies that deceive their investors and consumers through faulty claims of "ethical" behavior that must be weeded out. This may not always be easy, but keeping track of your investment and reading journal, magazine and newspapers is a good way to start.

Mutual funds in general also suffered from poor returns in 1994, and while forecasts for 1995 returns are more promising, socially responsible funds are the ones most harshly critiqued by the financial community. So called "green Funds" held an average

[4]One such "trade" is with the Kapayo Indians of Brazil. Trading with them for their "Brazil Nut Shampoo" is intended to slow rainforest depletion since it supposedly gives the Kapayo an alternative to dealing and trading with miners and loggers. However, due to a lack of communal control over the program, the estimated $50,000 per year realized from the trade goes to leaders at the centralized level, not the actual tribe.

gain 20% less than standard funds, but there are exceptions such as the Parnassus Fund whose phenomenal returns were mentioned earlier.

The overall lesson to be learned is that by taking responsibility for the power our money and financial decisions have, the destructive, exploitative nature of the market system can be highlighted and can be pushed into a new, positive direction of growth with compassion and insight for the future, not a quick, cheap buck. Employers, employees, the environment and communities, not only in our own back yards but around the world will be better off.