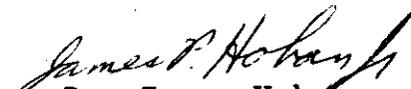


Can Socially Responsible Investing Be Profitable?

An Honors Thesis (HONRS 499)

by

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**ABSTRACT OF THESIS**

The purpose of this paper is to inform the reader about the many different aspects to socially responsible investing. This paper will explain many things regarding socially responsible investing including: what it is, who benefits, the options of responsible investing, and a comparison between normal investments and socially responsible ones. After reading this paper, the reader should have a much better understanding of socially responsible investing.

## INTRODUCTION

The socially responsible investing movement began in the 1960s with the Civil Rights movement, consumer movement, Vietnam War, and the beginning of environmentalism. Charles E. Wilson, former CEO of GM, once said that what was good for the country was good for General Motors, and vice versa. He was right, but it seems that it took a long time for him to be heard. If companies listened to their owners, would they not be in a better position than they are now? The 1960s were a troubled time when many changes occurred to the country. Socially responsible investing arose from this time of changes. People were changing their views on corporate America. This is the basis of modern socially responsibly investing. Investors tried to get corporate America to do what was right for the world not just the bottom line.

Socially responsible investing has increased dramatically from \$350 million in 1987. Today, institutional investors in "twenty-two states, fifty cities, and seventy universities, in addition to the religious and labor coalitions, now total \$625 billion of assets and invest them according to socially defined parameters"(Labadia 32). It is easy to see that investors of the social type control a large sum of money. With this being the case, it is important for corporations to yield to some demands of the socially responsible investor. Companies must look at the costs of doing what is best socially. Practically, a company cannot stay in business to

do just what is good for everyone, but they should try as much as is economically possible. Every company is forced to weigh what is best for them against what is best for the world. Many critics will try to point out that corporations are created for the sole purpose of making money for their shareholders. As is now being seen, this is not totally true. A balance is necessary for all companies that want to succeed in today's economy.

#### **INDIVIDUAL INVESTOR**

There are a lot of individuals who believe that in order to make money through investments, it is necessary to put moral aside. Socially responsible investing is defined by Peter Kinder as systematic incorporation of ethical values and objectives in the investment decision making process. Socially responsible investing is one way to avoid compromising principles in order to make money. Socially responsible investing is based on the individual's personal ethics. The individual is responsible for creating his own investment criteria, which he then uses to make investment choices. There are many issues that must be considered by the investor including: tobacco, alcohol, gambling, pollution, treatment of minorities and women, South Africa, animal rights, nuclear power and military contracting. Besides just criteria for investing, the individual investor must be aware of such things as financial planning and money management. It is important to remember that one individual's criteria may be totally different from another's criteria. For example, some

people may think that testing drugs on animals is wrong, but rest assured, a parent whose child was aided by that testing is not so convinced that drug testing on animals is wrong. The reason why all investors' criteria for socially responsible investing is not the same is because their values are not the same. As shown, a person places a different emphasis on different things.

#### **TYPES OF INVESTMENTS**

Pension funds are one way to invest ethically. With more and more money being invested in pension funds, they are becoming a powerful force in the investment community. Many people are beneficiaries of pension funds. Since pension funds are such a dominant force in the economy, it is imperative that the managers of the large corporations be aware of the pension fund's goals. Pension funds are beginning to exercise their ownership rights. Before, pension funds would only use the ownership powers in issues of corporate governance and financial return, especially to discipline managers who do not maintain the value of the shares. Some argue that pension funds should only be concerned with the financial aspects of the company.

Pension funds are administered by trustees, who have a responsibility to the beneficiaries of the fund. These beneficiaries can make their wishes known to the trustee who is then expected to act accordingly. Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF) is the nation's largest pension fund. TIAA-CREF's

holdings as of June 30, 1989 were \$596 million in tobacco firms, \$626 million in Exxon, \$7 million in Pittston Co., \$4 million in Elsevier, \$21 million in Nestle, and \$15 million in FMC(Link 58). The wishes of its beneficiaries led TIAA-CREF to create CREF Social Choice Account, which has been very successful(Kinder 11). It is important to remember that funds such as this do what is known as social screens. Generally, there are two types of screens that are used: exclusionary and qualitative. Some standard exclusionary screens are South Africa, tobacco, alcohol, gaming, military weapons, and nuclear power. Some standard qualitative screens are product quality, consumer relations, environmental performance, corporate citizenship, employee relations, and diversity in the workplace and executive suite(Kinder 11).

Trustees are, in a sense, the owners of the corporation, but the trustees are responsible for acting in the best interests and on the wishes of the beneficiaries. Most trustees' primary concern is based on performance, but it is important for pension fund trustees to be aware of the long-term interests of the beneficiaries. Pension funds are according to their focus long-term investors. They must focus on the long-term viability, which requires an understanding of how the company relates to society.

Mutual funds are another way that the individual investor can invest socially. There are many types of mutual funds to allow investors a wide variety of investments to appease their social conscience. Mutual funds offer higher returns than

savings accounts, but they offer lower risk than purchasing a particular stock because of diversification benefits. This is a list of eight socially responsible investments and a short description of what they are about:

Calvert Social Investment and Ariel Fund - Calvert investments combined total over \$1 billion. The Calvert-Ariel Growth Fund is a small capitalization fund currently closed to new investors. Calvert-Ariel Appreciation, a medium capitalization fund, screened primarily for environmental responsibility and to avoid investing in nuclear power, South Africa, and weapons. Each fund had returns of 12 and 7 percent respectively. The Calvert Social Investment Fund offers four conservatively managed portfolios: bond, equity, the balanced managed growth, and money market. Returns were 13.12 percent for bond, 5.72 percent for equity, and 10.85 for managed growth.

Covenant Portfolio - This fund takes 200 top companies that have the highest combined scores when ranked according behavioral issues.

Domini Social Index Trust - This fund invests its \$7.9 million in the 400 comprehensively screened stocks of the Domini Social Index.

Dreyfus Third Century - This fund has \$463 million, which makes it the largest single socially responsible stock fund. Average return for the past five years was 8.94 percent.

Green Century - It is primarily an environmental fund, that invests a combined \$2.5 million in a balanced fund and money market.

New Alternatives - It invests its \$25 million in alternative fuels, conservation, recycling, environmental, avoiding South Africa, and weapons-related companies. This fund lost 4 percent in the last twelve months.

Parnassus - It invested \$41 million and received a return of 17.2 percent in the past twelve months. Average return over the last five years is only 3.18 percent.

Pax World - This is the oldest of the ethical funds. It has \$352 million that it invests in equities and bonds. The fund rose 2.44 percent in the past twelve months(Walbert 62-63).

As is visible by the returns on these funds, high returns are not guaranteed. Also, some of these funds are somewhat volatile. There are even venture capital funds that invest in small companies that offer products and services to meet societal needs. Most socially responsible investments do seem to yield a return equal to or better than the benchmarks.

#### Selected Socially Screened Equity Portfolios

in 1992 Against the Benchmarks(Kinder 11).

The Parnassus Fund	31.85%
Calvert/Ariel Appreciation	13.24%
Working Assets/Common Holdings	12.87%
Righttime Social Awareness	12.59%

Domini Social Index Trust	12.10%
Domini 400 Social Index	12.07%
Calvert/Ariel Growth	11.73%
Lipper U.S. Diversified Stock Funds	8.90%
Calvert Social Equity	8.37%
Standard and Poor's 500	7.68%

Barr, Rosenberg Associates (BARRA) in Berkely, California, conducted a study to compared the industry exposure, size differences, currency fluctuation, and other relevant information of the Domini 400 Social Index compared to the S&P 500. They concluded that socially responsible investing does not necessarily mean above average returns are not possible. The study goes on to say that main reason for outperformance comes from the specific asset return. A specific return premium to the index is related to the social screens (Kinder 12).

Some ethical mutual funds focus on only a certain aspect of social responsibility. There are what are called environmental funds. There are only four mutual funds that activists give credit as solely investing in companies whose products and services are designed to help the environment. These funds are: the New Alternatives Fund, Progressive Environmental Fund, Green Century Fund, and Calvert Global Environmental Fund.

There are also funds called environmental-sector funds that provide environment-related services. Some of the companies in the funds do not necessarily protect the

environment. It is important to be aware of what companies that an environmental-sector fund invests in. Some funds that are environmental-sector funds are: Freedom Environmental Fund, Fidelity Select Environmental Services Fund, and Oppenheimer Global Environment Fund.

One misleading thing may be that most social and environmental funds have not been around for a full market cycle. Since their performance is based on a limited period of time, the long-term yields are difficult to predict with any degree of accuracy. If the long-term resembles the short-term, then respectable returns can be expected. However, most professionals dismiss ethical funds' solid performance as a fluke. The professionals believe judgement should be reserved until after about twenty years.

Individual stocks are yet another option for investors who want to invest their money in a company that they feel is socially responsible. Just because an individual wants to invest socially does not necessarily mean that he must sacrifice return. The only way to sacrifice return is to invest unwisely. There are more than 6000 companies traded on the U.S. exchanges or via Nasdaq, so the choices are quite large.

The Council on Economic Priorities, which was created twenty-four years ago, evaluates companies and their products. The main indicators used are: giving to charity, women and minority advancement, animal testing, community outreach, South Africa, environmental stewardship, family benefits,

workplace issues, and disclosure of information (Marlin 32). According to the Council on Economic Priorities, the most socially responsible companies of 1992 are:

Alexandra Avery	General Mills
Autumn-Harp	Giant Food
Aveda	Hershey
Avon	Johnson & Johnson
Ben & Jerry's	S.C. Johnson
Body Love Natural Cosmetics	Kellogg
Church & Dwight	Newman's Own
Clientele	Proctor & Gamble
Colgate-Palmolive	Quaker Oats
Earth's Best	Supermarkets General
Earthrise	Tom's of Maine
Eden Foods	Upjohn

(Marlin 32)

Companies are now more inclined to provide the information necessary to do a competent assessment of social responsibility. No matter what gains are being made there are still companies who have been identified by the CEP for their record of social irresponsibility:

American Cyanamid	Mobil
Archer-Daniels-Midland	Perdue Farms
Bayer U.S.A.	Pfizer
Chevron	Texaco
Conagra	Tyson Foods
General Electric	U.S.X.

Kimberly Clark

(Marlin 33)

Knowledge of which companies are socially responsible and which are not is important for the individual investor to make an informed decision. Another way to for the individual investor to invest in a responsible way is to pay a broker to select investments based on criteria provided by the investor.

The Coalition for Environmentally Responsible Economies (CERES) was formed in 1989 just after the Exxon Valdez spilled 11 million gallons of oil into Prince William Sound. The code of conduct that companies sign is called the Valdez principles. These principles bind companies to take significant step, including an annual audit of environmental behavior. There are a total of 34 companies that have signed these principles. There are no Fortune 500 companies that have signed on, mostly smaller companies. CERES does have regular meetings with the Fortune 500 companies to discuss environmental issues. CERES' goal is to raise environmental management information to the same level that financial management has achieved(Bavaria 23). This is a lofty goal, but any progress toward that end should be commended.

When an investor decides to invest in a single company or create his own portfolio of socially responsible companies, he must remember that research is very important so that he can find investments that meet his criteria. If companies learn to pay attention to the social bottom line, it will help them to remain profit leaders.

Foreign investments are important to social investors

also. By 1990 socially responsible investing caught on around the world, most notably Europe. One reason for this is because most social problems know no national boundaries. Because of the development of the global economy and the realized impact of social irresponsibility on the world, it is even more important for investors to research the companies that they invest in.

Domestic investors have choices about how to become involved in foreign markets. Investors can invest in companies developing ties to the foreign markets. They can invest in companies that have good foreign relations. Lastly, investors can invest directly in foreign securities. This is possible because foreign companies are listed on U.S. exchanges. American depository receipts(ADRs) aid in this trading. ADRs are printed and issued by a depository bank in cooperation with a custodian bank, usually foreign, that buys the stock on a foreign exchange and puts it into its custody. In 1987 there were more than 600 ADRs on all three U.S. exchanges(Lowry 152-153).

There is also the possibility of investing in foreign mutual funds. Typical social funds in Germany require an initial investment of about \$3000. The one problem is the lack of information concerning ethical investments. It is expensive to obtain information on the social responsibility that foreign companies exhibit.

Some foreign investments yield a large return. There are six Japanese companies that are available to U.S. investors

through ADRs. These companies are: Fuji Photo, Matsushita Electronics, Canon, Inc., Pioneer Electric, Sony Corp., and TDK Corp. The average yearly ADR price increased 489 percent for all six companies. These companies would please many social investors because they make useful and quality products, and Japanese companies have a lot of cooperation between management, labor, and government. Also, Japanese companies have no defense-spending exposure (Lowry 154-155).

These investments are not devoid of risk. They have both economic and social risks. Foreign markets are highly susceptible to speculation. It is difficult for U.S. investors to be able to make informed decisions.

Socially responsible investing is beginning to catch on in Europe. Many nations including Spain, Finland, Germany, and Great Britain are becoming more socially aware. As awareness increases, foreign companies will realize that it is necessary to focus on their social responsibility. Information about a company's social responsibility will most certainly become easier and cheaper for investors and potential investors to obtain. As the information becomes more readily available, companies will most certainly be more socially aware.

#### **CONCLUSION**

In conclusion, it is possible for just about anyone to invest in a socially responsible way. It is difficult to assess the long-term viability of many of the socially responsible mutual funds, but it seems likely that at least in

the short-term social funds should expect good growth. Socially responsible investing has a very large amount of assets totalling about \$625 billion. It is quite obvious that investors have spoken and continue to speak about the needs of a company to focus more on a balance between profits and social responsibility.

In order to show just how large the diversity in social investments is on the following page there is a list of "50 Clean and Green Investments"(Netzer 132). The criteria used is widely acceptable social-investing criteria. The study was done by Franklin Research & Development and was provided by Baie Netzer. Franklin excluded all companies connected with alcohol, animal testing, gambling, nuclear power, South Africa, tobacco, and weapons manufacturing. After this, Franklin ranked the shares of 1000 companies in three categories of social responsibility. A one is the highest and a five is the lowest. The firms that qualified scored at least two and one-half in each category. The three social responsibility categories used were environment, employee relations, and citizenship. The companies that remained were then rated against investment criteria excluding the blue chips selling well above the market P/E of seventeen and at least a B+ financial rating from Value Line Investment Survey. Growth stocks were considered on the basis of trend-setters in socially conscious activities. Utilities must offer at least a ten percent return and have a safety rating by Value Line of B+ or better. Only nine mutual funds are considered both

ethical and tracked by Franklin. Cash investments are those offered by banks that lend for socially conscious projects. The banks are federally insured and accept out-of-state deposits. The money market funds hold only securities of corporations that meet broad social screening tests.

BLUE CHIPS	STOCKS	Environment rating	Employee practices rating	Corporate citizenship rating	Price	P/E	Earnings growth rate	Yield
	Baytex Hudeco	2	1	1	\$75.00	12.9	16.5%	1.9%
	Digital Equipment	1	1	2	66.25	15.6	5.0	N.A.
	Stride Rite	2	1	1	46.25	18.9	21.5	1.0
	Xerox	2	1	1	56.75	10.9	11.5	5.3
	Amoco	2	2	1	54.75	15.0	8.0	4.0
	Cabot Corp.	2	2	2	32.25	11.9	19.5	3.2
	Minnesota Mining	1.5	2	2.5	87.75	14.5	10.0	3.6
	Stanley Works	2	2	2	34.75	14.5	11.0	3.5
	McDonald's	2	2.5	2	33.25	12.1	15.0	1.0
Northwest Corp.	2.5	2	2	28.00	10.0	10.5	3.3	

GROWTH	Apple Computer	1	1	1	\$50.25	10.6	15.0%	1.0%
	Ben & Jerry's	1	1	1	19.25	16.7	15.0	N.A.
	H.R. Fuller	1	1	1	45.75	17.6	14.5	1.4
	Sunrise Medical	1.5	1	2	27.75	20.0	19.0	N.A.
	Incor	1	2	2	82.75	23.6	17.0	0.5
	Thorne Electron	1	2	2	36.75	18.8	19.0	N.A.
	TJ International	1	2	2	21.00	35.0	9.5	0.0
	Bonnelly	2.5	1	2	46.50	15.5	12.5	2.2
	Unum	2.5	1	2	66.25	12.2	18.5	1.6
	Wellman	1.5	2	2	20.75	9.9	20.0	0.6

UTILITIES	Sierra Pacific	1	2	2	\$22.25	10.9	2.5%	8.3%
	Brooklyn Union	1.5	2.5	1.5	28.75	11.3	3.5	6.5
	Atlanta S&L	2	2	2	33.50	14.6	5.0	6.1
	Energus	2	2	2	16.75	9.9	8.0	5.6
	Idaho Power	2.5	2	2	26.25	13.1	6.5	7.1
	Southern New England	2.5	2	2	33.00	12.5	5.0	5.3
	Southwest Bell	2.5	2	2	53.00	13.8	8.5	5.4
	Ameritech	2.5	2.5	2	63.25	13.0	5.5	5.4
	People's Energy	2.5	2.5	2	24.50	11.4	3.5	7.0
	Pacific Enterprises	2.5	2.5	2.5	33.25	11.7	5.5	10.5

FUNDS	MUTUAL FUNDS	Total return for past year	Total return for past three years	Minimum initial investment	Minimum initial sales charge	Telephone
	Pax World	22.4%	58.8%	\$250	None	800-767-1729
	Progressive Environmental	22.4	N.A.	1,000	4.50%	800-826-8154
	Calvert-Artist Appreciation	21.6	N.A.	2,000	4.75	800-368-2748
	Broyles Third Century	21.5	58.6	2,500	None	800-645-6661
	Parsons	17.3	20.7	2,000	3.50	800-999-3605
	Calvert SIF-Bond	14.5	31.8	1,000	4.75	800-368-2748
	Calvert SIF-Growth	12.3	31.3	1,000	4.75	800-368-2748
	New Alternatives	11.7	38.6	2,650	5.66	515-466-0808
	Calvert SIF-Equity	10.1	38.5	1,000	4.75	800-368-2748

CASH	CASH INVESTMENTS	Current rate	Effective annual yield	Minimum initial investment	Bank safety rating	Telephone
	Vermont National Bank 2 1/2-year CD	6.77%	7.00%	\$500	★★	800-544-7108
	South Shore Bank 2 1/2-year CD	6.38	6.58	200	★★	800-669-7725
	Vermont National Bank one-year CD	6.53	6.75	500	★★	800-544-7108
	Elk Horn Bank one-year CD	6.15	6.29	1,000	★★★	501-246-5811
	South Shore Bank one-year CD	5.88	6.05	200	★★	800-669-7725
	Vermont National Bank six-month CD	6.39	6.60	500	★★	800-544-7108
	Elk Horn Bank six-month CD	6.00	6.09	1,000	★★★	501-246-5811
	Community Capital Bank six-month CD	5.49	5.64	1,000	★★	800-827-6699
	South Shore Bank MMMA	5.88	6.04	2,500	★★	800-669-7725
Calvert SIF-Money Market	5.71	5.87	1,000	N.A.	800-368-2748	
Working Assets Money Fund	5.48	5.63	1,000	N.A.	800-533-3863	

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