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Ethics: Socially Responsible Investing

Dear Dr. Ibeh,

I am submitting this report on the above subject to fulfill my requirement for the ethics program. The objective of the paper is to help the reader understand the concept of socially responsible investing. The paper gives an in depth definition and explanation of the techniques and issues involved in socially responsible investing.

Sincerely,

Jacob Cauble
PSU-CNCMM REU/RET 2005

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Socially Responsible Investing

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1. Summary

The idea of socially responsible investing, or SRI, is a relatively new industry in the United States. The concept of SRI has been around since the beginning of investment, but was not an organized practice until recently. Any investor who believes in ethical investments, or investing in morally acceptable companies practices socially responsible investing. SRI is an industry that is present all over the world and is growing larger in every nation that it is present.

Problem Statement: What is the basic concept of SRI and how does it operate against traditional investment?

2. Introduction

Scope

This report will help the reader understand the concept of socially responsible investing. In order to understand this concept, the report begins with a brief definition and history of SRI. A more thorough understanding of SRI and the three main strategies is discussed in the main body of the paper. This is followed by trends that will be present all around the world.

What is Socially Responsible Investing?

Socially responsible investing is when one takes the beliefs and values applied to one's life and the lives of loved ones and applies them to investing strategies. This is sometimes called having a double bottom line, the first of which being the need for a profitable investment and the second being the need to invest in a company that meets certain moral criteria and allows one to sleep well at night. There are three key strategies to SRI: screening, shareholder advocacy, and community investing. Screening involves searching for and examining companies that will support the moral values that the investor believes to be important. This will be different for every investor. For some, this will mean avoiding companies that are solely based on profit and damage the environment. Others will avoid companies that profit from vices such as smoking or drinking. The screening process will obviously be different for every investor. Shareholder advocacy is the investor's efforts to submit and vote corporate proxy resolutions in order to influence company behavior. This strategy is commonly used to improve environmentally safe practices. Community investing involves directing the capital from investors towards communities that will normally not benefit from traditional financial services. This allows local organizations to provide financial services to low-income individuals and provide capital for vital community services such as child care and health care.

Brief History

The idea of SRI dates back to biblical times where Jewish law discussed many methods for investing ethically. For several generations, religious investors have avoided investing in companies that profit from devices designed to enslave or harm human beings. It is believed that Quakers brought the concept of SRI to the new world because of their refusal to invest in slavery and war. This concept was also present in the 1960s when the Vietnam War took place. In the 1980s, the number of socially concerned investors grew dramatically when millions of people focused investment strategies on the minority government of South Africa to overthrow its racist apartheid system. The environment became a very important issue for socially responsible investors when the Chernobyl, Bhopal, and Exxon Valdez incidents took place. The most recent influences on SRI are school shootings, human rights issues and safe working environments in factories.

3. Literature Review

1. “SoYouWanna be a Socially Responsible Investor?”

This article helps the reader understand the concept of socially responsible investing and the importance of SRI to an ethical investor. This is followed up by a guide to researching investment strategies and organizing priorities in preparation of ethical investments. This article also helps the investor develop his or her investment strategies and gives statistical figures on the most commonly rejected and supported industries for socially responsible investment.

2. “SRI in the U.S.”

This article, authored by Steven J. Schueth, president of First Affirmative Financial Network, covers all of the key concepts of SRI. Schueth gives a history of SRI to help investors understand the beginning of SRI and how it has developed over the years. He also discusses the causes for the rapid growth of SRI and gives important information to help the interested investor get started with socially responsible investing.

3. “Ethical Investing-Where Capital Meets Conscience”

This site provides links to several articles with the common topic of ethical investing. Some of these articles are, “How to Find Companies That Come Clean Quickly,” “Who Profits from Rock-Bottom Pricing?,” and “How CEOs are Being Held to Higher Ethics.” This site, and the articles included in it, helps the investor grasp the essence of SRI.

4. “2003 Report on Socially Responsible Investing Trends in the United States”

As the title suggests, this article was written by a research group who investigated socially responsible investing trends in the U.S. They discuss the three strategies of SRI and give detailed factual information on the trends of SRI in the U.S.

4. The Three Strategies of SRI

I previously discussed the three main strategies of SRI, but to fully understand these concepts, a more in depth discussion is needed.

Screening

As stated before, screening involves searching for and examining companies that will support the moral values that the investor believes to be important. Article 4 from the literature review above gives detailed facts on the success of the screening process. For instance, total assets in portfolios involving social screening increased 7 percent from 2001 to 2003. There is a wide range of investors who have invested their money into screened portfolios: religious organizations, municipal and state governments, unions, foundations, universities and colleges, insurance companies, hospitals, corporations, and individuals with professionally managed portfolios. This is not saying that investors on a lower level do not participate in the screening process, but these organizations and investors have been more successful with the screening process.

Another fund associated with screening is the socially screened mutual fund. These are available directly to individuals, through variable annuities, or to institutional investors. Screened mutual funds have provided diverse options for investors because of a substantial increase since 2001. This area has seen a growth of 11 percent from 2001 to 2003 and continues to grow with the interest SRI. The five most popular screens used for mutual funds include tobacco, alcohol, labor relations, environment, and gambling.

Shareholder Advocacy

There are many different ways for the shareholder advocacy strategy to take place. This can be anything from simply writing a letter to management and can go as far as a class action lawsuit against the company. The most common form of shareholder advocacy is to file shareholder proposals or resolutions. There are three different types of shareholder resolutions: social responsibility resolutions, corporate governance resolutions, and crossover proposals. Social responsibility resolutions cover issues such as company policies and practices regarding the environment, health and safety, race and gender, and other controversial ethical issues. Corporate governance addresses confidential voting, repealing classified boards, compensation

of directors and executives, board composition, severance pay, and the accounting and indexing of stock options. Crossover proposals include executive pay tied to social benchmarks, board diversity, and review or limits on executive compensation.

Community Investment

Despite recent difficult market conditions, community investment has experienced tremendous growth. Currently, both individuals and institutions invest in four primary types of community investment:

Community development banks have the greatest amount of assets of the four primary divisions. These banks are present throughout the company and focus on providing funding to rebuild low income communities. They typically offer the same services as traditional banks for account holders. These banks are federally insured just as conventional banks.

Community development loan funds are the second largest division and operate in specific geographic locations. They act as intermediaries by pooling investments and loans provided by investors at below market rates to further community development. This capital is used to fund small businesses, affordable housing development, and community services such as child care and health care. These funds are oftentimes directed to locations overseas where there are communities in dire need of any sort of community service.

Community development credit unions serve citizens with limited or no access to traditional financial institutions. Much like the community development banks, account holders of community development credit unions receive all of the services of a traditional credit union.

Community development venture capital funds use the aspects and tools of venture capital to create jobs, entrepreneurial capacity, and wealth. The result of this is improvement in the livelihoods of low-income individuals and the economies of low-income communities. These capital funds make investments in small, local communities that are highly competitive and hold a promise for rapid growth. These companies typically employ between 10 and 100 people and are granted between \$100,000 and \$1 million per company.

5. Trends and Differences in SRI Around the World

SRI will obviously differ from culture to culture, but there are certain aspects of SRI that will remain the same in any culture. SRI has seen its largest recent growths in North America. All three of the main strategies are popular in Canada and the United States. North America is characterized by a wide range of diverse portfolio screenings, competitive community investment products, and growing popularity in shareholder advocacy initiatives. The use of these strategies has driven the growth of SRI in North America.

Europe is seemingly the leader in SRI development. Europe incorporates new regulations and legislation on a national level to encourage greater disclosure and facilitate higher investment in SRI in retirement accounts. This results in a more

mainstream effect than in North America or Asia.

In Asia, community investing is undoubtedly the most popular strategy of SRI. This plays a vital role in providing investment opportunities in small communities. However, the biggest and most prosperous area of SRI for Asia is pension funds. This is a relatively new area of SRI in Asia, but grows faster than any area of SRI around the world. SRI in general is relatively new in Asia compared to North America and Europe, but grows at a substantial rate.

6. Conclusion

SRI is an interesting area for investors interested in ethical investment. Although this concept has been present since the beginning of investment, the organized SRI industry will help install a more strict code of ethics in companies all around the world. As SRI grows, companies will be forced to improve moral values in order to retain and gain more investors.

7. Bibliography

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