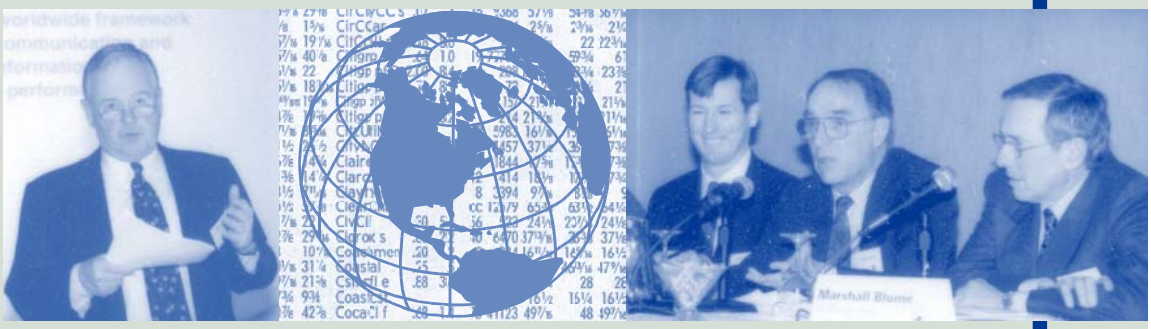
2000 Zicklin Center Wharton Impact Conference



Social Screening of Investments

february 3-4, 2000

Carol and Lawrence Zicklin
Center for Business Ethics Research

Wharton

The Wharton School
University of Pennsylvania

2000 Zicklin Center Wharton Impact Conference

Social Screening of Investments
February 3-4, 2000

Sponsored by the Carol and Lawrence Zicklin Center
For Business Ethics Research
The Wharton School of the University of Pennsylvania

Introduction: The Complex Equation of Doing Good

As socially responsible investment has moved from the fringes to the mainstream, it has elicited widespread debate about its financial and social impact. Do socially responsible investors pay a price for their investments or do these funds outperform others? Do they actually have an impact on social issues, or merely help in marketing funds and allowing investors to sleep better at night?

The field is just beginning to attract the research needed to get to the bottom of these and other questions, and we were pleased to contribute to this progress through this Impact Conference. Our conference brought together some of the pioneers and leaders of the social investment industry, along with academic thinkers and practitioners from a wide range of fields. While definitive answers often are elusive, this discussion helped to identify what we know about this important area and to clarify the questions we need to answer.

On behalf of the Zicklin Center, we would like to thank Lawrence Zicklin for his continued support and active involvement. We are very grateful to Bill Laufer who, with the strong assistance of Steve Dillenburg, Steve Schueth and Barbara Krumsiek, organized this conference, and we thank the many chairs and presenters who made it a success. We also would like to offer a special note of thanks to Lauretta Tomasco who worked tirelessly behind the scenes to put together the conference.

However social investment evolves in the future, it promises to have an increasing impact on investors, fund managers and corporate managers. We are pleased to contribute to the discussion with this conference and report. We welcome your comments.

Sincerely,

Tom Dunfee

Thomas W. Dunfee
Joseph Kolodny Professor of Social Responsibility;
Director, Carol and Lawrence Zicklin Center

Issues Addressed

Believers and Non-Believers ---------- 4
In opening remarks, participants heard directly from Nobel Laureate Lawrence Klein and the reported remarks of economist Milton Friedman, both of whom questioned the financial and social value of socially responsible investments. There are many very intelligent "non-believers" who remain unconvinced.

History, Current Practices and Future Prospects ---------- 6
Socially responsible investing is growing up, with nearly $1.5 trillion reportedly invested in portfolios that use some kind of social screen. Panelists reported that recent research has put to rest the "underperformance myth" that investors have to give up returns to make socially responsible investments. One of the leading researchers in the field discussed the evolution of "beautiful theories" and the sometimes "ugly facts" that undermined them.

Challenges of Social Screening ---------- 8
Assuming that screening is desirable, how can these screens be put into practice? Fund managers and researchers discussed the challenges of creating effective screens and following through to make sure they have the desired impact. Even if a university wants to make sure there are no sweatshops involved in producing its products, how can it practically monitor thousands of small producers?

How Ethical Are Socially Screened Funds? ---------- 11
Is an investment in Microsoft ethical in light of government antitrust action? Do investors really know what goes into these funds? Do they care? This panel examines an issue that is even more difficult to assess than financial performance: Are socially screened funds really ethical?

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Over lunch, a panel of senior executives of companies and funds discussed their thoughts on current challenges and future prospects in socially responsible investment – including education, diversity and how deeply to scrutinize companies.

Are Socially Responsible Funds a Good Investment? ---------- 16
Recent studies give a resounding "yes," but the deeper question is whether this is a result of "being right or just being lucky." Panelists questioned whether the strong returns would continue under different market conditions or redefined screens that might cut high-tech or biotech stocks.

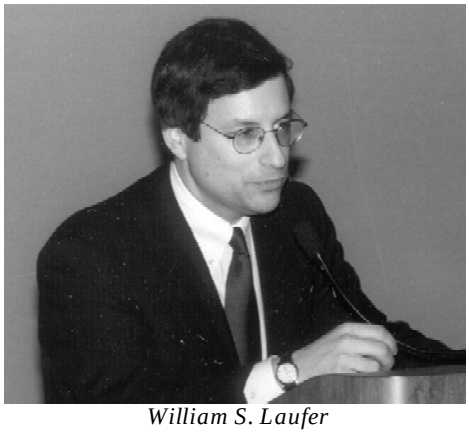
Emerging Alternatives and Global Perspectives ---------- 18
Creating more sophisticated and uniform measures and systems of social reporting and auditing are critical to the development of social investment. Panelists discussed initiatives to create standardized measures and indexes, as well as new pension law and corporate governance guidelines in the United Kingdom that are driving development of measures there.

Social Screening and Shareholder Value ---------- 20
Social investment is part of a broader movement marking the end of the 400-year "theology of investment" that separates the heart and wallet, according to a pioneer in the field. The final panel stepped back to examine some of the deeper cultural issues that underlie the social investment movement and their potential impact in the future.

Believers and Non-Believers

William S. Laufer, *Associate Director, Carol and Lawrence Zicklin Center for Business Ethics Research, The Wharton School; Associate Professor of Legal Studies, The Wharton School*

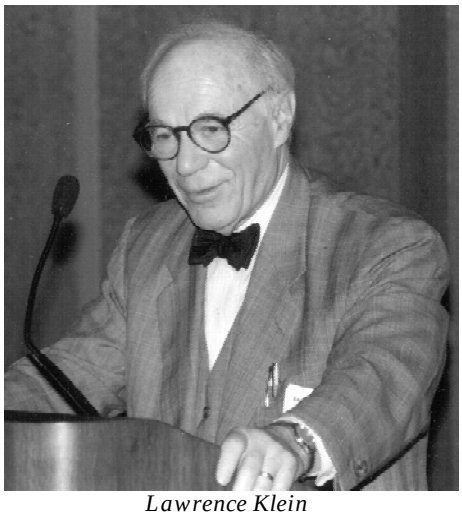
Lawrence Klein, *1980 Nobel Laureate in Economics and Benjamin Franklin Professor of Economics, Emeritus, University of Pennsylvania*



William S. Laufer

In preparation for the conference, William Laufer phoned distinguished economist Milton Friedman to solicit his perspectives on socially responsible investing. After a pause, Friedman said: "If people want to invest that way, that's their business. In most cases such investing is neither harmful nor helpful."

"There are many intelligent and thoughtful non-believers out there," Laufer said at the opening of the conference. "It is my hope that this forum will provide an opportunity for both believers and non-believers to discuss the wisdom and virtues of socially responsible investing."



Lawrence Klein

Nobel Laureate Lawrence Klein, who launched the conference with dinner remarks, was another non-believer (agnostic). A colleague of Klein's who helped found some of the first socially responsible investment funds at Shearson traced their rise to concerns about the Vietnam War, environment, tobacco and South African apartheid. Klein said his most direct exposure to the complexities of social investing came through his grandchildren. He had offered to invest funds for two grandchildren in the six leading holdings in Berkshire Hathaway companies in the same proportions as Warren Buffet, as long as the grandchildren agreed to fax him every week with a report on how the investments performed. But then there were concerns. "When Capital Cities merged with Disney, they said Disney exploits children. No Disney," Klein said. "I said it is

rumored that Warren Buffet likes McDonald's, but they are vegetarians, so they said 'No McDonald's.'"

These investments are made to do well, but are they also good investments financially? Klein was skeptical. "Socially responsible investment funds are probably not the ideal way to go, but if you have a conscience problem, it may make you sleep better at night," Klein said.

The strong economy, which has floated all boats, has made it easier for socially responsible funds to achieve good performance. "As long as we have a really strong economy, as long as equity market returns are very good, as long as there are many new startup companies that pay extremely high returns, it is not much of an issue," Klein said. "If you took the whole universe of securities that would be available and excluded the ones that you thought were dangerous in some way to society, you would still have the diversification that is needed. You'd knock out certain groups such as military contractors, but wouldn't knock out Silicon Valley."

Biotechnology may change that, Klein said. With the resurgence of biotech firms and increasing concerns about ethical issues such as genetically modified foods and cloning, financial interests and personal principles may collide. "I see a problem coming up on the horizon," Klein said. "Biotech is not as easy to deal with. It seems to me a socially responsible investor has no trouble with Microsoft, Intel or Cisco. But there are many questions beginning to arise with biotech. There, if we look for the highest returns, we will have a much more difficult problem deciding what is right and what is wrong."

History, Current Practices and Future Prospects: Beautiful Theories, Ugly Facts

Steve Schueth, *Chair and President, Social Investment Forum*
Lloyd Kurtz, *Vice President and Research Analyst, Harris Bretall Sullivan & Smith LLC*

Steve Scheuth

Social investing is a relatively new industry, but it is growing up quickly, said Steve Schueth of the Social Investment Forum. "We are still defining the language: social investing, socially responsible investing, socially aware investing, ethical investing, values-based investing, mission-based investing," he said. Its origins were in faith-based approaches to investing that have avoided certain "sin stocks," such as alcohol, tobacco and gambling, for hundreds of years. But modern social investing traces its roots to concerns about Civil Rights, the Cold War and the environment during the 1960s. It expanded dramatically during the 1980s with the worldwide campaign against apartheid in South Africa. Environmental issues, school killings, human rights, healthy working conditions in developing countries and other issues fueled interest through the 1990s.

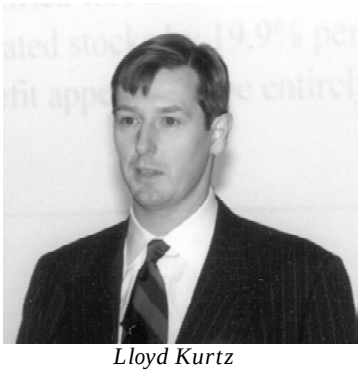
By November 1999, over $2 trillion was in professionally managed portfolios that used screening or more aggressive social investment strategies. Between 1995 and 1999, socially screened investments grew five times as fast as the market. By 2000, they accounted for nearly 1 in every 8 dollars under professional management in the United States.

Schueth attributed the increase to more educated and informed investors and a rising interest in social and spiritual issues among baby boomers. (A study by the Lutheran Brotherhood found that two of every three people seek divine intervention before investing today.) Schueth stressed that social investing was not something dreamed up on Wall Street, but rather a grassroots movement. Many mainstream firms jumped aboard only after the revolution was fully under way. "It is deep, heartfelt and consumer driven," he said. "It is future oriented, not just about securing my future as an investor, but about helping to *improve* our future as well."

Another sign of the maturation of social investing is a growing body of hard research to replace the speculation about performance. Schueth said the "underperformance myth" has been busted. "Any way you look at it, we stand out head and shoulders above market," he said. "The belief that you have to give up performance to invest in a socially responsible way is simply not valid, period."

Lloyd Kurtz, one of the leading researchers in the area, said the facts of social investing have confounded the theories used by both advocates and critics to explain it over the years. From 1965 to 1975, researchers such as Burton Malkiel concluded that social investors paid a price. These researchers examined individual portfolios over short periods, such as one study that found the "Princeton portfolio" outperformed portfolios that excluded South African investments by 3 percent per year. From 1975 to 1985, the rise of the efficient market hypothesis (EMH) raised new criticisms of social investment. The theory was that social investment funds, concentrating on a subset of the total market, are less diversified and so will have poorer performance.

There was only one small problem with this "beautiful theory," Kurtz said. When researchers Grossman and Sharpe studied South African investments in 1986, they found that South-Africa free funds outperformed investments that included firms in South Africa by 1.9 percent from 1960 to 1983, after adjusting for risk. A subset of a broader portfolio didn't suffer the expected weaknesses. "The risk-adjusted returns were a wash after adjusting for the size effect," Kurtz said.



Lloyd Kurtz

From 1985 to 1995, the focus shifted to risk. In 1992, a study by Teper identified five reasons why screened accounts might underperform: lower returns, higher security risk, lower diversification, divestment costs and opportunity costs of eliminating asset classes. That same year, Kurtz, Lydenberger and Kinder created the Domini Social Index which defied Teper's theory. Since its inception, Domini "has been a spectacular performer," Kurtz said. It has also created opportunity for analysis. "If there is an SRI effect, it is small," he said. "Adjusted for risk, the Domini Index achieves benchmark returns without any social penalty."

Kurtz said studies of socially responsible investing might have broader implications for financial theory. They indicate that factoring in risk is very important in assessing investment performance. He stressed, however, that all these observations depend upon the environment in which they are made. Schueth noted that a 1970 study found 30 companies that were deemed to be socially responsible performed better than the Dow. But with the arrival of an inflation-driven, oil-driven economy, "the list got killed." Perhaps the only certainty about future performance is: "Predictions about the future performance of screened accounts are almost invariably wrong," he said.

Challenges of Social Screening

Chair: ***Steve Dillenburg,*** *Managing Partner, Summit Investment Partners LLC*
Panel: ***Kenneth E. Goodpaster,*** *University of St. Thomas*
Janet Prindle, *Portfolio Manager, Neuberger & Berman*
Pietra Rivoli, *Georgetown University*
Frank D. Walker, *Chairman, WalkerInformation*


Steve Dillenburg

Assuming that you want to screen for social investments, what do you screen for? There are as many different issues as there are investors. In introducing the panel, Steve Dillenburg recalled going out for a steak dinner with a client, the chairman of a religious-based investment fund. Dillenburg normally orders a beer with his steak, but stopped himself just in time when he remembered the fund had an alcohol restriction in its portfolio. Every fund has its own concept of what is socially responsible.

Even with a clear idea of the goal – such as eliminating sweatshop labor from garment production – the right investment strategy is far from straightforward. Following the lead of students on campuses around the United States, Georgetown University students occupied the president's office for 85 hours to protest the use of sweatshop labor in producing university apparel. In response, the university agreed to require all licensees that produce university apparel to disclose the names of their manufacturers.

But this public victory for the students raised complex questions for the university, said Professor Pietra Rivoli, who serves on the investment committee and apparel licensing committee at Georgetown. With 250 licensees, each with perhaps 10 suppliers, the university will have some 2,500 data points. "The question is: What do we do with it?" Rivoli said. "Who is going to monitor compliance with codes of conduct? How will monitoring take place? What will be done with the information factory monitors come up with? We don't have an answer for that yet." Rivoli notes that some universities are hiring major accounting firms to do monitoring.

"These are nitty-gritty operational issues we are dealing with at Georgetown," she said. "We are very proud of our students and what they are trying to do. At the same time, our committee has been stuck as to what to do." Students see the issue in very simple terms. "There is a generational divide," she said. "They don't want to take the approach of shareholder activism and have adopted a much more

adversarial stance. The concern is that their activism might hurt the people it is designed to help." If student demands for a living wage requirement are met, it may lead to higher unemployment in nations that need the jobs. There also is concern that the U.S. labor movement, particularly textile and apparel unions, have provided support for student activism. "There is a possibility of a conflict of interest in this movement because of the large role U.S. unions have played," she said.

Finally, there is the issue of cultural imperialism. " There is not much involvement of the workers themselves in these discussions." When Reebok forced a Latin American supplier to comply with a code that limited work to no more than 60 hours per week, the workers at the plant went on strike. "It is a telling example of trying to decide what someone else's interests are," Rivoli said. Professor Rivoli noted that low-end textile work has played an important role in the early industrialization of virtually every modern economy, and there is concern that activism may short-circuit this process. "In the past, the sweatshops have been eliminated through the process of economic growth and industrialization," she said. "We need to be very careful not to stand in the way of these processes."

Kenneth Goodpaster outlined a process for putting conscience into action by moving from vision to priorities to benchmarks to measurements. This "cascade of concreteness" is important in making ideals actionable. "It is not enough to have a conscience, you need to have benchmarks. It is not enough to have benchmarks, you need measurements that are more concrete than benchmarks, he said.

Goodpaster said social investment may serve as a form of "moral education" for companies. "The challenge is operationalizing the function of conscience in the global business corporation," he said. The shift from a stockholder to a stakeholder perspective is one indication of the corporate realization that "my neighbor is as real as I am."

Janet Prindle of Neuberger & Berman has wrestled with the issue of operationalizing conscience as a portfolio manager. How can you make choices about investments that reflect the goals of the fund? The investments need to provide good returns while meeting certain criteria. "We don't just look at a good company and put it in the portfolio," she said. "We look for companies at a good price with good returns on equity."

Prindle said Neuberger & Berman does social screening for both avoidance issues – such as alcohol and tobacco – and leadership issues such as the environment, community, workplace, and human rights. Some of these issues have a natural relationship to the company's financial success, she noted. "Good corporate governance and working conditions directly influence profitability. Companies want to cut turnover and we look at what the company is doing to keep employees, promote diversity and address work-family issues."

Frank D. Walker of market research firm WalkerInformation compared growing interest in social responsibility to the rise of the quality movement. Quality had to evolve from a general concept to a specific set of actions with measurable impact. The challenge for social responsibility is to create and disseminate practical mea-

sures that show the strategic impact of social investments and actions.

Reputation is one way "doing good" is translated into positive bottom line performance. "We happen to believe that perception is reality, because in the long run it does reflect what is there," Walker said. "Companies perceived as good are in fact driven and led to be good." He noted that a 1994 study of 1,000 people asked them to identify characteristics of socially responsible firms and then rate 154 companies on a 10-point scale. The top 25 companies had an average return on equity of 20.12 percent while the bottom 25 had an ROE that was 9.71 percent, a difference in excess of ten percent.

One of the most significant ways values are translated into value is through the impact on the company's own workforce, he said. For example, companies that support community projects such as the Special Olympics find their employees are more committed to the firm. "We believe the employee is the key," said Walker, whose company offers an integrated set of products to measure the business impact of "soft side" of the balanced scorecard. "Being a leading company means attracting the best employees, who serve customers well, who attract the best suppliers, thus benefiting the bottom line," he said.

How Ethical Are Socially Screened Funds?

Chair: ***Thomas Donaldson****, Mark O. Winkelman Professor; Director, The Wharton Ethics Program, The Wharton School*
Panel: ***Lloyd Kurtz****, Vice President and Research Analyst, Harris Bretall Sullivan & Smith LLC*
Lynn S. Paine*, Harvard Business School*
Steve Schueth*, Chair and President, Social Investment Forum*
Catherine Sheehy*, Acting Director, Portfolio Screening Service of Investor Responsibility Research Center*
Alan Strudler*, The Wharton School*

Do socially screened funds actually make an impact on the world – or do they just make investors feel better about their investments? Alan Strudler of the Wharton School questioned whether the facts of social investment match the reality. Funds screen for sin (alcohol, tobacco, gambling) and military investments. "But do people think alcohol is unethical?" he asked. "Is military defense unethical?" On the other hand, most screens allow investments in Microsoft or Coca-Cola. "Do people think Microsoft's monopolistic behavior is ethical?" Strudler asked. "Do people think that investing in Coca-Cola is a socially responsible thing to do?"

Strudler noted that when he discussed these issues with friends who had investments in social funds, they were "surprised and disappointed" to find out what was really in their portfolios. "My conjecture is that people really aren't getting what they want in funds," he said. "The information about what is in these funds is publicly available, but people don't know what they are getting."

The decisions about what is ethical, or even what should be the focus of research, are fuzzy. When a researcher tries to compare one chemical company to another, should they focus on the number of Superfund sites as business or biotech? "All of those are very messy decisions," said researcher Lloyd Kurtz. "I don't think anyone who does social research would argue that it is a bulletproof process." As one example of the complexity of social investment, a conference participant noted that Philip Morris was on *Fortune* magazine's list of most admired companies for its employee relations, although it would be screened out by most funds for tobacco.

Over the years, funds accumulate artifacts that no longer reflect the values of investors. Kurtz noted that discussions at conferences on socially responsible funds are often carried out over cocktails, even though many of the funds screen for alcohol investments. He noted that artifacts such as alcohol restrictions tend to accumulate over the years because they are very hard to drop.

There is also a lot of confusion among consumers, Kurtz said. This may be because, beneath the marketing, the funds are actually quite similar, based on the analysis of about 30 researchers in the area. Investors are not usually aware of how closely aligned they are. "If you read all the prospectuses of the funds, you wouldn't know the funds are using similar screens and research," he said.

There are a wide range of attitudes toward social investment, said Lynn Paine of Harvard Business School. The arguments for socially responsible investment are based on long-standing principles that "ownership of property entails the rights and responsibility to exercise moral judgment in matters related to that property," Paine said. This is not a new concept. In a 1911 opinion, U.S. Supreme Court Justice Louis Brandeis said that a shareholder has the obligation "to see that those who represent him carry out a policy which is consistent with the public welfare." The problem is that to carry out this responsibility, investors need to have information about the social impact of their investments. In this view, social investment is a duty of investors.

On the other hand, others argue that socially responsible investment impairs efficiency, doesn't work socially, that charity works better, it's hypocritical or impossible. Paine pointed out weaknesses of these arguments. "Suppose it were true that economic output is greater in a society that permits slavery," she said. "That wouldn't permit us to ignore the moral problem with slavery. In a civilized society, efficiency is not the only thing we value." That attempts at socially responsible investment are sometimes hypocritical is perhaps a given. "The only way to do away with hypocrisy is to do away with morality all together," she said.

The contention that it is impossible to make effective social investments is perhaps the most significant of the criticisms. Paine said many of the early funds in this area have been scattershot and driven by the current hot issues. "Many sophisticated investors are skeptical," she said. "Investors are looking for the kind of sophistication on the social side that they have on the financial side."

Catherine Sheehy of the Investor Responsibility Research Center (IRRC), said they are developing the research for investors to make more informed decisions about both investments and activism. This research has had a broad impact since the IRRC was founded in 1972, from a shareholder resolution calling for Dow to cease making napalm during the Vietnam War to more than 200 proposals before companies today. The IRRC has expanded its research to 13 issue areas related to corporate responsibility. The focus is not on simplistic ratings of companies but rather to consult with clients about applying screens. This information can be used to guide investments or shareholder activism. "It is far more efficient for concerned investors to have access to an independent organization," she said.

One challenge is that investors and funds have different levels of commitment to the work. "It depends on the fund," Sheehy said. "Some became involved in this area because there is a market. Others because they are pushing an agenda. Some have a mission while others follow the market mean." Where should investors draw the line? For example, should they scrutinize suppliers or contractors? "If you start looking at contractors and suppliers, you end up with such a small portfolio, it is probably not going to be efficient," Kurtz said. Paine added that there is a sense of "responsibility fatigue" that sets in. "How can anyone be responsible for everything? We have to think in terms of degrees, not just yes versus no. How much control does the company have? How serious is the apparent misconduct? What is the moral minimum? Otherwise, irrationality overwhelms us."

In closing remarks on the panel, Schueth of the Social Investment Forum said he had to agree with many of the criticisms. As a young industry, "we have a lot of room to improve." But these improvements are under way. "The industry is moving quickly toward more qualitative and proactive screening and shareholder advocacy positions," he said. As the major investment firms are coming out with their own funds, there is also competitive pressure for pioneer funds to develop more sophisticated and distinctive funds. "We have to stay a couple of steps ahead," he said.

L to R: Steve Scheuth, Alan Strudler, Catherine Sheehy, Lynn S. Paine, Lloyd Kurtz, Thomas Donaldson

CEO Round Table

Chair: ***Barbara Krumsiek****, President, CEO and Vice Chair, Calvert Group*
Panel: ***Thomas W. Grant****, President, Pax World Fund*
Robert Mercer*, former CEO, Goodyear Tire & Rubber Co.*
John W. Rogers, Jr.*, President, Ariel Mutual Funds*
William L. Van Alen, Jr.*, CEO Noah Fund*

Over lunch, a panel of senior executives discussed issues of social investments and social responsibility. What do the executives see on the horizon for social investments? Investor education is the current focus for John Rogers, President, Ariel Capital Management (with $3.5 billion in assets in management as well as three mutual funds). Ariel is concentrating on education in the African-American community where investment levels are low. The firm's school, Ariel Community Academy, gives each incoming class $20,000 to allow them to make real investments and use the profits for scholarships and charity.

Barbara Krumsiek said Calvert is creating a new social index, applying one of the most stringent social screens today. She noted that when the fund was announced, a corporate manager called to ask how his firm could get onto the Calvert list. This indicates the impact such a list is beginning to have in shaping how firms are "viewed positively by the socially responsible investment universe," she said.

What are the greatest challenges? One of the major challenges for corporate leaders is to balance commitment to customers and shareholders with new demands from socially responsible investors. Robert Mercer recalled that as CEO of Goodyear Tire & Rubber Company during the calls for divestment from South Africa, he resisted shareholder activists who called for the company to pack up its substantial South African operations. Goodyear felt it could make more of an impact by staying in the country and promoting non-discriminatory policies than by pulling out. Mercer received a visit from a bishop's representative from the Catholic Church in Cleveland who criticized this position. The bishop concluded: "You've been there for 50 years and you still haven't gotten rid of apartheid." Mercer replied to the bishop's representative: "You've been there for 400 years, and I don't think the Catholic Church has been any more successful."

Rogers said increasing diversity is another challenge for socially responsible investment funds. Noting that there were just three African-American participants at the Wharton conference, he said the mutual fund industry is "one of the least diverse industries known to mankind."

The issue of where to draw the line in applying screens is still a significant one, said William L. Van Alen, Jr., whose Noah Fund screens for biblical issues such as alcohol, tobacco and abortion. When Bill Gates donates money to Planned Parenthood, should they pull their investments in Microsoft? Van Alen said they have decided that, as a $16 million fund, they need to stop screening at the production level. "We don't screen for directors," he said. "If you did, how far would you go? Officers? Shareholders?"

Thomas Grant of Pax World Fund, founded by two Methodist ministers to promote world peace, said the challenge is to "live up to the standards of the original organizers." Once the principles are set for the fund, "you have to stick to them and what is written in the prospectus going forward."

What do they see for the future? Krumsiek noted that Professor Klein saw biotech as a significant issue. Panelists said the challenge is to expand to serve new sets of investors, to move from passive screening to more proactive approaches, and for funds to find new competitive positions as large investment houses move into the social arena.

L to R: Barbara Krumsiek, Robert Mercer, John W. Rogers, William L. Van Alen, Jr., Thomas W. Grant

Are Socially Responsible Funds a Good Investment?

Chair: ***Marshall E. Blume****, The Wharton School*
Panel: ***Steve Dillenburg****, Managing Partner, Summit Investment Partners, LLC*
Robert Edelen*, The Wharton School*
D. Bruce Johnsen*, George Mason Law School*
Krishna Ramaswamy*, The Wharton School*
Lloyd Kurtz*, Director of Quantitative Research, Harris Bretall Sullivan & Smith LLC*
Larry Zicklin*, Chairman of the Board, Neuberger & Berman*


Marshall Blume

The performance of socially responsible investments is complex. Lloyd Kurtz said that finding a social issue that pays off has become a "snipe hunt or search for the Holy Grail." The book *Built To Last* contends that cultural differences lead to differences in long-term performance, for example. "The tantalizing nature of these claims is that they rely upon very strong common sense advice, but you can never be certain if you were right or just lucky," he said.

While research shows socially responsible funds are a good investment today, Wharton's Marshall Blume questioned whether this "luck" would hold with changes in the market and definitions of what is socially responsible. As an example, he asked: "How many people here are opposed to child pornography? Where is one of the biggest providers of child pornography? On the Web. You could make a strong case that socially responsible investors today should not invest in Internet stocks. What would that have done to social investments in the past year? Their returns would have been significantly below the benchmarks." Changes in screens, or high-performing companies that move into the crosshairs of current screens, will have a significant impact on performance, he said.

Steve Dillenburg of Summit Investment Partners, said that when they back tested a new fund they developed that applies a more active assessment (rather than filtering out negatives), they found it added three percentage points to performance over the past two years. In contrast to screening out investments, this approach offers a weighting system for looking at the relative social impact across a wide range of investments.

Even simply avoiding "sin," seems to have a beneficial impact. Wharton's Roger Edelen said that even some of the simpler screens for issues such as tobacco and

gambling have had a positive impact on recent performance. He noted that tobacco firms have returned about 60 percent less than the S&P 500 over the past five years, gun firms have lagged the S&P by 60 percent and casino gaming firms by 30 percent. "Was this just an outlier odd event?" he asked. "Or was the fact that socially responsible funds don't own these stocks part of the reason these funds had good performance over the past five years."

D. Bruce Johnsen of George Mason Law School notes that socially responsible investing may go beyond investing only in firms that are certified as ethical. "What we think of as breaches of ethics by the firms in an industry can sometimes be seen as the outcome of a prisoner's dilemma. If one firm engages in unethical but profitable practices, others may not be competitive unless they follow suit. Everyone, including consumers, would be better off if the firms could avert a race to the bottom. If and to the extent these firms' stock can be placed in a common portfolio, managers would be less aggressive in pursuing unethical practices. This is because their concern is serving the ultimate beneficial investors, who own portfolio shares representing the joint value of all firms in the portfolio; any unethical action by one firm to gain at the expense of its rivals will reduce the value of portfolio shares."

Larry Zicklin of Neuberger & Berman said he remains skeptical about the performance results. As in other funds, the focus is often on the winners. Zicklin said that in a list of 44 socially responsible funds, "8 beat the S&P 500 and everyone else did worse."

Strong overall stock growth and differences in performance between high-tech stocks and traditional industrials have also helped the social funds. "The market doesn't always go up 26 percent per year," he said. The indexes tend to screen out "smokestack America," which is being hammered by the stock market, while leaving in high-tech, which is growing rapidly.

Zicklin also expressed concern that "companies are going to get blackmailed into this and forced to do things they don't want to do as the power of these companies grows. We should go there, but I don't think we should arrive at the conclusion before doing all the legwork."

To have an impact on corporate behavior, screens and measures need to be made more sophisticated and precise, panelists said. "If we take a look at Wall Street, it has gotten its message across to corporations loud and clear that we measure bottom line results," said Dillenburg. "We need to send a message to corporations equally clear that we are measuring other aspects than cash flow. What gets measured gets managed." He said companies are developing solid benchmarks and measures, and new ratios need to be created.

Participants questioned whether there may be conflicts between the fiduciary responsibility of fund managers to maximize wealth for investors and the desire to achieve social objectives. They noted that this may not be an issue in a bull market, but could become much more contentious in a downturn. A Calvert representative said that the SEC had affirmed in a letter that socially responsible investments are consistent with fiduciary responsibility to investors.

Emerging Alternatives and Global Perspectives

Chair: ***Thomas W. Dunfee****, The Wharton School*
Panel: ***Richard Ciuba****, Dow Jones Indexes*
Elizabeth Elliott McGeveran*, Friends, Ivory and Sime*
Mike Peirce*, Institute of Social and Ethical AccountAbility*
Alan D. Willis*, The Canadian Institute of Chartered Accountants*


Alan D. Willis

Socially responsible investing depends upon the quality and cost of information, said Wharton's Thomas Dunfee in introducing the panel. As companies issue social reports and the social auditing profession develops, the information needed to make informed decisions is becoming better and cheaper.

Alan D. Willis, a consultant on the Global Reporting Initiative (GRI), said the project developed by CERES in 1997 is designed to standardize social responsibility reporting for investors, stakeholders and analysts. The GRI is a coalition of 54 investor, environmental, religious, labor and public interest groups, and companies. "It was developed because companies receive requests for information, and analysts and stakeholders receive incompatible reports from different companies," Willis said. The GRI established environmental, economic and social standards that are being tested by a set of companies. The GRI is working to become more global, independently verified and aligned with other initiatives. "There are many initiatives around the world, which we hope will converge to create a framework," Willis said.

One of these initiatives is the AccountAbility 1000 standard, discussed by Mike Peirce of the Institute of Social and Ethical AccountAbility. The AA1000 standard was launched in November as a foundation standard in social and ethical accounting, auditing and reporting. "We need to reflect at all stages of the accounting process the aspirations and needs of different stakeholders," Peirce said.

Regulation can accelerate the development of standards. Elizabeth Elliott McGeveran, of the U.K. based investment firm Friends, Ivory and Sime, said that new regulations are raising responsibility higher on the corporate agenda for U.K. firms and institutional investors. A new U.K. law requires pension funds to provide ethical disclosure to pension holders combined with new corporate governance recommendations that audit committees should assess social environmental risks. This means that companies must become more sophisticated in measuring and reporting on social and environmental issues. It has increased pressure to create standards for information collection and reporting. McGeveran said the regulation also would result in "a convergence between SRI screened funds and other funds."

Richard Ciuba of Dow Jones Indexes said that while there is no overall socially responsible investment index, the company has created the Islamic Market Index

and the Dow Jones Sustainability Index. The Islamic Market Index screens along Islamic legal and religious precepts, such as avoiding fixed-income securities, entertainment, pornography and alcohol. It has outperformed other market indices, he said. The second index, the Sustainability Index, evaluates companies based on sustainability through innovative technologies that use resources efficiently, high standards of corporate governance, strong shareholder returns and demonstrated industry leadership in supporting sustainability and responding to rapid social change. Dow Jones created the index by sending questionnaires to companies about sustainability and ranking companies based on their responses.

Social Screening and Shareholder Value

Chair: ***Larry LaBoda****, Director, Finance & Administration, Great Lakes Protection Funds*
Panel: ***Hal Brill****, Partner, Natural Investment Services*
Ed Freeman*, University of Virginia*
Eric W. Orts*, The Wharton School*
Stephen Viederman*, President, Jessie Smith Noyes Foundation*

Obstacles to social investment are deeply ingrained in the culture of finance, said Stephen Viederman of the Jessie Smith Noyes Foundation. He described socially responsible investment as "an educational process that makes explicit non-financial consequences of investments. It is designed to reduce what Ghandhi called 'the dissonance between creed and deed.' We all experience dissonance, but we try to reduce it as much as possible, to ameliorate the consequences of corporate behavior on society."

Viederman said there are psychological and social barriers to focusing on these issues. One of the most significant is the "theology" of economics which considers the environment, for example, as an externality, and which excludes concerns for justice. "Citizenship in corporate America has become an avocation rather than a vocation," he said. "By and large, if you ask consultants to a foundation about socially responsible investing, first they say it cannot be done. When they loosen up a bit, they say you can do it if you want but it's a mistake. Financial advisors will tell you not to do it. The culture isn't there. And to understand why we have to look at the theology of investment. The very theories and practices we live with are a form of theology."

This culture may be changing, however. Hal Brill of Natural Investment Services said the social investment movement should be seen "as part of a larger movement. For the past 400 years we've been told we have to separate money from values when making financial decisions. I think people will look back at this and say this is a strange culture. It is much more natural to be including our values and money together and quite unnatural to have this split."

In more than a decade of social investment, Brill has seen a greater acceptance and change in the tenor of discussion. There is a move from avoidance screening (keeping away from the wrong investments) to more affirmative screening that focuses on making investments that have a positive impact on the world. The debate also has shifted from whether to make social investments to how. "The shift in values that is going on is monumental," Brill said. "I think we are going to see a lot more change in the next ten years."

Ed Freeman of the University of Virginia also has seen a major change in the attitudes toward these issues. He recalled that when researchers submitted the first paper on "stakeholder management" to a major academic journal, it was such a radical concept that "the editor called to say there was a major typo in the title of the paper," Freeman said. "But the editor said, 'Don't worry, we'll fix it.' " Now, the

concept of creating value for *stakeholders* rather than just *shareholders* is taken as a given by most corporations. Freeman said the whole question of the performance of social funds is "a dead end." It is a byproduct of a distinction between economic and social issues. The deeper question is whether social investments actually lead to more ethical companies. Investors and researchers need to push to truly assess whether the investments have the desired impact. "The dangers are obvious," he said. "We might unmask the fact that what we know now as an ethical investment is either a politically correct investment for investors or a marketing strategy for investment houses."

Wharton's Eric Orts compared the challenge of socially responsible investment to the separation between the interests of managers and owners. "We have closed the gap as institutional investors are in the boardrooms pressuring managers to deliver shareholder value," he said. "Now we need to address this split between the beneficiaries of institutions (investors in pension funds) and those running the show (managers of funds)."

Where do we go from here? Orts said the discussions at the conference highlight a continued evolution of institutional investors, a movement toward social investments by major investment funds, the need to recognize that maximizing shareholder value is only one choice of values, the need to consider legal standards, and a need for education of both managers and investors.

L to R: Steve Viederman, Hal Brill, Ed Freeman, Eric Orts, Larry LaBoda

Research Identified

Throughout the conference, there was a variety of issues identified that could benefit from further research:

- How have socially responsible investment funds performed financially? How sensitive has this performance been to definitions of the funds? (For example, if biotech or high-tech are screened out, how would performance be affected?) How sensitive is it to the overall growth of the stock market? What would it take to convince non-believers?

- What is the social impact of ethical investments? What are the correct measures to assess this social impact? Are there measurable social effects of these investments? How are these investments changing corporate policies and actions?

- What are appropriate screens for social investments? What are common characteristics of socially responsible screens and indexes? Can a uniform set of standards be developed across industries?

- How can funds more effectively communicate their purpose and impact to investors? How much do investors care about this impact (versus just wanting to feel good about their investments without delving into the details)? How would giving more (or different) information to investors have an impact on their decisions?

- What global initiatives are influencing the development of social investing? How do regulations such as the U.K. pension law affect the development of socially responsible investing?

Attendees

Larry Alan Bear, New York University
Ronald E. Berenbeim, The Conference Board
John Blanchard, Calvert Group, Ltd.
Marshall Blume, The Wharton School
Norman Bowie, University of Minnesota
George Brenkert, Georgetown University
Hal Brill, Natural Investment Services
Bruce Buchanan, New York University
Richard Ciuba, Dow Jones Indexes
Philip Cochran, Pennsylvania State University
Joel Coleman, Playtex Products, Inc.
Lois Coleman
Elizabeth Craig, The Wharton School
Stephen J. Dillenburg, Summit Investment Partners
Thomas Donaldson, The Wharton School
Christine Drevalas, California State Treasurer's Office
Thomas W. Dunfee, The Wharton School
Ron Duska, American College
Roger Edelen, The Wharton School
Ed Freeman, University of Virginia
Kenneth E. Goodpaster, St. Thomas University
Thomas W. Grant, Pax World Fund
Robert Gunther, Robert E. Gunther Communications
Ed Hartman, Rutgers University
David Hess, The Wharton School
Karen Jehn, The Wharton School
D. Bruce Johnsen, George Mason University
Stephen I. Kasloff, Guardsmark, Inc.
Lawrence R. Klein, University of Pennsylvania
Michael Kline, Fox, Rothschild, O'Brien & Frankel, LLP
Barbara Krumsiek, Calvert Group, Ltd.
Lloyd Kurtz, Harris Bretall Sullivan & Smith LLC
Larry LaBoda, Great Lakes Funds
William S. Laufer, The Wharton School
Peter D. Linneman, The Wharton School
Ann E. Mayer, The Wharton School
John McCall, Saint Joseph's University
Elizabeth Elliott McGeveran, Friends, Ivory and Sime
Robert Mercer, Goodyear Tire & Rubber Company
Jennifer M. Moore, U.S. Attorney's Office
Julianne Nelson, N.W. Partners
Kate Nelson, William M. Mercer, Inc.
Eric W. Orts, The Wharton School
Lynn S. Paine, Harvard University
Moses Pava, Yeshiva University
Mike Peirce, Institute of Social and Ethical AccountAbility
Ed Petry, Ethics Officer Association

Attendees (*continued*)

Robert A. Phillips, Georgetown University
Georgette Poindexter, The Wharton School
Janet Prindle, Neuberger & Berman
Krishna Ramaswamy, The Wharton School
William T. Redgate, Redgate & Co. Consultants
Pietra Rivoli, Georgetown University
John Rogers, Ariel Mutual Funds
Nicholas Rongione, Villanova University
Arnold J. Rosoff, The Wharton School
William T. Ross, Temple University
Dianne Saenz, Calvert Group, Ltd.
Michael Santoro, Rutgers University
Donald Schepers, Baruch College
Steve Schueth, Social Investment Forum
S. Prakash Sethi, Baruch College
Catherine Sheehy, Investor Responsibility Research Center
Kenneth L. Shropshire, The Wharton School
Craig Smith, Georgetown University
Alan Strudler, The Wharton School
Edward T. Swaine, The Wharton School
Diane L. Swanson, Kansas State University
Iwao Taka, Reitaku University
Dominic Tarantino, Price Waterhouse
Linda K. Treviño, Pennsylvania State University
Judy Van Alen
William L. Van Alen, Noah Fund
Deborah Vidaver-Cohen, Florida International University
Steve Viederman, Jessie Smith Noyes Foundation
Frank Walker, WalkerInformation
Danielle Warren, The Wharton School
Reshima M. Wilkinson, PricewaterhouseCoopers
Alan D. Willis, Canadian Institute of Chartered Accountants
Rich Wokutch, Virginia Tech
Lawrence Zicklin, Neuberger & Berman
Sally Zimmerman, Friends, Ivory & Sime

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The Carol and Lawrence Zicklin Center for Business Ethics Research was established in 1997. The mission of the Center is to create and disseminate leading edge research on critical topics of business ethics and to serve as a focal point for the interaction of business, professional and academic leaders concerning responsibility in business.

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"Employee Deviance," K***. Etty Jehn***, *The Wharton School and* ***Danielle Warren***, *The Wharton School.*

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"Vulnerable Values: Professionalism vs. Business," ***Thomas Donaldson***, *The Wharton School.*

"The Cultural Context of Ethical Judgment: Making Ethical Decisions in Multi-National Organizations In Post-Communist Russia," ***Andrew Spicer***, *University of California, Riverside and* ***Thomas W. Dunfee***, *The Wharton School.*

"Normative Implications of a Marketplace of Morality," ***Norman E. Bowie***, *University of Minnesota and* ***Thomas W. Dunfee***, *The Wharton School.*