

Does ethical investment pay?

By Wayne Visser

The first article in this series on ethical investment gave some background on the nature and size of the international ethical investment movement. But it left the BIG question unasked: Does it pay to invest ethically? Read on to find out.

In a recent NM Conscious Fund survey in the UK, it was revealed that 87% of the unit owners had bought on the strength of the ethical approach of the fund, while only 7% had done so on the grounds of investment performance. In other words, these investors were prepared to sacrifice their level of financial returns for "social returns". But is this really necessary? Do ethical funds underperform?

While financial theorists argue that by limiting the diversity of investment choice, ethical screens compromise potential returns, in practice very few analysts have been able to show under-performance except for some of the "exclusive green funds". Most conclude, among them Fortune magazine, that the ethical funds either reflect the average for mutual funds, or significantly outperform the market.

For example, an analysis of the US Domini Social Index of 400 ethically screened companies shows it to marginally but consistently outperformed the Standard & Poors 500 Index between 1986 and 1992, and a similar study of the UK FT All Share Index between 1983 and 1988 draws the same conclusions. According to Russell Sparkes, author of a recent book called "The Ethical Investor" (HarperCollins, 1995), the explanation for this phenomenon can be found in a number of possible effects:

- the smaller companies effect - that responsible investors are forced to avoid large conglomerates, and concentrate on smaller companies which over time grow faster;
- the anticipation effect - that exclusion of certain companies on grounds of moral or environmental repugnance anticipates later legal action and financial problems;
- the information effect - that properly done ethical/green investment needs a higher level of knowledge about the companies invested in than normal investment managers possess; and
- the positive selection effect - that the positive criteria used by such funds help them target well-run companies.

This average or above-average performance of ethical funds seems to be in evidence in South Africa as well. The Mail & Guardian feature on ethical investment (May 30 to June 5) reports the following results:

- Community Growth Fund (Syfrets) - top performing unit trust over the first quarter of 1997, showing a profit of 17.4%; placed 16th out of 31 general equity funds over the past two years (and 7th over the past year, according to the Stones Internet Unit Trust website)
- Community Income Fund (Old Mutual) - assets of \$28 million and a return at the end of March 1997 of 14,1%; profits doubled between June 1996 and March 1997
- Futuregrowth (Southern Life) - assets of R1,6 billion and profits of 25,6% on the balanced fund and 75,4% on the equity fund
- Futurebuilder (Metropolitan Life) - too new to evaluate credibly.

It is important not to lose sight of the wood for the trees however. What are the real returns of ethical funds? Their true value is in directing money towards the fulfillment of social and environmental goals which usually get underfunded in the marketplace. Their returns may not be short term financial profits and may not directly benefit the individuals making the investment. Instead, their legacy may be a better world for future generations to live in.

In addition, ethical investment may be an important system of checks and balances to counter the unrestrained might of the large, influential companies of the world. It may be the very vehicle we need to keep business accountable and responsible; to ensure that they don't sell off the quality of life of our unborn children in the name of "mammon".

Recommended references:

The Ethical Investor (1995), Russell Sparkes, Harper Collins, London.

Source:

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