

HAVING A LOOK AT THE EFFECTIVENESS OF SRI-ENDEAVOURS

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ABSTRACT

This paper, an epilogue to the special issue on socially responsible investment (SRI), is a first attempt to philosophically tackle information asymmetries that pertain to the consequences or the effectiveness of SRI-policies. The paper discerns four types or techniques of SRI: 1) shareholder engagement; 2) the selection of best-in-class entities; 3) the maintenance of categorical exclusions; 4) the financing of alternative economies. For each technique, the paper first briefly sketches the mechanism that is put to work by the SRI-investor. Then, I try to assess whether the investor is able to know whether or not his SRI-effort is being or has been effective in the real world.

1. Introduction

The preceding papers in this issue analyse the presence, absence and effects of information asymmetries in conceiving and implementing SRI-policy. In turn, I want to go into information asymmetries that pertain to the consequences or the effectiveness of SRI-policies. Contrary to the consequences on portfolio performance that have been given ample attention² – and justly so – real world consequences have been

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² As does for instance Karl. W. Einolf in this issue; a collection of professional and academic research papers has been put together by the UNEPFI and Mercer Consulting (UNEPFI and Mercer 2007).

comparatively neglected or mostly simply taken for granted without further analysis.

Irrespective of motivations and legitimatisations, we discern four types or techniques of SRI: 1) shareholder engagement; 2) the selection of best-in-class entities; 3) the maintenance of categorical exclusions; 4) the financing of alternative economies. I will treat these in reverse order. For each technique, I will first briefly sketch the mechanism that is put to work by the SRI-investor. Then, I try to assess whether the investor is able to know whether or not his SRI-effort is being or has been effective in the real world.

2. Investing in alternative economies

This type of SRI investments aims at sustaining ‘alternative’ economic projects that would not be funded through mainstream markets, mostly for financial reasons. This implies at once four things: 1) we talk about economic projects that are at least marginal from a financial point of view (liquidity, risk/return, ...), 2) but the financial act is to be distinguished from other money-acts such as donations, evergetism and maecenas because titles, claims, cash flow promises are created and made. 3) the motive of the investor is not strictly financial, yet has altruistic, idealistic, innovatistic, or other components that interfere with financial rationality. 4) the financing is tied into (a bundle of) concrete projects.

At first sight, the investor can never be mistaken about the effectiveness of his investment act: he contributes to the project at hand and he is able to verify its development. Most investors of this type are perfectly happy with this.

Yet, if and when this type of project is financed through a mutual fund, a bank balance, a holding company or some other financial intermediary, the financially conscious investor is likely to feel that this state of affairs leaves him in a considerable information asymmetry about his money. Because, within those financial intermediaries, the monies gathered on one balance sheet become perfectly interchangeable. This prompts two evident questions. First, it might be that unwanted co-investors are in the project or in the intermediating structure. Here, we will not further treat this interesting puzzle but will do so in its own

right.³ Secondly, it might be that this intermediary also finances projects that are at odds or at cross purposes with the intention of the SRI-investor. For instance, when he puts his money in a bank that finances projects in the social, cultural or ecological sphere but also heavily invests in bond issued by defence industry, issued by governments that deploy nuclear armament and in stocks issued by tobaccoists.⁴ These are first order information asymmetries that pop up when one realises that money-in-the-financial-system is not attributable and that it can at best be traced to the next step in the endless chain of financial transactions.⁵ But, at least the investor may be relatively sure that his financial act is contributing to a project or a bundle of projects that corresponds with his intentions and information asymmetry on this point is absent or easily overcome.

A philosophically conscious investor may ask himself whether his investment and the project contribute to a state of affairs that is an absolute improvement or whether it contributes to overall happiness, now

³ This puzzle is not as much about *investing* as it is about the curious fact that monies are perfectly interchangeable when donating, financing, supporting, holding and so on once they are put together in one basket. *Pecunia non olet* - money does not smell just as numbers do not.

⁴ I feel very assured that empirical testing would back up the claim that such proverbs are pertinent, yet I am not aware that such studies exist. My warrant for claiming is twofold. First, discourse analysis shows that providers of this kind of intermediation do indeed uphold discourses on exclusions. See for instance Triodos Bank and the Cooperative Bank. Secondly, the investor who participates in this type of SRI is consciously choosing to forego market conform financial outcomes by putting his money behind non conform projects. A fortiori then, he is very likely to be of outspoken opinion about what particular projects, sectors or economies he does not want to finance, even if they promise conform financial results – because he if he wants to obtain those, he has many alternatives besides investing in those particular projects, sectors, economies.

⁵ In the final end, the exhausted researcher who pursues the quest for knowledge about “who’s money is causing what in the world?”, shall find that all money is in all the institutions of the financial sector taken together and that all of the economy is financed by all the money that flows through the system. In this sense, money is like blood that flows through the body economic; you can not attribute some blood to the left arm and some other blood to the legs.

and in the future.⁶ A project might, for instance, be excellent from a social point of view, yet put additional burden on natural resources or diminish pension perspectives. Yet, such questions pertain to all economic projects. The SRI-investor will realise that he is, just as his counterpart, the ‘traditional investor’, unable to oversee the far away in the economic chain and the longer term consequences over time of his investment-policy.

Yet, he will find a satisfied mind in the immediate non-financial aspects of the projects at hand; likewise a purely financial or economic investor will not worry about long-term and further-in-the-chain effects but will find a satisfied mind in finding that his return is up to expectations.

3. Categorical exclusions

This type of SRI-policy excludes certain activities or purposes in a categorical way. These investors try to avoid investing in defence industry, alcohol, tobacco, nuclear power, preservatives, gambling and so on. The reasons for doing so might be of a religious, political, moral, ethical, aesthetical, technological nature. No mechanism is put to work; stocks and bonds of issuers that carry the activities at hand, are simply not in the portfolio – they are simply not eligible for investment. This lack of mechanism is not problematic at all for those investors; they find a satisfied mind not to earn money gathered in turn by tobaccoists, genetic manipulators, gambling corporations and so on.⁷

⁶ As I have argued elsewhere, “sustainable development” is a concept that has much in common with “happiness” – synchronically, it refers to the (conditions for) happiness of the greatest number of people and it carries an outspoken diachronic dimension (“future generations”, “*development* that may be *sustained*”).

⁷ The absence would be problematic if and when those investors would intend to annihilate the said economic processes by financial means. But then again, such a purpose can never be part of an SRI-policy because each and every SRI-policy pertains to a particular investment project. An SRI-policy that would formulate that it aims at de-financing a sector or industry thereby supersedes its function as investment-policy for a particular portfolio – it trespasses into the political realm

The investor may be relatively sure that his portfolio is clean from the activities he precludes from financing – although I refer to the remarks on information asymmetries in demarcating activities. But he may be equally sure that his SRI-stance does not impact the real economy. When one investor refuses to finance gambling activities, another is happy to do so. As a matter of fact, “vice funds” have been developed as a reaction to this type of SRI and they are being offered to the general public.⁸ Hence, the impacts on real world economy are at most negligible. Categorical exclusions may only become effective when they are universally applied – then, it is no longer (to be) conceived of as SRI because this should be done by means of law and regulation and no longer left to individual discretion.⁹

So, there is no information asymmetry pertaining to the effects of this type of SRI: they are likely to be non-existent and at most they are negligible.

4. Best-in-class selection

and contains statements that are of no use and completely out of scope for the managers of the portfolio.

⁸ The marketing response was provoked on the moral plane, being a response to the SRI-discourses about exclusion, yet it is backed up by sound financial reasoning. See: <http://www.vicefund.com/>. Financial rationality suggests that when many investors start shunning stocks for non-financial reasons, a financial opportunity arises for investors with less inhibition: they can obtain an extra return buying those stocks. This intuition plays a minor role in the very entertaining and intelligent philosophical thriller about guilt and contribution by Iain Banks in which one of the protagonists amasses extra wealth by implementing this reasoning (Banks 1995).

⁹ In fact, such categorical exclusions by law are in place, yet not conceived of as “SRI”: regulation forbids financial intermediaries to accept deposits by Organised Crime (drugs, human trafficking). It goes without saying that such universal categorical exclusions are rare and seldom because universal consensus on tobacco, preservatives, alcohol, etc. is lacking. The production thereof is not forbidden in the ‘real economy’. Accordingly, there is no legal prohibition to finance these processes.

Best-in-class SRI selects, within a given investment universe, corporations that perform best on a more or less wide range of environmental, social, economic, governmental and ethical criteria, without (necessarily) hurting financial values in the process.¹⁰ In fact, this investor builds or uses a screen by which only ‘the best’ corporations (within the investment universe) are eligible and the lesser-than-excellent ones are filtered out.

The mechanism that is put to work, is the podium: investors or service providers build a podium on which only the best are invited to shine.¹¹ The effectiveness of this mechanism rests on the ambition of senior corporate officers to win a place on the podium and on their zeal and ability in keeping up with moving goal posts and objectives in deploying people management, in enhancing diversity, in augmenting eco-efficiency, in the upholding of human rights, and so on - the list is open ended and the podia are numerous.¹²

There is no information asymmetry in the mechanism itself. However, the SRI-investor can not be sure about the impact on progress and healthy developments. Indeed, besides SRI-investors other parties invite and pressurise corporations to enhance practices from an environmental, social, cultural, economic, ... perspective. The SRI-podium is evidently not the sole cause that determines corporate decision making and policy execution. Best-in-class SRI is merely a force among

¹⁰ See the articles in this issue of *Philosophica*. See also UNEPFI and Mercer (2007).

¹¹ Following Philippe Van Parijs (2004), I recognize the force of two dialectical mechanisms in the deployment of CSR (Leys 2004), viz. “the microphone” (CEO’s producing sociably acceptable discourse on sensitive issues) and “the spotlight” (confrontation with actual practices). But, in my opinion, two other mechanisms, that are not unrelated, also dialectically drive developments, viz. “the podium” (competitors striving to be the most virtuous) and “the table” (rational, professional dialogue, internally with corporate officers, for instance in Ethics Committee, and externally with whoever is to knock at the corporate door).

¹² In Belgian retail, all major asset managers have built in-house capacity for selection and the Ethibel-charity offers a non-asset manager best-in-class podium pertinent for many sectors and regions.

others. Thus, an information asymmetry about the SRI-impact is evident: impacts cannot be incrementally discerned. This does not need to disappoint these SRI-investors. Perhaps it even is not worthwhile to occupy oneself with the question what exactly the causal contribution of the SRI-policy is. It may be nil but that does not constitute a problem as the expected financial impacts of this type of SRI, if and when applied in a professionally competent manner, are at least neutral if not positive.

5. Engagement Policy

Engagement SRI consists in dialoguing with the investee corporations. Subject of the dialogue usually is about normative aspects of corporate policy, for instance more scrupulously observing safety-, environmental or human rights norms.¹³ Contacts with corporate officers are specific and particular because they concern the particular corporation's practices and policies. Yet, even if change comes about, the engaging investor meets with the same kind of information asymmetry about impacts and effectiveness as the best-in-class investor does. Indeed, the engaging investor is not the sole force for improvement of compliance as governments, NGOs and management itself also push for progress.¹⁴

Besides this general fact, it is very unlikely that changes in corporate policy would be (openly) attributed to dialogue with individual investors because that would be contrary to psychology. Corporate officers are very unlikely to admit guilt, fault, wrongdoing, negligence,

¹³ It would be ridiculous to occupy oneself with non-normative issues and detail, because as an investor, one ethically can and should not become a burden for management. Goal-oriented questions are likely to be treated by making investment and divestment decisions; an evident example is categorical exclusion. One does not invest in a tobaccoist and at then starts pestering the management with time consuming dialogues about him giving up being a tobaccoist.

¹⁴ If it is true that the development of engagement SRI by individual investors is hampered by the free rider problem among investors, it is clearly also the case that the development of engagement by the investors is hampered by a free rider problem among stakeholders: why engage if other parties do the work for you free?

and so on, even in private correspondence with individual investors.¹⁵ Moreover, in situations that are or might become *sub judice*, it would be very imprudent and deontologically unethical for corporate officers to deploy discourse that is hazardous from a legal perspective.

To illustrate this with an example: it may be the engagement and the ensuing spectacular exclusion by the Norwegian Pension Fund Global¹⁶ that ‘caused’ Wal-Mart to set up a program of improvement. Anyway, Wal-Mart officers refer to *overall* criticism on its operations. Thus, the NPFG nor any other investor for that matter, is put in a position to claim that he caused a change. But then again, the investor may be sure that he did indeed contribute to change, along with other parties and forces.

Ineffectiveness of engagement, on the other hand, seemingly may be identified without any difficulty: when corporations or corporate officers do not respond to letters or invitations, the engagement effort may seem idle and vain. Yet even then, it may be that the corporation is unable or unwilling to communicate and at the same time taking the signalling seriously and building a framework for better practices.

In order to be sure of the (in)effectiveness of dialogue, one should be able to read the mind of the other party and that is not a given possibility – the content of other minds is the subject of an absolute information asymmetry.

6. Conclusion

It may come as a rather disappointing conclusion that information asymmetries preclude a clear view on the real world effectiveness of

¹⁵ This is born out by real world correspondence initiated by Portfolio21; see Vandekerckhove et al (2007).

¹⁶ My terminology differs from the one the NPFG uses to describe its own operations. Yet, exclusions by the Ethics Council based on the unacceptable manner in which corporate activity is carried out (such as Wal Mart), are preceded by dialogue with corporate officers about the matter at hand – in this sense engagement precedes exclusion. The NPFG however, reserves “engagement” for the activity that is carried out by the Norges Bank – those engagement endeavours do not lead to exclusion from the portfolio.

SRI-policies. The overall effects of financing alternatives are unknown; effects of categorical exclusion are nil (and not intended); the impact of best-in-class formulas is undoubtedly positive yet can never be measured; the effectiveness of dialogue is extremely difficult to pinpoint.

Instead of disappointing, the conclusion should be taken as realistic. The outcome of this high level assessment may serve to temper expectations about SRI-policies. Investors by themselves will not be able to (prove that they have) change(d) the course of history for the better. Too high a set of expectations would lead to disappointment and cynicism - being realistic from the outset shields us from both evils.

It also serves to warn us implicitly not to cause excessive costs when deploying SRI-policies, because, as a general economic rule that applies to investing too, “profits” should exceed “costs”.

Least of all, such an high level appraisal should be taken as an invitation to indifference, apathy or even cynicism. Even if we are inevitably confronted with information asymmetries about causality and effectiveness in societal matters, we may be sure that the efforts contribute to healthy developments rather than to the opposite. So, instead the appraisal may function as an incentive to look for optimisation of informational approaches and input output relationships. Even if that would not lead to enhanced information about effectiveness it could not work to the contrary either. It is, for instance, evident that engagement-policies carried out by considerable investors together are more likely to cause effect than a multitude of engagement-policies that vary in subject matter, temperament, and so on. Effectiveness of best-in-class may be enhanced by formulating the criteria for the podia in a way that is easily comprehended by corporate officers and investors alike.

Information asymmetries about effectiveness do not preclude intelligent efforts in developing and implementing SRI-policy. The fact that they are recognised as such, shields us from exaggerated optimism and its consequent disappointments that are ruinous for ethos and morale. Finally, calculating consequences is not the sole type of ethical reasoning. Besides a calculus of effects, other reasons for doing good and doing better, in finance too, may be not less motivating and inspiring.

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