

Riding the ‘third wave’ of ethical investing

Seb Beloe, Head of SRI Research, Henderson Global Investors looks at the continued evolution of ethical investing

It has been fascinating to chart the progress of ethical investing over the last few decades. Ethical investment was originally championed by religious groups, borne out of a desire to avoid certain categories of company or business. During the 1990s, the debate moved onto corporate citizenship and corporate social responsibility (CSR). Companies began to report on their CSR initiatives and programmes claiming that they were seeing real financial benefits from better social and environmental performance – the so-called ‘business case’.

The fund management industry responded by developing ‘positive screens’, identifying companies that were outperforming their peers on social and environmental issues. Many of the original ‘ethical’ funds began to integrate these screens into their research process, aiming to invest in so-called ‘best-in-class’ companies - even in controversial sectors like retail, pharmaceuticals and oil and gas.

The ‘third wave’

The most recent shift in ethical investment has seen the industry move even closer towards mainstream investing. The focus increasingly is on companies providing solutions to challenging social or environmental issues such as climate change. Regulatory changes and shifts in consumer behaviour have created opportunities for the private sector to develop and scale-up the technologies that can provide workable solutions to these problems. The result has been the emergence of a range of funds aimed at financing new technologies, ranging from wind and wave power to businesses offering educational and healthcare services around the world.

Some of these funds are unapologetically mainstream, focusing simply on what companies do and largely ignoring the CSR issues of how they do it. Others funds, including the Henderson Sustainable and Responsible Investment (SRI) fund range, take a more holistic approach. The SRI approach demands that even those companies focused on providing solutions to sustainability challenge are still operating responsibly. This standpoint takes the logical view that companies developing renewable energy are just as likely to behave irresponsibly if not held to account for their actions.

Three waves of SRI

‘Values’	‘Value’	‘Vision’
<ul style="list-style-type: none"> - Driven by ethical values - Focused on excluding certain types of company using negative screens 	<ul style="list-style-type: none"> - Enabled by differing standards of CR - Focused on best-in-class social & environmental performance and financial value 	<ul style="list-style-type: none"> - Enabled by emergence of environmental & social issues in the mainstream - Focused on investing in ‘solutions-providers’ to critical issues

Show me the money

For fund managers, as well as avoiding or prioritising certain types of companies, there has been a long-running debate about the financial performance of their funds. Critics argue that by limiting the range of companies that these funds can invest in, they also limit the money that they can make.

While initially this might seem to make sense, there is a solid body of evidence that finds the reverse. On balance, companies that pay attention to social and environmental issues appear simply to be better-managed companies than those that don't. Limiting your universe, as critics had originally seen SRI, looks like quite a good idea if you are effectively screening out companies that are badly managed!

Ethical and SRI funds have proven popular over the last few years, as companies with an active focus on environmental issues have benefited from growing political and consumer support. However, 2008 has brought an altogether more turbulent market, and clean-tech and other SRI funds have not remained immune to the downturn. But even so, the outlook remains promising. New legislation - focusing in particular on climate change, but also championing social issues such as healthcare and product safety - continues to be developed in the UK, EU, US and beyond, serving to provide continued good news for investors in these sectors. What is clear is that the ethical investment sphere will continue to evolve at a rapid pace, which can only be a good thing for investors, and for society as a whole.

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