

Ethical portfolios flex their morals

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By Proinsias O'Mahony

Ethical funds across the world are showing an interesting sense of right and wrong in their dealings with firms that are the focus of intense public criticism.

What do the words 'ethical investment' bring to mind? A portfolio containing names specialising in green technology? Companies of the squeaky clean variety? Corporations that engage in fair trade practices?

What everone's image, one certainly doesn't think of companies like McDonalds when one imagines an ethical portfolio. You don't think of oil behemoths like Shell or BP. You don't think of uranium miners. And you most definitely don't think of tobacco manufacturers.

Think again. You'll find them all - and many more - in many an 'ethical' portfolio.

The whole question of standards in the arena of socially responsible funds (SRIs) has been attracting debate in Britain, after a recent report found that most funds are "surprisingly mainstream" in their choice of companies.

The report noted that, out of 58 funds that were put under the microscope, only one had more than 50 per cent of its portfolio in environmental stocks.

For the most part, most funds were populated by the major high street banks and by technology companies like Microsoft. Mining groups, companies involved in oil exploration, airline stocks and fast food giants were also far from uncommon. Indeed, one fund - the Aberdeen Ethical Engagement Fund - included among its top holdings what looked like a Who's Who list of companies targeted by protesters (for example, oil firms Shell and BP, uranium miner Rio Tinto and - bizarrely - British American Tobacco).

The Irish situation appears to be no different. Only one fund - Dolmen's Green Effects fund - is of the 'hard green' variety, populated as it is by wind turbine manufacturers, wholesalers of organic foods and natural products, solar power plants operators and others of this ilk.

The others are a pretty mainstream bunch. New Ireland's Ethical Managed Fund, for example, contains the usual Irish banks, as well as CRH and Ryanair. Many advocates of ethical investing believe that airline stocks in general have no place in SRI portfolios, due to their obvious environmental impact.

Ryanair, in particular, has raised the ire of many critics. British minister Ian Pearson dubbed the firm "the irresponsible face of capitalism" in 2007. Nor is it just on the environmental front that Ryanair has faced criticism. Its treatment of disabled passengers has attracted attention on many occasions, such as forcing customers to pay €18 for the use of a wheelchair.

Ryanair has also been maligned for its trade union policies, hidden charges and alleged misleading advertising.

Bank of Ireland's inclusion might also raise some eyebrows. In 2004, it was embroiled in controversy, when it emerged that it had provided loans to Remnant Media for the purchase of a portfolio of pornographic magazines that included names like Horny Housewives, Mega Boobs and Asian Babes. "We don't moralise," a spokesperson told the Irish Examiner at the time.

Unfortunately for the bank, others do, and it was forced to apologise to customers after a media furore erupted.

The inclusion of such names is no surprise to American environmental campaigner Paul Hawken. Hawken has long been a critic of the SRI industry, writing in 2004 that the industry had "no standards, no definitions and no regulations, other than financial regulations". Hawken's wrath was particularly directed at funds whose "Orwellian logic" dictated that McDonalds be included in its portfolios for its progressive waste management practices.

What's so wrong with McDonald's? For starters, its business model, which is to "entice and lure children with

clowns, toys, and advertisements into a lifetime of junk food consisting of burgers, fries, Coke, and food additives", causes "obesity, heart disease, and type 2 diabetes".

Add in the firm's "union-busting activities", the fact that the "vast majority" of its workers "do not have any benefits" and the "untold damage" it has done to US agriculture by "forcing down costs", and it becomes clear that Hawken will not be scooping up McDonald's shares anytime soon. "If the business model is corrupt, then it hardly matters if a company uses recycled paper or provides daycare."

Hawken's critics counter that they "do not look for the best; we look for the better", to quote Amy Domini, founder of Domini Social Funds and co-founder of the US-based Domini 400 Social Index.

Domini has written that McDonalds should be praised for its "impressive record of responsiveness to our concerns", and that the ethical industry is not about "applying eco-fundamentalism to investments".

Rather, "we are entering the belly of the beast of the financial/corporate juggernaut and we are shaping it".

Domini's inclusive 'best in class' approach mirrors the position taken by the creators of the FTS&EURO;4Good index, Britain's version of the Domini 400. Spokesmen have said that its purpose is not to contain "squeaky clean companies", but to "encourage progress toward greater corporate social responsibility in the business world". True to its word, 2006 saw the FTS&EURO;4Good policy committee declare its "ongoing commitment to remove the negative screens currently employed. . . and replace them with appropriate entry criteria", paving the way for the inclusion of controversial global mining giant RioTinto in 2007.

Hawken told this paper that he's not impressed by such gradualist arguments. " 'For the good of what?' might be the question to ask the FTS&EURO;4Good maker." While ethical fund managers have long protested that financial returns need not be sacrificed, it's unarguable that funds that restrict themselves to a small supply of companies are likely to experience greater volatility and, very possibly, poorer returns. Hawken sees performance concerns as being the "primary driver" of loose screening practices.

"As SRI funds attract more institutional money, they are subject to 'prudent man' rule scrutiny. They are doing everything they can to be acceptable to the broadest possible clientele, and with that, has come dilution of meaning and standards, and an emphasis on comparable returns."

It's a far cry from the early days of the movement. While religious groups like the Quakers raised concerns over unethical investments as far back as the 18th century, the world's first SRI fund was not seen until the launch of the PaxWorld Fund in the US in 1971. Publication in 1972 of the famous photograph of a naked and screaming Vietnamese child as she ran from a napalm attack on her village, her back on fire, galvanised support for ethical advocates, with napalm producer Dow Chemical becoming the first high-profile company to be targeted by demonstrators.

The apartheid regime in South Africa was shunned by investors in the 1970s and 1980s, leading Nelson Mandela to credit the SRI industry for its role in dismantling the system.

In 1984, the Friends Provident Stewardship Unit Trust became the Britain's first ethical fund. Widely-derided at the time, the fund was christened Brazil by derisive city analysts, the reason being that it was only for 'nuts'.

What's clear is that it's a big mistake to think of the ethical industry as some kind of idealistic monolith. Ethical funds are big business today, with the industry controlling over \$2 trillion world wide. There are over 90 different funds in Britain alone, where a recent survey revealed that 85 per cent of investors would consider ethical funds when looking for a suitable venue to park their money.

Like their British counterparts, Irish SRI funds are, for the most part, a middle-of-the-road bunch. Unfortunately, detail is lacking on the websites of many of the main providers.

The popular picture of a typical ethical fund is very much at odds with the reality. Unless investors have really done their homework, it's likely that many have bought into funds whose definition of ethical corporate behaviour is somewhat more elastic than their own.