
NEW YORK STOCK EXCHANG

Social Investors

New Patrons of Community Development

by Kristin Kanders

Corporate responsibility is a serious topic this year, with profiles of impropriety dominating the business news. This attention has bolstered the ranks and resolve of socially responsible investors — those who want to make money while doing good. Groups that promote socially responsible investing are multiplying, investment options are growing, and — of interest to readers of *Communities & Banking* — investors are increasingly directing socially invested money toward community economic development.

At the most basic level, social investors want the same thing as traditional corporate investors: maximum return on investment. But how social investors decide which companies merit investment is what sets them apart. After evaluating a company's financial potential, social investors judge whether the company meets certain social and environmental standards. These standards vary depending on the investor's personal values.

A socially responsible investor, for instance, may screen against companies that profit from tobacco, weaponry, sweatshop labor, or pollution-heavy manufacturing processes. Deceptive accounting practices have also fallen on the watch list of socially conscious investors because of their potential to destroy wealth and mislead the public. On the proactive side, socially responsible investors may seek companies that support employee diversity, a sustainable environment, and community involvement.

Although it is natural to think that restricting the investment field through screens will entail a financial sacrifice, social investors see it otherwise. They believe that social investing often steers investors away from companies likely to face public relations disasters and provides a more rigorous understanding of a company. Christopher Brown, vice president and portfolio manager for Pax World Funds in Portsmouth, NH, notes, "You get a better perspective of what a company is all about when you look at it not just financially, but socially. You get a better sense of management, of how they treat their employees and the environment. A better-run company translates into better financial returns." To support his claim, Brown cites Lipper & Company data ranking Pax Balanced Fund in the top 7 percent of all 5-year-return balanced funds through 2001. (See the sidebar "From Sin Screens to Sustainability" for more on social investing performance.)

Despite their stereotype as tree-huggers, socially responsible investors are of many political persuasions. The provision of same-sex partner health benefits, for example, cuts across political boundaries, with some screening for companies providing benefits and some screening against such companies.

From sin screens. . .

Socially responsible investing is a negotiation between money and morality. In the United States, Quaker settlers were the first to employ the technique, using it to avoid supporting weaponry and slavery. Later religious followers created "sin screens" to avoid connections with alcohol, tobacco, and gambling. Numerous religions today sanction particular mutual funds because of their avoidance of pharmaceuticals (Christian Science), abortion (various Christian denominations), or interest-based lending (Muslims).

Aversion to the Vietnam War, however, unleashed social investing from its religious roots and brought it to the general public. Environmental disasters, such as the 1989 Exxon-Valdez oil spill, drove even more investors to the cause. So did the victory social investors saw when South Africa abandoned its policy of apartheid under pressure from, among others, international investors.

An important development in the social investing story over the past decade has been proof of profitability. Prior to 1990, socially responsible investors lacked a benchmark, such as the S&P 500, to gauge success. The Domini 400 Social Index (DSI 400), a benchmark for socially screened equity portfolios, now fills this deficiency. Other benchmarks, many managed by KLD Research & Analytics, Inc., Boston, provide investors with comparative information on social investments. Since its 1990 inception, the DSI 400 has outperformed the S&P 500, leading many to view socially responsible investing as legitimate investing, not just a sport for the politically correct.

Assets dedicated to social investing have followed suit. According to the Social Investment Forum, socially invested assets grew from $640 billion in 1995 to over $2 trillion in 2001, and roughly 230 U.S. mutual funds employed social screening in 2001. Even during the market downturn from 1999 to 2001, assets in socially screened portfolios grew 1.5 times faster (36 percent growth) than

Various religions invest according to their beliefs.

The Vietnam War unleashed social investing.

When South Africa abandoned apartheid, more social investors emerged.

Along with screening, another hallmark of social investing is the use of shareholder advocacy to promote corporate responsibility. Wielding the power of stockownership, social investors support resolutions to persuade corporate executives of investor priorities. After a nonprofit conservation organization failed to convince Home Depot to stop offering old-growth timber products in 1997, it enlisted the help of Trillium Asset Management, a Boston-based manager of socially responsible investments. As a Home Depot shareholder, Trillium first wrote letters of concern to Home Depot management. When that tactic failed, Trillium informed the company that it would file a proxy resolution to bring the matter before shareholders. This got Home Depot's attention. Talks ensued and so did the proxy resolution — which obtained 11 percent of shareholders' support. Home Depot then committed to phase out all old-growth timber products by 2002.

Philosophy: "You get a better perspective of what a company is all about when you look at it not just financially, but socially."

Other resolutions succeed by attracting media attention and raising public awareness. Many of these campaigns are grounded in concerns

. . . to sustainability

total U.S. assets under professional management (22 percent growth).

Social investing has long made use of negative screening — ruling out investing in a company because of its undesirable activities. Many social investors believe the industry's next step should be to increase its use of positive screening. The premise of positive screening is to seek companies that provide a benefit to society or the environment. A positive screen, for instance, might sift through companies to highlight those that support affordable housing, pollution control, or women in the workplace. Although the range of filters is wide, the focus in positive screening is on "sustainability" for communities and the environment.

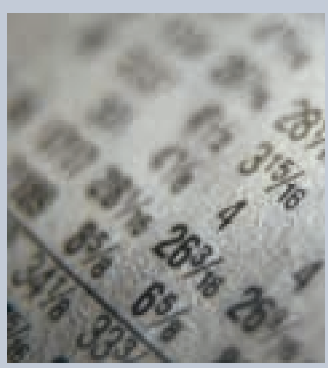
One obstacle to positive screening is that it is fuzzier than negative screening. While a typical negative screen might rule out a company like Phillip Morris for its tobacco reliance, positive screening is more complex. The Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF), one of the nation's largest pension providers, has been grappling with this issue since 1996, and the pressure keeps increasing. TIAA-CREF uses negative screening in some of its funds, but has resisted creating a positively screened fund for feasibility reasons and fears of low financial returns.

Social investment advocates, however, launched "Social Choice for Social Change: Campaign for a New TIAA-CREF" to convince TIAA-CREF of investor interest in positive screening. The campaign, led by Neil Wollman, a professor at Manchester College in Indiana, is in the process of gathering fund pledges among TIAA-CREF clients in support of a potential positive fund. They base their campaign on the results of a 1995 survey of TIAA-CREF's social fund clients which found that over 80 percent wanted positive screening in areas such as community development and low-income housing. Why all the fuss? TIAA-CREF's actions are important to social investors, says Wollman, "because when they do something, others often follow."

Social investors of today seek companies with good workplace practices.

Tobacco remains the most common "No."

With benchmarks, social investors have proof of profitability.



about community stability. During the 2002 annual meeting season, three of the ten shareholder resolutions filed by Responsible Wealth, a project of the Boston-based organization United for a Fair Economy, aimed to link executive pay with reductions in predatory lending practices. At the 2002 annual meeting of Household International, the nation's second largest subprime lender, an anti-predatory resolution won 27 percent of the shareholder vote. Scott Klinger of Responsible Wealth and organizer of the Household campaign, says that Household "refused to discuss" the matter prior to the vote, but that immediately after, it was "much more conciliatory." Household has now opened lines of communication, says Klinger, although it does not acknowledge that it bears responsibility for predatory lending.

The campaigns against predatory lending came about in part, says Fran Teplitz of the Social Investment Forum, a nonprofit trade association, from a desire not to undo the work of community investing. "Community investing is a way to put money into a disadvantaged community – we didn't want it to be stripped out faster," says Teplitz. Although small, community investing is gaining recognition among social investors as a method for direct influence through investing.

Unlike typical socially responsible investments in major corporate stocks such as Microsoft and Coca-Cola, community investing supports community development financial institutions (CDFIs) – organizations such as nonprofit and profit community banks, credit unions, loan funds, and venture capital funds. These investments, often marketed as "high-impact investments," provide financing in credit-needy communities for affordable housing, microenterprises, and small businesses. Risks for community investing vary, as do the rates of return, which generally top out at 5 percent.

The Social Investment Forum and its partner, Co-op America, also a nonprofit advocacy organization, have initiated a "1 Percent in Community" campaign to encourage each social investor to dedicate at least one percent of portfolio funds to community investing. In addition to the work of these umbrella groups, some socially concerned money managers, such as Domini Social Investments, are marketing the benefits of community investing and are even creating new products for it. The appeal, they say, is the large social return.

Many socially responsible mutual funds already invest a small portion of their portfolios in community investing. What's more, large institutional investors may get into the business. Ford Motor Company, for example, has a 401(k) plan that partially invests in socially responsible mutual funds. If those funds include community investing, it could be a significant source of funding. Should these trends continue, community economic development practitioners could see a stable base of financing from a mainstream capital market.

Activism: The campaigns against predatory lending came about in part from a desire not to undo the work of community investing.

Shareholder activism convinced Home Depot to stop selling old-growth timber products.

Starting Small

Community investing has a long way to go before it becomes a significant part of the social investment industry. According to Social Investment Forum's 2001 Trends Report, of the more than $2 trillion in socially responsible portfolios, only about 4 percent, or $8 billion, was in community investments. From the upbeat perspective, however, community investing is growing rapidly – up 41 percent from 1999 to 2001, five times as fast as the whole of socially responsible investing.

Expansion of community investments is limited by several factors, some more easily surmounted than others. For one, community investments typically yield below-market rates of return. For this reason, the Social Investment Forum urges investors to allocate only a small portion of their portfolios to community invesments. In its report, "Increasing Investment in Communities: A Community Investment Guide for Investment Professionals and Institutions," it underscores that "low risk and low return community investments representing just one percent of a client's portfolio . . . will help meet the social impact objectives of that portfolio" while having minimal financial consequences. As the social investment industry has learned by creating benchmarks for socially responsible investments, demonstrating profitability is key to attracting investors. The "1 Percent in Community" campaign recognizes this reality.

As further motivation, the Social Investment Forum argues that by providing community investment options to clients, investment professionals and their institutions will "end up with loyal, high-quality clients" and differentiate themselves "from those who engage in lower-impact forms of responsible investment."

But investment professionals are not clamoring to promote community investments because the investments provide less broker compensation. Richard Glod, an investor associate for Calvert Group, LTD, a $7.8 billion manager of social portfolios, says that this translates into reduced incentive to offer community investment products. He adds that many community investment firms often lack the funds to market their products competitively.

Marketing is necessary because many social investors incorrectly view community investment as a higher risk investment. In actuality, the risks vary tremendously, from secure investing in savings accounts at insured institutions such as Vermont Development Credit Union to higher risk microenterprise and venture capital investing. With certain community investment products, investors may even specify what return they want, ranging from 0 to 5 percent.

Mark Thomsen, research and news director of SRI World Group Inc., believes that investor perceptions will continue to improve as community investing establishes a longer track record. As the field matures, says Thomsen, and as more innovative community investment products are fashioned, more investors will become interested. Developing new products is critical to the field's growth. Currently, there are few examples of community investment instruments that pool funds to then invest in a varierty of CDFIs, and fewer with low investment minimums. Some examples of pooled investments with low investment minimums include Calvert Community Investment Notes and the Domini Social Bond Fund.

Growing Connections

The social investment industry is serving an important role as a bridge between mainstream investors and the CDFI industry. This point is made by Kirsten Moy and Alan Okagaki in their July 2001 *Capital Xchange* article, "Changing Community Markets and Their Implications for Community Development Finance." They note that this is a key role since the CDFI industry still operates on a separate framework from mainstream financial institutions, and, therefore, has had less success in attracting general investors.

Socially responsible investing can be expected to grow as industry leaders prove that it can be both financially and morally satisfying. And, although still small, the community investing segment has the potential to spur significant new investment in CDFIs. A further dividend could come as community investors engage regular investors with the practitioners and different forms of community economic development.

Web Resources

The Social Investment Forum web site, www.socialinvest.org, offers helpful information. It has content and links for shareholder advocacy, www.shareholderaction.org, and community investing, www.communityinvest.org.

The site www.sriworld.com is the home of four web sites that provide information on social investing and corporate responsibility.

Potential: Socially responsible investing can be expected to grow as industry leaders prove that it can be both financially and morally satisfying.