Socially Responsible Investing : Part 2

Investment Options and Pros & Cons

Socially Responsible Investing - is it a worthwhile endeavour? Part 2 of this article looks at some investment options and the pros and cons.

Socially responsible investing is an investment strategy that has been gaining traction in recent years. Many active investors have begun to insist that the companies they invest in make socially responsible choices.

In addition to being good stewards of the environment, these “socially responsible” businesses are expected to treat their employees well, create healthy products and services, and steer clear of unethical or predatory business practices.

In this type of business and the individuals who have a stake in them, investing is not just about turning a profit and growing one’s nest egg. It’s about building and thriving responsibly and sustainably.

What Socially Responsible Investing means…

Socially responsible investing, or SRI, is when you strategically invest in companies that have ethical practices.

The definition is a broad one, as “ethical practices” vary widely based on who is evaluating them. An example of an ethical practice might be the use of green technology, such as solar panels for power in the factories.

A socially responsible fund, for instance, may avoid investing in specific areas, such as tobacco or firearms.

An Introduction to Some Investment Options…

1. Socially Responsible Investing Funds

There are several “classes” of socially responsible investing funds. The first, and most traditional funds are known merely as socially responsible investing funds, and they avoid companies that play in significant areas of controversy such as gambling, firearms, tobacco, alcohol, and even oil.

2. Environment, Social, and Governance Funds

The next class is Environment, Social, and Governance funds (or ERG funds for short).

Where socially responsible investing funds tend to focus on excluding industries that don’t use ethical practices or products, ERG funds concentrate on including ones that do.

There’s a big difference here, because a fund excludes a company that produces a product like tobacco, it doesn’t mean there aren’t some unethical practices in the companies that are included in the fund - it tows the line in some cases.

So ERG funds focus on companies that do function in ethical ways.

3. Impact Funds

Developing on ERG funds are impact funds. These funds are all ERG funds, but place an equal focus on fund performance, whereas an ERG fund may not.

This might mean the company is more aggressive in creating ethical changes with the products and services. An impact fund is an excellent option if you want to be socially responsible, but still, need a stock that performs well.

However, please keep in mind, the more “niche” you get, the fewer the options you have.

4. Faith-Based Funds

Finally, there are faith-based funds, which only invest in stocks that follow Christian, Catholic, or Islamic values. Any company that doesn’t fit this category will be excluded from the fund - and it’s pretty strict.

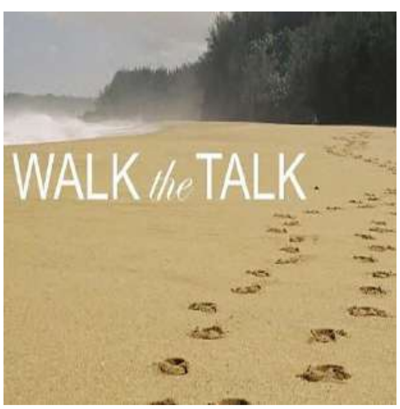
The Pros and Cons of Socially Responsible Investing

The Pros…

Often, when you see someone taking the SRI strategy route, it tends to be all-or-nothing.

That is to say, people either fill their portfolio entirely with “socially responsible” stocks and funds, or don’t put a targeted focus on them at all. Here are some of the benefits of employing a socially responsible investment strategy:

1. You’re Talking the Talk and Walking the Walk.



If your values are important to you, then socially responsible investing allows you to put your money where your mouth is, so to say.

It’s hard to insist you’re a committed environmentalist if part of your portfolio is invested in companies or industries that are destroying the environment.

By investing in socially responsible businesses you’re doing more than talking the talk, you’re walking the walk–with your money.

2. You're Taking a Stand.

When you commit to socially responsible investing, it's an opportunity to withhold your investment money from businesses that are not behaving in a way you feel comfortable with.

Now, this is strictly a theory, but if you're standing for a cause, it might motivate you. It's the same reason people protest and stand up for purposes that may face insurmountable odds. But if nobody took a stand, no changes would ever happen.

Like all causes, it takes a snowball effect of people getting on board to make a change.

Just last year, James Kynge of Financial Times said that "although ESG is still evolving as a concept, the pull it exerts over investors appears to be reaching critical mass." It is safe to assume that company executives keen to maintain shareholders' support, (and increasing stock price) are also taking notice when making business strategy decisions.

Ethical Investing is growing in popularity - which means more and more people are focused on investing in companies that are doing the right thing.

3. You're Rewarding Ethical Companies.

It may seem like it's being done on a small scale, but socially responsible investing punishes companies that act unethically, and it also rewards companies that are doing the right thing.

If you want companies to make more responsible choices, you have to support them in the most tangible way possible, which is through investment capital.

The more people who begin to invest in socially responsible companies, the more rewards those companies will see. Long-term, this could be a catalyst for significant social change. A perfect example of this is Lego, who ended their partnership with Shell Oil a few years ago and are now partnering with organisations like the World Wildlife Foundation on social initiatives.

The Cons…

Socially Responsible Investing isn't all sunshine, rainbows, and solar panels.

While socially responsible investing offers plenty of benefits, there are drawbacks as well. Here are a few cons:

1. Ethics Might Become More Important Than Performance.

You've probably considered this point by now. When you limit your investment options and potentially pay more to invest in companies that practice social and ethical responsibility, you may give up a little of your return on investment.

Let's not forget the point of investing in the first place - obtaining the highest return on investment possible within your tolerance to risk.

When socially responsible investing becomes the primary objective, the financial side of the equation may suffer somewhat - at least part of the time.

There is some data to validate this, but most of it is opinion.

2. You May be Leaving a Lot of Great Investments on the Table.

If you focus solely on socially responsible stocks and funds, you could be leaving strong investments out of your portfolio.

Let's say there's a new investment opportunity that has below average performance regarding social responsibility, but a history of creating innovative products and services that improve lives and generate jobs. If you pass on this attractive investment opportunity because of the social responsibility factor, you may lose out.

3. Many Companies Claim to be Socially Responsible, but they aren't.

Putting a marketing spin on anything for sale is part of a modern business culture.

In many cases, it's more important to craft the image of being socially responsible than to actually be socially responsible.

As the saying goes, it's not the truth, but what the people believe that counts.

With the right marketing campaign, people will believe nearly anything.

Volkswagen is an excellent example of this. Their commercials and general image portray social responsibility. For a long time, they put a hefty amount of marketing into their "clean diesel" cars - marketing them as safer for the environment. Sadly, their 'green credentials' apparently only applied during standard emissions tests.

As you are probably aware, this led to a scandal which later began to unravel VW's image of being an ethical company. Even recently, Audi (owned by Volkswagen) CEO Rupert Stadler resigned amid criminal investigations related to the scandal.

The lesson here is that just because a company says it's socially or ethically responsible, doesn't mean it is.

There is a further consideration. Many large listed companies doing great things in the new(ish) world of social responsibility and ethics, may also be involved in less than ethical issues too.

For example, a company producing sophisticated medical electronics for equipment such as MRI scanners, (probably a good thing), may also use the same technology in military equipment (probably not so good).

Waste recycling companies would fall into the list of 'socially responsible' , but not if part of their business is to export waste for sorting by 10 year old children in Indonesia.

An oil company, having made its profits for the last 80 years by producing hydrocarbon fuels may be diversifying into wind power. Does an investor buy the stock to support the company's change to cleaner energy production; or not buy, because of it's history of producing oil?

In Conclusion…

At the end of the day the ultimate choice of whether to take the Socially Responsible Investing route - either partially or totally - lands with yourself. It is worth considering, however, the reality that it is not easy to find the definitive solution, as so much depends on your own personal focus and opinion.

Only you can make these decisions, but if you do decide that this is the way forward then I am happy to guide you through the process of making the right investment choices that will help you sleep better at night, knowing that your investments are helping the world become a better place.