ETHICAL INVESTMENT AND ECOLOGICAL CITIZENSHIP

By

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Workshop 5: Citizenship and the Environment

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ETHICAL INVESTMENT

The current debate about environmental or ecological citizenship has focused on why it is necessary and what its distinctive features might be. However, there has been relatively little work on the practical forms that ecological citizenship might take. This paper examines whether the concept of ecological citizenship makes sense when applied to the increasingly popular practice of ethical investment.

Ethical investment, or socially responsible investment (SRI), is a broad term for a range of investment activities that aim to influence companies to adopt responsible policies that benefit society and the environment. In recent years ethical investment has boomed as both the number and variety of new ethical products, such as socially responsible, environmental and sustainable mutual funds, have grown rapidly throughout Europe, North America and Australasia. The creation of specialist ethical investment teams by many of the leading fund managers, backed up by new ethical investment financial indices such as the FTSE4Good and the Dow Jones Sustainability Index, demonstrates that ethical investment is very much part of the financial mainstream. Millions of citizens, either directly as individual investors or indirectly via pension funds, are now engaged in ethical investment, which accounts for assets worth billions of pounds.

Ethical investment has also indirectly received official support from the political establishment. The scope to invest ethically relies on company reporting of environmental, social and ethical policies and behaviour, commonly grouped under the term Corporate Social Responsibility (CSR). The European Commission has published a Green Paper on CSR (European Commission 2001) and several countries, including Germany, Sweden and the UK, have introduced CSR requirements into recent financial or pensions legislation. The UK now has a minister responsible for CSR matters. In short, ethical investment and CSR are politically fashionable.

Not surprisingly, the ethical investment phenomenon has attracted considerable academic interest from economics, accountancy, and business and management studies, whilst rarely a week passes without at least one special section on ethical investment in the personal finance pages of the weekend press. By contrast, there has been very little interest from academic politics. Yet ethical investment raises several fascinating questions that resonate right across the discipline from political philosophy to policy studies. For example, ethical investment offers a fascinating laboratory for applied ethics, for it implies that individuals are prepared to place ethical concerns, such as a desire to protect the planet from pollution, above financial returns in their personal investment choices. Indeed, by suggesting that non-monetary altruistic considerations might influence personal financial decisions, ethical investment poses interesting questions about the self-interested, utility-maximising assumptions of the rational economic individual that underpins rational choice theory. Alternatively, from an environmental policy perspective, ethical investment could be regarded as an example of ecological modernisation, which is a policy strategy aiming to restructure capitalist political economy along more ecologically sustainable lines (Mol and Sonnenfeld 2000). For ethical investment involves individuals using market mechanisms to influence businesses, encouraged by light touch government interventions, or governance, that appear to work with the grain of business sentiment. However, perhaps the most interesting question, not least because it encompasses elements of all the above concerns, is whether ethical investment can be regarded as an example of ecological citizenship?

If it is the case that individuals engage in ethical investment because they believe it to be the right thing to do, rather than because there is any financial incentive to do so (indeed,
there may be a financial cost from doing it), then that implies that individuals are acting in a way that is consistent with the broad notion of citizenship. More specifically, there seems to be a good case for regarding ethical investment as a form of what Dobson (2003) calls ‘ecological citizenship’. According to Dobson, ecological citizenship is a particular form of post-cosmopolitan citizenship, which stresses responsibilities rather than rights, and regards those responsibilities as non-reciprocal rather than contractual, thereby contrasting with traditional liberal and civic republican notions of citizenship obligations (Ibid: p.139). Dobson (Ibid: ch.3) distinguishes four defining characteristics of ecological citizenship. First, it is non-territorial. Conventional notions of citizenship are firmly located within the nation state, but because many environmental problems are international and do not respect national boundaries, ecological citizens have to operate both within and beyond the nation state. Secondly, it takes place in both the public and the private realms. Citizenship is traditionally concerned with the way individuals behave in the public sphere, but the private acts associated with our day-to-day lifestyles have public implications (by contributing to environmental degradation), so ecological citizenship activity must also encompass the private realm. Thirdly, ecological citizenship is associated with a range of virtues that enable citizens to meet their obligations; in particular, social justice is needed to ensure a just distribution of ecological space, and care (and compassion) is required for the effective exercise of justice. Fourthly, ecological citizenship involves a range of non-contractual responsibilities, notably an obligation to ensure that ecological footprints have a sustainable impact, that are owed to strangers near and far (including future generations), but without any expectation that they will be reciprocated.

The grounds for regarding ethical investment as a form of 'ecological citizenship' are that it seems to share all of these defining characteristics. Ethical investment is non-territorial in the sense that investment activities and their implications are not necessarily confined to a single nation state. Ethical investment is concerned with the private activities of individuals - the way they spend their personal finances - which have an impact on the public realm. A wide range of citizen virtues is implied by the act of ethical investment most notably a wish to secure greater social and environmental justice, but also an expression of care and compassion about disadvantaged people and the state of the environment. Lastly, by engaging in ethical investment, individuals are expressing non-contractual responsibilities and duties towards strangers living either elsewhere in the world or who are not even be born yet, but from whom they neither demand nor expect any specific response. In this paper we use these four characteristics as a framework for assessing the extent to which ethical investment can be regarded as a particular form of ecological citizenship.

Of course, there are obvious objections to regarding ethical investment as a form of 'ecological citizenship'. Is it appropriate to equate the rather narrow act of consumerism (for ethical investment involves the purchase of particular investment products in the market place) with the broader and fundamentally different concept of citizenship? Moreover, if citizenship is to be an inclusive activity, then a further problem with ethical investment is that it is an exclusive activity, which is confined to the wealthy minority, even in relatively affluent industrialised nations. But the most fundamental objection must be that any engagement in the market essentially legitimates the capitalist system, by failing to challenge the logic of capital accumulation, the pursuit of profit or, crucially, the patterns of consumption that underpin the capitalist market. However, notwithstanding the force of these objections, in this paper it is assumed that the aim of ecological citizenship is to achieve some form of sustainable development. As sustainable development is a policy paradigm predicated on reforming capitalism, rather than overthrowing it, and open to using market mechanisms as
an instrument of change, then it seems unreasonable to rule out on principle the possibility that ethical investment could represent one example of ecological citizenship.

To answer the main research question – whether the activity of ethical investment can be regarded as ecological citizenship - the paper addresses a range of sub-questions. How important is ethical investment? Who are the actors involved in ethical investment, and what forms does it take? How do ethical investors choose where to make their investments? Would they be prepared to invest ethically even if they make a financial loss relative to a conventional alternative investment decision, or will they only invest ethically as long as it is not costing them financially? It is important here to introduce the key actor on the other side of the equation: business. Why should companies be interested in ethical investment? To what extent and why do companies engage with CSR? How does their engagement affect ethical investment? Can ethical investment change the behaviour of companies and, if so, is it possible to regard companies as ecological citizens? The focus of the paper is on ethical investment in the UK, although reference will be made to experiences elsewhere in Europe and in the USA.

**Ethical Investment: Too Big to Ignore?**

In recent years ethical investment has grown rapidly in many advanced industrialised nations, although there is some disagreement over the precise size and value of this sector. The main vehicle of ethical investment is the screened mutual fund, which assesses and invests in companies. The number of green, social and ethical mutual funds has increased steadily in the USA from 139 in 1997 to 200 mutual funds in 2003 (US Social Investment Forum, 2003), and in Europe from 159 between 1995-1999, to 313 in June 2003. Two thirds of the European funds were located in just four countries - the UK, Sweden, France and Belgium - although the fastest growth was in Italy where the number of ethical funds had doubled in 18 months from 10 to 21. With just under 21 per cent of the total, the UK's 62 ethical funds represented the largest national share and there were almost half a million ethical unit trust holders in the UK (Bartolomeo et al 2003).

The total value of European ethical funds was 12.2 billion euro in 2003, slightly down from 14.5 billion euro in 2001 due to the stock market collapse (Bartolomeo et al 2003). In the UK, there was an estimated £4.2 billion in ethical unit trusts in 2003. In the USA, total assets rose from $136 billion in 2001 to $151 billion in 2003 (US Social Investment Forum, 2003). However, some estimates of SRI funding produce much larger figures, for example, the UK Social Investment Forum put the UK figure at £224.5 billion (See Table 1).

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SRI Unit Trusts</strong></td>
<td>2.2</td>
<td>3.1</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>Pension Funds</strong></td>
<td>0.0</td>
<td>25.0</td>
<td>80.0</td>
</tr>
<tr>
<td><strong>Insurance Companies</strong></td>
<td>0.0</td>
<td>0.0</td>
<td>103.0</td>
</tr>
<tr>
<td><strong>Churches and Charities</strong></td>
<td>20.5</td>
<td>24.0</td>
<td>38.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>22.7</td>
<td>52.1</td>
<td>224.5</td>
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</table>

Source: UKSIF (2003a)

This larger figure reflects the spread of ethical investment principles across pension and insurance funds. A key trigger for the shift in the former was the introduction of new regulations for pensions in July 2000. An amendment to the Pensions Act 1995 requires pension funds to state ‘the extent (if at all) to which social, environmental or ethical
considerations are taken into account in the selection, retention and realisation of investments’. However, to date, the Universities Superannuation Scheme (USS), the occupational fund for university lecturers, which was the third largest UK pension fund in 2002 with around £20 billion assets, is one of the few to have even adopted an ethical investment strategy. Nonetheless many pension funds across Europe have begun to adopt ethical investment principles, including Europe's largest pension fund, the ABP for Dutch civil servants. In Sweden, the AP-7 fund - the default fund for Swedish nationals who do not make a specific choice of pension provider - dropped 28 companies from its portfolio for poor human rights or environmental practices.

To summarise, there has been significant and rapid growth in ethical investment in recent years. As it has grown, it has become increasingly mainstream, with at least half of all fund managers now offering ethical investment funds and several large occupational pension and life insurance mutual funds adopting ethical investment principles. As government legislation increasingly imposes CSR requirements on companies, the potential for further growth in ethical investment seems undiminished. However, this expansion must be placed in context; for the amount of assets governed by ethical investment remains, in relative terms, very small. The £4 billion held by individuals in UK ethical unit trusts in 2001 represented just under 2 per cent of the total £229.9 billion in individually-owned shares. Indeed, by far the biggest group owning shares were institutional investors, which collectively owned 50 per cent of UK (see Table 2) – a figure that further underlines the potential importance of the recent spread of ethical investment principles amongst pension funds and insurance companies.

Table 2: Share Ownership in the UK (31 December 2001)

<table>
<thead>
<tr>
<th>% of total equity owned</th>
<th>£ billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK Institutional Investors</td>
<td></td>
</tr>
<tr>
<td>Insurance Companies</td>
<td>20.0</td>
</tr>
<tr>
<td>Pension Funds</td>
<td>16.1</td>
</tr>
<tr>
<td>Unit &amp; Investment Trusts</td>
<td>4.0</td>
</tr>
<tr>
<td>Other Financial Companies</td>
<td>9.9</td>
</tr>
<tr>
<td>UK Individual Investors</td>
<td>14.8</td>
</tr>
<tr>
<td>Overseas Investors</td>
<td>31.9</td>
</tr>
<tr>
<td>Other Investors</td>
<td>3.3</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: UKSIF (2003a)

Moreover, as we shall see, whilst an increasing amount of assets are invested according to some form of ethical investment principles, it is not clear what impact, if any, it is having on company behaviour? Before answering that question it is first necessary to be clear what ethical investment is and what forms it takes.

**Forms of Ethical Investment**

Ethical investment encompasses a wide range of investment activities that aim to influence companies to adopt responsible policies that benefit society and the environment. Before discussing the various forms of ethical investment, the cast of actors involved in ethical investment needs to be introduced.
The major actors in the ethical investment process are individual investors, businesses and, playing a crucial intermediary role, the fund managers who use the financial resources of the former to influence the behaviour of the latter. Typically, ethical funds are set up and managed by specialist teams within investment companies alongside a range of conventional funds. Some investment companies have simply treated ethical investment rather like any other specialised investment ‘theme’– (such as technology, emerging markets or property) and have done no more than establish an ethical fund within their portfolio of funds. Others, such as Insight, Jupiter and Morley, have deliberately sought to develop a strong ethical fund arm to their business; for example, Morley Fund Management has established six ‘Sustainable Funds’ offering an ethical version of several conventional investment themes (UK Growth, European Growth, Absolute Growth, Global Growth, Managed, Corporate Bonds). With the recent shift of pension and life insurance mutual funds into ethical investment, where the trustees choose not to manage the fund in-house, there are significant opportunities for the specialist ethical fund managers to win valuable contracts to run these large accounts. Two further important actors in the ethical investment process are governments and non-governmental organisations (NGOs). As noted above, several national governments have introduced new pension and corporate legislation encouraging CSR disclosure, which has contributed significantly to the recent spread of ethical investment principles amongst pension and life insurance funds. In recent years, many NGOs have run campaigns encouraging the active engagement of their members with major corporations. It is also important to note that there are also many proponents of ethical investment in the financial and business community. Financial institutions have collectively devised ethical investment indices, such as FTSE4Good and the Dow Jones Sustainability Index, while some individual institutions have played a leading role, such as the Co-operative Bank in the UK which has steadily adopted a wide-ranging, inclusive ethical policy in all its activities and – consistent with the long tradition of co-operative education – has played a critical proselytising role publishing reports and funding initiatives.

Ethical investment criteria for selecting companies for investment can take various forms, but the basic types are: negative screening, positive screening and engagement. **Negative screening** is the oldest, most established, form of ethical investment. It involves investors refusing to invest in companies whose activities contravene their beliefs, such as producing tobacco, operating nuclear power stations, dealing in the arms trade or engaging in environmentally damaging activities. Ethical funds simply apply a 'passive' screen that excludes all such companies from the 'ethical' portfolio. One drawback of negative screening for the individual investor is that the subjective nature of ethics means that a fund may cast a large ethical net that excludes activities to which many potential ethical investors do not object. Thus many well-established ethical funds screen out gambling and alcohol related activities, reflecting their strong Quaker and Methodist roots, but an environmentalist may have no objection in principle to these activities. Furthermore, a strict screening strategy will produce a narrow portfolio, which increases the likelihood of the fund under-performing the wider market, as illustrated by the disproportionate hit that many ethical funds suffered due to their high weighting in technology stocks when the technology boom collapsed in 2000. The most 'principled' funds, such as 'dark green' funds, tend to employ negative screening, but investors often pay for their principles by having to accept lower financial returns.

**Positive screening** aims to prevent financial underperformance by selecting companies with the best environmental or social performance. This 'best-in-sector' strategy means that very few sectors are entirely excluded from a portfolio, which should make a fund less likely to under-perform the market. Thus an ethical fund will still invest in a multinational oil
company, but it will, say, select from those that are investing serious money into developing renewable energy sources. Furthermore, in the environmental context, this approach is informed by an ecological modernisation strategy, which assumes that companies with a good environmental record will outperform their competitors either due to the cost savings associated with improving eco-efficiency (including reduced fines for infringing environmental regulations), or by being first to enter new markets in cleaner, green technologies. In short, investing in environmentally progressive companies should also represent a sound business proposition (O'Rourke 2003: 685). The success of best-in-sector strategies will depend partly on how far environmental criteria enable ethical fund managers to pick out 'undervalued' companies, perhaps by identifying companies likely to benefit from new environmental trends such as the switch to renewable energy, more effectively than rival managers of conventional funds.

In practice, many funds combine positive and negative approaches; they may exclude a few stocks where there is a general consensus that they should not form any part of an ethical portfolio (such as tobacco production or human rights abuses), and then use positive screens to seek socially responsible sectoral 'winners'. Nonetheless there will still be certain increased risk in the portfolio due to the exclusion of some sectors.

One solution to this problem is the third form of ethical investment, active engagement, or ‘positive action’, whereby investors use their rights as shareholders to ‘engage’ companies in constructive dialogue to encourage them to improve their CSR performance. Engagement can take several forms, ranging from informal meetings with management to voting or even tabling critical resolutions at company annual general meetings (AGMs). One advantage of a pure engagement strategy is the absence of screening, which ensures that ethical fund portfolios are as broad-based as any conventional fund, thereby minimising potential under-performance. Several British-based fund managers now pursue active engagement. Friends Ivory Sime, for example, have set up a unit to pursue their ‘Responsible Engagement Overlay’ strategy that aims to encourage companies to adopt best practice on social, environmental and other ethical issues. Morley Fund Managers have adopted a voting policy that requires FTSE100 companies to publish environmental reports and 'to have robust processes to minimise damaging environmental impacts'; failure to comply will lead Morley to vote against accepting the annual report. Henderson Global Investors apply a similar policy across what looks to be a wider range of issues: environment, human rights, employee relations and community relations. Similarly, Fortis Investments, a European-wide fund manager, recently announced it would vote down the reports and accounts of any European company that did not match its CSR disclosure standards (Financial Times 29 March 2004).

Several NGOs have pursued engagement strategies in recent years. Interestingly, environmental groups such as Friends of the Earth and Greenpeace, which in their earlier, more radical days, would have rejected the very idea of constructive dialogue with the business community (Carter 2001: Ch.6), have pursued particularly active engagement. Friends of the Earth purchased £30,000 of Balfour Beatty shares in order to table a challenging resolution at its May 2001 AGM. A Greenpeace initiative, Shareholders Against New Oil Exploration (SANE BP), involves a range of international and national NGOs using AGMs and other forms of shareholder lobbying to pressure BP to shift away from oil exploration towards developing renewable energy. The most concerted efforts have been carried out on behalf of the Pensions and Investment Research Consultants (PIRC), an institutional shareholder lobby group, including opposition to peat extraction by Fisons, third world debt and the banking sector and on social and environmental lobbying by Shell.
If the primary aim of ethical investment is to promote better corporate social, ethical and environmental practice, the different forms of ethical investment represent contrasting approaches to achieving this aim. Negative screening applies a clear set of standards to corporate behaviour, leaving businesses in little doubt about what they have to do to become acceptable. One problem is that strict negative screening simply excludes several sectors completely, leaving little incentive for businesses in those sectors to change. So negative screening may fulfil one subsidiary aim of ethical investment, which is to enable ethically concerned individuals to invest their personal wealth in a way that is consistent with their strongly held values (even if it requires them to make a financial sacrifice), but as long as this group of investors remains numerically small, then negative screening will probably exert little impact on corporate behaviour. Both positive screening and engagement are arguably more ‘market savvy’. On the one hand, they recognise that many ethical investors want a good financial return on their outlay, and that narrow forms of negative screening make it difficult for fund managers and mutual fund trustees to perform well against conventional financial indicators. On the other hand, the more positive approaches, especially if they attract larger funds, may have more chance of influencing businesses either by setting up ‘best-in-sector’ standards of good practice or by directly lobbying business to change its ways. Of course, the critical question is whether these approaches do, in practice, influence corporate behaviour? But first we look at the individuals who are engaged in ethical investment to find out whether they are acting as ecological citizens and, if so, why do they do it?

Why do Individuals Ethically Invest?

To determine whether individual ethical investors are ecological citizens it is important to understand who they are and what motivates them. To answer this question we draw on data from the most thorough academic survey of ethical investors to date, which secured 1146 respondents (a 32% response rate) recruited from ethical investors with Friends Provident and NPI, two leading UK ethical unit trusts (Lewis and Mackenzie, 2000; Lewis 2002).

The distinguishing features of ethical investors are not age or income, but their value systems and lifestyles. Like most investors, they are middle aged and middle class, but ethical investors are found more frequently in caring professions (notably health and education), and they are more frequently religious, active in pressure groups and supportive of liberal and green political stances. Thus ethical investment seems to be part of a particular kind of lifestyle that is based on a set of values which, with the possible exception of the strong religious beliefs, is typical of the postmaterialist, new middle class that emerged in the 1960s and 1970s (Carter 2001, pp. 86-91). Indeed, many of today’s ethical investors are clearly the middle aged and respectable remnants of that earlier radical generation.

Ethical investors are, as Lewis (2002, p. 60) puts it, both ‘saints and sinners’: 80 per cent held a ‘morally-mixed’ portfolio containing both ethical and ordinary investments. Many ethical investors believed that they were making a financial sacrifice: 42 per cent believed their ethical investments generated a lower return than ordinary investments, and 19 per cent regarded their ethical investments as ‘riskier’ (although 14 per cent believed they produced a higher return). However, many of those individuals who did believe they were taking a financial hit by investing in ethical products, were prepared to do so. Based on a set of hypothetical questions to ascertain the elasticity of demand for ethical products, the survey found that 80 per cent of respondents would stay loyal to their ethical investment even if they were performing 20 per cent below ordinary investments, and 56 per cent would do so even if the ethical funds were 50 per cent lower. The willingness to accept financial loss was similar no matter how large or small the proportion of ethical investments in an individual’s portfolio,
which Lewis (2002, p.75) suggests is evidence that the proportion invested ethically can be taken as a proxy measure of moral commitment.\(^4\)

This willingness to make a financial sacrifice in pursuit of personal values seems to be a clear example of the fourth characteristic of ecological citizenship – a non-contractual (and non-reciprocal) responsibility towards strangers near and far. The main issues that motivated ethical investors – nuclear power, ozone-layer degradation, the Third World, armament production and animal testing – are all consistent with the sustainability and eco-footprinting agendas that underpin ecological citizenship, and, specifically, they imply that individuals are expressing the virtues of social justice and compassion identified in the third characteristic of ecological citizenship. Indeed, the more strongly these views were held, the more willing individuals were to stick with ethical investments, even when they perform badly.

**Company Potential to Engage with CSR**

As we have seen, although ethical investments only represent a small percentage of the market share, they continue to grow. Given the increasing importance placed on social, environmental and ethical concerns in the investment decisions made by institutional fund managers, they might be expected to exert a substantial influence in encouraging companies to move towards more ethical behaviour through engaging with CSR. There is already some evidence to suggest that listing on ethical indices does matter to companies (RPS Group plc, Press Release July 2001). However, some companies are likely to find it easier than others to attract ethical investors by taking on CSR.

There are a growing number of companies for which social and environmental considerations are of prime concern. These include, for example, renewable energy producers and suppliers (such as the wind turbine manufacturer, Ecotricity); organic agricultural growers; and fair trade producers (such as Café Direct). Companies in this category, appealing to a niche market, usually have goals of social and environmental responsibility embedded in their company policies. Other businesses whose aims are less determinedly green in nature nevertheless are directly dependent on the quality of the environment in which they operate. Water and forestry businesses, for example, have operating costs that can be substantially lower where abstracted water needs less treatment to make it safe to drink, or where tree growth is uninhibited by polluted air or soils. Some companies are able to use social and environmental issues productively in marketing and communications with little additional cost or effort. These are generally characterised by businesses in the financial or banking sector. The Co-operative bank, for example, has long been at the forefront of promotion of CSR and has been joined more recently, by Triodos Bank, which only lends money to socially responsible enterprises, such as the Ethical Property Company.

Where production processes or products inevitably have negative environmental impacts, however, it can be more difficult for companies to meet criteria for environmental, if not social, responsibility. Quarrying, mining and road building fall into this category, as well as more obvious candidates, such as fossil fuel producers, chemical and agrochemical industries and manufacturers of motor vehicles, refrigerators and processed foods. These companies face inherent tensions between meeting the demands of the market for their goods and the demands of environmental responsibility. However, as we have seen, the criteria used to identify companies for inclusion in SRI portfolios are varied and the use of a ‘best in class’ approach can allow the inclusion of companies making efforts to improve their environmental and social performance as well as those that are already ethically sound.
Why do Companies Engage with CSR?

There are several reasons why companies might engage with CSR, but the arguments tend to overlap and are not easy to disentangle. In this section we try to distinguish them by outlining the business, ethical and government cases.

The business case

The potential advantages likely to accrue to companies as result of taking CSR seriously have been well documented (Havemann & Webster, 1999; Kemp, 2001; CIS, 2002; Christie, 2003). The argument goes that the costs of engaging with the wider social and environmental impacts of a company’s activities are matched or even outweighed by the potential this brings to compete more successfully in the market place and increase profits.

A business with a strong reputation for CSR will benefit from consumer trust and loyalty, increasing demand for its goods and services and avoiding costs stemming from consumer boycotts, environmental campaigns and liability claims. It will be in a position to attract and retain better recruits to its workforce and its good employee relations will reduce risks related to disputes and industrial action. The long term perspectives that CSR demands of company strategy and planning will encourage innovative developments that enable the company to secure ‘first mover’ advantage in new markets. It will be better placed to argue a case for self-regulation and voluntary monitoring and reporting, thus enabling it to pre-empt any expanded rules governing disclosure and avoid any restrictive impacts of government intervention and legislation. Care taken to reduce materials and energy consumption in line with environmental protection policies will result in savings through increased resource productivity. And, of course, its enhanced social, environmental and ethical reputation will attract ethical investors. Other investors may also be attracted, recognising the benefits of risk reduction in long-term consideration of environmental factors and seeing concern for CSR as an indicator of general good management. Many of these arguments are recognised in the European Commission Green Paper on CSR (European Commission 2001).

The business case is clearly based on the principles of ecological modernisation for, theoretically, if it delivers its promised benefits then all concerned are winners - businesses, investors and the environment. Companies finding their profitability increased by CSR will attract more investment through the added value this provides for shareholders. The latter in turn may encourage companies to improve their environmental, social and ethical strategies still further, resulting in a positive feedback loop (Figure 1). The figure distinguishes between cost-free or profitable investment as ‘quasi-ethical’ in contrast to ‘real’ ethical investment which involves an acceptance of lower financial returns (Cullis et al., 1992).\(^5\)
However, in practice, the empirical evidence for the higher returns of ethical compared to other funds is mixed. Havemann and Webster (1999) studied the performance of 15 UK unit trusts and found that, while some did relatively well, returns on average were somewhat lower than those for other funds with similar geographical focus. Bauer et al. (2002) analysed the investment style and performance of 103 UK, US and German ethical mutual funds, controlling for size, book-to-market and stock price momentum. Their findings identify a possible ‘learning effect’ as recently launched ethical funds at first trail behind their conventional peers but do eventually catch up. Overall their research corroborates previous studies showing little difference in performance between ethical and conventional types of fund (Luther, 1992; Hamilton et al., 1993; Diltz, 1995; Guerard, 1997; Kurts, 1997; Spiller, 2000). While investment in CSR companies does not necessarily lead to lower returns, higher returns are by no means guaranteed.

Basing arguments for CSR on the business case has been criticised for prioritising economic concerns over real concern for environmental and social matters (Christie, 2003). But a very practical danger in relying on the business case is that any failure of moves towards CSR to produce its promised financial rewards may lead to a general loss of confidence in the whole notion. It appears that some companies, failing to see immediate benefits, are already resisting the CSR trend, providing disclosure of their environmental, social and ethical performance at the minimum levels required by government legislation (WRI, 2003). The European Commission (2001) recognises the implications for ethical investment as increasing demands for more, and more varied, information on environmental and social performance impose increasing costs on companies, leading to a risk of aversion to and non-co-operation with, CSR legislation.
A further danger from failure of the business case is that many investors may exit from the market or at least reduce their levels of support for CSR. According to EIRIS (2003), a 1999 survey showed that 77 per cent of pension scheme members were in favour of their funds following ethical criteria if their financial returns were not reduced. In the event that financial returns are reduced, or not increased, the positive feedback loop described above may become reversed, leading to marginalisation or rejection of CSR (Figure 2).

Thus there are problems with the business case on its own terms, but even if it does work, if businesses are motivated by the business case alone then they look more like ecological modernisers than ecological citizens.

Figure 2: The negative feedback effect on CSR when it fails to enhance shareholder value.

**The Ethical Case**

Companies might, of course, engage with CSR for reasons other than purely financial ones. If they do so, this could act to mitigate the negative impacts on CSR of the short term or temporary failure of the business case.

Tuppen and Porritt (2003) suggest that an ethical case for sustainable development through CSR underlies ‘even the strongest business case’ (p.9). Their argument is based on the principles of intra- and inter-generational equity, environmental justice and obligations of stewardship. Since ethical values frame and underlie the attitudes and behaviour of individuals, they claim, ‘by extension’ they also do so for companies. However, the rationale for this argument is rather vague, not least the assertion that such values also apply to companies. Moreover, whilst the principles of equity and social justice are examples of the virtues referred to in the third characteristic of ecological citizenship, the notion of an obligation of stewardship seems to fall outside the fourth characteristic of non-reciprocal responsibilities.

Christie (2003) also supports the ethical case, arguing for the need for companies to respect universal needs and rights. However, as Christie points out, it can be difficult to formulate an ethical case when CSR arguments are framed largely in terms of a hard
commercial model of corporate goals. Ethical concerns do not translate readily into practical business language. While there is some evidence that some individual pension scheme members, for example, would prefer their schemes to invest ethically even if this meant accepting lower returns (Havemann and Webster, 1999), it is harder to see how companies might be persuaded by the ethical case alone. In practical terms, the problem is how to move beyond the business to the ethical case for CSR, encouraging companies to take environmental and social responsibility for their actions without any necessary financial benefit and possibly with added costs; in short, to behave as ecological citizens.

Business, Society and Government

At the core of the dilemma is the question of the role business should play in society. Indeed, Husted and Allen (2000) recognise that ‘social and ethics-based strategies provide new and exciting opportunities to reconceptualize the role of the firm in society’ (p29). The Tuppen and Porritt (2003) argument presupposes a stakeholder model in which companies’ rights to trade carry responsibilities to the global communities in which they operate (see Hutton, 2001). If international agreements have been reached on certain values and principles (such as sustainable development and CSR), then it is incumbent upon businesses to conform to them. However, such a view is far from universal. Henderson (2001), for example, draws on Friedman’s (1962) shareholder model of capitalism to argue that the only role of business is to make profits and increase value to shareholders. The adoption of CSR, he suggests, will increase costs and impair efficiency, ultimately limiting competition and reducing financial performance.

It could be argued that the market alone cannot adequately balance the costs and benefits to businesses of taking on board social and environmental concerns. Public policy at national, regional or international level may be needed to help ensure that business activities have fewer detrimental effects on society and the environment. There may be a role for government in information provision, regulation and radical fiscal change to ensure that businesses can benefit from engagement with these concerns. Certainly the recent flurry of activity – speeches, committees, reports – on the part of the UK government suggests that these ideas are being taken seriously, notably in the response of the Department of Work and Pensions (Horack, 2003) to the Myners Report (Myners, 2001) which, among other things, led to the launching of a voluntary code on shareholder activism in 2002. However, the jury is out on whether this rhetorical enthusiasm will translate into any real change.

The role of government may go further than simply reinforcing the business case. Tuppen and Porritt (2003) argue that it is through government that the ethical case should be promoted through its influence on expectations and values. Kaler (2000) and Solomon et al. (2002) both identify government, together with the interacting influences of campaigning groups and public opinion, as a principal source of pressure for ethical behaviour in business. Fox et al. (2002) go even further, elaborating on more than 30 kinds of role that public sector agencies can play in strengthening the development of CSR.

Criticisms of CSR from a different direction are based on the idea that it has no real impact other than to give companies a superficial cloak of respectability. It has been described as a dangerous PR exercise, a vehicle for opposing regulation (Pendleton, 2004; Bendell et al., 2004) and a label that, as Stefan Stern has observed, is ‘worn like a halo’ by ‘plaster saints’ (The Guardian 19 January 2004). If CSR is to have any real impact on social and
environmental conditions then it needs to be based on changing attitudes and values rather than simply on economic performance.

**Changing company behaviour?**

Even if we suppose that improving the CSR performance of businesses does lead to improvements in social and environmental conditions, the question arises as to whether ethical investment actually works to enhance CSR. Does the prospect of being selected by ethical funds for investment or for inclusion in ethical indices have any influence on how companies behave? Some commentators have suggested that while consumer demand (including demand for ethical investment) may act as a driver of CSR in high-income countries, there is little evidence that it does so in less affluent parts of the world (Fox et al., 2002).

The influence of investment could operate through a number of routes: by investment patterns leading to change indirectly through the passive signals they give to the market, and by shareholder action and engagement with companies encouraging active change. The potential for these effects can be examined in the case of both individual and institutional investment.

However, the evidence to date is inconclusive and there are wide ranging views about the likelihood that real change will be effected. Lewis (2002), using interviews and focus groups, found that individual ethical investors do believe that they are having an effect, either indirectly (changing the culture of society) or (sometimes) directly on share prices (p.152-3), or, as Lewis puts it, they ‘feel part of a movement which can change markets in the long run’ (p. 98). In a survey of 250 retail investors, Burke (2002) found that 48 per cent of respondents believed that ethical investment could influence company behaviour.

By contrast, it is significant that interviews with seven financial advisors revealed a different, more sceptical, picture. Five of those interviewed did not think that ethical investment had any impact on business behaviour.

The potential for the institutional investors to effect change is greater given their dominance in the market (See Table 2). Pension funds in the UK, for example, were worth £1,100 billion in 2003 and represented 10.3 members of occupational pension schemes and 11 million personal pension holders (EIRIS, 2003). Investment choices made by pension funds will clearly produce passive market signals but even more influence may be possible if institutional shareholders also take positive action to engage with companies. There are signs that some investors are working collaboratively to influence companies through active engagement (UKSIF, 2003b).

A survey of 130 UK pension fund trustees found that 42 per cent thought that investor activism could improve the way that companies manage their social and environmental impacts within 10 years (Gribben and Faruk, 2004). Individuals, acting as ecological citizens, can also play a role here. EIRIS (2003) argues that if more pension scheme members question their funds about ethical investment, they can reinforce its importance. NGOs have begun to exploit this opportunity for individual engagement. An Amnesty International campaign – ‘Pensions, Protecting your Future’ - aims to mobilise pension fund members to lobby trustees to ensure that their fund takes account of human rights issues. War on Want's 'Invest in Freedom' campaign similarly encourages pension funds to pressure multinational companies to act on a range of poverty-related issues. But there is a long way to go. An EIRIS survey of the top 250 UK occupational pension funds (by capital value) achieved a response rate of only 28 per cent. However, while 90 per cent of the 70 respondents said that they did consider...
social, environmental and ethical issues in their investment decisions, only 77 per cent had consulted their members about incorporating these into their investment strategies.

Solomon et al. (2002) see the power of institutional investors as making ethical investment crucial for the growth of CSR and, by implication, for social and environmental protection and improvement. They note an increasing incidence of shareholder action through exercise of formal voting rights and through one-to-one meetings between investors and companies as reflecting an increasing potential to influence corporate strategy. However, they also point to the problems posed for fund trustees stemming from perceived conflicts between their fiduciary duties to provide stable returns to shareholders, keeping the potential for portfolio diversification and the need to influence companies’ CSR performance. The fact that shareholder return is seen by many as the primary driver for institutional investors lends added weight to the arguments of those who see the business case for ethical investment as the only way forward.

A further problem arises where fund trustees lack expertise or training in CSR matters, often leading to the transfer of responsibility for ethical investment to fund managers. Following the revision to the Pensions Act in 2000 (see above), UKSIF surveyed the 500 biggest pension funds. The response rate was 34 per cent and, of these, 27 per cent left all ethical investment decisions to their fund managers while 14 per cent still took no account of the issues at all (Environmental Data Services Report 310, November 2000). The EIRIS (2003) survey found that while three quarters of the funds in their survey (see above) said they engaged with firms on social, environmental and ethical issues, only a half of fund managers had training on how to incorporate these into investment strategies. The Environmental Data Services Report 341 (June 2003) quotes the Director of Investor Responsibility of Insight Investment as claiming that few fund managers have sufficient understanding of the issues and that many only consider them in the short term, for example where regulation, litigation or reputation are involved. The majority of respondents in the Gribben and Faruk (2004) survey believed that ‘additional regulation or legislation is needed to require all pension fund trustees to receive investment training incorporating social, ethical and environmental issues’ (p3). Other barriers to shareholder engagement are a lack of disclosure or poor standards of information provided by companies, and difficulties in creating and maintaining a coalition of interests between shareholders who may have very different agendas (Burke, 2002).7

On a more positive note, the Advisory Committee for FTSE4Good argues that the index’s prestige value makes it a positive driver for company improvement and that its existence has led to better disclosure of company information. When the UK’s largest supermarket chain, Tesco, was excluded from the index following its launch in 2001, the fall in the company’s share value lasted for only a few days (Environmental Data Services Report 339, April 2003). Nevertheless, Tesco is now back in, implying that the company has actually changed or that it is now disclosing more information.

Responses to decisions about inclusion in ethical indices may be based on reputational risks that conform more to the business case for CSR than to the demands of ecological citizenship. However, the influences of finance and ethics on companies’ CSR developments are no easier to disentangle than they are on investment decisions. A survey of 891 pension fund trustees by Solomon et al. (2002) used a Likert scale to assess respondents’ agreement or disagreement with a number of possible motivations for the development of ethical investment policies. The response rate was low (10%) but there was strong disagreement with the idea that the interests of fund managers, demand from active or retired fund members or religious beliefs of the public played an influential role. Opinions on the impacts of NAPF
actions, EU legislation, the social dimension of EU membership and the interests of fund trustees were more divided but still largely negative. The only influences for which majority agreement was expressed were the impact of environmental and social lobby groups, an increasing interest in CSR in society in general, the power relationships of political parties and the effects of companies seeking to improve their reputations and corporate identity. This latter source of influence might be seen as a response to the other three and points to a need for a better understanding of the motivations of companies in moving towards CSR.

However, it is clear that the scrutiny of institutional investors is, at the very least, having some annoyance value in the corporate world. Businesses refer to the syndrome of ‘questionnaire fatigue’ resulting from the deluge of SRI questionnaires they are sent (Financial Times 26 March 2004). A survey of 33 firms controlling £480 billion of assets showed that active engagement is increasing, with fund managers holding regular and more frequent meetings with the companies in which they invest their funds (Investment Management Association, 2004). Indeed, elements of the business community have become so disgruntled by this growing interference, particularly after a series of AGMs where institutional investors have voted against huge pay increases for company executives, that ‘peace talks’ were recently held in London between the two ‘sides’ (Financial Times 29 March 2004).

MacPherson (1998) used qualitative analysis to explore the complex relationships between personal and social values and attitudes, corporate culture, regulation and financial aspects of environmental decision-making in companies in Hong Kong. In the UK, Jenkins and Hines (2003) identify similar factors influencing company involvement in CSR, categorising these as personal values, stakeholder management, risk management, employees, consumer pressure and financial performance. Attempting to quantify the relative importance of these motivating factors they surveyed 800 top UK companies. Although the response rates were again very low (4%) the findings reinforce the views of pension fund trustees, suggesting that ethical imperatives play little part and that more important to companies is the need to protect or improve business reputations. If we are to be able to decide whether or not companies that attempt to attract ethical investors are acting in some sense as corporate ecological citizens, more research is needed to help understand the balance between the business case and the ethical case for their actions.

**Discussion**

The relationship between ethical investment and CSR is potentially a recursive one. Without CSR and associated information about its effectiveness, neither individuals nor institutions would be able to make investments that meet their ethical demands. From this point of view, CSR can be regarded as a necessary driver for ethical investment. On the other hand, the growth in ethical investment might be a driver for CSR if it continues to the point where it makes a substantial contribution to the capital assets of companies. At present, however, ethical investment still only accounts for a small proportion of the total investment market and there is little evidence that it has much direct financial influence on company behaviour.

It is possible though that companies will be pushed to concern themselves with CSR as a result of the increasing active engagement demanded by individual and institutional shareholders. The combined effect of changing public awareness and attitudes, pressures from social and environmental NGOs and government regulation and legislation, is to make companies more susceptible to business risks related to their social and environmental
reputations. Improvements in CSR performance that occur in response to these risks are still then dependent on the business case, in line with the idea of ecological modernisation. Yet we have seen in this paper that a major flaw in the business case is its instability and dependence on short to mid-term financial reward, which suggests that the development of long-term social and environmental sustainability requires a shift in business attitudes towards a recognition of the ethical case described earlier. The difficulty in producing such a shift is formidable but it is here that notions of ecological citizenship may prove useful.

We have seen above how individual ethical investors display elements of Dobson’s (2003) ecological citizenship. The very nature of investment means it meets the non-territoriality condition, except in those few cases where investment is geographically localised. Ethical investors clearly recognise that their private acts have public implications both in terms of their own impact on environmental and social conditions and in their expectations that their investment choices will affect those conditions for other people, in other places and at other times. Their ethical investment, at least if we leave aside varying requirements that it will bring financial shareholder benefits, reflects their commitment to those people and places harmed by their lifestyles and behaviour, now and in the future. And, in making investments according to ethical principles, the investors display virtues of ecological citizenship – the care and compassion implicit in their quest for social and environmental justice.

It is harder to claim that institutional investors are acting as ecological citizens, not least because their decisions (even when they ‘consider’ social and environmental factors) tend to be dominated by their fiduciary duties. Under the shareholder model of capitalism, companies too are dominated by the drive to make profits and increase shareholder value. It is debatable whether or not companies might ever be regarded as corporate ecological citizens in the fullest sense. However, the idea of ecological citizenship may have some practical relevance in providing a means of strengthening the ethical case for persuading companies to change their CSR behaviour. Current constructions of the ethical case stress obligations of stewardship and universal needs and rights. The argument is that companies should behave responsibly towards society and the environment simply because it is somehow ‘right’ to do so. It is hardly surprising that few hard-edged, practical business people appear to have been convinced by the case as it is currently framed.

The idea of ecological citizenship offers a rather different framework in which to couch the argument for CSR. It relies less on the claim that companies have a general responsibility to everyone and everywhere, and more on the clear-cut notion that they have a citizenship commitment to those people and places that have suffered (or might suffer in future) as a result of their activities. This non-contractual responsibility of citizenship is already implicit in some government laws and regulations and is made explicit in the definition of CSR used by the Department of Trade and Industry in the UK.

‘A responsible organisation does three things:

1. It recognises that its activities have a wider impact on the society in which it operates;
2. In response, it takes account of the economic, social, environmental and human rights impacts of its activities across the world; and
3. It seeks to achieve benefits by working in partnership with other groups and organisations.’

(DTI, 2002: p7. Our emphases.)

The ecological citizenship case for CSR does not necessarily require that we view companies as corporate citizens in the sense that they conform to all of the Dobson (2003) characteristics. Its effects may operate indirectly through its resonances for key company personnel and
government policy-makers, and by strengthening the arguments of social and environmental NGOs. But, by whatever means it operates, the case formulated in terms of ecological citizenship would appear to have more potential than the ‘pure’ ethical case for changing company behaviour.

However, even if companies remain unconvinced by the ethical and citizenship arguments, they can still play a vital role in nurturing individual ecological citizenship. For changes in company behaviour that improve both environmental and social conditions are also the aim of individual ethical investors. If individual investors, acting as ecological citizens, influence company behaviour for the better then do the motivations of funds or companies actually matter? Where the responsibilities of ecological citizenship are taken on by companies only as a result of legislation or regulation, because of lobby group pressure, or for business reasons, then we cannot properly regard the companies as behaving like corporate environmental citizens. Nevertheless, they are playing a critical enabling role by making possible the demonstration of ecological citizenship by individual ethical investors.

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1 This paper uses the term ethical investment as it is still widely known as in the UK. However, SRI is gaining wider international currency; indeed, some definitions of SRI incorporate ethical investment as one, narrow, form of passive investment (e.g. CIS 2003).

2 The US Social Investment Forum (2003) claimed that an extraordinary $2.14 trillion was invested in US screened funds in 2003 (or2?), but this figure is based on a very broad (and loose?) definition of SRI.

3 See Burke (2002) for further examples of PIRC engagement.

4 In interviews Lewis (2002) found that ethical investors display different attitudes to different types of money. Where money has been inherited and is located in ‘ordinary’ investments, it tends to be left untouched, but when money has been self-earned it is more likely to be invested ethically. He also found a strong motive to bequeath to one’s family. In short, he found that ‘moral and financial compromises are commonplace where individuals are neither maximising their financial return nor their ethics’ (p.89-90).

5 Lewis (2002, p.60) prefers the terms ‘committed’ and ‘pragmatic’ ethical investors.

6 Over a quarter of the sample can be regarded as ‘real’ ethical investors who were prepared to take some financial loss. The fact that more than 10 per cent said they would be prepared to lose more than £200 on investments of £5000 over five years is described as demonstrating a ‘moral pull’ towards ethical investment.

7 We have not dealt with the issue of social and environmental accounting or disclosure fully in this paper, although WRI (2003) sees the scope and quality of information available to potential investors as the key determinant of how, if at all, ethical investment will affect corporate governance.
References


