

The ethical side of investment

Many investors are following their consciences

and buying "ethical" shares.

Even though their returns might be modest,



While the central concern of most investors is the financial return on their money, there are others to whom the nature of the investment is as important as the reward. "Ethical investment" (known in some countries as "social investment") is a relatively recent phenomenon in Australia, with most of the vehicles being less than a decade old. But it is likely—if the experience of Europe and especially the United States is a guide—that the sector will continue to grow in both size and diversity.

Ethical investment can be defined as an investment which is made with social, as well as financial, goals. Much ethical investment is conducted on a "negative" basis, with funds being directed not so much towards favoured investments as *away from* certain companies or industries held to be undesirable. For example, ethical investors or institutions might refuse to put their funds into companies which participate in the weapons industry, or have links to the South African government (this was an especially high-profile cause during the late 1980s), or engage in animal testing, or are involved in the wood-chipping industry, or are involved in the production and sale of alcohol and cigarettes.

In the past few years, however, some vehicles have developed with a

more "positive" focus, aimed at investing funds in "good works" (such as environmental protection and wildlife conservation) in line with the values of the individuals who provide the funds. Of course, a "positive" attitude towards certain investments goes hand-in-hand with a negative attitude towards others.

In the United States, the definition of ethical investment, especially that carried on by pension funds, has become very wide. In a recent book (*Power and Accountability*, Harper Business, 1991), A.G.R. Monks and N. Minow argue that fund beneficiaries "don't just want to retire on a comfortable income; they want to retire into a world where they can breathe the air and drink the water, where the economy is safe, and criminals go to jail."

This points to activism by institutional shareholders on a large number of fronts, although it leaves the question of how to ensure that the actions of fund managers reflect the values of the fund contributors and beneficiaries. In Australia, the small scale of the ethical investment industry has so far meant that such questions do not need to be asked, let alone answered.

Nearly all ethical investment by individuals takes place through specialist intermediaries. While it is open to individuals to choose their investments directly (at least those in

Derek Parker suggests

that more thorough

analysis would show that

ethical investments

warrant a higher status.

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listed companies), it appears that not many of those with ethical concerns do so. They often see the stockmarket as dangerously volatile, according to some investment advisers.

In the trusts area, the main vehicles are the August Investments Managed Trust and the YWCA Ethical Investment Trust (one of the oldest and largest ethical investment entities). The ANA Housing Co-operative Ethical Investment Bond and the Australian Conservation Society/Over 50s Friendly Society deal in bonds, while the Friends Provident Life Assurance Company offers a superannuation bond, ordinary insurance bond, and a growth trust.

The Mercator Master Superannuation Plan (also known as the Earthrise Investment Pool) is aimed at individuals investing or rolling over superannuation payouts. It was recently acquired by Global Funds Management Vic Ltd, the manager of the YWCA Ethical Investment Trust.

There are also smaller local vehicles which aim to promote ethical regional development. These include the Macaulay Community Local Investment Fund Ltd, the Macaulay Community Credit Cooperative, the North Coast Ethical Credit Union, the Bellingen District Loan Fund, the ACT Local Investment Fund, the Fitzroy and Carlton Community Credit Co-operative Ltd, and the Maleny and District Community Credit Union.

Aside from vehicles like these, there are financial advice firms which specialise in ethical investment, such as Ethinvest and Ethical Financial Planners. A Sydney-based body called Action for World Development provides information kits and other material on ethical investment.

Another type of investment which might be classed as ethical is that undertaken by religious bodies, especially the Uniting Church and the Catholic Church. The churches are, in fact, by far the largest ethical investors, with total investments of about \$200 million. However, they are often excluded from the ethical investment sector on the basis that they are not open to the general investing public.

All ethical investment institutions have a charter or code as part of the Articles of Association, which details

the sort of investments that they will and will not make. Clearly, the nature of the institution has to be made clear to investors, so that the investors can make an informed decision.

Likewise, a fund that does not publicise itself as an ethical investor cannot begin to undertake ethical investment if it reasonably believes doing so will diminish the financial returns. This point is illustrated by the case of Arthur Scargill, who was not only president of Britain's radical National Union of Miners but also chairman of the union's pension fund. In the latter capacity, he directed investment funds away from certain firms or industries which, for example, were in competition with coal, or which operated in South Africa. Because of this, the return on the fund decreased. A number of beneficiaries sued and won.

By and large, individuals who undertake ethical investment through intermediaries seem willing to accept lower returns, which they presumably see as balanced by the inner glow of doing good works. Nevertheless, most advisers in the ethical investment field will direct only a small amount of a client's money to ethical firms.

The problem, stated bluntly, is that there are simply not enough firms whose activities are sufficiently ethical—at least in the terms of ethical investors. Nearly any large firm, if scrutinised carefully enough, can be shown to be "unethical": BHP steel is used in warships, the Coles-Myer chain sells cigarettes, the large banks are unaccountable to customers, and so on.

Concentrating investment in only a few "acceptable" companies (if defined in a narrow way) would lead to a dangerously unbalanced portfolio, so in practice the definition of "ethical" tends to be somewhat elastic. In many cases it seems to be a relative, rather than absolute, measure.

A further problem for ethical investors is that non-bank financial institutions are obliged to hold part of their assets in highly liquid form. This usually means placing funds on the short-term money market—and there is no way to determine the ultimate users of these funds.

The notion that ethical investors are willing to accept a lower financial

return raises a key point: is it intrinsic to such investments in Australia that they produce lower returns than ordinary portfolios? A good deal of empirical evidence points this way (it should be noted, however, that no rigorous analysis has been done to compare ethical and other investment returns).

This evidence does not indicate that intermediaries for ethical investment are necessarily poorly managed. The research firm ASSIRT last year ranked 35 managed trusts for 1990/91: August Investment Managed Trusts was ranked ninth and the YWCA Ethical Investment Trust eleventh.

Significantly, large institutional investors in Australia, such as the superannuation funds, have not tried to enter the field by setting up separate ethical funds. This is a different pattern from that in the United States, where the pension fund sector has a very significant involvement in ethical investment. It is thought that in the US funds worth about \$A520 billion are managed according to ethical considerations. Monks and Minow discuss some evidence—albeit not without its flaws—that the returns on ethical investments need not be significantly lower than other investments.

There is only one case of a large fund establishing a separate fund for ethical investment. In 1990, the Occidental Life Insurance Co launched its Environmental Opportunities Fund. The new fund was frozen in the following year as a result of its parent's difficulties.

The relatively small size of the sector in Australia, and consequently its low public profile, is a major restraint on growth. Indeed, it is difficult to establish accurately the size of the sector.

Excluding the churches, the total amount of funds managed according to ethical considerations is probably around \$25 million. The sector is growing but only slowly—perhaps at about \$1 million a year of managed funds. A lack of public awareness about the opportunities for ethical investment limits the growth opportunities for ethical intermediaries, which in turn cannot engage in advertising campaigns to promote themselves and their products.

Yet there is some evidence of unmet demand in the sector. An important exception to the small size/low awareness pattern can be found in one of the most interesting and recent of the ethical investment vehicles: the Australian Conservation Foundation Green Bond.

Launched in June 1991, the Green Bonds are to date a cooperative venture between the Victorian government, the ACF, and the Over 50s Friendly Society. The investment begins with the purchase of a single-premium life insurance bond from the Over 50s Friendly Society; the society then uses those funds to purchase 10-year government-backed securities, at the going rate of interest, on behalf of the individual investors. The government has accepted a condition from the ACF and the Over 50s Friendly Society that the money would ultimately be used in projects determined as suitably "green" by the ACF.

The "Priority Victoria" statement made by the premier, Joan Kirner, in May 1992 detailed the first projects flowing from the Green Bonds. The

government plans to use the funds—about \$1 million—to acquire land to protect penguin rookeries on Phillip Island, install a sprinkler system in the Melbourne Botanical Gardens, and build two "environmentally friendly" demonstration homes (these projects having been approved by the ACF).

Clearly, the individual investors involved could have simply bought government securities directly and gained a higher return than that offered by the Green Bonds (as the return would not involve administrative charges). But, if they did so, there would be no way for them to direct their money into particular projects.

The most significant point regarding the Green Bonds was that the initial issue was substantially oversubscribed. This may indicate that a crucial factor in the slow growth of the ethical investment sector is not lack of public interest, but lack of public knowledge. The Green Bonds had the advantage of being marketed through the ACF—an institution with a

high public profile, good credibility among important sections of the community and the media, and access to a ready market of potential investors through its own membership.

In some respects, the surprise is not that the ACF has moved into the ethical investment field, but that it has been slow to do so. The marketing of the Green Bond may be the harbinger of the future, as existing environmental and similar bodies move to capitalise on their reputations among the faithful. It remains to be seen, however, whether ethical investment can break through into the financial mainstream.

The key to widespread acceptability of ethical investment seems to be the attitude of the large investment institutions, particularly the superannuation funds. Just as they have started to target women as a previously untapped market, they might find that there is a younger, more socially conscious audience which can be won through an appeal to its values as well as its wallet. ■

Banks: giving us what we deserve

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regard is Westpac, with its May 1992 profit-release producing an NTA per share more in line with the share price. The market would say: "I told you so."

Do banks get credit for their disclosure? No, not much, although it is worth noting that the ANZ Bank, closely followed by NAB, has just been judged in London by Lafferty Publications Ltd (a major financial publisher) to have the best annual report, following a survey of the annual reports of the world's major banks.

In fact, Australia as a whole, thanks to its major banks, ranked in the survey ahead of the US, which has tended to be held up by our financial press as the benchmark of excellence in reporting.

Although the major banks (and the Reserve Bank of Australia) have incurred the wrath of the community and the politicians for the lending excesses of the 1980s, they should be given due recognition for the hugely

improved quality of their present financial reporting—even if one Sydney-based bank has had to come into line recently on provisioning. Anyone who does not accept that should simply compare the published accounts of any of the major banks in, say, 1974-75 or 1982-83 with those in 1990.

That's the past and the present. What about the future? Clearly, the clock is not going to be turned back in terms of the level of information disclosed in the financial statements of banks.

Nonetheless there are some who would argue that the old concept of profit-smoothing and of letting only the regulator (and hopefully the board and auditors) know the full condition of the bank, was not necessarily such a bad practice.

The reality is that in a deregulated financial environment, the ability of a regulator to maintain public confidence in the financial system is more at risk. The emphasis in future, therefore, has to be on increasing still

further the quality and timeliness of financial and management reporting. For banks, this means never losing sight of some elementary principles:

- levels of capital and liquidity must be appropriate to the risks being undertaken by that bank (the Bank for International Settlements must continue to take a leadership role in developing international policy in these areas, in particular capital);
- the earnings stream must be capable of maintaining capital levels, rewarding shareholders and, most important, funding provisions for doubtful debts;
- boards, auditors, management and regulators must recognise that prudence and best practice should be the watchwords of everybody involved in the banking industry; and
- banks (and other deposit-taking institutions) must acknowledge that at the end of the day they exist only by the grace of their depositors, not their shareholders—and that in difficult economic times that grace can be extremely fickle. ■