

# Capitalism's Trojan Horse: Social Investment and Anti-Free Market NGOs

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According to its advocates, social investing (also known as socially responsible investing (SRI) or ethical investing (EI) is a fast growing phenomenon that represents 'nearly one out of eight dollars under professional management in the United States' and similar percentages in Britain and Australia. Although those investment estimates are wildly exaggerated, the disruptive impact of what is essentially an anti-free market movement with ideological roots shared with anti-business NGOs is real and growing.

The central tenet of SRI is that investors can follow their hearts and political whims and make a killing on the stock market at the same time. In the words of the umbrella group for the liberal wing of social investing, the Social Investment Forum, clients can 'invest for their own futures and a better world at the same time'<sup>1</sup> by avoiding companies that are overtly linked to defense spending, global warming, genetically modified organisms, tobacco, nuclear energy and other litmus issues that are the favorite subjects of NGO hysteria. Truisms of SRI include the embrace of the romantic, anti-science wing of environmentalism, rigid pacificism, animal rights on a par with human rights, and vague notions of social justice that are well beyond the influence of corporations.

So-called 'good' companies allegedly perform better financially and on the stock exchanges. These are mostly smaller corporations that emerged out of the Sixties counterculture and sell commodities like toothpaste, yogurt, ice cream and shampoo at premium prices - companies like Tom's of Maine, Ben & Jerry's Stonyfield Farms, and The Body Shop. They are distinguished by 'good intentions' and their eagerness to make grand pronouncements in support of 'sustainability,' 'human rights,' and 'diversity' - vague principles that no one opposes in theory. The irony is that SRI superstars are often neither progressive nor particularly ethical. Many SRI icons are authoritarian, intensely anti-union entrepreneurs who built their business models on social marketing rather than providing quality products or services at reasonable prices. For the most part, their workers are in dead-end jobs and paid near-minimum wage. The two most celebrated ethical superstar corporations, Body Shop and Ben & Jerry's, are notorious for being operationally dysfunctional and poster companies for exploiting consumer idealism.<sup>2</sup>

Set against the good guys is the rest of the business world - Corporate America. Multinationals are led by executive desperadoes ascribed the most selfish of motivations: a desire to grow their companies by selling desirable products or services. Black hat corporations manufacture weapons (which helped topple Saddam Hussein and the Taliban);

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<sup>1</sup> Gravitz, A. 2002. News Release: 2002 SRI Trends Report. [www.socialinvest.org](http://www.socialinvest.org) 1.

<sup>2</sup> Entine, J. 1994. 'Shattered Image: Is The Body Shop Too Good to Be True?' *Business Ethics*, 8(5): 23-28.

Entine, J. 1995b. 'Rain-forest Chic.' *Toronto Globe and Mail Report on Business Magazine*, 12(4): 40+. Entine, J. 1999. 'The Odwalla Affair—Reassessing Corporate Social Responsibility.' *At Work*, 8(1): 7-11.

develop energy (for transportation, industry, and electricity for second homes in Aspen and Nantucket for these liberal money managers); or the worst of all offenses, develop consumer products or medicines using ingredients tested on animals according to international standards to ensure safety and efficacy for humans.

As an illustration of this anti-business, illiberal sensibility, and the unholy alliance of NGOs and social investors, consider the recent widely circulated letter written by an influential social investment manager.

Corporate governance reform, voluntary codes and watered-down SEC regulations are placebos. It is time that we in the SRI [Socially Responsible Investment] community join together with environmentalists, anti-war, labor and human rights activists, public interest lawyers and social investors to coordinate corporate campaigns to seriously challenge corporate management. We need targeted shareholder resolutions, litigation, mass mailings, demonstrations, legislation, boycotts, citizen referendums and coordinated political action to save our global community.

Shades of 1984! According to the prevailing social investment *Zeitgeist*, corporations are greedy control freaks out to squeeze society. This is paranoia laced with demagoguery. ‘We expect corporations to act irresponsibly,’ writes Peter Kinder, the president of Kinder Lydenberg Domini (KLD), the premier research organization for the social investment community, in a similar vein. ‘Why? Because corporations have as their explicit purpose the insulation of management and employees and shareholders from responsibility for their actions.’<sup>3</sup>

Despite its dedicated anti-business ideology, the social investment movement and self-proclaimed ‘socially responsible’ businesses are widely portrayed, and as a result viewed by much of the public, as not only benign but also beneficial honest brokers of stakeholder dialogue and a force for corporate reform. Perhaps because many reporters come from the same ideological and social milieu, the media by and large give social investing a free pass or worse: they echo the anti-free market biases of many social investing leaders.

Reasonable people should be concerned about the growing influence of the social investment community, and its emerging partnership with NGOs, many of whom share a knee jerk demonization of corporations and free markets. Its leaders are products of the activist community; yet, they are different and more dangerous. While activist groups have long existed as corporate gadflies, whose political views were more or less openly stated and argued, the leaders of the social investment movement are a more insidious breed. They constitute capitalism’s Trojan horse. Although they purport to support free markets, and in fact attempt to make money playing the world’s stock markets, they are anti-business and interventionist by conceit. While they purport to want to soften the edges of capitalism, their actions are designed to undermine it.

To cite one example of how this synergy works in practice, the Rainforest Action Network, a San Francisco-based environmental group, initiated a campaign against Citigroup about three

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<sup>3</sup> Kinder, P. 1997. Email to Social Investment Forum Mailing List. November 13.

years ago, blaming the bank for rainforest destruction, climate change, and the disruption of the lives of indigenous peoples. The NGO launched a worldwide campaign, accusing it of 'banking on' global warming and forest destruction. It teamed with social investment research groups like KLD and Calvert, which have Citigroup on its taboo list of investments because of such controversies. Clearly, this one issue will not bring a multi-faceted company such as Citigroup to its knees. But it is more than just a mere annoyance; it is reputation management hell. Moreover, collective attacks on corporations in general feed a growing anti-American, anti-West sentiment in certain countries. On the defensive, and before its 2003 annual meeting, Citigroup opened a dialogue with Rainforest Action Network, which planned to introduce shareholder proposals attacking the company's environmental policies. In June 2003, Citibank was among ten banks from seven countries that announced their adoption of the Equator Principles, a voluntary set of guidelines for promoting social and environmental responsibility in financing development projects, especially in emerging markets.

Corporations and governments that embrace or even engage this new breed of stakeholder activist, either out of intimidation or misplaced idealism, do so at their own peril. The activist wing of the social investment community, by and large, is out to destabilize free markets in the name of promoting their agenda. Take them at their word: they view global corporations as the implacable enemy. Social investing is a mutant new iteration of the NGO octopus - and perhaps the most insidious.

### **The Legacy of Religious-Inspired Social Screens**

Social screening has its origins in conservative religious principles. The first known consumer screens date to the 18th century, when Quakers withdrew their business from companies involved in alcohol, tobacco or gambling – so-called sinful behavior. The Quakers also incorporated what is believed to be the first issue-specific screen resulting in boycotts of companies tied to the slave trade.<sup>4</sup> In what is believed to be the first externally screened US investment, the Pioneer Fund in 1928 incorporated these negative screens, excluding companies involved in tobacco or alcohol.<sup>5</sup>

The social activism of the 1960s spurred the development of additional negative screens based on overtly political sentiments. In 1968, a pension fund in Boston asked a young securities analyst, Alice Tepper Marlin, to compile a 'peace portfolio' of corporations with the least involvement in supplying armaments for the war in Vietnam. Hundreds of church and community groups asked for her report. The Interfaith Center on Corporate Responsibility, composed of hundreds of religious members from varying faiths, was formed in 1971. That same year, a Methodist group launched the Pax World Fund, which included a negative screen on military contracting along with alcohol and gambling.

The 1970s and 1980s witnessed the blossoming of a concurrent movement known as green or ethical consumerism. Self-appointed watchdog organizations such as the Council on Economic Priorities (CEP), founded by Tepper Marlin, began rating companies on a variety

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<sup>4</sup> For an historical overview, see Domini, A. 2001. *Socially Responsible Investing : Making a Difference and Making Money*. Chicago: Dearborn Trade Publishing. Waddock, S. 2000. 'Performance Characteristics of Social and Traditional Investments.' *Journal of Investing*, 9(2): 27-38. Hutton, B., D'Antonio, L. and T. Johnsen, 1998. 'Socially Responsible Investing.' *Business & Society*, 37(3): 281-304.

<sup>5</sup> See SocialFunds.com; <http://www.socialfunds.com/media/index.cgi/screening.htm>

of social issues including animal rights, nuclear energy, homosexual and feminist issues. In the spirit of the times, many activist consumer groups criticized ‘multinational’ corporations often using the pejorative ‘Corporate America.’ In contrast, entrepreneurial businesses such as Ben & Jerry’s and The Body Shop, although beset by ethical and operational problems, were often romanticized as ‘socially responsible,’ in part because their founders’ anti-corporate rhetoric.<sup>6</sup> The stated goals of most green consumer groups was not to encourage stakeholder-centric behavior, as generally understood by academicians and practitioners, but to promote pet social causes and ‘shop for a better world’ (as reflected in the CEP guidebook series ‘Shopping for a Better World’). Many of social investing’s most prominent researchers, including Steven Lydenberg, a principal at KLD, cut their eyeteeth as researchers at ideologically-charged CEP.

These two essentially anti-corporate currents – socially conservative ‘sin’ notions promoted by religious-based mutual funds and the vaguely liberal, consumerist brand of Sixties activist ideology – coalesced during the 1980s to form the core of what is today called social investing. The catalyzing event was the boycott of apartheid South Africa, which further politicized corporate critics and tapped into the sentiments of newly affluent baby boomers sympathetic to a ‘green’ romantic, anti-corporate pitch. Portfolio management firms such as Franklin Research and Development (now Trillium Asset Management) and social investment research companies such as KLD and Calvert were formed. By the late 1980s, socio-religious screens conflated with populist, but shifting activist concerns, to form the hodgepodge that today constitutes the principles of the liberal wing of social investing.

### **Fungible Standards of Social Investing**

Social investing research has attracted widespread interest among academicians who have been struggling for years to find reliable and objective ways to measure corporate social responsibility (CSR). All social research rating systems rely to some degree on perceptual measures, often translated into numerical rankings. In part, because it evaluates thousands of companies including all of the corporations in the S&P 500, the database launched by KLD in 1990 has emerged as a popular and favorite academic benchmark. KLD originally established eight categories, later expanded to ten, constructed around negative or exclusionary screens: nuclear power, alcohol, gambling, tobacco, and military contracting, with other negative attributes such as insensitivity to homosexuals swept into an ‘other’ category.<sup>7</sup> Companies that fail this initial sin screen are designated as not socially responsible and summarily excluded from various KLD social indices. After sweeping for negative concerns, KLD then evaluates companies in qualitative areas such as community relations, workforce diversity, employee relations, environment, non-US operations, and product safety. Using a process of data collection, analysis, and ranking that it does not explain in detail, KLD staffers assign numerical ratings for each company in each category, which become the basis for its hierarchical rankings. The highest rated companies are included in one or another index, including the Domini Social Index 400 (DSI), which is explicitly tied to KLD’s research. Launched in May 1990, the DSI was the first benchmark for equity portfolios subject to multiple social screens and today remains the most prominent.

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<sup>6</sup> Entine, 1995. ‘Rain-forest Chic’. *Toronto Globe and Mail Report on Business Magazine*, 12(4), 40+.

<sup>7</sup> See [www.kld.com/benchmarks/BMSImthd.html](http://www.kld.com/benchmarks/BMSImthd.html)

Many corporate social performance (CSP) researchers<sup>8</sup> including its most fervent advocates<sup>9</sup> have pointed out the methodological and conceptual problems of linking CSP research to social investment data.<sup>10</sup> Although there is general agreement that CSP is a multidimensional construct, there is no agreed standard or theoretical rationale or way to aggregate and therefore compare multiple dimensions across or within industries. Rowley And Berman<sup>11</sup> go so far as to argue that CSP is not a theoretically viable construct,' noting that it is a 'complex collection of factors that do not maintain the same meaning across contexts' and 'must be defined according to social context'. Compounding such concerns, researchers often subjectively select which categories suit their personal notions of CSP and adjust the data using idiosyncratic formulae.<sup>12</sup> Despite such widespread deficiencies, many academic researchers rely on this data. Among the characterizations: KLD has developed a 'consistent, largely objective, set of screening criteria'<sup>13</sup>; 'the database ... objectively rates firms'<sup>14</sup>; and the rating system is 'carefully constructed' and reflects 'mainstream social concerns'.<sup>15</sup> Even some social investing skeptics have referred to the data as 'largely objective'.<sup>16</sup>

Just how objective and carefully constructed are these ratings? In an astonishing assertion Waddock and Graves have written that 'although the limitations of KLD's data need to be recognized, these data do represent the only currently-available externally-based assessment of the S&P 500 corporations over a consistent range of stakeholder arenas, over time, by a set of observers with no immediate 'stake' in any given company.'<sup>17</sup> The fact that KLD's ratings are the 'only currently-available' data begs the critical question: is the data reliable and a fair measure of CSP? The quality of conclusions depends upon the credibility of the data. What are the standards of data collection and analysis? What conceptual and operational definitions are being used? Do social investment data provide a reasonable measure of corporate social responsibility?

## Methodological Issues

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<sup>8</sup> Rowley, T. and Berman, S. 2000. 'A Brand New Brand of Corporate Social Performance.' *Business & Society* 39(4): 397-418. Hutton et al , 1998. Griffin, J. and J. Mahon, 1997. 'The Corporate Social Performance and Corporate Financial Performance Debate: Twenty-Five Years of Incomparable Research.' *Business & Society*. 36(1): 5-31. Wood, D.J. and R. Jones,. 1995. 'Stakeholder Mismatching: A Theoretical Problem in Empirical Research on Corporate Social Performance.' *International Journal of Organizational Analysis*, 3(3): 229-267.

<sup>9</sup> Kurtz, L. 2000. SRI Studies. <http://www.sristudies.org/essayh.html>. Waddock, S. and S. Graves, 1997a. 'The Corporate Social Performance-Financial Performance Link.' *Strategic Management Journal*. 18(4): 303-319. Waddock, S. and S. Graves, 1997b. 'Quality of Management and Quality of Stakeholder Relations: Are They Synonymous?' *Business and Society*, 36(3): 250-279.

<sup>10</sup> For a comprehensive bibliography of SRI quantitative studies, see [www.sristudies.org/bib\\_frameset.html](http://www.sristudies.org/bib_frameset.html).

<sup>11</sup> Rowley, T., & Berman, S. (2000). A brand new brand of corporate social performance. *Business & Society*, 39(4), 397-418.

<sup>12</sup> Graves, S. and S. Waddock, 1994. 'Institutional Owners and Corporate Social Performance.' *Academy of Management Journal*, 37(4): 1034-46. Turban, D. and D. Greening, 1997. 'Corporate Social Performance and Organizational Attractiveness to Prospective Employees.' *Academy of Management Journal*, 40: 658-672.

<sup>13</sup> Graves, S. and S. Waddock, 1994. 'Institutional Owners and Corporate Social Performance.' *Academy of Management Journal*, 37(4), 1038.

<sup>14</sup> Johnson, R. and D. Greening, 1999. 'The Effects of Corporate Governance and Institutional Ownership on Corporate Social Performance.' *Academy of Management Journal* 42(5): 556.

<sup>15</sup> Sauer, D. 1997. 'The Impact of Social-Responsibility Screens on Investment Performance: Evidence from the Domini 400 Social Index and Domini Equity Mutual Fund.' *Review of Financial Economics*, 6(2): 141.

<sup>16</sup> Griffin and Mahon, 1997, 10.

<sup>17</sup> Waddock and Graves, 1997b, 255.

*CSP research data suffers from a lack of reliability.* There are fundamental questions about the quality of the research data. With skimpy resources, KLD and other research groups review thousands of companies. Research relies upon often unreliable, anecdotal, and highly interpretable data. Overworked and undertrained junior staffers draw on government data banks, journalistic sources, and information supplied by companies, collating whatever information they deem relevant. The task is daunting and highly subjective. This data are then given a patina of objectivity by being turned into hierarchical numbers or letter grades.

The controversy over the California-based ‘natural’ juice company Odwalla offers a notable anecdotal example of the problematic nature of such data. By 1996, Odwalla was considered a model of social responsibility. Researchers at Adams, Harkness & Hill extolled the company for ‘respecting the fruit’ and for its ‘intense caring [which] translate[s] into a superior product .... We believe that no other juice company takes these steps to ensure the quality of its products.’<sup>18</sup> At the time, KLD gave it glowing ratings and Domini included Odwalla in its index. Amy Domini, a founder of KLD and president of Domini Investments, orchestrated the appearance of Odwalla founder Greg Steltenpohl at that year’s Social Investment Forum conference, where she lavishly praised his company. One month after the conference, one child died and at least seventy people were injured after drinking Odwalla apple juice tainted by poisonous bacteria. Investigations by *The New York Times* and documents introduced in court cases found Odwalla criminally negligent and derelict for ignoring a known pattern of quality, safety, and health problems, and culpable for withholding that information from the public.<sup>19</sup> Even after these revelations, Domini showed her emotional attachment to her friend’s company when she wrote: ‘Odwalla has been compared to Johnson and Johnson (Tylenol) in rapid recall and voluntary assumption of blame, and the reporters give management high marks for action.’<sup>20</sup> However, after more embarrassing revelations and adverse court rulings, Steltenpohl was forced to resign and the company, in financial disarray, was acquired.<sup>21</sup> As it turns out, Adams, Harkness & Hill and KLD used highly selective data and based their conclusions primarily on company representations. Even after details of its criminal conduct became known, Domini and KLD’s Kinder declined to revise their high ratings of their friend’s company.

The Body Shop case offers another dramatic example of the methodological problems besetting CSP research. In the early 1990s, every social investment company including what was then Franklin Research and Development gave the British cosmetics company high grades. However, after *Business Ethics* magazine published an article that raised substantive concerns about its performance,<sup>22</sup> Franklin did more research,<sup>23</sup> lowered its ratings across the board, and divested itself of its Body Shop shares. As Franklin’s research director noted, ‘We learned a hard lesson: never take a company’s representations at face value. This is not a

<sup>18</sup> Patsky, M., Galle, K. and P. Negron, 1996. ‘Healthy Returns: How Healthier Lifestyles Create Investment Opportunities.’ *Adams, Harkness & Hill, Inc.*, September 23, 48.

<sup>19</sup> Drew, C. and P. Belluck, 1998. ‘Deadly Bacteria a New Threat to Fruit and Produce in the U.S.: Odwalla-A Costly Strategy, a Slump in Sales.’ *New York Times*, January 4, 1+.

<sup>20</sup> Domini, A. 1998. Email to Social Investment Forum Mailing List. January 5.

<sup>21</sup> Entine, 1999.

<sup>22</sup> Entine, 1994.

<sup>23</sup> Bavaria, J., Becker, E. and B. Billenness, 1994. ‘Body Shop Scrutinized: Faces Allegations on Social Performance.’ *Insight: Investing For A Better World*. Franklin Research and Development. September 15, (article available at: <http://www.hcaassessmentexperts.com/books/bs-frank.htm#asweseeitnow>)

science but an art.<sup>24</sup> The Odwalla and Body Shop affairs underscore the personal and ideological biases that challenge the credibility of CSP research.

*CSP research uses arbitrary standards.* Can social performance attributes be measured and compared in a meaningful way, from company to company and across industries? The use of exclusionary screens highlights the subjective and often arbitrary nature of such ratings.<sup>25</sup> Each fund sets cut-off points to determine whether a company is excluded. For example, Washington Mutual Fund, with \$40 billion in assets, screens out companies that derive 50 per cent or more of revenue from tobacco or alcohol. Why 50 per cent? Ethical Funds, a Canadian social research firm, screens out companies that make packaging for the tobacco industry – unless tobacco-related production represents less than 20 per cent of business. How does EF verify that figure? It cannot. Why a 20 percent cutoff? ‘That’s just the percentage we set,’ said its founder, David Shuttleworth.<sup>26</sup> KLD screens out companies that derive more than 2 per cent of revenues from weapons sales; 15 per cent of their revenue from adult entertainment; own 20 per cent of another company with abortion involvement; or are 50 per cent owned by a company with alcohol involvement. Putting aside the prickly issue of how it determines such things, what is the meaningfulness of these arbitrary percentages?

*CSP research ignores corporate activity that is not easily measurable, and is a priori biased against some industries that are more transparent.* In practice, all current social screens eschew complexity. While banks do not release details on their portfolios and the technology industry is notoriously secretive, basic industries churn out reams of environmental data. That makes them easy targets for simplistic screens. Social research rating systems that do not use a ‘best in sector’ approach (KLD does not) severely limit as a matter of principle investments in chemicals, natural resource, energy, and mining – companies and industries with large, negative environmental impacts.

Most research does not extend beyond the first-level of corporate activity, which can result in a distorted picture of company practices. For example, bank portfolios are not screened for relationships with companies involved in tobacco, nuclear power, or weapons production. The loan lists of banks are littered with investments in industries that are taboo according to liberal-oriented sentiments, but are not available for public scrutiny so therefore are not subject to screening. Such superficial standards conveniently allow social investors to screen in fast-growth stocks of banks, financial institutions, communications firms, and technology companies - even though they all do a high percentage of their business with the military and other so-called sin-related businesses. Researchers do not examine layered business models (such as franchising) or the kind of complex business structures increasingly common in modern corporations (such as the dense corporate structure of Enron). Simplistic screens often miss egregious corporate behavior. Consider Microsoft, by far the favorite stock in social portfolios and 6 percent of the Domini Social Index. It has been found guilty of antitrust violations by the federal government and the European Union, and remains embroiled in other consumer antitrust suits. Yet, it consistently gets high marks from social researchers because antitrust violations and their impact on stakeholders, most notably consumers, are not screened.

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<sup>24</sup> Billenness interview with Entine, February 1994.

<sup>25</sup> Hutton et al, 1998.

<sup>26</sup> Entine, J. 1995a. ‘In Search of Sainly Stock Picks.’ *Toronto Globe and Mail Report on Business Magazine*, 12(4): 45.

First-level screens make a mockery of the complexity of modern corporations and underscore the methodological limitations of niche CSP research. In their defense, social funds contend they do not have the sophistication to go beyond a superficial analysis. 'It's just too complicated, with too many variables,' admits Jerry Dodson, who heads Parnassus, a leading social fund that nonetheless relies on incomplete data to make its investment choices.<sup>27</sup> Social researchers pleaded poverty and limited research capabilities when it turned out that many of the recently disgraced companies including Anderson, Enron, WorldCom, Adelphia, Tyco, and Tenet Healthcare were favorites of social funds.

*The numerical ratings used by CSP researchers create an illusion of objectivity.* Consumer activists such as the Council on Economic Priorities pioneered the rating systems used by social researchers. In its 'Shopping for a Better World' guide (no longer published), CEP graded companies like school children, from A-to-E on a range of social issues. For instance, CEP awarded an A in the category 'Women' or 'Women's Advancement' if a company had 10 percent or more female representation on the board of directors, and lesser grades for lower representation. Did CEP examine the quality & contributions of board members before assigning grades? No. As with many of social ratings, this was purely a litmus test.

KLD adopted this litmus test formula. KLD gives high marks to companies in which women, minorities, or the disabled hold four or more board seats. What is the empirical basis for such criteria? There is none and none is offered. Other categories are even more subjective. Companies get high grades for implementing 'innovative hiring programs' involving the disabled. What is innovative? Who crunches subjective perceptions to come up with the hard numbers? Behind KLD's ratings is a socially responsible Svengali who assigns numerical ratings. These numbers represent the perceptions of the ratings makers, colored by personal and ideological biases. The decision about what data to collect and the translation of this information into numbers render social investment data subjective and unreliable. Although numbers do not by themselves confer objectivity or meaningfulness, social researchers often cite these grades as if they represent an objective judgment and incorporate them in elaborate analysis.

### **Conceptual Issues**

As has been noted, some academic researchers mimic the propaganda line of social investing advocates, who equate aspects of social investing with CSP. This is problematic. While corporate social performance reflects a *substantive* definition of behavior that assumes some choices are more ethical or socially responsible than others, social investing is burdened by a historical reliance on a client-centered *procedural* definition that requires only that the investor believes he is acting ethically.<sup>28</sup>

Social investing advocates have never made the case that buying and selling stocks based on social criteria promotes reform or is more ethical or socially responsible than mainstream investing. According to cant, clients can 'invest for their own futures and a better world at the

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<sup>27</sup> Dodson interview with Entine, November 1997.

<sup>28</sup> Mackenzie, C. 1997. *Ethical Investment and the Challenge of Corporate Reform*. PhD thesis, at: <http://staff.bath.ac.uk/hssal/crm/>

same time'.<sup>29</sup> However, in postmodernist fashion, there are no agreed-upon standards about what constitutes a 'better world' or which companies are more ethical and responsible. Each individual gets to decide for herself what is a 'better world' and which companies are deemed ethical. 'Our common goal,' stated Joan Bavaria of Trillium at a SIF gathering in 1997, 'is to give people the information they need to make their own determinations about what they want to invest in.'<sup>30</sup> According to Cliff Feigenbaum, editor of *Greenmoney Journal*, the movement seeks to 'match your capital to the companies that best represent your moral and ethical values.' Social investing is based on investor feelings – the 'heart' according to social investor advocates who talk about aligning investments with one's beliefs – not explicitly on company behavior.<sup>31</sup>

There are literally hundreds of funds and investment strategies with different ideological colorings and varying definitions of socially responsible and ethical corporate behavior. Social investing principles run the gamut from ultra liberal to hard conservative, from pacifist to militarist. Perception not ethical performance drives social investing. Because of this definitional ambiguity, social investing has devolved into an exercise in tactics and liberal sentimentality, focusing on litmus screens and pandering to perceptions, rather than sorting estimable from questionable corporate behavior. Favored investments – consumer products, media, health care, and business services – reflect a consumerist 'shopping for a better world' esthete that people's purchasing habits define strong corporate social performance.

As the controversy over corporate business practices began to build in recent years, social investment leaders have tried to reposition their movement by attempting to equate ideologically based social investing with the very different notion of corporate social responsibility. In its most recent trend report, under the heading 'social investing defined,' it often interchangeably refers to SI and CSR as if they are the same thing. Following a description of social investing practices, it quotes the Prince of Wales Business Leader Forum to the effect that 'Corporate Social Responsibility means open and transparent business practices'.<sup>32</sup> It further claims, 'social investment requires investment managers to overlay a qualitative analysis of corporate policies, practices, and impacts onto the traditional quantitative analysis of profit potential.'<sup>33</sup>

In practice, however, the most prominent *social investors generally ignore the impact of most corporate practices on stakeholders*. The single largest American social mutual fund company, which runs two funds with 40 per cent of all the SRI dollars, does not screen for stakeholder or corporate governance issues at all. It screens only for tobacco and alcohol investments. In fact, not one of the SIF's 73-member funds screen for the array of corporate practices touted by the SIF in its trend report. As is typical within the industry, its leaders, such as Peter Kinder, have long-standing personal biases against corporate governance related screens. 'Focusing on non-issues such as independent boards, transparency and the like makes it easy to avoid taking stands on real issues of corporate accountability,' he claims that social

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<sup>29</sup> Gravitz, 2002, 1.

<sup>30</sup> Entine notes from SRI in the Rockies social investment conference, Breckenridge, Co., September 22, 1997.

<sup>31</sup> Feigenbaum, C. 2002. 'Taking Stock: Investing with Your Head—and Your Heart.' *Vegetarian Times*, 303: 78+. Domini, 2001.

<sup>32</sup> SIF, 2001. *Report on Socially Responsible Investing Trends in the United States*. November 28, 8. [www.socialinvest.org](http://www.socialinvest.org),

<sup>33</sup> SIF, 2001, 8.

issues are far better measures of corporate responsibility.<sup>34</sup>

While KLD underplays corporate practice screens, Calvert historically has ignored them altogether. In the wake of recent corporate scandals, Julie Gorte of Calvert was asked why Calvert had never screened for accounting or governance issues. ‘This is a meteor,’ she said, acknowledging that Calvert had long ignored a fundamental measure of corporate responsibility. ‘We’re still measuring the depth of the crater’.<sup>35</sup> Although it has since introduced limited corporate practice screens, Calvert and the rest of the industry pay short shrift to the range of CSP standards that the SIF report claims are the centerpiece of social investing.

*Instead of examining corporate practices, social investors favor litmus tests on trendy social issues with an outsized reliance on ‘sin’ screens.* Consider the most popular screen, on defense weaponry. KLD’s Kinder hyperbolically brands all defense contractors as ‘merchants of death’; KLD and reflexively screens them out as not socially responsible. Many social researchers and academics are so convinced that defense production is a priori not ethical that they do not even attempt to justify this sentiment. ‘In the view of social investors,’ wrote KLD’s Steven Lydenberg and Karen Paul, ‘full scale nuclear war poses a risk to the survival of life on Earth. Companies that manufacture nuclear weapons increase that risk’.<sup>36</sup> Sandra Waddock and co-author Neil Smith toed this ideological line when they ranted against ‘...individually harmful products (such as cigarettes, nuclear equipment, or military arms).’<sup>37</sup>

By using ambiguously defined and applied sin screens, ideology has replaced analysis. There is no evidence that a ban on military production promotes the presumably desirable goal of preventing war. The screen sidesteps the more important social policy issue of what defense expenditures may be wasteful or unnecessarily provocative. History suggests that absolutist pacifist ideology can have horrific unintended consequences and often leave countries more vulnerable. In the 1930s, ultra-pacifists and Nazi sympathizers formed an alliance in an attempt to keep the US out of World War II. Holocaust survivors or supporters of Israel might find a screen on military production in the name of ethics offensive. It is certainly arguable that military production can act as a deterrent to aggression. Some historians believe that the military escalation undertaken by the US in the 1980s was a key factor in bankrupting the Soviet empire and hastening the end of the Cold War. It is particularly ironic to note that according to public opinion surveys, the liberal community (and presumably liberal-minded social investors and academicians) has overwhelmingly supported two recent wars: the overthrow of Slobodan Milosevic’s repressive regime to stop genocide and bring Western values to the Balkans, and the military response in Afghanistan in the wake of 9/11, both on humanitarian grounds. It is hypocritical and logically and morally indefensible for social investors and academic researchers to personally back selective humanitarian military interventions while simultaneously endorsing an exclusionary screen on all military production.

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<sup>34</sup> Kinder, 1997.

<sup>35</sup> Entine, J. 2002. ‘The Backlash of Social Investing.’ *Chicago Tribune*. October 14.

<sup>36</sup> Paul, K. and S. Lydenberg, 1997. ‘Stakeholder Theory and Socially Responsible Investing: Toward a Convergence of Theory and Practice.’ March 9 IABS Meeting, Sandestin, FL.

<sup>37</sup> Waddock, S. and N. Smith, 2000. ‘Corporate Responsibility Audits: Doing Well by Doing Good.’ *Sloan Management Review*, 41(2): 78.

| *Social screens are based on idiosyncratic biases that differ dramatically in conceit and implementation; in other words, they are arbitrary.* Because of the procedural bias of social investing, there is no unanimity about what values or practices constitute social investing. Some investors focus entirely on one or two issues such as animal rights or tobacco. Many investors and funds are faith-based, drawing on varying Protestant, Catholic, Islamic or Jewish beliefs. Clearly, a religious fundamentalist in Kansas does not share many social and political values with a gay activist in New York. Some funds filter-out companies that profess support for abortion rights and others screen-in these same companies. The conservative Timothy Plan excludes Disney, a favorite target of right wing activists, for its allegedly lax moral standards. In the past, Disney has been a favorite investment of more liberal social investment funds such as KLD. Despite the view of most liberal social investors that its values are by definition socially responsible, one investor's taboo is another's sacred cow.

Compounding these differences, social researchers with similar ideologies often apply different conceits or methodologies. As a result, those screening for the same issue and with the same purported social goal may sometimes reach differing conclusions. For example, while Boston-based US Trust was praising Gillette in the early 1990s for being 'extremely proactive in disclosing ... its animal testing policies,' concluding that it is 'quiet about its corporate social responsibility achievements and forthcoming in areas of social controversy,' Gillette was screened out of numerous funds including Domini Social Equity because it engaged in animal testing.<sup>38</sup>

KLD, as other CSP research organizations, offers little explanation as to why certain categories are selected and others excluded. Indefinable 'social justice' issues take precedence over classic stakeholders. Investors, vendors and franchisees are given second-class citizenship in comparison to ambiguous ideals like 'peace' and 'fighting oppressive regimes.' Companies that create high-paying jobs, for example, get few of the social credits of companies that pass flowery social mission or ethic statements – like Enron. Oddly, there is little focus on a company's responsiveness to its customers, arguably its most important stakeholder. Although KLD developed a category called 'product quality,' the use of that screen as a surrogate for customer relations by Waddock and Graves<sup>39</sup> is dubious at best.

By elevating trendy social issues, mission statements, and sin screens over broader stakeholder measures, liberal social investors often ignore behavior with significant social and financial implications. As an example, Levi Strauss, the jeans and clothing company, basked in a tremendous amount of good press in the 1980s and 1990s because of its ethical pronouncements on a variety of trendy issues. Yet it made increasingly shoddy products, treated piece workers poorly, and eventually saw its CEO mismanage the company into the ground. It was ultimately forced to retrench, shutter its American facilities and flee to low-wage havens. Thousands of its employees no longer have jobs and the company still has not recovered. In essence, Levi Strauss' high-minded ethical stands – the actual operating centerpiece of liberal social investing – proved worthless in real terms.

The arbitrary nature of the categories used by social researchers can be illustrated by comparing the dominant liberal social investing model with the rating system developed for

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<sup>38</sup> Entine, J. 1997. 'Vivisectioning the Anti-Vivisectionist Movement.' *Drug and Cosmetic Industry* 160(1): 39.

<sup>39</sup> Waddock, S. and S. Graves, 2003. 'Beyond Built to Last...Stakeholder Relations in 'Built to Last' Companies.' forthcoming *Business and Society Review*.

black trade unions in South Africa in the early 1990s. Consultants Richard Adams and Jayanti Durai surveyed members about how to invest their pension fund, which then totaled \$175 million.<sup>40</sup> Rather than relying on the socio-religious criteria popular in North America and the UK, the workers devised their own guidelines. Litmus-test social sin issues such as armaments manufacturing and alcohol production were scrapped. Union members focused on product quality, working conditions, benefits, safety, and equal opportunity as weighted measures of CSP. Worker-related issues represented more than 75 per cent of the screening criteria. Unlike the liberal model with its procedural focus on perception and its reliance on exclusionary screens, the workers' model focuses on behavior and stakeholder rights.

### **The Financial Footprint of Social Investing**

Every two years since 1995, the Social Investment Forum (Key members include KLD and its sibling Domini Investments, Calvert Group, Parnassus, and Citizens) has issued a report on industry trends including estimates of the assets of investors who use social screens and shareholder advocacy. According to the SIF's most recent report, as of June 30, 2001 'nearly one out of eight dollars under professional management in the United States is involved in socially responsible investing'; \$2.03 trillion, 12 per cent of the \$19.9 trillion in investment assets under management, are socially screened; these assets 'grew 1.5 times faster than all US managed portfolio assets' over the previous two years; and 'socially screened separate accounts grew by nearly 40 percent'.<sup>41</sup> Citing the spate of corporate scandals, Citizens Advisor, Inc. founder Sophia Collier claimed, 'Socially responsible investing is about to come into fashion,' predicting it will double in three to five years.<sup>42</sup> Academic researchers and journalists credulously report these purported trends, often reproducing SIF statistics and news releases almost verbatim.<sup>43</sup> These are certainly astounding statistics, worthy of academic study if they are accurate and in context. Are they? How does the SIF define social responsibility and thereby determine which assets are considered socially responsible?

The SIF counts all assets that by its definition are 'screened, involved in shareholder advocacy, or are directed to community investing.' Under the heading 'What Was Counted,' the study notes that 'an institution was considered to engage in socially responsible investing' if it 'utilizes *one or more social screens*' or if the institution sponsors or co-sponsors shareholder resolutions *on issues the SIF considers socially responsible* [emphasis added] – even if the client or investment manager does not consider those investments social investments.<sup>44</sup> What does this mean in practice? Any institution, investment manager, or investor that screens on almost any issue as part of a 'formal' policy is by SIF definition engaging in social investing. This definition is problematic. Consider the recent proliferation of governance screens on such things as accounting issues, board makeup, and pension fund liabilities. Under SIF criteria, a pension fund that screens for a majority independent board or the compensation of executives has that investment counted as a 'social investment.' Yet, almost every responsible investment advisor now reviews corporate governance issues as a matter of course. According to SIF's boundary-less policy, their investments could be counted

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<sup>40</sup> Adams, R. and J. Durai, 1995. 'South Africa's Community Growth Fund.' *New Consumer*. September.

<sup>41</sup> SIF, 2001, 4-5.

<sup>42</sup> Ackermann, M. 2002. 'Socially Responsible Fund Boom: Maybe.' *American Banker*, 167(141), 8.

<sup>43</sup> Waddock, S., Bodwell, C. and S. Graves, 2002. 'Responsibility: The New Business Imperative.' *Academy of Management Executive*, 16(2): 132-148. Sauer, 1997, 140.

<sup>44</sup> SIF, 2001, 31-32.

as social investments – if the screening is deemed formal. With such ambiguous standards, there are almost no barriers to entry into the SIF’s social investment club.

There are also glaring computational mistakes in the SIF report. It stated that ‘assets in socially screened mutual funds stayed steady from 1999 to 2001, despite a substantial market downturn,’ and set the total at \$153 billion.<sup>45</sup> That is inaccurate. Socially screened mutual fund investments totaled only \$144.5 billion. SIF misstated the Calvert Large Cap Growth Fund by a factor of ten – an \$8.5 billion error.<sup>46</sup> Using the corrected figure, the 1 per cent drop in mutual fund social investments turns out to be a 6.2 per cent fall off. According to the Investment Company Institute,<sup>47</sup> the mutual fund market grew by 14.36 per cent over that two year period. So while the amount of money being invested overall in mutual funds was soaring, dollars were being drained from the most prominent social investment funds. It is disconcerting to note that these erroneous data have already been incorporated in academic research papers, including the winner of the 2002 SIF Moskowitz Prize,<sup>48</sup> which was also published by the *Journal of Investing*.

How large is the financial footprint of the liberal wing of the social investment movement, which garners most of the media attention? If the mutual fund market is the measure, it is tiny. Of the 73 SIF member funds, only 16 broadly screen for social issues and hold assets over \$100 million, accounting for less than \$8 billion. The 73 liberal-minded funds in total hold only \$10.11 billion in total investments, or 0.16 per cent of the \$6,555.1 billion mutual fund market. Since the puncture of the market and technology bubble, tech-weighted funds including most liberal focused social funds that placed outsized sector bets on technology have cratered and continue to underperform. While there has been an overall rise in mutual fund investments of 2.5 per cent over the two-year period, Domini Social Equity, the largest SI fund with \$1.296 billion in assets as of December 31, 2002 has shrunk by 22 per cent; Pax World has dropped 14 per cent; and Calvert, the third largest fund, is off 25 per cent. Not one of the largest social funds tracked by the SIF showed an increase, with the overall drop approximately 20 per cent.

We are faced with the apparent anomaly that while social investing advocates claim dramatic growth, investments in socially focused mutual funds are contracting relative to the overall size of the mutual fund pie. It seems counterintuitive to claim that interest in social investing by individuals is soaring while social investment dollars in mutual funds, which are generally believed to reflect individual investment interests rather than institutional sentiment, now represent the tiniest fraction of fund investments.

This pattern of applying an ideological filter on data also extends to performance analyses. For example, John Guerard, Jr. asserts ‘there is a growing literature in academic and professional investment journals that suggests socially responsible investing might produce higher risk-adjusted portfolio returns than merely using all available stocks in the equity universe’.<sup>49</sup> However, the data does not support that sweeping conclusion – as he himself

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<sup>45</sup> SIF, 2001, 12.

<sup>46</sup> Confirmed in conversation with SIF public relations spokesperson Todd Larsen, 1/21/2003.

<sup>47</sup> [www.ici.org/facts\\_figures/historical\\_trends.html](http://www.ici.org/facts_figures/historical_trends.html)

<sup>48</sup> Bauer, R., Otten, R. and K. Koadijk, 2002. ‘Ethical Mutual Performance and Investment Style.’ 2002 *Moskowitz Award*. [www.socialinvest.org/Areas/Research/Moskowitz/moskowitz\\_versie.pdf](http://www.socialinvest.org/Areas/Research/Moskowitz/moskowitz_versie.pdf)

<sup>49</sup> Guerard, Jr., J. 1997a. ‘Is Socially Responsible Investing Too Costly.’ *Pensions and Investments*, 25(4): 26.

notes. Guerard cites studies that mostly show either no statistical difference or relative underperformance by social funds. Similarly, Waddock, Bodwell and Graves have written that ‘significant evidence from a large and growing body of academic research suggests at a minimum a neutral, and quite likely a positive, relationship between responsible corporate practices and corporate financial performance.’<sup>50</sup> Yet, those who have reviewed the performance analysis literature, including Waddock, find no such consistent evidence that socially screened companies and funds outperform.<sup>51</sup>

The few studies that purport to show either a neutral or positive social investing or financial performance tout the KLD data as a reliable measure of CSP practices.<sup>52</sup> Also, many studies and popular articles have favorably compared the performance of the KLD-linked Domini Social Index or the Domini Social Equity Fund (DSEF) with the S&P 500.<sup>53</sup> There are significant problems with this assumption. Although the DSI counts as its benchmark the S&P 500, it is not a passive large cap index fund and is not optimized to any broader benchmark. The DSI only includes about half of the top 500 stocks and weights them as it chooses and arbitrarily. While some academic researchers incorrectly state that Domini maintains a ‘passive fund’,<sup>54</sup> like all social investing funds, it is actively managed.

Researchers also often overlook that there are a variety of factors that can convincingly explain the competitive performance of social investments, most notably: the concentration of investments in a narrow range of formerly high growth sectors; and, the time frames that these researchers arbitrarily select to compare social investment funds with mainstream funds. The KLD database (and as a result the DSI) is biased towards larger growth companies concentrated in a few key sectors—technology and financials most prominently. While the S&P has 20.5 per cent of its holdings in financials, the DSI hold more than 25 per cent; S&P holds 14.3 per cent in technology stocks while the DSI hold 18.75 per cent<sup>55</sup> (and as much as a third of its portfolio in recent years). The DSI underweights, as a matter of principle, infrastructure, manufacturing and energy companies claiming these are more likely to have adverse environmental impacts.

Almost every academic study that purports to show a neutral or positive correlation pre-dates the current bear market during which large growth stocks and technology companies outperformed. For example, Guerard, Jr. has used various time frames between 1984-1997.<sup>56</sup> Waddock’s social investment study covered a ten-year period from 1986-1996.<sup>57</sup> The 2002 Moskowitz Prize paper by a team of Dutch researchers incorporates data through 2000.<sup>58</sup>

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<sup>50</sup> Waddock et al, 2002, 136.

<sup>51</sup> Waddock, 2000. Sauer, 1997. Griffin and Mahon, 1997.

<sup>52</sup> Waddock and Graves, 2003. Waddock and Graves, 1997a and b. Guerard, 1997. Kurtz, L. 1997. ‘The Impact of Social Screening on Growth-Oriented Investment Strategies,’ *The Journal of Performance Measurement*, 65-71. Guerard, Jr., J. 1997b. ‘Is There a Cost to Being Socially Responsible in Investing.’ *Journal of Investing*, 6(2): 11-18. Guerard, Jr., J. 1997c. ‘Additional Evidence on the Cost of Being Socially Responsible in Investing.’ *Journal of Investing*, 6(4): 31-35.

<sup>53</sup> Feigenbaum, 2002. Guerard, Jr., J. and B. Stone, 2002. ‘Social Screening Does Not Harm Performance.’ *Pensions & Investments*, 30(19): 30-31. Waddock et al, 2002. Sauer, 1997. Young, L. 1996. ‘Socially Responsible Stock Index Leads S&P 500.’ *Dow Jones News Service*, December 26.

<sup>54</sup> See ‘How We Did the Study’ in Waddock and Graves, 2003, 8.

<sup>55</sup> As of December 31, 2002.

<sup>56</sup> Guerard, Jr., 1997. Guerard, Jr. and Stone, 2002.

<sup>57</sup> Waddock, 2000

<sup>58</sup> Bauer et al, 2002.

These time frames are never theoretically defended; in fact, they present a much-distorted picture of social performance. Even a minor change in dates selected for market analysis can significantly alter the results. For example, in the early 1990s, when sin stocks including military companies performed well, a sin portfolio yielded a significantly higher return than screened funds.<sup>59</sup> Later in the decade, the DSI and other social funds prospered with sizable bets in financials, technology, health care and communications.

The period beginning in the early 1980s and ending in 2000 corresponds to a historically unprecedented extended bull market in which growth companies and sector investments favored by social funds outperformed. It is no wonder that tech-heavy social funds performed competitively during this period. According to Morningstar, with the bubble at its largest during 2000, more than 90 per cent of tech mutual funds rated five stars.<sup>60</sup> During the 1970s and early 1980s, large company growth stocks including technology companies that are prominent in the DSI performed relatively poorly for an extended period. Neither the DSI, nor academic studies using DSI data, have tested for this period to fairly evaluate performance in varying investment climates.

Three researchers at the Wharton School of the University of Pennsylvania, using market performance data through 2001, as the 1990s technology boom began to wane, confirm the illusion that stocks selected using a 'socially responsible' model outperform the overall market. In a study released in June, 2003,<sup>61</sup> Geczy and Stambaugh, both finance professors, and Levin, a graduate student, analyzed these funds in light of market factors that historically have been most correlated with fund performance, like the average market capitalization of a fund's stock holdings or where its stocks fall on the value-growth spectrum. They found that the relatively strong performance in the 1990s by socially responsible funds using so-called liberal screens likely reflected no more than the temporary strength of the overheated tech sector. Equalizing for such variables as portfolio management skill, the researchers found that the liberal-activist version of social screening costs investors 30 basis points a month or more. Not only does the long-term trend indicate that pseudo-liberal SRI funds underperform the overall market, they also underperform broader based funds who also emphasize hot sectors, such as high technology stocks. In other words, social investing screens are not only ideologically incoherent, they are a financial drag.

The mediocre performance by social funds since the market bubble burst in 2000, when many of social investing's favorite sectors were out of favor, underscores the limited value of academic studies using narrow and arbitrary time periods. The Domini Social Equity Fund - has been a notable recent laggard. It rates a below average '2' in Morningstar's Ratings and a 'C' over 3 years by Lipper.<sup>62</sup> It trails the S&P 500 index funds that it claims in its prospectus to track over the 3-and 5-year periods. However, comparing it to the S&P 500, which many social investing advocates and academic researchers choose to do, understates its even poorer performance relative to its peers. According to the Domini Fund's web page, the DSEF is a

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<sup>59</sup> Naber, M. 2001. 'Catholic Investing: The Effects of Screens On Financial Returns.' *Journal of Investing*, 10(4): 58-65.

<sup>60</sup> McDonald, I. 2003. 'The Stars in the Sky Flicker, And Fund Stars Do the Same.' *Wall Street Journal*, January 15, C1+.

<sup>61</sup> Geczy, C., Stambaugh, R. and D. Levin, 2003. 'Investing in Socially Responsible Mutual Funds.' March 17, <http://finance.wharton.upenn.edu/~stambaug/sri.pdf>

<sup>62</sup> As of December 31, 2002.

large blend (Morningstar) or large-cap core (Lipper) fund. Against these indices, Domini underperforms by about 15 per cent over three years independent of fees, which would increase the disparity.

The DSI stock mix would have significantly underperformed the market even during the 1990s if they had screened these once outperforming stocks for key stakeholder issues such as corporate ethics. If only one stock, Microsoft, which represents more than 6 per cent of the indices, had been screened out because of alleged consumer anti-trust violations, the performance data would have looked markedly less robust. Entire groups of questionable stocks were screened in only because their problem area – pension fund shenanigans and shifty accounting – are too arcane for the social investment community’s porous screens. For example, Verizon, the US’s largest local phone company and the DSI’s seventh largest holding at 2.4 per cent, reported a strong fiscal 2002 with profits of \$389 million. Only those investors who dug into the small print at the back of the document learned that Verizon’s reported earnings included \$2.7 billion in gains from its pension fund investments. One problem: as Verizon knew and KLD researchers did not pick up, those profits did not really exist. The company pension fund actually lost \$3.1 billion, a footnote on page 58 of the 68-page report revealed, and \$15 billion since 2000. These are not just abstract accounting issues. Verizon’s pension fund fiasco has vaporized more than 30,000 jobs including 25 per cent of the union workforce. Even today, with the full details of the misrepresentations (that has so devastated key stakeholders including investors, workers and local communities) public knowledge, Verizon remains a KLD/DSI favorite. Numerous other companies considered favorites by social researchers including Cummins Engine, American Airlines and Delphi Automotive face a raft of ethical questions about underfunding of their pension funds or unilaterally trying to change their pension fund schemes.

There is no evidence to believe that the principles of social investing, rather than active-fund portfolio management and sector bets, explain the competitive (though eroding) performance of some social investments during the late bull market. Although it is certainly possible and even intuitively likely that CSP is positively correlated with both stock performance and financial performance, the data generated by social researchers is too methodologically flawed and theoretically suspect to be of serious use for academic research. There is absolutely no convincing evidence that social investing principles help identify ethical high fliers, profit stars, or stock market winners.

## **Discussion**

While social investment advocates claim that ‘social investors [are] consciously ... working to build a more just and sustainable economy’,<sup>63</sup> there is an unbridgeable gap between rhetoric and reality. As with most NGOs, perception and anti-corporate ideology, not corporate reform, drive the movement. The rating systems that have evolved are based on superficial litmus screens judging social propriety and social conventions. They lack a coherent moral or ethical perspective. They confuse social liberalism with ethical behavior. They systematically underplay key aspects of corporate behavior including corporate governance and transparency and overplay facile moral notions. They reflect the personal ideologies of those who conceived the ratings and collect the data. Social investing remains

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<sup>63</sup> SIF, 2001, 8.

trapped in an anachronistic paradigm based on a bouillabaisse of problematic conservative religious principles and dated liberal social notions.

Despite these intrinsic limitations, social researchers convert this ideological stew into so-called objective ratings. They commit what is called the fallacy of reification – the conversion of a complex and multi-faceted concept, in this case corporate social responsibility, into a putative real entity – a number or rating. This is pseudo-science, on the level of astrological research. Social researchers who rely on this data caricature the complexity of business to suit their ideological beliefs. Business ethics requires decision-makers to weigh the impact of their ethical choices on a number of stakeholders. Such decisions do not lend themselves to litmus tests or reductionist numerical ratings.

‘Socially responsible’ investing principles and the databases based on them are hopelessly flawed proxies of corporate social responsibility. Although social investing has demonstrated that it can be an effective brand marketing strategy, it does not fulfill its stated rationale of promoting systematic investment in ‘good’ companies and effecting positive change – to ‘do good’. Moreover, by implicitly encouraging the belief that the intentions of a business can be judged distinct from the economic impact of a company, social investing may promote corporate behavior that is neither socially progressive nor ethical and may result in adverse consequences to stakeholders.

To date social investing has drawn modest but increasing interest from institutions and mutual funds that view it as a potential brand with appeal to niche investors. Nonetheless, it continues to draw outsized and consistently positive media coverage, and is increasingly being characterized and often perceived as a proxy for good corporate citizenship. Its influence, and therefore its potential for mischief, dramatically exceeds its small financial imprint. Anti-free market NGOs under the guise of corporate reform are extending their reach into the boardrooms of corporations. In many cases, naïve corporate reformers, within corporations and in government, are welcoming them. This is an unsettling trend. As practiced, social investing is capitalism’s Trojan horse.