The challenge of investing ethically. Could you do it?

CASTLEFIELD
THE THOUGHTFUL INVESTOR

Anyone attempting to invest responsibly or 'ethically' will soon discover that it isn't easy. To do so properly takes a lot of time and effort, skilled assessment and detailed research. Even once you form your selection methodology, you will soon find that there are plenty of grey areas needing careful consideration and skilled decision making, of the type that goes deeper than mere technical comparison. Beyond this, things evolve and reacting to what is in front of you is as important as planning ahead.

However, if you are able to, you will find that there is power in investing responsibly; power to influence businesses, organisations and the people who run them to do the right thing; power to make them accountable when they don't; power to improve the world we live in and improve it for future generations; power that gathers weight with every penny you invest in this way.

The following 10 steps explain some of the considerations, issues, practicalities and opportunities that all play their part in the process of deciding how to invest responsibly.

1. Promoting good things / Avoiding bad things

On the face of it, it seems easy...

There are glaringly obvious elements of the modern world that would benefit from your support. An ambitious, eco-sensitive, profitable, UK based wind farm doing what it can to dampen the effects of climate change, for example, will always have appeal. A well supported social housing project, with decent funding, working in deprived areas of the UK where regular house prices are out of the reach of many, is something you may readily choose to support and invest in.

Equally, there are industries that are simple to identify you might like to avoid - tobacco and gambling, for instance. Indeed the whole ethical investment industry started life in the 1980s built on funds solely focused on avoiding such 'sin stocks'.

So, in with the good and out with the bad: you're off.

....but it gets harder...

2. Pragmatism

Investment portfolios chocked full of wind farms and social housing projects may well appeal, but from a practical perspective alarm bells should ring. A 'well diversified' portfolio is always best, comprising a variety of underlying investments, be they split by things such as geography, industry, riskiness or any number of more nuanced factors.

This need for 'diversification' should feed into your investment selection process. It will mean considering investments that wouldn't necessarily spring to mind for the average ethical consumer. And, on occasion, you will need to consider businesses that are primarily positive but could have elements that are less savoury. Or they aren't wholly 'good' yet but getting better. Do you still invest? You decide.

You might, for example, consider investing in a utility company that traditionally relied on fossil fuel generated energy, but is going to great lengths to convert their business to renewable energy. Should you support their transition by investing in them now, or should you wait until they rely solely on renewable sources and leave others to support them along the way?

Or, what about a software business that brings the benefit of modern technology to millions in developing countries, but generates a tiny percentage of its revenues from arms businesses, which you wouldn't ordinarily support? Do you still invest? If you did you would be helping improve the lives of many, but the pay-off is that you could inadvertently affect the lives of those at the sharp end of that military software.

Or, consider investing in an apparently ethically neutral sector such as insurance, but the firm you're looking at gives excellent customer service, treats their employees brilliantly and goes out of its way to support the wider community. Would you invest? You might well, but then again there could be other businesses which, on the face of it, make more of an obvious positive impact that are missing out from your investment.

...and then there are the lies...

3. Greenwashing

....Well, perhaps 'lies' is a little harsh, but then again perhaps not.

Companies are governed by increasingly stringent laws and have to publish increasing evidence of what they've done to comply with them. Consumers are becoming ever more enlightened, forcing businesses to improve their act if they are to gain and retain their custom. Increasingly customers are looking for investments with a 'green' factor.

One of the outcomes is that nowadays in most company's annual reports and websites you'll often find a section called 'sustainability', 'responsibility', 'CSR' (Corporate Social Responsibility) or something equally earnest. This might tell you how much they give to charity, measures they're taking to reduce their carbon footprint, safety measures they have in place, how their practices are scrutinised by independent specialists or other 'green' credentials.

On the face of it this is great. It's right that businesses are taking steps and understandable that they choose to talk about what they are doing. Considering these things should certainly be a part of your investment selection process. However, sadly some claims can be shallow, spurious and misleading. There are 'tick-box exercises' set up to give a false impression that a company is virtuous, diverting the eye from the honest truth. This artificial veneer of ethical claims is commonly called 'greenwashing'. You may find this disheartening but there is clear evidence that it happens and, without being wise to it, many could be innocently fooled.

So, as part of your selection process you also need to be aware of 'greenwashing' and maintain a degree of healthy scepticism.

4. Taking extra steps

....But its not just about policy issue data...

Greenwashing in mind, you've gathered a good amount of information about your prospective investment from publicly available sources. But you want to do more. You really want to deepen your understanding before you choose to invest.

Ideally you want to hold regular meetings with senior post holders in the company; to run your own, independent surveys and questionnaires; when you have concerns you want to ask direct questions of the people in power and act on their replies.

If you are extraordinarily wealthy and have millions at your disposal to invest in any one business then you might be taken seriously enough to warrant direct contact with the heads of a business, but for most investors this direct contact is beyond you.

So now you're straying into the territory of professional investment businesses, who have the personnel, resources and collective investment power to take that research to an extra level; resources that are unlikely to be available to you as a lone investor.

5. Monitor

....and you need to keep them on their toes...

Even when you have gone to great lengths to identify the businesses you want to invest in, you can't stop there. Things change. Standards can slip. Senior decision makers move on. Businesses grow, amalgamate and shrink. Firm's cultures improve or breakdown. New information comes to light and focuses change (who was thinking about ocean plastic pollution 20 years ago?). New and potentially better investment opportunities arise.

So, assuming you've got this far, selecting and building your investment portfolio of well diversified, intensely researched, ethically sound businesses, you can't leave it there. You need to be able to monitor and continually assess them over time, react to changes that occur and reinvest accordingly. If you don't, your current portfolio is likely to become obsolete and out of touch.

6. Allow them to make amends

....and give them a chance...

You're carefully monitoring your investments when something goes wrong. What do you do? Perhaps an employee blows the whistle on a poor practice that's being covered up. Maybe you find that the figures you based your investment decision upon were falsified. Or, perhaps stories emerge of staff bullying or inappropriate behaviour where you've chosen to invest.

Do you stick with your investment, or do you get out?

Problems can be fixed, but some are too embedded or expensive to resolve. The reputation of the business may have been indelibly tarnished. Official bodies may get involved and fines may be levied. But if you disinvest like others are doing and the business collapses then innocent employees may suffer along the way. So, what do you do as an investor? Do you keep faith and remain invested in the hope and expectation that they'll improve?

Or, would you feel uncomfortable prolonging your support? If you knew in the first place what you know now would you have made your original investment? Maybe you need to make a clear statement, both to that business and others that may be taking the wrong path, by pulling your money out.

These are difficult, sometimes painstaking decisions, but ones that you'll need to make to keep your portfolio 'ethical'.

7. Think about the money

....But it's not just about ethics...

Until now, much of this article has centred on moral issues, i.e. whether businesses are good or bad and whether you can identify and support the good ones. What can't be ignored, however, is whether they can make money too and how important that is to you.

Responsible, ethical businesses can also be profitable ones. The challenge, if you want your investor power to increase, is identifying those that will also make a profit and allow the good you can do with your money to grow. So, where do you start?

With responsible investing there are often complex decisions around profitability. There are businesses where profitability is not always the main focus, such as those that deliberately employ ex-prisoners who may otherwise not be able to re-enter the job market. Others plough extra profits into social endeavours, say by spending money within their local community. The question is should you dampen your focus on profit in order to deepen the ethical intentions of you chosen portfolio?

Even once you've decided how important profits are to you, the challenge is to find the right businesses that strike the balance of profit and social, ethical, sustainable impacts that are important to you.

8. Practicalities

....and there are other things too...

Beyond the moral and profitability issues there are a whole plethora of other considerations... How liquid is the investment? Could you sell it easily enough if you needed to? How risky is it and are you able to take on that risk? Could you afford to lose all of the money you've invested? What are the costs involved? Whether they are seen as ethical or not, some businesses could ultimately be profitable to invest in but the costs of arranging that investment are prohibitive. Can you even access a particular investment or is it reserved for professional investors? How many investments is enough to give good diversification but not so many that you can't manage them all?

What about your personal and financial circumstances? What other investments do you have outside of your portfolio? How suitable are these potential investments for you? Have you thought about any other costs involved and your tax position and how this might affect your finances overall? In fact, your circumstances may even dictate that putting money into investments in the first place is wholly unsuitable for you. Have you considered this?

The list goes on. If you are still considering doing this yourself you will need to think about all of these things and make a call on what to invest in and what to avoid, having taken everything into consideration – no easy ask!

9. Charitable Support

....Or should I just give it all away?..

So far we've assumed that you want to create and maintain an investment portfolio that's at least to some extent profitable. But do you even need to make money? If you don't need it, why not just give it away? This approach certainly has merit.

Most charities welcome donations and many can put them to good use immediately. Compare this to investing in and supporting a business, who may well be acting responsibly, providing goods and services that benefit society, but these benefits can take time to come to the fore. Those with altruistic intentions might want to see an immediate impact, so giving the money away is a better thing to do, right?

Perhaps, but this approach has a major drawback. If we all donated to charity instead of investing in our money it would leave less scrupulous firms open thrive, unchecked by their investors' examination and the wider society might suffer as a consequence.

So, whilst giving to charity in the short term seems a convincing argument, in the long term perhaps not. But there is a third option if you are interested in charitable support. A better solution could be to integrate your charitable intentions within an investment portfolio, thus benefiting from the best of both worlds. This can be done in various way including structuring your investments as a charitable trust which is invested ethically but the charity is the beneficiary and not you; growing your investment portfolio and gifting the profits to charity as and when they arise; or building your investment portfolio then gifting it to charity in your will upon your death.

There are significant and often complex tax implications to each of these options, so you'd probably want to seek advice from a tax expert, but you can see that your choice isn't as simple as charity or investment, you can sometimes do both.

10. Can you really do this?

....Is this all too much?...

By now, you've hopefully gleaned a good understanding of what could be ahead of you. In summary, assuming you can afford to do this, you need to choose what to invest in, having conducted detailed research that goes beyond analysing information available in the public domain. You've ensured that you have a balanced, considered, liquid, cost effective, hopefully profitable portfolio, which may or may not include a charitable element. You're prepared and able to monitor this over time, react to changes, and apply more pragmatic decisions when things go astray.

What do you think? Do you have the skills, time and resources to do this? Maybe so, but then again you may wish to seek help! At Castlefield, we are specialists in responsible investing and having been in business since 2002 we've built up a great deal of experience and are well equipped to act for most people seeking to invest in this way. Do call us and we'll be pleased to help.

CONTACT US:

We hope you have found this guide a useful insight into professional financial planning. If you think you would benefit from receiving such advice please do get in touch and we would be happy to help you.

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