Why ethical investing is important.

CASTLEFIELD
THE THOUGHTFUL INVESTOR

Ethical investing has increased in importance over recent years as more people become aware of environmental, social and governance (ESG) issues, and whether their investments are helping to combat these or if they may actually be contributing towards them.

This article highlights 10 ways in which investing ethically can make a positive difference to the world and explains the influence that you, as a thoughtful investor, can have.

1.

Avoiding harmful industries

Early 'ethical investing' practices started by avoiding investments in specific industries, the so called 'sin stocks'. The principle being that a) some people feel uncomfortable supporting and profiting from such industries, and b) by reducing the demand they should eventually become less profitable and therefore less successful. Traditional harmful industries include the likes of tobacco, alcohol, pornography, arms, nuclear power and trading with oppressive regimes. Over time this has grown to include things such as businesses with dire environmental credentials and those with poor human rights records.

2.

Supporting green technology

The ethical (or "thoughtful" as we like to call it) investment industry has also evolved to include the promotion of initiatives that have a positive impact on the world. At the forefront of such 'positive impact' investing has been a drive to encourage anything that favours environmental initiatives.

There has been a profound increase in 'green tech' over the last 30 or 40 years, with the proliferation and development of technological innovation in many areas, from solar panels to wind farms to low energy light bulbs to electric vehicles. Many such initiatives have been and continue to be supported by responsible investors. Indeed, forward thinking individuals – including many of our clients - were the first to invest in such sectors, long before institutional investors followed their example.

3.

Energy efficiency and cost savings

Industries that work more efficiently have obvious environmental advantages (i.e. the less energy used in manufacturing the less this leads to global warming). But beyond the purely environmental impact, there is usually also a cost saving opportunity associated with this, so it's something that should appeal to all business owners whether they are concerned about the environment or not.

The drive to promote industrial efficiency can give rise to various investment opportunities, from the introduction of more efficient manufacturing processes, to better built, longer lasting products, to consultancy firms that specialise in seeking out and recommending efficiency gains.

4.

Using earth's resources wisely

Another important area focusing on environmental issues is to consider how we make best use of the world's limited resources (such as rare metals, drinkable water, etc), and what we can do to stop these being completely exhausted and/or manipulated to such an extent that they no longer become useable.

For many responsible funds, especially those with an environmental bias, this is a theme that they support. It means backing companies that are at the forefront of waste management and recycling, those that are working to use less material in their products, packaging and processing methods, and those that promote less water usage and more internal recycling within their own manufacturing processes.

5.

Helping charities

As with any other type of organisation, charities need funds in order to conduct their business. Where charitable giving is not enough, some larger charities have used other initiatives to raise money, often in relation to specific projects for example to build a particular building for them to use. They may raise the money by issuing an investment bond. Investors can purchase part of the bond and in return they receive a set interest payment over a number of years after which their capital is returned. Charities often finance the returns given to investors using government grants, which is a fair relationship as the investor takes on the risk of the project failing and is rewarded for removing this risk from public finances. This can be a fantastic way for thoughtful investors to promote charitable endeavours whilst at the same time aiming to make modest returns from their money.

6.

Opposing excessive pay

One of the most powerful elements of thoughtful investing to have evolved over recent times is that of stewardship, also called engagement. The shareholder uses their status to influence the underlying business, typically by voting at AGMs and other shareholder meetings, although other direct engagement as a shareholder can sometimes be involved. The bigger their holding, the bigger the influence they have, which is why funds and other collective investments can often have a greater shareholder influence than individual holders.

One common use of this influence is to question excessive executive pay. Where those at the top of an organisation receive pay that is many, many multiples of the lowest paid, it's only right to question this as a matter of fairness. It may be justifiably argued that those at the top are paid handsomely because they have exceptional talents that the business as a whole benefits from. But all too often it's simply greed and opportunity, with no one opposing them. A thoughtful investment team will always question this and often vote against excessive pay rises or bonuses if there is no clear evidence to justify it.

7.

Fighting discrimination

A second area of influence where stewardship can play its part in is to take on inequality and other discriminations – sexism, racism, ageism, homophobia, disability rights. A good stewardship process will set out to question a business's experience and approach to such things. For example, demanding change when gender equality surveys reveal fewer numbers of women in senior positions.

They will also set benchmarks to use as internal standards i.e. minimum standards to which they expect their investee businesses to adhere to. This can help certain businesses to work better, especially growing, fledging businesses with limited experience and resource in this area.

8.

Re-shaping irresponsible businesses

If there are no thoughtful investors invested in harmful industries demanding that action be taken, then the stewardship examples given in point 6 and 7 hold no weight, as there's no one responsible for keeping them in check!

There is some validity to this, but it needs to be handled carefully. There can be an argument to invest in, for example, a major oil business that promises to convert to supplying renewable energy rapidly over the near term. But that investor has to do so with deep conviction and the ability to properly police the investee. If the firm's promises are actually achievable with enough conviction and momentum behind them, it is essential that they are held to account. They need to prove that they are being achieved and if they fall short they need to give valid reasons as to why. This needs to be an ongoing process and ideally the world at large needs to be told about this – both when things go well, and when not so well.

9.

Holding other organisations to account

Businesses who are generally revered as being ethical for one reason or another can, on occasion, be exposed for undertaking certain poor practices that, until then, the public at large were all unaware of. Stewardship can play its part in this too. When this happened the standard response of the exposed business is to own up to their mistakes and promise to make amends in order to save face and, hopefully, retain or repair their image (and profitability!). A thoughtful investor will assess the situation and may well choose to give them a second chance if they do successfully change their ways, but sometimes such businesses fail to do so in which case, after a period of reprieve, it could be time to disinvest and seek opportunities elsewhere.

10.

Collective action

This article has been a whistle-stop tour of some of the most obvious as well as number of the less well-known advantages of investing ethically. One final thing to stress, and which builds on all of this, is the power of doing this together.

The more that the issues within this article are publicly exposed and acknowledged, the greater the influence responsible investors will have, and the more business and the wider world will want to react to them. Fund managers should also be held to account for following through on their ethical mandates. By questioning an invested business thoroughly or holding them to account following poor practices we can avoid many of the greenwashing practices that invalidate the theory! Our latest 'Winners and Spinners' report covers examples of this in more detail.

The wider industry is becoming more sophisticated too.For example, ShareAction works to influence businesses to work better via collective share ownership, and collaborates with certain responsible investment teams. The deeper and wider the means of tackling the issues at hand, the deeper and wider their impact will be, which, ultimately, is better for us all. Not only better for humankind, but better for the planet and our collective futures.

CONTACT US:

Hopefully this article has given you a flavour of the power of responsible investing and some of the issues it tackles and methods it employs. At Castlefield, we have been pursuing and refining our comprehensive approach to thoughtful investing for almost three decades and as we continue to grow so too does our influence. If you feel strongly about any of these issues and would like to help us in our cause by investing your money in this way please do get in touch.

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