

Socially Responsible Investing

Calvert Mutual Funds & Corporate Governance

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I. Executive Summary

Corporations are entering an exciting stage in history—profits, once the focal point of all corporate actions, are beginning to make room for another business priority: social responsibility. Corporate social responsibility (CSR), or the prioritization of societal concerns in addition to maximizing shareholder wealth, has been gaining momentum over the past few decades, enjoying a recent surge following the various Enron-era corporate scandals.

Much of the acceleration in interest can be attributed to the growing popularity of socially responsible investing (SRI), which seeks to evaluate companies as investment candidates that not only meet certain financial performance baselines, but also show a commitment to corporate integrity. Asset management firms such as Calvert have popularized SRI through the use of SRI mutual funds and simple, easy to understand rating systems (e.g. the Calvert Ratings™). Nothing is perfect, however, and while it is easy to identify the strengths and shortcomings of the various rating schemes, additional rating criteria such as disclosure, product/service safety and purpose, and commitment to and the impact of corporate social responsibility, would make the system more solid.

Unfortunately, there are a few factors impeding SRI's growth. First, there is a misconception that SRI investments provide lesser returns than non-SRI investments. Second, a corporation's governance structure is inherently in conflict with the pursuit of social concerns. A corporation's fiduciaries have duties of loyalty and care to the corporation and its shareholders, which typically leads to the prioritization of profits over any other concern. Placing corporate integrity and social concerns first, or even in addition to profit maximization, may cause the fiduciaries to be in breach of one or both duties. Introducing additional fiduciary duties, such as duties of citizenship and humanity, which stipulate a greater social concern by the corporation, may alleviate this conflict.

II. Socially Responsible Investing

Overview

Socially Responsible Investing, often referred to as SRI, entails finding and investing in companies that minimize corporate externalities and strive to reduce or eliminate harmful practices such as pollution, child labor, and discrimination. For the investor, SRI can function as a screening method allowing investment in companies that reflect the investor's personal beliefs and social concerns. However, SRI also has the potential to create social change through shareholder activism. Coupled with a strong set of social investing criteria, SRI mutual funds or other SRI institutional investors, may wield far greater power to impose positive social change within an invested company than may an individual investor, consumer, or advocacy group.

The origin of SRI reaches back to the 1920's when church organizations began to divest in "sin stocks" of companies that produced alcohol, tobacco and engaged in gambling activities.¹ The SRI methodology gained more participants in the 1970's and many SRI-specific mutual funds and investing groups have since been established.

SRI vs. Non-SRI Investments

The first question many investors ask when introduced to SRI is whether such investments return gains comparable to non-SRI investments. The concern is valid and perhaps key to increasing participation in SRI. Many investors may care about social issues but are unwilling to forego returns—such investors will choose the option that provides the greatest potential return, regardless of its social impact. If, however, it can be shown that specific SRI investments meet or exceed the performance of the market, while also promoting SRI-related concerns, a greater number of investors will show interest. Similarly, if it can be shown that SRI investments lag non-SRI investments, a fewer number of investors will be willing to commit funds.

So how do SRI investments fare in comparison to non-SRI investments? A considerable amount of research has been performed on the topic, a portion of which indicates that SRI

investments tend to perform just as well or better than non-SRI investments, while the remainder shows that SRI investments actually under-perform.^{2,3,4,5,6,7} This split is fairly typical of complex and perhaps “touchy” subjects, and may boil down to what set of criteria are used in the comparison, including benchmarks, timeframe, sector, investment vehicle, and other similar variables. On a case-by-case basis, it is possible to identify individual SRI investments that support either conclusion.

In undertaking my own performance comparison, I was able to achieve both results: one SRI fund that outperformed the market, and one that underperformed the market. I chose to examine two broad SRI funds that would be easy to compare to the overall market. In the chart that follows, the two SRI investments I chose are compared to the S&P 500 Index, which is commonly used as a “market” benchmark. The investments compared are the *Domini 400 Social Index* (ticker: *_KLDDSI*), the *Calvert Social Index A* (ticker: *CSXAX*), and the S&P 500 Index (*_GSPC*). I chose a 5-year time frame to show a more long-term trend, as well as to examine the performance of each investment in relation to the post-2001 market decline.



The comparison clearly shows that the Domini fund outperforms the S&P index, though quite marginally, while the Calvert fund underperforms in comparison to the S&P index. Further, it is worth noting that the 5-year returns for all three investments are fairly paltry—a 3-year (February 2003 to present) comparison would have indicated that all three investments offered very healthy returns (each offering 30-35% gains). Additionally, altering the time frame from 5 years to 2 years or shorter produced charts that showed the S&P Index outperforming both funds.

While my comparison is simplistic, it hopefully illustrates that there is a certain amount of “fuzziness” surrounding the question and assessment of SRI investment returns in relation to non-SRI investments. A simple change in scope (say a shift from a 5-year time frame to a 1-year time frame) will produce different conclusions. Additionally, the overall results of my comparison may have been different if I had used an alternate benchmark such as the Dow Jones Industrial Average or the Russell 2000 Index.

In searching for possible explanations for lower performance by SRI funds, a number of logical answers presented themselves. First, SRI investments may tend to have a more long-term focus due to their potentially stronger adherence to governance and social concerns. Companies that are focused on long-term objectives such as strong environmental stewardship may experience lesser short-term gains than companies not focused on such social issues. If non-SRI investments were comprised of primarily companies focused on short-term performance, while SRI investments contained long-term oriented companies, clearly it would seem reasonable for non-SRI investments to achieve superior short-term returns. Second, SRI investments are subject to two screening processes: a financial analysis, then an analysis to determine if the investment meets the social criteria of the SRI vehicle. Due to this extra screening, SRI investments may tend to have greater management fees (where applicable) than their non-SRI counterparts. The increased management fees will negatively impact the investment vehicle’s performance.

Regardless of the validity of studies showing superior or inferior returns of SRI investments, the fact remains that many investors have the perception that they are inferior investments. Due to their longer-term focus, many SRI investments suffer from a lack of interest by

investors seeking primarily short-term returns. Accordingly, such investors directly and indirectly pressure fund managers to focus more on short-term returns. For example, in the case of pension trustees there is “pressure for money managers hired by [the] trustees to rely on short-term benchmarks [which leads] to a kind of lowest common denominator investment strategy.”⁸

As a final thought regarding the comparison of returns by SRI and non-SRI investments, it is interesting to consider the level of comparative risk of the two options. Some maintain that despite potentially lower returns, SRI investments offer lower risk than non-SRI investments, while others argue that there is negligible difference in risk between the two vehicles.^{9,10,11} Again, the discrepancy may have more to do with the comparison criteria and scope than empirical data.

Whether you agree with the data promoting or criticizing the returns of SRI investments, one factor is not debatable—they are clearly screened and approved based on adherence to social criteria. Data substantiating both results prevents a clear conclusion from emerging, other than establishing that “it depends.” In the end, like all investments, SRI options should be analyzed and invested in on a case-by-case basis, and in accordance with an individual’s personal risk-profile and investment objectives.

Does SRI Cause Positive Social Change?

One exciting aspect of SRI is its potential to cause positive social change. A passive result of shifting funds from regular investments to SRI investments is the gradual building of support for companies that meet SRI objectives. At the same time, a gradual removal of support for non-SRI oriented companies also occurs. The net result, over time, is that more investment will be made in those companies advancing SRI objectives, perhaps improving their performance, at the direct expense of companies not advancing SRI objectives.

More direct and powerful change is possible, however, through the potential for shareholder activism via SRI. When SRI mutual funds and SRI-focused institutional investors buy large chunks of stock in a company, they gain a significant voice in impacting the corporation’s actions. Indeed, some SRI investors will hold stocks in “bad” corporations for the single

purpose of “[introducing] shareholder resolutions to denounce corporate misdeeds and demand reform.”¹² While such efforts have resulted in minor inroads, widespread positive change has yet to occur as a result of such shareholder activism.¹³

As SRI gains more traction and exposure, positive change via shareholder activism is sure to increase, if not in success, then at least in volume of effort. Even if the increase in capital flowing into SRI investments does not lead to a greater success rate of shareholder activism, it may indirectly push corporations to adopt more socially responsible practices. As SRI funds gain in popularity and exposure, non-SRI funds may feel pressure to “clean up” their image by pushing the companies they invest in to adopt better practices or do away with “bad” ones. This last possibility may arise as a result of a kind of peer-pressure, and in the absence of shareholder activism. The greatest impact and potential for positive social change will occur if both pressures are imposed on corporations.

III. Calvert

Overview

Once committed, the socially responsible investor has many options among the various SRI-oriented asset management firms. Each firm offers a unique mix of investment products and services. Perhaps more critically, though, are each firm's unique methods of screening and qualifying the various corporations as investment-worthy or not. The completeness and depth of the process will have a direct impact on the quality of the companies comprising the SRI investments the firm offers. Due to the importance of the screening and rating process, it is important to thoroughly evaluate an SRI asset management firm in addition to the investment vehicles it offers. In this section I look at Calvert, one of the more prominent SRI asset management firms.

Founded in 1976, Calvert is an SRI-focused asset management firm offering equity, fixed income, and mutual fund products, all screened for performance and for corporate integrity. Though not the only SRI-oriented firm, Calvert helped pioneer the concept of socially responsible investing.¹⁴ Some of Calvert's peers include: Domini Social Investments, Newground Social Investment, Parnassus Investments, Pax World Funds, Advocacy Investing, and Aquinas Funds. Popular Calvert mutual funds include: Calvert Social Index A, Calvert Income A, and Calvert Social Investment Equity A.

Calvert Ratings™

To effectively analyze a company's merit as a socially responsible investment, and in relation to its peers, Calvert created a comprehensive rating system, dubbed the Calvert Ratings™, to rate a company's actions, corporate social responsibility initiatives, and related performance. Measured across five key areas, the ratings are on a scale of 1 to 5, ranging from "performance is substantially below Calvert standards" to "superior performance" respectively. Eligibility as an investment in one of Calvert's funds is limited to those companies achieving a rating of "3" or higher for each of the five key areas, which are comprised of the following:

- **Environment:** In addition to an assessing a company's compliance with federal, state, and local environmental regulations, performance and policies are measured in four specific areas: the environmental impact a company has during its manufacturing process; the impact of the company's product use as well as its disposal; the transparency and nature of the company's environmental management and policies; and, the sustainability of the company's development practices.
- **Workplace:** Workplace practices, programs and policies are assessed across three areas: labor-management relations, worker safety, and workplace diversity. Also assessed is a company's compliance with federal and state regulations.
- **Business Practices:** Corporate governance is examined to determine the rating for a company's business practices by reviewing the following areas: board practices; board independence and diversity; compensation of executives and directors, quality and independence of auditors, corporate charters and bylaws, and, the degree of shareholder communication.
- **Human Rights:** Domestically and internationally, Calvert assesses a company's record of compliance with human rights statutes and international standards, and the degree to which it supports governments with poor human rights records. Also considered, in relation to human rights, are a company's policies and practices, whether a company exceeds or simply meets the minimum standards required by a host country, the extent to which a company actively addresses human rights abuses, and the level of disclosure and reporting a company offers regarding its human rights record.
- **Community Relations:** Corporate philanthropy, employee volunteerism, and other means of supporting nonprofit organizations by a company, specifically in relation to such initiatives' impact on communities, are assessed.

[Source: calvertgroup.com]¹⁵

Strengths & Weaknesses of the Calvert Ratings™

Though not necessarily unique among SRI asset management companies, Calvert's rating system is clear and easy to follow. Every categorization process has strengths and

weaknesses, however, and there is considerable value in taking them into account. Some of Calvert Ratings™ main strengths are:

- The 1 to 5 numbering scheme is very easy to read and use to identify the relative corporate integrity of a company.
- Side-by-side company comparisons, to determine which is a more sound SRI investment, are as simple as comparing the companies' respective ratings.
- Calvert's minimum investment criteria is clear and easy to check against—a company either receives a rating of “3” or higher, and is then deemed to be an acceptable investment, or it does not.
- Each of the criteria is viewed as having the potential to increase the value of the company when it excels in the rated area. Examining the correlation between a high rating and high performance is easy to do, and also creates an incentive for companies to increase their ratings, not just their performance.

In addition to the strengths listed above, the ratings also suffer from a few weaknesses:

- Though the simplicity of the numbering system is a benefit, limiting the range to 5 values is too broad and may reduce the value of the ratings. The difference between receiving a “5” or a “3” is small from a ratings standpoint but could be very large within an actual company. A scale of 1-10 would provide greater information without being too detailed to be useful.
- The ratings do not seem to be industry specific. In actuality, they are, as each rating is adjusted to account for specific company criteria, however, unless an investor digs deep into the ratings explanation, this fact is not readily apparent. Accordingly, such ambiguity may cause reservations and questions for investors. Are the ratings of “3” for an oil company and a financial services company in “Environment” the same? Or is the oil company given more latitude due to the nature of its products, and is thus a greater polluter (without a reduction in rating) than the financial services company receiving the same rating?

- The rating system allows the incorporation of outliers. Because the overall analysis is represented by a single rating, aberrations in a company's operations will not necessarily drop its rating. For instance, Cisco has recently been criticized for aiding the Chinese government in censoring access by China's citizens to information via the internet.^{16,17,18} Despite such criticisms, Cisco is held in large portions by several of Calvert's mutual funds and boasts a rating of "4" for Human Rights. While Calvert makes note of the discrepancy in the ratings explanation for Cisco¹⁹, it is possible for an investor to see the rating yet miss the footnote that the company is still engaging in questionable practices. Further, it sends the message to companies that they can still achieve a very good rating, while still engaging in highly questionable business practices. What incentive does Cisco have to end its business relationship with the Chinese government if not only is it receiving a lot of revenue as a result, but its Calvert Ratings™ stays firm at "4"?

Not All SRI Criteria Are Created Equal

While Calvert's rating system is clear and concise and allows for easy analysis and identification of socially responsible companies, one has to wonder if the process could use some tweaking. For example, out of the five rating criteria, is there a range of importance, or are all five treated with equal weight? If they are given equal weight, are some issues such as widespread pollution downplayed while lesser issues are elevated, such as not providing full premium coverage on dental insurance?

To review, the five Calvert Ratings™ categories are as follows:

- Environment
- Workplace
- Business Practices
- Human Rights
- Community Relations

As noted earlier, each company is analyzed across each of the five areas and given a single rating (e.g. a rating of “4” for Workplace). The ratings for each criterion are then listed together to determine whether the company meets Calvert’s minimum standards (a rating of “3” or higher in each of the categories) or is worthy of being a Calvert Leader™ (high ratings in all five areas). Is this approach too simplistic? Should the categories be arranged according to importance and then given weights to better identify high and low performing companies?

If one of the five rating categories can be shown to have a greater impact on society when a company excels or lags in the area, then the categories should be ranked and given relative weights. Without the ranking and relative weight being calculated, it is possible for two companies to receive the same aggregate rating (e.g. both receive aggregate scores of 19) even though one of the companies may be far more socially responsible than the other.

For example, a financial services company and an oil company both receive aggregate scores of 19, yet the financial services company receives a “5” for Environment whereas the oil company receives a “3”. For simplicity, let us assume that the financial services company received a “3” for Workplace and the oil company a “5”, while the companies had the same ratings for the remaining three categories. Since both companies meet the minimum rating of a “3” in each category and receive an aggregate score of 19, they could presumably be viewed as equally socially responsible. Yet, when reviewing the rating differences in the Environment and Workplace categories for the two companies, it is questionable whether the equality is fair. Do environmental issues carry more weight than workplace issues? Do they carry less? Does failure or excellence in one category impact society more than failure or excellence in the other?

I believe that there is a difference in importance among the five rating categories and that they should be arranged and weighted in the following manner (greatest to least importance):

1. **Human Rights:** How a company values and treats its workers, both domestically and internationally, is of the utmost importance. Abusing the rights of a human being whether out of poor practices and labor policies, or as a matter of policy to maximize

profit, is the most deplorable form of corporate abuse. Companies that prioritize human dignity and strive to exceed human rights standards, however, will benefit from higher productivity and worker satisfaction, lower risk from worker injuries and lawsuits, and will enjoy greater retention rates. Additionally, a greater positive public perception of the company will result, leading to positive PR and further exposure. Because of the nature and impact of its potential abuse, I believe *human rights* should be the most important rating criteria.

2. **Environment:** A company's abuse of the environment can have very significant and long-term ramifications both locally and globally. Because of the possible wide-reaching impact of environmental abuse, companies should have very strong and effective environmental policies and standards in place. Due to the potential long-term and geographical scope of its abuse, I believe the *environment* should be the second most important criteria.
3. **Business Practices:** The presence and adherence to a strong standard of corporate governance ensures that shareholder objectives are being met while all of the checks and balances to maintain the stability of the company's leadership are also in place. Moreover, a company that prioritizes strong business practices will also set a standard of compliance to policies and further underscore their importance in the structure of the business. While not the most noticeable of the five criteria, due to its ability to set the tone and adherence to governance standards, I believe *business practices* should be the third most important criteria.
4. **Workplace:** Strong wages, diversity, the quality of the work environment, and the extent to which labor policies are promoted and adhered to will have a noticeable impact on employee morale and productivity. Risk of injuries and lawsuits are also reduced, further adding to the bottom line. Due to the impact positive or negative workplace conditions can have on employee safety, morale, and retention, I believe *workplace* should be the fourth most important criteria.

5. **Community Relations:** Companies that give back directly, and by supporting employee volunteerism, to the communities within which they operate will enjoy a greater connection to their employees. Moreover, by supporting nonprofits and community organizations, a company can increase the positive PR it receives and may obtain future business opportunities as a result of its efforts. While corporate philanthropy is both admirable and important, it contributes little to profitability and may create extensive conflicts of interest through either the inclusion or exclusion of various charities. Due to its lack of contribution to the bottom line, and potential to create conflict amongst shareholders and employees, I believe *community relations* should be the least important criteria.

New SRI Rating Criteria

In addition to the ordering of the rating categories above, I also believe that three additional rating categories should be considered. While the above five cover a fairly broad set of criteria, adding the following more focused categories will increase the value of the overall company rating:

- **Disclosure:** All public companies are expected to deliver a certain amount of disclosure to their shareholders, in accordance with SEC guidelines as well as new Sarbanes Oxley regulations. However, loopholes still exist, and many companies are able to withhold certain types of information from shareholders. For instance, various forms of retirement benefits and “phantom” compensation allocated to senior executives do not have to be disclosed. The end result is reported financials that appear higher than they actually are and executives that are compensated at a higher level than is reported. The lack of full disclosure puts shareholders at a disadvantage, and the hidden compensation for executives increases their pay with little incentive to increase performance by a relative amount. Since disclosure loopholes will most likely continue to exist, companies should be rated according to the extent and consistency of their disclosure. Companies that voluntarily lead their peers through full and consistent disclosure should receive the highest rating. Similarly, to achieve Calvert’s minimum investment-worthy rating of “3,” companies

should be expected to meet the disclosure practices of the top 20% of the companies in their industry, and minimally have consistent annual full-disclosure of information.

- **Product/Service Safety and Purpose:** Companies can more or less choose what products and services they produce and offer. To be clear, the market determines the demand for the products and services, but companies have to choose to fulfill the demand. Accordingly, companies have a choice of products and services to offer. Aside from pursuing options that fit with the company's capabilities and business strategy, it should also prioritize the products' safety and purpose. For instance, does a product that has the potential to cause great bodily harm and pollutes the environment have less or more societal integrity than one that furthers an individual's education and quality of life? Clearly, products and services that are safe and increase the recipients' quality of life, without imposing negative externalities, have greater societal integrity than ones offering lesser benefits. Companies that offer products and services that are safer and have a greater societal purpose than those of its competitors should receive the highest rating. A mid-range rating of "3" should be awarded to companies that meet the standards of product and service safety, and quality of purpose, of the top 20% of their industry.
- **Commitment to and Impact of Corporate Social Responsibility:** Most large corporations have begun to create corporate social responsibility (CSR) initiatives. The validity and extent of the commitment, however, fluctuates wildly from company to company. Indeed, some companies create CSR initiatives out of a deep concern and passion for various issues, while other companies simply create "shell" initiatives in an effort to garner positive publicity and goodwill.²⁰ The companies that truly embrace, support, and promote their CSR initiatives, in contrast to those that simply create the glossy PR but fail to go any further, clearly have a more positive impact on society. The highest rating should be awarded to companies leading their industries in CSR, while a midrange rating of "3" should be awarded to the ones that meet the CSR standards of the top 20% of their industry.

IV. SRI and Corporate Governance

Overview

After examining the intricacies of SRI a very serious question comes to mind. Even if the returns of SRI investments exceed those of non-SRI investments, based on the governance structure and purpose of a corporation, can it pursue SRI objectives without creating conflict?

As defined by Robert Monks and Nell Minow, corporate governance is, “the structure that is intended to make sure that the right questions get asked and that checks and balances are in place to make sure that the answers reflect what is best for the creation of long-term, sustainable value.”²¹ While accurate, this definition may imply a far greater emphasis on long-term directives than most corporations adopt. An SRI-focused company would benefit from this definition, and perhaps use it to justify many of its actions, as many SRI initiatives are long-term in scope. Most corporations, however, focus almost single-mindedly on maximizing shareholder wealth, a task that is more achievable in the short-run. In fact, according to Joel Bakan, a company seeking to incorporate non-shareholder wealth-maximizing activities will actually be *acting illegally*: “[Corporations are] set up by statute to serve the best interest of the shareholder, and that’s creating wealth. Any manager or director who actually pursued the triple bottom line [of people, planet and profits] at the expense of shareholder interests would be acting illegally.”²²

As indicated by these varying perspectives on the purpose of corporate governance, depending on the definition a company adopts, SRI-oriented objectives may or may not create conflict. Clearly conflict will arise if from a governance standpoint a company is charged primarily with maximizing short-term shareholder gains, yet the company instead chooses to pursue several long-term initiatives, even more so if done at the expense of profit maximization.

Conflict With Fiduciary Duty

Perhaps where the greatest conflict may arise between corporate governance and socially responsible investing is within a fiduciary’s duty to the corporation. Fiduciary duty can be

defined as the responsibilities a corporation's director, officer, or other important executive holds to the corporation. In most jurisdictions, there are two duties fiduciaries are legally obligated to uphold: the duty of care and the duty of loyalty.²³ To uphold his or her duty of care, a fiduciary needs to, "exercise due diligence in making decisions...[and] must discover as much information as possible on the question at issue."²⁴ Similarly, a fiduciary needs to, "demonstrate unyielding loyalty to the company's shareholders," in order to honor his or her duty of loyalty.²⁵

While both duties may seem to have little to do with socially responsible investing, there are several serious conflicts that may arise. The overarching conflict is the potential for socially responsible investment objectives to disagree with a fiduciary's duty to the corporation, thus forcing them to choose between the SRI initiative or his or her fiduciary duty. In other words, it is possible for a fiduciary to find and implement an attractive SRI investment that could potentially breach either duty (this is the scenario alluded to in the quote by Joel Bakan above).

As a practical example, imagine that the CEO of a publicly traded apparel company finds out about a community program for low-income garment workers based in various cities in the United States. The program coordinates training and management of the workers and partners with participating companies in order to produce the same products the companies manufacture in garment factories overseas. There are a number of significant differences, however, including that the garment workers in the program are paid at least minimum wage, work in a clean and safe environment, benefit from all of the regulations of the US labor department such as periodic required breaks, and have an opportunity to receive health benefits if they work 40 hours a week. Contrast that with the overseas garment factories the company is currently using where they pay the workers less than \$1/hour, do not have to worry about or adhere to many labor regulations, if any at all, do not have to provide healthcare, and do not have to spend capital (either in increased wages or direct infusion) to improve the working conditions of the factories. Without doing the actual math, it is safe to assume that the company's production costs, if it chooses to shift production to the US program, would increase significantly.

If faced with the above scenario, the CEO would have to carefully consider the trade-off of higher costs but greater societal benefits, in participating in the program, against lower costs but very low societal benefits in continuing to keep production overseas. By choosing to forego profits and shift production to the US program, the CEO does so at the expense of shareholder wealth, possibly breaching his or her duty of loyalty. Additionally, by not considering more options (perhaps there are a few more programs offering similar worker-benefits, yet with far lower costs) the CEO may be breaching his or her duty of care. My example is obviously a bit extreme, but hopefully helps to illustrate the inherent conflict between a fiduciary's duty to the corporation and his or her duty to society. Robert Monks and Nell Minow discuss the conflict between profit and choosing socially responsible goals quite well:

“But can companies thrive when the cost of social responsibility raises prices too high, instead of making the products more marketable making them less so? Clearly, there is some point past which the company's goods and services will become too expensive.

“At one end of the scale are the most basic aspects of social responsibility, like compliance with the law. At the other end of the scale are activities so unrelated to the goods and services sold that pursuing them is considered by the marketplace to be irrelevant, and even detrimental, to the company's productivity.”¹²⁶

Is There A Future For SRI?

So is there any hope for corporations to strive to do anything other than to maximize profits? Are the various corporations that *do engage* in taking greater care for the environment, paying better wages, providing more ample benefits, and other CSR initiatives, potentially subject to shareholder backlash?

Indeed, there are a growing number of corporations that have begun to implement CSR programs and that have taken on an increased focus on providing more value to society. Some shareholders most certainly feel shortchanged, yet the companies are nonetheless able to push forward with their initiatives as well as their overall goal of profit maximization.

The harmony is possible due the fact that many socially responsible actions, if structured correctly, can actually increase the long-term value of the company²⁷, even at the expense of greater short-term costs. In fact, it can be argued that, “corporations must have as their primary and overriding goal the generation of long-term value...a commitment to the satisfaction of employees, suppliers, customers, and the community is essential for achieving this goal.”²⁸ Corporations and shareholders alike are beginning to understand that concept more and more, evidenced by the increase in interest in SRI investments in the past few decades as well as the more recent surge in CSR program implementations by corporations.

V. Expansion of Fiduciary Duties

Overview

As discussed in the previous section, often times there exists a conflict between a fiduciary's duties to the corporation and a push to increase the corporation's social integrity. Since it can be shown that socially responsible companies have the potential for greater long-term value, perhaps modifying or expanding a fiduciary's duties is a plausible solution to bring these goals closer together. If the fiduciary duties are expanded to include new requirements geared toward increasing corporate integrity, while still allowing for a focus on profit maximization, corporations will suffer from less internal conflict between generating profits and "doing good," and will enjoy clearer directives as to how to achieve both.

Rather than suggesting a modification to the two legally required duties of loyalty and care, I propose the introduction and requirement of two new duties: a duty of citizenship and a duty of humanity.

Duty of Citizenship

Duty of citizenship would require the fiduciary to consider the impact of a corporation's actions both on profits and on the communities within which the corporation operates. By tying the two together the corporation then has an incentive to pursue activities that promote good citizenship while also generating profits. Formerly, the fiduciary choosing between profits and citizenship would always see the value in focusing on profits—such focus serves to maximize shareholder wealth and was in concert with the fiduciary's duty of loyalty. An example of duty of citizenship would involve a fiduciary considering the impact on a community if the corporation were to close a factory and move production overseas. The fiduciary would adhere to his or her duty of care in performing extensive analysis of the cost savings of such a move, but will also carefully review the potential impact the loss of the factory will have on the community in adherence with his or her duty of citizenship. If the fiduciary determines that the cost to the community would far exceed the cost of not moving productions overseas, but chose to move production nonetheless, he or she would be in breach of the duty of citizenship.

Duty of Humanity

During his or her daily activities, a fiduciary would meet the duty of humanity by considering the impact of each his or her actions and decisions on humanity. Duty of humanity differs from duty of citizenship in that it focuses on individuals as opposed to duty of citizenship's focus on communities. The consideration should occur at both a macro and micro level, taking into account the welfare of the global population all the way down to a single individual. Therefore, the fiduciary would be charged with preventing the corporation from engaging in activities that would prove harmful to an individual or the global population. As a practical example, the fiduciary would be in breach of his or her fiduciary duty of humanity if he or she authorized the corporation to manufacture and sell cigarettes since the product has not only been shown to cause cancer in smokers, but also in individuals exposed to secondhand smoke.

VI. Concluding Thoughts

The constant drive for profits and shareholder gain has created a considerable amount of wealth over the past few decades. Individuals such as Warren Buffet and Bill Gates derive a large portion of their fortunes from gains realized as shareholders of various public companies. Moreover, their prosperity has enabled both individuals to give back—Gates, for example, donated \$3.4 billion to the Bill & Melinda Gates Foundation in 2004 alone.²⁹ ‘Business as usual’, it seems, is doing just fine at generating wealth and improving society at the same time.

All is not well, however, evidenced by the harm imposed by corporations in the form of externalities to communities and individuals both domestically and abroad, as well as to Earth’s environment. The externalities are a byproduct of prioritizing profits single-mindedly—were corporate integrity and corporate social responsibility prioritized as well, the externalities might be minimized or even eliminated.

The world and the global community will only improve if corporations strive to achieve more than profit maximization. The desire to pursue more socially responsible concerns must come from shareholders as well as from corporate leadership. Momentum and awareness are building, however, with a greater number of corporations adopting CSR initiatives each year. Awareness through socially responsible investing has played a large part in building the momentum, creating exposure for social concerns and corporate integrity and also by empowering shareholders through collective activism. As SRI asset management firms such as Calvert continue to lead the way, we may see an increasing performance gap between SRI investments and non-SRI investments. Corporations will invariably get better at becoming good corporate citizens and will increasingly learn how to make greater profits while pursuing corporate social responsibility. The companies that arrive late to the game will lag and may suffer even greater consumer and investor apathy than currently exists. One thing is for certain—SRI appears to be here to stay, and looks like it is going to have a bright and profitable future.

Endnotes

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