

Biblically Responsible Investing: An Evaluation Report

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KEYWORDS

Socially Responsible Investing, SRI, Biblically Responsible Investing, BRI

ABSTRACT

This article presents an evaluation of Socially Responsible Investing (SRI) and its evangelical, faith-based equivalent, Biblically Responsible Investing (BRI), which is noted as sharing much in common with the broader SRI. The benefits of SRI/BRI have been well-explored in other literature but less commonly understood are some notable practical issues which are necessary considerations for potential investors. Presented in this article are the background and basis of SRI/BRI together with some important concerns. This research suggests that although SRI/BRI offers the possibility of improved ethical choices, the decisions that underlie these choices are not straightforward. A further contribution of this article is an assessment of long term financial performance of the MSCI KLD 400, the oldest and most significant SRI equities index, with the data suggesting that there is a financial penalty in pursuing SRI/BRI.

THE BACKGROUND TO BRI AND SRI

Many investors prefer to align their investment choices to their values, in many cases expecting that they will also outperform the general market. The values that underpin these investment choices may derive from the ethical preferences of the individuals concerned or, in the case of evangelicals, from the Bible. In the latter case, BRI has emerged as a means of partaking in global markets from within a Christian context. It is a somewhat fringe activity within the global investment community: even among evangelicals, it is neither well known nor popular. Compared to the global investment business, its adherents and proponents are few, academic studies sparse, and investment vehicles limited. This may yet change but even so, many of the principles behind BRI are shared with the more popular SRI (also known as ethical investing or responsible investing). It is thus possible to glean useful information by analysing the wider SRI industry. This article thus also discusses SRI in depth, partly because of overlapping issues, but also because SRI practice offers useful pointers for those considering BRI-based choices.

SRI, like BRI, is an investment philosophy that attempts to combine financial performance with social or ethical responsibility. This approach typically precludes investments such as tobacco, alcohol, weapons/firearms, nuclear power and environmental concerns (a narrower approach, *sustainable investing*, concentrates on environmental issues). Once a fringe activity, SRI has become a global concern with explosive growth occurring in recent years. Although ethical investment principles have been advocated for generations by religious groups and other social reformers, the contemporary notion of SRI did not gain mainstream traction until the 1990s. Since then, the movement has expanded greatly. The 2012 annual report of the UN Principles for Responsible Investment (PRI) Initiative, notes that SRI investments among its signatories have grown to \$32 trillion assets under management, representing around 20% of the estimated total value of global asset markets. The equivalent figure in 2000 was less than \$5 trillion. BRI attracts far lower, though not insignificant, sums: \$30 billion under management by Oct 2012.¹

Screening

SRI/BRI differs from conventional investing through the practice of screening, the evaluation of a company on ethical grounds to assess its suitability for inclusion or exclusion. If businesses are understood to function in ways that maximise shareholder return, then it follows that they should operate in ways that meet the best interests of their owners. For such investors, it is not enough for a company to generate strong earnings and free cash flow; they must also deliver in terms of social responsibility.

It is cheaper to use slave labor than to pay living wages; it is cheaper to pollute than to clean; it is cheaper to tar over a parking lot than to build one around planted trees and benches. If civilised people continue to define monetary rewards to investors as the reason that corporations exist, the future we hope for cannot be realized.²

The most common SRI screening categories are as follows (approaches differ but the following is representative).

1 David Kathman, "Getting Religion With Faith-Based Mutual Funds," *Morningstar*, November 5, 2012.

2 Amy L Domini, *Socially Responsible Investing: Making a Difference in Making Money* (Chicago: Dearborn, 2001), 4.

Category	Screening	Notes
Alcohol	Negative	Examples include Anheuser-Busch and Diageo.
Tobacco	Negative	Examples include Philip Morris and British American Tobacco.
Gambling	Negative	Examples include Las Vegas Sands and MGM Resorts International.
Defence (Military Contracting), Weapons and Firearms	Negative	Examples include Lockheed Martin and Raytheon.
Abortion	Negative	Abortion companies, or those that donate or are associated with abortion providers such as Planned Parenthood.
Pornography	Negative	Examples include Playboy and Rick's Cabaret.
Labour Relations / Workplace ethics	Negative	Avoids child labour, 'sweatshops', or other worker exploitation.
Human Rights / Oppressive Foreign Regimes	Negative	Avoids companies associated with human rights violations, or mainly invested in oppressive regimes.
Animal Rights	Negative	Avoids companies testing on animals, typically for medical research or cosmetics. Also includes intensive farming.
Environmental	Positive or Negative	<i>Negative:</i> fossil fuel/nuclear power. Can include companies involved in genetic modification of food <i>Positive:</i> companies proactively involved in recycling or conservation.

There are three broad types of screening:

1. *Negative Screening*: avoiding companies engaged in objectionable activities.
2. *Positive Screening*: investing in companies engaged in approved or commendable activities.
3. *Activist Screening*: investing in objectionable companies in order to use shareholder rights to seek changes.

BRI DIFFERENCES

Christians are called to be good stewards of that which God has entrusted to them. For BRI, appropriate ethical and moral actions are derived from scripture. The Parable of the Talents (Matt 25:14-30) serves partly as a lesson to Christians to be industrious and faithful with resources given by God. The Bible teaches that God is holy and calls his people to be holy (I Pet 1:15-16). Principles of justice and holiness reach all parts of Christian life and by extension include the companies in which investments are made.

BRI attempts a biblical basis to stock selection and investment choices. It shares much with other Christian ethical investing movements which, in the modern sense of SRI, dates to 1948 when church based investment groups including the Church of England, the Methodist Church, and the Quakers avoided sectors such as alcohol, tobacco, defence and gambling.³ But long before, Christians had linked business practices with faith: John Wesley preached about it in a famous sermon titled “The Use of Money,” and in 1758, the Quakers prohibited members from doing business with companies involved in the slave trade.⁴

Some Christians, while accepting this, see no special reason for BRI. One evangelical financial writer notes a difference between *direct* and

³ Russell Sparkes, *Socially Responsible Investment: A Global Revolution* (New York: J. Wiley, 2002), 27.

⁴ W. Timothy Coombs and Sherry J. Holladay, *Managing Corporate Social Responsibility: A Communication Approach* (Malden: Wiley-Blackwell, 2012), 17.

indirect relationships with companies. Investing in a mutual fund is not an endorsement of every activity of the companies within it. He notes that,

Regular mutual funds are acceptable investment vehicles, even though they may, on occasion, hold objectionable companies in their portfolios. The important stewardship issue for me is that I don't directly involve myself with morally questionable enterprises⁵

Investment should not necessarily be equated with approval. BRI remains a relatively small market compared to SRI. There are no faith based funds operating in the UK and attempts to launch US-based ETFs targeted at Christian investors failed in 2011 following insufficient interest. Moreover, BRI or protestant funds sometimes show little, if any, differentiation from standard SRI funds. The Thrivent (Lutheran), New Covenant (Presbyterian), GuideStone (Southern Baptist), and Praxis (Mennonite) mutual funds operate screens that are very similar to typical SRI funds. Commenting on the New Covenant funds, George Schwartz remarks, "the criteria for selecting stocks are virtually indistinguishable from any number of secular funds without an ideological focus."⁶ This may be a reflection of Christian groups deriving ethical values from contemporary societal norms rather than from the Bible.

Some BRI funds screen with notable differentiation. The evangelical Timothy Plan includes a unique fund aimed at companies operating in Israel, representing a country-level form of positive screening.⁷ It invests at least 80% in companies domiciled or headquartered in Israel. Another firm, Stewardship Partners, screens on more than a dozen lines focused on concerns such as traditional marriage and family values. Some BRI funds also consider bioethics (screening against stem cell research and cloning), a matter not often considered in SRI.

Green issues are an area of common divergence with SRI. The Timothy Plan's screening criteria do not explicitly include environmental or 'green investing' issues. Their funds include holdings of oil and gas companies such as Exxon Mobil and Noble Energy, both infrequently found in SRI because of concerns over global warming. Among the Timothy Plan's top holdings is

5 Austin Pryor, *The Sound Mind Investing Handbook: A Step-by-Step Guide to Managing Your Money from a Biblical Perspective* (Louisville: Sound Mind Investing, 2008), 327.

6 Schwartz, *Good Returns*, 10.

7 Timothy Plan Israel Common Values Fund.

Israel Chemicals, a company unlikely to be accepted in SRI funds an account of alleged pollution of the Dead Sea.⁸ Some Catholic investments adopt similar viewpoints: the Ave Maria Mutual Funds have significant investments in oil stocks, including Forest Oil, Halliburton, and Schlumberger. They also passed over SRI concerns regarding ‘fracking’ (a controversial fossil fuel extraction method that some opponents link with contaminated ground water) by taking a position in shale gas producer XTO Energy.⁹

More commonly, the difference is with the degree to which screening criteria are used. Russell Sparkes notes that faith-based groups have stronger screens against alcohol, gambling and tobacco, while SRI funds have greater interest in issues such as environmental matters and animal testing,¹⁰ a point also made by the BRI Institute who note that SRI has traditionally been the domain of social liberals.¹¹

SRI/BRI PERFORMANCE

Ethical investors hope that companies with strong social and environmental records will perform at least as well as the general market. If claims are true that SRI/BRI investments facilitate improved ethical choices as well as giving financial outperformance, then such investors have the best of both worlds. Their consciences are clearer and their bank balances are healthier. But, if SRI/BRI produces comparatively lower financial rewards, then such investors should be wary of the potential financial penalty and must consider sacrificing performance for ethical choice.

This section assesses long-term performance but is restricted to SRI because there are no BRI market indexes and very few BRI funds. Of the latter, there are none that have been in existence for longer than 10 years which makes long-term performance comparison impossible. In any case,

8 Alon Tal, *Pollution in a Promised Land: An Environmental History of Israel* (Berkeley: University of California Press, 2002), 69.

9 George P. Schwartz, *Good Returns: Making Money by Morally Responsible Investing* (Bloomfield Hills: Geodi 2010), 143.

10 Sparkes, *Socially Responsible Investment*, 71-2.

11 BRI Institute (1997) *The Biblically Responsible Investing Institute - The Scriptural Basis for Biblically Responsible Investing*. [online] Available at: <http://www.briinstitute.com/basis.htm> [Accessed: 1 Mar 2013].

comparing mutual funds is problematic because any performance difference may reflect differing fund manager skill levels and not a fundamental superiority of SRI against conventional investments or vice versa.

First, a brief word on the occasional claims that SRI/BRI provides superior financial returns: as long ago as 1995, there were claims that multiple academic studies found SRI outperformance over the general market: Moses Pava and Joshua Krausz reported that 21 separate studies demonstrated SRI screening enhanced performance.¹² Meanwhile, Peter Camejo claimed that:

Socially responsible investing (SRI) has financially outperformed conventional investment strategies. And not only has SRI outperformed, it has also lowered risk. SRI reduces risk and improves performance ... The empirical evidence for SRI's outperformance is overwhelming.¹³

This remarkable claim suggests that compared to conventional investing, SRI offers the best of three worlds: superior ethics, lower risk, *and* better performance. Camejo's study looks at the relative performance of an entire index (S&P 500) against the leading SRI equivalent (KLD 400). It shows that in the ten years to January 1, 2001, the KLD 400 outperformed the S&P 500 by 1.53% per year.

Schwartz, meanwhile, makes the following claim with regard to faith based investments:

Companies that appreciate in value – and whose share price rise correspondingly in price – are generally companies that are well managed, whose decision makers follow sensible business practices, offer good products, and deal ethically and reliably with their suppliers, employees and customers.¹⁴

This claim sounds good but is largely unsupported. The actively managed funds he cites may have performed well but this could reflect the superior stock selection skills of the fund manager, rather than an inherent advantage of faith-based selection screens over conventional investing.

12 Moses L. Pava and Joshua Krausz, *Corporate Responsibility and Financial Performance: The Paradox of Social Cost* (Westport, Conn: Quorum Books, 1995).

13 Peter Camejo, *The SRI Advantage* (Gabriola Island: New Society Publishers, 2002), 1.

14 Schwartz, *Good Returns*, 5.

Other studies also seem to show SRI outperforming non-SRI equivalents: a recent report by Deutsche Bank found significant opportunities for market outperformance by portfolios oriented towards greater sustainable investing.¹⁵ But it should be noted that other researchers have demonstrated no advantage: a paper analysing portfolio performance of SRI stocks from 1998 to 2009 revealed that SRI principles were neither penalized nor rewarded by the stock markets.¹⁶ Likewise, Lloyd Kurtz and Dan diBartolomeo state, “We see no evidence for a distinct social factor. This means that managers using the KLD400 as an investment universe have had neither headwinds nor tailwinds.”¹⁷

The reasons for the differences in findings may be due to researchers’ choice of date ranges and/or funds or indexes chosen for comparison purposes. The relative strengths and weaknesses of the various approaches taken by researchers is beyond the scope of this article but the approach taken here is to assess only the long-term total return performance of the oldest and most widely used SRI index (KLD 400) against its main comparator, the S&P 500 – the same approach taken in the Camejo study cited above. Its advantage is that by avoiding comparisons of actively managed mutual funds, it strips out the possibility of fund managers’ differing skill levels affecting performance data. In addition, by looking at long-term performance since the late 1990s, the effects of short term volatility are ironed out.

Launched in 1990, the KLD 400¹⁸ is the oldest and most closely followed SRI index. It comprises 400 companies and is broadly equivalent to the S&P 500. Presented below are the total returns (capital growth plus reinvested dividends) for the two indexes for the last 10 and 15 years.¹⁹

15 “Sustainable Investing: Establishing Long-Term Value and Performance” (2012, unpublished).

16 Janick Christian Mollet and Andreas Ziegler, “Is Socially Responsible Investing Really Beneficial? New Empirical Evidence for the US and European Stock Markets,” *MAGKS Papers on Economics* 201228, The Philipp University of Marburg. Unpublished report.

17 Lloyd Kurtz and Dan diBartolomeo, “The Long-Term Performance of a Social Investment Universe,” *The Journal of Investing* 20, No. 3 (2011): 100.

18 The index was previously known as the Domini 400 and the FTSE KLD 400. Since 2010, it has been the MSCI KLD 400. In this article, it will simply be called the KLD 400.

19 Since taking over the KLD 400 in 2010, MSCI have preferred to compare it with the MSCI USA rather than the S&P 500. Historically, however, the S&P 500 has been the main comparator. MSCI note that the KLD 400 has underperformed the MSCI USA over the last three years.

LONG TERM PERFORMANCE OF THE KLD 400 VS S&P 500

Total returns (to Feb 28, 2013)

	Last Ten Years	Last Fifteen Years
S&P 500	121.73%	89.64%
KLD 400	113.54%	87.86%

(Data from MSCI and YCharts.com)

The data shows the KLD 400 underperforming the S&P 500 in the two time periods. This contrasts with Camejo's results who found that in the first decade from 1990, the KLD 400 performed more strongly. His conclusions about the superiority of SRI investing appear to have been premature although Camejo was not alone in finding such results. Various studies around the late 1990s and early 2000s showed better SRI results, leading to this observation: "Amazing as it may sound, in the last ten years [1992-2002] there have been no research studies reporting that SRI limits investors to lower performance"²⁰

'Dot-com bubble' effect

What could be the reason for Camejo's finding of SRI outperformance during the ten years after 1990? One reason might be the greater technology weighting in SRI. Compared to conventional funds, SRI tends toward higher weighting in technology stocks (a result of the wholesale avoidance of other, objectionable industries). Today, the KLD 400 has a 24.4% weighting in IT firms compared with 19.8% for the S&P 500. Six of the ten largest positions in the KLD 400 are technology firms compared with four in the S&P 500.

During the late 1990s, Internet stocks attracted extremely high valuations with the tech-oriented NASDAQ reaching an all-time high of 5132 on March 10, 2000. Although the 'dot-com bubble' burst shortly afterwards, tech stocks remained richly valued *compared to the overall market*. And while a US recession and the 9/11 attacks preceded further losses in the technology sector,

²⁰ Camejo, *SRI Advantage*, 25.

the S&P 500 and Dow Jones also fell – down to multi-year lows. Technology stocks may have crumbled but so too did the overall market. Moreover, large-cap technology firms were still commanding historically high valuations. Compare below the significantly lower P/E ratios²¹ for some industrial firms compared to technology firms:

Average Annual P/E Ratios

	Screening	2000	2001
Microsoft	Technology	53.1	35.3
Intel	Technology	36.1	>100
HP	Technology	33.3	31.7
Cisco	Technology	99.7	>100

	Screening	2000	2001
Exxon Mobil	Oil/Gas	17.3	18.9
United Technologies	Defence	17.4	18.1
Boeing	Defence	17.1	18.6
Chevron	Oil/Gas	10.6	28.8

(Source: Value Line.)

This implies that SRI indexes and funds, with greater technology weighting, were boosted both before and after the NASDAQ collapse, exactly the time when Camejo and other SRI proponents were reporting above-market returns. This ‘dot-com’ effect seems to be a plausible explanation for strong SRI performance around the turn of the millennium.

Testing the *degree* to which technology overvaluation affected performance is problematic because, remarkably, none of the three firms previously responsible for the KLD 400 hold historic constituent data. It is

21 A *price to earnings* (P/E) ratio is a commonly used guide to valuation. It is calculated by dividing a company’s share price by its earnings per share. A low P/E is suggestive of a cheaper market valuation; a high P/E suggests an expensive valuation.

widely recognised that the KLD 400 is technology-heavy but the constituent companies in the index and their respective weightings during the above periods is no longer known.²² Nevertheless, what is clear is that it took some time for technology stocks to return to ‘normal’ valuations. And that return to normality is perhaps a good reason why SRI has subsequently underperformed, and especially so during the last ten years.

The Impact of Fees

The above data shows slight underperformance of the KLD 400 but do those figures accurately reflect the real returns an investor might actually receive? After all, the performance data merely gives *gross* performance figures. For individual investors, what matters is the total return *net of fees*. To partake in the performance of an index, investors purchase a tracker, such as an ETF, which mirrors index performance by holding equivalent constituent companies in the same weighting as the index itself. Such ‘passive’ investments tend to be inexpensive because active fund management is not needed. But even low costs will cause a drag on performance because returns are lowered by the annual fees levied. Importantly, SRI funds have higher fees than conventional funds.

The cheapest KLD 400 tracker is the iShares MSCI KLD 400 ETF with an annual fee of 0.50%. This is more expensive than the iShares S&P 500 ETF which charges just 0.07%. Since annual charges cause a drag on performance, the pricier KLD 400 tracker will produce lower returns than the above performance results suggest. Before investigating just how low this might be, it is worth noting two reasons why SRI causes higher charges:

- (1) **Maintenance and Licensing:** The need for continual SRI-related research means that constructing and maintaining an SRI index against screening criteria is costly. This in turn leads to higher licensing prices for fund managers and thus higher fees for investors.
- (2) **Size and scale:** There are fewer investors in SRI funds so

²² The current owners of the KLD 400, MSCI, were contacted along with the previous holders FTSE. The original owners, KLD, are now part of MSCI. Surprisingly, MSCI and KLD no longer hold constituent data for the index during the date ranges discussed above.

the costs of fund management are spread across fewer investors. For an idea of the difference, the iShares S&P 500 ETF has \$40 billion invested compared to the iShares KLD 400 ETF with \$0.2 billion.

Taking the above performance data into account, consider both the gross and net performance figures.

	Investment of \$10,000 becomes:
KLD 400 over 10 years	\$21,351 gross
S&P 500 over 10 years	\$22,176 gross
KLD 400 over 15 years	\$18,778 gross
S&P 500 over 15 years	\$18,968 gross

But consider the effect of fees.

	Investment of \$10,000 becomes:
KLD 400 over 10 years	\$20,381 net
S&P 500 over 10 years	\$22,033 net
KLD 400 over 15 years	\$17,472 net
S&P 500 over 15 years	\$18,778 net

The higher fees for the KLD results in overall lower net returns than the original gross figures suggest. Even so, one might argue that this SRI underperformance remains acceptable: the difference between the above scenarios is an acceptably small price to pay for ethical peace of mind. But there is, however, still more to this story: it is questionable whether the S&P 500 is a true comparator for the KLD 400.

The S&P 500: a true comparator for the KLD 400?

Although the KLD 400 showed slightly inferior results, closer examination suggests that its underperformance is *understated* because of differences in how it is constituted. Outwardly, the KLD 400 is broadly comparable to the

S&P 500 but, in fact, the former includes a number of small-cap and mid-cap companies. By contrast, the S&P 500 is exclusively large-cap. This means that KLD 400 versus S&P 500 is not a like-for-like comparison. The following section explores the effect this might have on performance data.

The KLD 400 maintains a composition of approximately 90% large-cap, 9% mid-cap, and 1% small-cap.²³ The KLD 400's weighting towards smaller companies could artificially skew comparison results in its favour because mid-cap and small-cap companies, by virtue of their smaller size and better growth prospects, outperform large-caps on average over long time scales.

The outperformance of smaller companies is well known. There is clear correlation between market returns and company size: large-caps exhibit lower average returns, an effect sometimes known as 'the size premium'. Such outperformance can be easily observed by comparing the simple price performance of the mid-cap S&P 400 against the large-cap S&P 500. As shown below, the mid-cap index outperforms the S&P 500 (and does so even if dividend reinvestment is included in the S&P 500!).

S&P 400 compared to S&P 500 (data to Dec 31, 2012).

Investment	10 years	15 years
S&P 400 (mid-cap only) without dividends	+140.4%	+218.0%
S&P 500 (large-cap only) without dividends	+61.4%	+50.40%
S&P 500 (large-cap only) with dividends	+98.6%	+92.8%

(Source: Yahoo.)

The higher average return of small and mid-cap companies indicates that the performance comparisons shown earlier may have artificially favoured the SRI index. That the S&P 500 still managed to outperform, despite the encumbrance of larger size, suggests that the outperformance would be even higher if the KLD 400 were restricted to large-caps only.²⁴

²³ This weighting is historic. It was unchanged after MSCI took over the index in 2010.

²⁴ This practice of including small cap and medium cap stocks has been found to be true of SRI mutual funds also, which should serve as a warning for comparisons between SRI and non-SRI mutual funds. A sample of US and European SRI funds were found to have a surprisingly high number of small-cap and growth stocks in their portfolios. See Maria Ceu Cortez, Florinda Silva and Areal Nelson, "Socially Responsible Investing in the Global Market: The Performance

Accordingly, a brief word on another SRI index, the Calvert Social Index, may be worthwhile. It is less popular than the KLD 400 but arguably the only other social index in general use. It began in May 2000 and its performance data is somewhat useful for comparative performance since it goes back more than 10 years. The Calvert is closer to the S&P 500 because it selects only from the largest 1000 US companies. There are thus no small-cap companies and although its universe of stocks is wider than the S&P 500, any size effect is probably small enough to be disregarded. Yet here again the Calvert Social Index underperforms the S&P 500. Since inception its total annualised returns have trailed the S&P 500 by 1.13% per year.²⁵ It is perhaps too early to draw conclusions using the Calvert index but future SRI-related performance comparisons may be better served with the Calvert index versus S&P 500.

In sum, it is clear that the KLD 400 underperforms the S&P 500 when additional factors such as fees and the inclusion of smaller companies are also considered. It seems reasonable to suggest that SRI, and by extension BRI, suffers from a clear performance headwind.

‘Sin Stocks’: Questioning the Alleged Outperformance of SRI

It might be argued that the underperformance of SRI is unsurprising given some interesting observations by investors noticing something quite different from SRI: that ‘sin stocks’ actually generate above average returns.²⁶ Indeed, some investors take advantage of this: the Vice Fund is the largest example involved in this kind of reverse-SRI, putting at least 80% of assets into firms engaged in alcohol, tobacco, gambling and defence contracting. Among its ten largest investments are Philip Morris and Lorillard (tobacco), Las Vegas Sands and MGM Resorts (gambling), United Technologies (defence), and Diageo (alcohol). Interestingly, the Vice Fund has dramatically outperformed not only SRI mutual funds but also the S&P 500 over the 10 years to March 22, 2013:

of US and European Funds,” *International Journal of Finance & Economics* 17, no. 3 (2012): 254-71.

25 Date ranges May 1, 2000 to Mar 22, 2013; from www.calvert.com and publically available data from Robert Shiller, Yale University, (www.econ.yale.edu/~shiller/data.htm).

26 Caroline Waxler, *Stocking Up on Sin: How to Crush the Market with Vice Based Investing* (Hoboken: Wiley, 2004).

Investment	Performance over 10 years
Domini Social Equity Fund	+74.66%
Calvert Social Index Fund	+78.71%
S&P 500	+81.72%
Vice Fund	+183.16%

Data from Yahoo Finance. This data does not include reinvested dividends but 'vice stocks' typically pay higher dividends which means that these figures probably understate the outperformance of the Vice Fund.

This does not mean that 'sin stocks' inevitably outperform: actively managed mutual funds may perform better due to better stock selection skills of the particular manager. Nevertheless, these results do accord with other findings. A recent study showed that tobacco stocks outperformed market averages even when discounting for the effects of market size and valuation effects.²⁷ Tobacco investments also showed strong market outperformance in a study of S&P 500 firms from 1957 to 2006, where the best performing company was Philip Morris (makers of Marlboro cigarettes). Its 19.88% total return far exceeded the S&P 500 total return over the same period, which delivered 10.88%.²⁸

Because social funds negatively screen industries such as tobacco, alcohol and defence contracting, they do not partake in gains that such companies may realise. If 'sin stocks' do generate higher returns it follows that SRI/BRI performance will be impeded by their exclusion. This gives further reason to doubt that SRI/BRI investing should inevitably lead to higher returns. Investors who want to put their money into investments that are ethically, morally or socially superior may need to consider the likelihood that performance will be sacrificed.

DIFFICULTIES AND PROBLEMS WITH SRI/BRI

Following are some practical issues with SRI/BRI. This is not to question the benefits of SRI/BRI: many positives are amply presented in various

27 Harrison Hong and Marcin Kacperczyk, "The Price of Sin: The Effects of Social Norms on Markets," *Journal of Financial Economics* 93 (2009): 15–36.

28 Jeremy J. Siegel, *Stocks for the Long Run: The Definitive Guide to Financial Market Returns and Long-Term Investment Strategies* (New York: McGraw-Hill, 2008), 99-100..

publications,²⁹ but the nature of ethical investing, particularly through its screening process, causes unique problems which are rarely mentioned in works promoting SRI. The following discussion thus highlights important problems that BRI and/or SRI investors may encounter.

1) High SRI research costs

Often, considerable research is needed to examine accusations of improper business conduct, especially when claims are vigorously denied by the company in question. For example, fashion retailers such as Gap, Next, Primark, C&A, and M&S have all been accused at various times of exploiting workers in 'sweatshops'. In the absence of clear evidence or a concluding legal case, the research needed by SRI managers to determine the accuracy of such claims is likely to be considerable.

A current example concerns pharmaceuticals. Companies engaged in medical research are sometimes accused of misleading doctors and patients with insufficient data from clinical trials, especially if these trials produce inconclusive results.³⁰ An ongoing case concerns the influenza drug Tamiflu, manufactured by Roche. The British Medical Journal has accused the company of withholding vital data about the efficacy of the drug³¹ leading to (unproven) accusations by others of unethical behaviour.³² The SRI screening decision in disputed instances such as this is not straightforward and the research may be costly.

SRI/BRI requires detailed knowledge of the many industries being screened, including such disparate matters as green issues, human rights, workplace ethics, weapons manufacturing, corporate governance, medical research, or animal rights. Acquiring these skills or obtaining third party research reports can be expensive and time consuming.

29 Including Budde, *Compelling Returns*, 2002; Domini, *Socially Responsible Investing*, 2001; Schwartz, *Good Returns*, 2010.

30 Ben Goldacre, *Bad Pharma: How Drug Companies Mislead Doctors and Harm Patients* (London: Fourth Estate, 2012).

31 www.bmj.com/tamiflu

32 Harlan Krumholz, "The Myth of Tamiflu: 5 Things You Should Know," *Forbes*, January 8, 2013; Darshak Sanghavi, "The Flu Vaccine Controversy: Are Drug Companies Really More Dangerous than the Flu Virus?" *Slate*, December 18, 2012.

2) Changing business environments

Screening necessitates continual evaluation of the changing business environment. A kind of moving target exists in the process of ensuring that companies meet ethical standards. For example, adverse publicity recently highlighted in the British media may trigger additional screening needs for two issues hitherto not widely considered. These are:

a) *Concerns over multinational companies avoiding corporation tax.* In recent months, a number of multi-national firms were accused of paying little or no UK corporation tax through the use of questionable but legal financial arrangements enabling tax avoidance.

b) *Questionable ethical standards at media companies.* The recent Leveson Enquiry in the UK focused upon illegal media intrusion ('phone hacking') and prompted calls for greater regulation over press standards.

Sometimes controversies occur over screening in established categories. An example concerns Walden Asset Management, who eventually included Novartis (pharmaceutical and chemical) in their SRI fund but not without difficulty:

Each of the component Novartis companies has a well-documented, troubling legacy of product liability and environmental problems. Nonetheless, Walden approved Novartis because it responded with a significant turnaround in internal environmental management systems and with openness to dialogue with its critics. Further, we approved it expecting to continue our dialogue with the company.³³

This difficulty illustrates the 'grey area' that can exist with SRI choices. This is a problem not just at the fund manager level but also at the level of the private investors who entrust their money to a fund manager, expecting that they will make the 'right' decision. The evolving business landscape makes necessary continual evaluation considerations adding further costs to the management of screens.

33 Geeta Aiyer and Stephen Heim, "Crossing the Black Waters': The International Dimension of Socially Responsible Investing," in *The SRI Advantage*, ed. Peter Camejo, (Gabriola Island: New Society Publishers, 2002), 179-80.

3) Complexity of Companies

Large corporations can be difficult to analyse because they may own varied operating units, or hold stakes in multiple affiliates. This complexity can make SRI research harder. For example, Sony is best known for its consumer electronics and entertainment business but within its vast corporate structure are fully or partly owned subsidiaries including a life insurance company (Sony Life), a bank (Sony Bank), a chemicals business (Dexerials) and two healthcare and medical companies (Sony Biotechnology and Micronics). Assessing Sony's validity for inclusion in an SRI fund will require considerable understanding of its subsidiaries.

For BRI investors, there may be concerns over positive screening for Christian companies: for instance, two major evangelical publishers, Zondervan and Thomas Nelson, might once have been candidates for inclusion but were subsequently bought by Rupert Murdoch's News Corporation, a company currently accused of engaging in questionable press standards. Another example dates from the mid-1990s and involved the Methodist Church in the UK who sold shares in BSKyB because of the company's links with the Playboy Channel.³⁴

One approach to this problem is to consider the overall benefit which the objectionable activity presents to financial results. For instance, SRI/BRI investors avoid tobacco or alcohol but may choose to invest in companies that are associated with these industries as long as revenues from such operations do not exceed a set amount, typically between 5-10% of revenues. As such, companies such as Diageo (alcohol) and BAT (tobacco) are avoided but a retailer such as Wal-Mart would be permitted if its tobacco and alcohols sales remain under the pre-determined quota.

4) Difficulties with definition

There are few hard boundaries in ethics. Decisions about screening and shareholder activism are rarely straightforward for investors and managers of SRI/BRI funds. Determining what may be an 'objectionable corporate activity' is a subjective task and, in the case of BRI, is an activity that also incorporates Biblical standards. What is suitable for one investor may be abhorrent for another:

34 Sparkes, *Socially Responsible Investment*, 94.

First, I discovered that much of what passes as socially responsible investing (SRI) in many cases is nothing more than a panacea for those who want to rid themselves of the misplaced guilt of western capitalism. I was assured by one true believer, for example, that investing in weapons manufacturers is socially irresponsible, as if everyone should know that. Does this suggest a woman is immoral for carrying a handgun while walking alone to her car after work in a dark, crime-ridden section of the city? Is the firm that produced the handgun socially irresponsible, per se, for having done so? Were those who fought with guns to maintain our Union and free black Americans from slavery doing the devil's work? The answer to these questions, in my mind, must be a resounding NO.³⁵

Not only is there difficulty in definition but also with the very human tendency for an individual or group to favour one screening criteria over another:

Using SRI screening strategies requires fund managers to decide on subjective grouping of preferences for their investors ... Decisions to include firms in a portfolio can also be swayed by publicity, as some firms heavily market some of their SRI values and underplay others. Fund managers who look at the company as a whole sometimes subjectively ignore gray areas within their operations.³⁶

The difficulty with finding the dividing line is well known in SRI/BRI and the viewpoint is usually that the imprecision in determining boundaries should not be a barrier to investing. Nevertheless the practical challenges of pursuing an SRI/BRI policy must not be lost or presented as a simple or straightforward task.

5) Transparency of fund managers

This is a 'client-side' concern, and relates to the degree to which mutual fund managers provide open and accurate information to the individual investor. The screening process is not only costly but in most cases is necessarily proprietary: investment companies incurring high costs in determining the SRI credentials (or otherwise) of a given company will not want competing fund managers to gain free access to their research materials. But the result is that their customers are deprived of detailed information to assess the

35 D Bruce Johnsen, "Socially Responsible Investing: A Critical Appraisal," *Journal of Business Ethics* 43, no. 3 (2003): 219.

36 Hung-Gay Fung, Sheryl A. Law, and Jot Yau, *Socially Responsible Investment in a Global Environment* (Cheltenham, UK, 2010), 40.

underlying research of the fund they choose. In short, people must trust the judgement of the fund manager.

6) Insufficient range of managed investment options

This is another ‘client side’ issues and relates to the relative lack of SRI/BRI funds compared to conventional investments. For index investors, the KLD 400 and Calvert Social Index are broadly comparable to the S&P 500 but there are no equivalents to other widely used indexes such as the NASDAQ, S&P 600 or the Russell 2000. Mutual funds are limited but growing: The Forum for Sustainable and Responsible Investment notes that there are 333 SRI funds in the US, significantly fewer than the 7000+ conventional funds. The UK has even fewer choices: the YourEthicalMoney.org website currently lists just 84 SRI funds.

For BRI investors, there are no market indexes of any type, and funds are even fewer: just a few dozen in the US, depending on definition. There do not appear to be any BRI funds in the UK, although a few money management and advisory firms exist that operate with a Biblical basis.

7) Higher fees

This has been noted already so only a brief recap is needed: SRI/BRI typically incurs higher costs due to the added expense of research and the comparatively lower economies of scale. Conventional funds choose investments on simpler grounds: valuation, growth expectations, industry sector, and market capitalisation meaning the selection process is relatively quicker and cheaper. The various Timothy Plan BRI funds have fees rated as “high” or “above average” by the independent observer Morningstar. The same is true with SRI mutual funds – the highly popular Domini Social Equity Fund is rated by Morningstar as “above average.”

FUTURE DIRECTIONS

A few possibilities for the future of BRI may be suggested, both for the industry and for potential investors. For the former, a wider choice of funds would enable greater choice, especially sector-based ETFs. A dedicated BRI

index is also important if the movement is able to attract wider attention: without an index, low cost trackers such as index ETFs cannot exist. Given the parallels with other faith-based investing concepts, a 'Christian index' may be more practical by enabling a larger number of potential customers from Protestant and Catholic backgrounds. Where practical, it may be useful to give BRI investors more information, including biblical reasons, for the choices behind screening decisions.

An important finding in this paper is that SRI performance over the long term underperforms conventional investing, especially when management fees are considered. It seems reasonable to suggest that BRI would see similar results and therefore current and potential investors must be mindful that such routes are unlikely to bring both superior financial and ethical gains. Also, the current paucity of investment vehicles means that BRI investors are largely limited to a handful of American mutual funds. As such it may be fruitful to consider (with the aid of a financial advisor) self-selection of a portfolio of suitable companies. This in turn means additional work in researching and examining the ethics of potential companies.

Finally, ethical investing, whether SRI or BRI, involves additional practical problems, including higher research costs, annual fees, and difficulties with transparency, definitions, and changing business environments. For many, of course, these are easily outweighed by the benefits of investing in more socially or biblically responsible companies but for others, these very real concerns may make SRI/BRI a less obvious choice for personal financial commitments.

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