Sustainable Investing Makes Sense

Would you give a check to the American Cancer Society and then buy stock in a major tobacco company because it earned 15 percent a year? Probably not. But many investors—even very large, sophisticated investors—do just that, consciously or unconsciously ignoring the relationship between their core values and their financial activities. As a conscious investor, you can choose to align your personal finances with your goals and values, and earn a fair return on the sustainable investment portfolio you create.

What happens when there's a disconnect between values and investment policies? The Bill and Melinda Gates Foundation is perhaps the best-known example. For years, the Foundation dedicated tens of millions of dollars to improving health in some of the world's most impoverished communities. In Nigeria, for instance, it funded polio and measles research and inoculations, and supported organizations combating cholera, malaria and AIDS. At the same time, the Foundation's endowment advisors were investing hundreds of millions of dollars in the oil companies most responsible for polluting the Niger Delta. Until the Los Angeles Times reported on this situation in 2007, no one was connecting the dots between the ills the Foundation was pledged to fight and their source: the companies' toxic airborne chemicals, oil spills in the Niger River and bore-holes full of mosquito-breeding water.

This is but one example of a good-hearted, mission-driven organization failing to consider the role its own investments play in causing the conditions it seeks to eradicate. How many of us do the same thing, only on a smaller scale? In our own lives, we strive to limit our waste, reduce energy consumption, buy local and organic and support our community businesses. Meanwhile, our 401k contributions may be underwriting corporate activities we abhor. But we can become conscious investors. We can improve corporate behavior through our actions as shareholders. And we can contribute to a better world with our investment strategies as well as our lifestyle choices, by choosing to invest sustainably.

Within the context of the rigorous financial analysis necessary for any investment decision, sustainable investing—sometimes called Socially Responsible Investing or SRI—also takes into account an investment's environmental, social and governance factors. It does so by applying one or more of three key strategies: screening, shareholder activism and community investing.

1) Screening: Investments are negatively screened to avoid certain activities, such as weapons or tobacco production, environmental abuse, unfair labor practices or excessive executive pay. Investments also may be positively screened by searching for companies with desirable attributes, such as sound environmental practices, full disclosure of executive pay and good employee benefits. And some funds use a "best in class" strategy. For example, a fund that accepts the need for oil would invest in the oil company with the best environmental practices and strategies, and then engage with that company as a shareholder to help improve its environmental performance even further.

2) Shareholder Activism: Through shareholder activism, mutual funds and other shareholders vote proxies, engage with corporate leadership and submit shareholder resolutions to actually change corporate behavior. For instance, recent initiatives have convinced several well-known companies to allow their shareholders to cast an advisory vote to ratify their executive officers' compensation. In 2007, a soft-drink multinational agreed to commission a study and report on the potential that each of its activities and proposed activities had to damage environmental and public health if they extracted water from arid parts of India.

3) Community Investing: Investors can be an important source of capital to communities that are underserved by traditional financial services. Community investing helps create jobs and opportunities for the economically disadvantaged. It also facilitates the development of affordable housing, improved child care and other community facilities, and even cooperative ownership of manufactured housing parks. Some investors use their community-investing dollars to support microfinance in developing countries, allowing micro-entrepreneurs to borrow a few hundred dollars to stock their vegetable stand or buy supplies for their shoe repair business.

When it comes to returns, sustainable investing is like any other investment strategy—you may do somewhat better during certain market periods and somewhat worse during others. However, with a diversified portfolio over the long run, SRI is as productive as any other strategy, says Steve Scheuth, of First Affirmative Financial Network.

"We never claimed you'd make more money investing in a socially responsible manner, but you can do just as well and might do better or worse at times. So why not put money to work in a way that helps society along the way?" (Financial Planning magazine, January 2009)

Why does socially responsible investment work? Imagine two companies in the exact same business and financial condition. One is known as an employee-friendly workplace, submits its executive compensation packages to shareholders for review, and has launched an initiative to reduce packaging, energy use and carbon emissions. The other company recently was sued for employment discrimination and is being investigated by the EPA for potential environmental violations. Over the long term, which company do you think is the better investment?

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