Business and Economics Journal

Capaldi, Bus Eco J 2014, 5:3
http://dx.doi.org/10.4172/2151-6219.1000106

Research Article Open Access

The Meaning, Nature, and Limits of Ethical Investment

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Received date: July 15, 2014, **Accepted date:** September 10, 2014, **Published date:** September 20, 2014

Abstract

In this paper, we seek to understand the relationship between ethical investment and corporate social responsibility. This requires us to identify both what we mean by 'ethical investment' and by 'corporate social responsibility'.

Keywords: Ethical investment; Corporate Social Responsibility (CSR); Ethics

Introduction

'Ethical investment' is, prima facie, seems easier to explain than 'corporate social responsibility'. The reason is that the former is a more or less clearly identifiable empirical phenomenon while the latter seems to be a highly controversial normative concept. We can, for example, say that TIAA-CREF has a special socially responsible fund which consists (a) of investments in specific corporations chosen by TIAA-CREF and (b) where the allocation of one's pension funds or percentage thereof to such funds is a voluntary personal choice (This in itself raises another important issue. Current TIAA-CREF policy allows participation in the socially responsible investments to be voluntary. What would be the case if members voted a majority of shares to make such participation mandatory? TIAA-CREF has such massive clout that it could redraw the landscape of the economy. This is all the more reason to clarify what is meant by corporate social responsibility and to recognize that this is itself a controversial issue. One of the misguided assumptions behind the promotion of democratization is the mistaken belief that there is a collective good that is determined by majority vote (a perverse reading of Rousseau's notion of the 'general will').

Actually, it is very difficult to identify what 'ethical investment' means. Sometimes it means no more than the existence of an arbitrarily chosen list of investments. One might choose not to invest in a company that engages in defense contracting with a government, but what about the bank that lends money to that company? What about a company that produces sophisticated weapons systems that reduce casualties and shorten armed conflicts? Suppose there is a Muslim Ethical Investment Club that refuses to invest in companies that do business in Israel or that hires Jews. Is that 'ethical' [1]? What if it invests in companies that make "charitable" donations to terrorist organizations? Sometimes elaborate lists of criteria are prepared and weighted. But what are the criteria for weighting [2]? By manipulating the definitions, almost any investment could be called 'ethical' or excluded on 'ethical' grounds [3].

'Corporate social responsibility' (CSR) is even more difficult to identify. Major privately owned corporations with many shareholders may have "CSR" divisions and personnel and they may engage in activities which they designate as "CORPORATE SOCIAL RESPONSIBILITY" activities, but there is no scholarly consensus on the role and rationale of these activities. It is not even clear that within many corporations there is a clear and consistent sense of what they mean by such activities. There are also a potentially infinite number of things that theorists and activists inside and outside such corporations want to be included under "CORPORATE SOCIAL RESPONSIBILITY" but which are not reflected in current corporate activity.

In addition to the problem of relating ethical investment and corporate social responsibility concepts when it is not clear what at least one of them means, there is a second difficulty. The second difficulty is what the term 'ethical' means in the context of 'ethical investment'. This is itself part of a larger problem, namely, the confusion between 'business ethics' and what, for lack of a better expression, I choose to call 'business ideology'.

'Ethics' refers to the rules or norms of conduct recognized in respect to a particular class of human actions (e.g., the ethics of a profession, the ethics of corporate practice in a free-market economy, the ethics of an industry, etc.); it presupposes (i) that everyone involved in the practice recognizes some of the norms, although they may disagree about some of the others; and (ii) there is always an agency problem – how to get people to act consistently with those rules. Failure of some or even many to act consistently with those norms is not taken either to deny the existence of norms or to invalidate the norms. 'Business ethics' I take to be the recognized norms of commercial and corporate practice in a free-market economy. From this perspective, 'ethical investment' means investment in a free-market economy, presumably designed to reflect and to promote the agreed-upon norms. There may be specific business ethical norms to which practitioners pay lip service but to which they do not adhere; ethical investment may be directed to promote compliance. All of this presupposes that we have some agreement on what those internal norms are.

There are many, however, who take a free market economy to be an inherently evil practice, and for them 'business ethics', if they use the term at all, reflects a critique of commercial and corporate practice in a free-market economy from the point of view of an external perspective normative for them. From this perspective, 'ethical investment' means investment designed (a) either to undermine or eliminate certain practices of a free-market economy, and/or (b) to promote certain practices that reflect the external normative perspective. Moreover, if there is no consensus on the external perspective, and if we live in a post-modern world with no consensus on a larger and all-encompassing narrative, that is, a morally pluralistic world, then the expression 'business ethics' will be hopelessly muddled. We would then be moving within the realm of what I call 'business ideology.' 'Ideology' refers to the aims, principles, or activities of an interest-group either seeking or exercising power within an institution or whole society, such that not everyone in the institution or society shares those particular aims or principles, and that while there may be agreement on procedural norms, there isn't such agreement on substantive norms.

It seems to me that if there is no agreement on either (a) the norms internal to business practice or on (b) the external substantive normative framework to which we are appealing, then it will be difficult to gauge the connection between ethical investment and corporate social responsibility or the impact thereon. What some would take to be a positive connection, others will find to be negative; more importantly, what looks like dissonance or a lack of impact may be to some the normal rejection of an alien practice, while to others it will be the failure to benefit from an external stimulus because of an (perhaps newly discovered) internal malfunction or miscommunication. In short, depending upon one's understanding of how commercial enterprises function, one will "see" or "not see" one thing impacting another thing.

There is another important distinction that needs to be made, and this has to do with the motivation for ethical investment. We can distinguish very broadly between negative and positive motivation. Negative motivation for ethical investment is the refusal to invest in companies which produce certain products/services or which produce them by objectionable means. Generally speaking, negative motivation would seem to produce little measurable effect. If I refuse, for example, to invest in companies which produce tobacco, alcohol, or firearms, can we honestly expect these companies to go out of business? Will other investors have the same scruples? Can we imagine a "Socially Irresponsible" investment club that specifically invests in lucrative companies which produce such products? Might not negative motivation be no more than a form of moral posturing (whether we approve of it or not) best understood as a form of symbolic speech rather than an issue in business ethics? [4]

Positive motivation I take to be a form of investing meant to alter company practices [5]. Such investing might work either by providing a persuasive voice at annual meetings or even a minority voice at board meetings or by literally investing in order to achieve majority control. In order for there to be a persuasive voice, someone will have to make the case that specific forms of corporate social responsibility are consistent with other corporate goals including making profits. This requires a robust account of corporate social responsibility around which some kind of meaningful consensus of shareholders can be built. Moreover, even if one were successful within one company, there is always the possibility that a new or rival company would start to do what the former company no longer does. Under these circumstances even positive motivation is reduced to negative motivation. In order for there to be significant positive motivation and lasting effect one would have to tap into a much larger investing community consensus on corporate social responsibility.

A final distinction worth making is whether the ethical investment is to be made in an existing company or whether it is to be made as a form of venture capital to establish a new firm. To ethically invest in an existing company where such investment remains a minority shareholder interest requires persuasion of other shareholders. It might also morally entail "indemnifying" dissident shareholders if the persuasion is successful and that success leads to an immediate and precipitous decline in market value of the shares. At the very least it may require a public announcement before shares are purchased of the full intent of the ethical investment with regard to corporate policy. The "indemnification" issue arises as well if the ethical investment achieves a majority of shareholder voting power. Majority ethical investment in a new venture does not raise the indemnification issue. However, what it does raise is the question of what we mean by corporate social responsibility. Precisely because there are competing ideas of what constitutes corporate social responsibility, such investment might under some circumstances be better characterized as philanthropy rather than investment.

Corporate Social Responsibility (CSR)

The firm's major responsibilities are both negative and positive. Negatively, the firm must adhere to the rule of law. This means much more than simply obeying the extant laws. It means that there is no larger collective good in terms of which CSR can be defined
(The technological project is not a larger collective good. The ultimate value of the system is personal autonomy. The technological project is in the service of personal autonomy). Positively, the firm must be profitable, where profits reflect the creation of products and services that innovatively meet consumer demand. Supplementary obligations are compatible with this view as long as they are both voluntary and contribute to profits [6].

Having said all this, it is important to note R. H. Coase's analysis of the firm [7]. Coase maintains that a firm is a nexus of contracts guided by efficiency concerns. Coase also argues that there are intra-firm structures that are more efficient than markets precisely because they eliminate transaction costs. In addition to intra-firm transaction costs, there are external social and political transaction costs. CORPORATE SOCIAL RESPONSIBILITY is a way of responding to these external social and political costs. For example, we live in a post-Nader world in which product safety is an important consumer consideration. It may not be efficient to negotiate product trustworthiness but to convey trustworthiness in other ways. There are, thus, a number of areas in which voluntarily assumed supplementary obligations contribute directly to the bottom line. The most obvious of these is assuming social obligations that contribute to marketing and recruitment. Companies do have to worry about boycotts as well as criminal and civil suits [8]. Moreover, some of these obligations can be firm specific, industry specific, or encompass the entire business community (e.g., education). Finally, a case can be made that ethical investors concerned about the environment may be more farsighted about factors (climate, fossil fuels, etc.) that will impact the future earnings of some industries than the industry itself [9].

How can ethical investment fit within this perspective? Instead of construing ethical investment as posturing or as trying to impose a private agenda, ethical investment might be better construed both as (1) an endeavor to call attention to overlooked transaction costs and as (2) ways of trying to educate both consumers and management on how best to increase the bottom line. It is certainly a more efficient means that costly regulation and litigation. This kind of view also eliminates the adversarial nature of ethical investment. It is much more in keeping with the evolving nature of the relationship among business, government, and non-profit organizations. Finally, to the extent that ethical investment and corporate social responsibility are related to profits, over time, we would actually have an empirically measurable way to determine the impact of specific forms of ethical investment. By incorporating ethical investment and corporate social responsibility within this scheme, we now have a coherent framework within which the normative value of ethical investment itself can be determined. Otherwise, ethical investment remains an extra-systematic factor whose relation to the social forces of technology and markets is neither intelligible nor measurable in any inter-subjective fashion.

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