Changing the world through investment?

An aid to orientation on ethically-related investment

A study by the Group of Experts on
“World Economy and Social Ethics”

Published by the
German Bishops’ Conference
Research Group on the
Universal Tasks of the Church

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The **Research Group on the Universal Tasks of the Church** is appointed by the Commission for the Universal Tasks (X) of the Church of the German Bishops' Conference. The Research Group consists of scholars from various disciplines. The task of the Group is to study issues related to the universal responsibilities of the Church in Germany.

The authors of the study

The **Group of Experts on "World Economy and Social Ethics"** is a specialised section of the Research Group on the Universal Tasks of the Church of the German Bishops' Conference. It was formed in 1989 to advise institutions within the Catholic Church on aspects of global economic development. The members and aims were chosen with a view to securing an appropriate blend of economic and socio-ethical expertise.

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1. Introduction

“You cannot serve God and mammon” (Mt 6:24). Jesus confronts us with these words: He calls on us to make a decision either to follow him or to take money and possessions as our orientation. A way has seemingly existed for some time to bridge this contradiction: “Ethical investment” promises that one can invest money with a good conscience: making a profit and doing good at the same time. The Central Committee of German Catholics called in its 2007 Declaration entitled "*Ethisches Investment*" (Ethical investment) to take responsibility by engaging in just such forms of investment, and to support the spread of investment products which have an ethical dimension. Pope Benedict XVI also points in the same direction when in the latest Encyclical Letter he praises the positive impact of “ethical” accounts and investment funds (Caritas in Veritate 45).

This study will explore those forms of investment for which suppliers or investors themselves claim an ethical orientation. The opportunities and boundaries of ethically-related investment are to be explored and criteria drawn up for assessing the financial institutions and products in question. Hence, this study addresses both private investors seeking an orientation as to their investment, as well as (ecclesiastical) institutional investors, and not lastly those enterprises in the financial sector offering ethically-related investment products or considering doing so in the future.

The prohibition to take (usurious) interest can be found in all three monotheistic world religions. It is evident that there was and still is in these religious traditions a heightened feeling for the fact that those who have considerable assets exercise power and can exploit people in need. The concern that the dignity of those who have no assets and rely on selling their labour is not respected has led to many efforts in Christianity to shape the capitalistic economic system, which is strongly formed by the interests of those who own assets in an ethically-responsible manner, inter alia by bringing into being structures of compensation and of legal protection. As contributors to this, we can mention church social movements, Christian social ethics as an academic reflection on these challenges and the public statements of church dignitaries and bodies which can be summed up under the term social message. These political efforts to set off ethically sensible changes to the way business is done may be supplemented by initiatives to consume or to invest money in a socially- and ecologically-responsible manner without thereby becoming less urgent.

In socio-ethical terms, ethically-related investment can be allocated to the topical field of "Ethics of financial markets". Where it appears to be helpful, references to this comprehensive topic are taken up in the reflection on ethically-related investment. However, it is not to be discussed in this study as such.

We have started below by providing a fundamental overview of major aspects of ethically-related investment (2). Next, we introduce criteria for reflecting on this practice in ethical terms (3). On this basis, an analysis will be made of targeted strategies to influence developments in the industrial sector through ethically-related investment (4), as well as, finally, identifying some potential consequences of such acts (5).

2. Ethically-related investment

As the securities markets have increased in significance in the last twenty years, the term "investment" has also become increasingly prevalent in German. Unlike in English, in most German-language texts, however, it does not encompass the purchase of *real* assets, such as of real property or production machinery; this continues to be referred to by the German term "*Investition*". Rather, in most cases it is restricted to the financial investment of money through purchasing financial securities. In addition to lending, it is one of the central tasks of the financial sector to facilitate investment that is to offer investment products which correspond to the preferences of the investors. Since the outbreak of the financial crisis, critical voices have been more frequently heard to express fears that the form taken by the financial sector as determined by securities markets and investment banking threatens to become detached from the real economy. Others, by contrast, stress the opportunities entailed by this new manifestation taken on by the financial sector. In doing so, they also refer to those forms of investment which in their opinion permit ethically-orientated investors to influence the direction taken by developments in the economy as a whole.

2.1 Some fundamental terms

The spectrum of investments with which ethical claims are linked is characterised above all by two types of term: Socially-responsible and sustainable investment. They each have a certain historical genesis: *Socially-responsible investment* borrows from the religious tradition of the Quakers, who at the beginning of the 20th Century started to re-orientate their investment according to moral criteria. In particular, any holding of shares in enterprises from the defence, gambling or narcotics industry, which they rejected as being depraved, was to be avoided when making investments. This line became known to a broad public above all in the course of the protest movements against the Vietnam War and the South African apartheid regime. *Sustainable investment* dates back to the fact that the awareness of the risk to the natural environment has increased since the nineteen seventies. In Germany, the Churches have also helped to make investment with a claim to meet ethical demands known to broader population groups.

There have been greater efforts in recent years to integrate the impetus from both fields. For instance, one speaks of social-ecological, ethical-ecological, sustainable or indeed principled investment. The term SRI (for Socially Responsible Investment or also Sustainable and Responsible Investment) has become established in the English-speaking world. The term "ethical investment" is used, and not only in the ecclesiastical field. No consensus has however yet been reached with regard to a uniform definition.

Ethics constitute a methodically-instructed reflection of morals. The formal umbrella term "*ethically-related investment"* is used below to refer to an investment in the composition and refinement of which non-economical, that is in particular social and ecological goals of good management are also taken into consideration. As with the more common term "ethical investment", this lends expression to the moral claim which is asserted de facto both by investors when it comes to investment practice and by suppliers with regard to the corresponding financial products. Unlike, however, the term “ethical investment”, “ethically-related investment” avoids the appearance that this practice or the product in question actually has a special moral quality. The use of a neutral term is initially to avoid expressing a valuation in order to create latitude for an independent ethical assessment.

Against this background, ethically-related investment refers not only to the investment “product” which is ultimately offered. Rather, investment refers to a service in the comprehensive sense, the quality of which is decided not solely by the so-called results dimension that is the output. Equal relevance with regard to quality attaches to the so-called potential dimension that is the available infrastructure, to the staff and material, to the self-portrayal of the respective institution, including advertising, as well as to the process dimension, that is the manner in which the service is rendered. The latter include for instance asset management, as well as customer service and care.

If one takes a look at the environment in which ethically-related investment finds itself, it is noticeable first and foremost that it only accounts for a small market share of 0.7 percent. However, it is developing very quickly – on the basis of this relatively low level; the market for ethically-related investment is hence undergoing high growth rates. The volume of ethically-related investment tripled between 2002 and 2005 in the European Union (EU), and doubled again in the period between 2005 and 2007. In Germany, too, the volume of ethically-related investment doubled from 2005 to 2007, 70 percent being invested in shares or direct holdings and another 21 percent in fixed-interest-bearing securities.

The term “ethically-related investment” turns the spotlight on investment in securities and hides the fact that there are financial institutions which offer a broad range of financial services whilst claiming to take ethical criteria into consideration. There are for instance ethically-related versions of giro and overnight money transactions, lending or indeed investment in real property. The term can nonetheless be justified; ultimately, the products of investment in securities are by far the most widespread in the ethically-related financial services segment.

Ethically-related investment is to be understood as an attempt to bring about a correction that is in conformity with the financial system: The established forms of asset investment on the financial markets, which are perceived as having shortcomings, are to be corrected by alternative forms of investment on the same markets. The protagonists of ethically-related investment take on the existing institutions and function mechanisms of the financial system in order to make social and/or ecological change in the industrial sector more probable as a result of their assistance. Hence, there are many links between ethically-related investment and the services of the traditional financial sector which open up possibilities of mutual influence. The technical language or the product conception of the suppliers of ethically-related forms of investment, for instance, differ hardly or not at all from those of their colleagues who do not specialise in alternative investment products. The boundaries are in flux, which makes it difficult to clearly delimitate the field of ethically-related investment.

A core of all conceptions of ethically-related investment can be regarded as lying in the fact that the traditional economic goals of capital investment (profit, security and liquidity) are explicitly supplemented by moral goals: Above all also social and ecological aspects of business policy, as well as structures of proper, responsible management of enterprises (Corporate Governance) should be taken into account in addition to the financial aspects. The economic and ethical goals are complementary to some degree. This is the case, for instance, if refuse is profitably recycled by nature-friendly recycling methods or if the ethically-sensible orientation of an enterprise helps its staff to identify with the business better, and consequently promotes their motivation, thus increasing enterprises’ long-term economic success. These goals however frequently conflict, especially in a short- and medium-term view. Above all there are so-called trade-offs to be made between the amount of the profit (taking the risk entailed by the investment into account) on the one hand, and the ethical goals pursued on the other hand.

2.2 Financial intermediation with ethical management

Ethically-related investment constitutes a specific form of financial intermediation. Its particularity is the application of ethical standards to the investment.

2.2.1 The process of financial intermediation

There are economic units in each money economy which wish to or need to spend more money at a particular time than they currently have. At the same time, there are others which have more money than they currently wish to spend. The placement of money between one group of players and the other is known as financial intermediation. If this is more than bridging a short-term payment bottleneck, one speaks of mediating capital. In most economies today it is enterprises above all, in addition to governments, which cause demand for additional capital. Superfluous capital is offered primarily by private households.

The process of financial intermediation can operate, firstly, via financial institutions. The latter grant loans to players who require additional purchasing power. At the same time, they offer to those who have superfluous capital the opportunity to save via interest-bearing deposit accounts. Secondly, financial intermediation can also take place on organised financial markets, in particular at stock markets. In this case, the units demanding capital issue securities and promise to provide adequate interest. The units offering capital, in turn, can purchase these securities. There are also institutions on financial markets which mediate as financial intermediaries between capital supply and demand: Thus, for instance, some investment funds bundle capital from private households and other players and invest this in securities in order to obtain the highest possible profit.

Two motives above all are likely to be decisive for investors who are seeking opportunities for ethically-related investment. Firstly, when investing they presumably wish to avoid making their savings available for activities which appear to them to be ethically dubious. Secondly, many of them also intend to invest their money in order to make an impact that is to use their own savings to promote forms of business corresponding to or very close to their conception of good management. Whilst trustees of the assets of large foundations are certainly able to collect information on the issuers of securities and to acquire ethically-related investment skills, private households (and other organisations wishing to invest money) rely on the “detour” via professional ethically-related financial intermediation to implement both intentions: Firstly, they are virtually unable to acquire sufficient information at a justifiable expense in order to take a sound investment decision for or against an enterprise. Secondly, they seldom have the means of communication or sufficiently large investment volumes required to exert an influence on security prices or on company boards. Their most important decision hence lies in the selection of the financial institution whose ethically-related investment products and fundamental orientation correspond most closely to their own values and whom they may expect to exert a relevant influence.

These financial intermediaries specialise in bundling both concerns of ethically-motivated investors and bringing them together with borrowers’ interests: They use the money invested which they collect directly to buy shares and corporate bonds, or they invest it in turn in specialised funds which then use it to buy securities or pass it on directly to enterprises which are looking for capital. More than the many private investors, financial intermediaries are able to collect the necessary information on enterprises by commissioning internal analysts in special departments with the appropriate research or by obtaining them as a service from specialised external agencies.

The financial institutions constitute private investors’ key interface with the financial markets. They have a long head start when it comes to information, so that investors have a hard time verifying the investment process. They are hence virtually unable to judge whether the investment process is implemented in their interest or to what degree the intermediary keeps to the agreed investment strategies. Against this background, a number of supervisory instances such as rating agencies have been formed which are to optimise, reflect and make transparent the ethically-related investment process.

2.2.2 Levels of action and reflection of ethically-related investment

Ethics reflect morals in order to *orientate action* that is the actions of individuals, as well as the joint actions or interactions in groups or institutions. The goal of ethical reflection, which is linked to ethically-related investment, consists of justified ethical claims being incorporated into the enterprises' business strategies. In principle, it is possible to distinguish between three levels of ethically-related financial investment.

The *first* level encompasses the process of financial intermediation itself. Here, the relevant players are those investors who demand ethically-related capital investment, those financial institutions which offer such investment products, and finally enterprises, states, etc., which are selected as objects for investment or are ruled out as borrowers.

At the *second* level, enterprises, sectors and states are evaluated using ethically-related criteria. Three groups of collective players are relevant here: Firstly, the ethically-related rating agencies which offer as a service the valuation of enterprises and investment products using qualitative criteria; secondly, the financial institutions which for their investment products demand either a sound ethical assessment of the potential investment objectives or the composition of a reduced investment spectrum from which undesirable enterprises are filtered; and thirdly enterprises which either voluntarily subject themselves to ethically-related rating or whose commercial conduct is evaluated without their consent.

The *third* level, finally, is concerned to justify ethical principles and on this basis to develop a list of criteria by which enterprises are valued and in line with which the investment practice is orientated. The organisational structures of this level include advisory councils set up by the relevant rating agencies and financial institutions.

Ethically-related investment is hence as a whole a multifaceted practice of financial intermediation aiming towards ethical governance.

2.3 The legal framework

The coordination of the acts of various players via markets imposes many prerequisites. It needs amongst other things regulation by state instances. The rules in the EU have become very closely harmonised in recent years. The regulations on enterprises’ sustainability reporting and the corresponding provisions for in-company old-age pension funds are relevant above all for the ethically-related investment market.

2.3.1 Enterprises’ sustainability reporting

In order to be able to invest money on financial markets efficiently, access to corporate data is vital. Over and above enterprises’ general profit prospects, ethically-related investors find qualitative benchmarks especially interesting, that is those data which encompass the impact of corporate policy on the natural and social environment. Since enterprises seldom publish such corporate data themselves, some legislators have passed legal requirements making some of the relevant qualitative information accessible.

In the framework of the Aarhus Convention of 1998, which as an international treaty prescribes that the signing states and supranational organisations must grant certain environmental protection rights to their citizens, some private enterprises were obliged to disclose information relating to environmental and employee interests. The EU implemented this in 2003 in an Accounts Modernisation Directive. This states that enterprises may not restrict their annual accounts and annual reports to the financial aspects of business activity. Where necessary for the understanding of business events, of profit or of the situation, the report must also disclose the most important non-financial performance indicators for the respective fields of business. This is to depict a picture corresponding to the “actual situation”. This provision was implemented in Germany in January 2005: Large corporations and groups must provide information in the shape of sustainability reporting on non-financial performance indicators such as environmental and employee interests.

2.3.2 Regulations for pension funds

Pension funds in most countries are subject to a large number of requirements. Since as elements of the social system of old-age pensions, they take on a quasi public task and are legally obliged to provide a return for their beneficiaries, more stringent requirements and trust obligations apply here than with other institutional investors. The UK Government introduced a duty to report for the first time in 2000 for facilities of in-house old-age pensions, encompassing qualitative aspects. This regulation has been adopted by Belgium, Italy and Austria, amongst others. Germany has also enacted a qualitative duty to report for state-promoted old-age pension facilities as to whether and if so how they take ethical aspects into account in using the contributions that are paid in.

Some other countries go beyond such information obligations and indeed require that the old-age pension institutions adhere to ethically-related investment practice. In Sweden, those funds which administer the reserves of the pay-as-you-earn pension systems are obliged to take account of social and ecological criteria in their investment concept where this does not harm the profit outlook. In France, company old-age pension funds must develop internal sustainability guidelines and must at the same time report on their ethically-related investments. What is more, the state reserve fund must provide information as to the degree to which it takes qualitative criteria into account in its investment policy. This has led to a considerable increase in its share of ethically-related investment. In Norway, the guidelines of a parliamentary committee which formulates goals for investment sustainability apply for the central old-age pension facility.

2.4 The practice of ethically-related investment

Most regulations on sustainability reporting and those intended to promote ethically-related investment so far apply exclusively to old-age pension funds. Nonetheless, the socio-ethical claim on the economic system as a whole is retained, namely that the individual economic activities as a whole lead to a result which largely corresponds to the social and ecological goals shared in the respective society (cf.

section 3.1). Ethically-related investment is to be understood as an attempt to supplement the legal provisions in influencing the decisions taken by management such that the business strategies which they adopt lead to ethically better results. To this end, it is attempted to influence boards' goals and to provide them with incentives to steer their decisions in the desired direction. This possibility is opened up for private investors above all by virtue of the fact that there are financial institutions and research agencies which specialise in the ethically-related investment processes which are necessary for this.

2.4.1 Influencing enterprises by financial institutions with ethically-related investment products

In addition to financial institutions which comprehend ethically-related investment above all as a strategy with which they can acquire new clients, there are also institutions which have adopted the underlying concern: They endeavour to give management incentives for socially- and ecologically-responsible corporate policy and at the same time to impose penalties on those business models which run counter to this concern. A financial institution which offers ethically-related investment products can attempt by three means to influence the development of enterprises with ethical goals:

- Exerting an influence via the financing conditions and via security prices. Suppliers of ethically-related investment frequently attempt to offer particularly favourable funding conditions to enterprises that in their view are doing business in a particularly good way or to make worse the conditions of enterprises which in their view are operated in a problematic way. Given that ethically-related investment largely consists of buying and retaining shares and bonds which have already been issued, it is above all a matter of "rewarding" economic practices which are considered to be ethically good through rising security prices on the basis of increasing demand or of "punishing" business activities which are perceived to be ethically bad by means of falling prices. If the enterprise in question then issues new securities, an influence is thus exerted as to the *conditions under which* it is hence able to acquire external funding. If the managers of the enterprise receive share options as performance-orientated remuneration, the ethically-related purchases and sale of securities may well directly influence the income of those who make the decisions in the company.

- Exerting an influence via a critical dialogue with company boards. Financial institutions with ethically-related investment products then attempt to exert an influence by entering as investors – in most cases as shareholders – into confidential talks with the management in order to encourage an enterprise to develop in the direction which they understand to be ethically right.

- Exerting an influence via public pressure which can be built up via deliberately providing information on negative aspects of the business activities to the capital market-related or general public. The starting point of such an influence is formed here by the reputation of the enterprise. If an image is damaged, which may have taken a long time to build up; this may have a negative impact on the funding open to the enterprise in the future or on its sales proceeds.

The two ways of exerting an influence which were lastly mentioned are also summarised under the English term of “engagement”. The possibilities for exerting an influence that have been described are not to be regarded as mutually-exclusive alternatives, but in practice are frequently applied in combination.

2.4.2 Ethically-related research by specialised agencies

Ethically-related research refers to a procedure to analyse and evaluate enterprises and capital investment using qualitative criteria. If the corresponding valuations are expressed in grades, this is referred to as rating (ranging for instance from D to A+). Ethically-related rating is intended to enable investors to identify those enterprises which do business in an ethically-responsible manner and are suitable for ethically-related investment. The list of criteria used in each case defines here the breadth and depth of the study of the assessment process.

Agencies carrying out ethically-related rating and similar research tasks have been created because the institutional differentiation of research tasks for ethically-related investment entail a specialisation advantage. What is more, enterprises can be expected to be more independent when it comes to the qualitative evaluation of what increases the credibility of the assessments that have been submitted. The tasks of acquiring information and carrying out the qualitative evaluation of enterprises initially lay exclusively in the hands of internal analysts who were employed by the suppliers of ethically-related investment products themselves.

In analogy to the task of *financial* intermediation in the financial institutions, this specific form of information provision may be referred to as qualitative *information* intermediation. In order to draw up a pre-structured investment spectrum for the financial institutions and their customers, the rating agencies' employees must not only acquire a differentiated picture of the enterprises, but must also take account of the financial institutions' demands. The latter in turn are based to a great extent on the ideas which the institutions' staff have of customers' expectations and goals. Above all by publishing the evaluation criteria and outcomes, the research process is likely to impact the further development of the industrial sector. The goal of ethically-related information intermediation is for standards of good corporate governance to become established which give rise to a competition between enterprises within a sector which do as well as possible in this evaluation.

A middle course between ethically-related financial and qualitative information intermediation is steered by suppliers of ethically-related security indices. Given that they delimitate an investment spectrum using normative criteria, and hence identify a number of financial securities meeting specific demands, they undertake research. This approach facilitates "benchmarking", for instance a comparison between the development of the index thus delimitated with a general index, that is with the average of the share market. At the same time, a delimitated investment spectrum enables fund managers to also derive index-related products. This is the case, for instance, if a certain fund precisely portrays the ethically-related index or if the index serves as a limiting framework for the selection of financial securities.

2.4.3 Development and application of lists of norms

The ethical orientation of financial investments is a task for applied ethics which is always characterised by the tension between ethical norms and the institutional context. A pragmatic approach prevailed in the initial period of ethically-related investment: Individual exclusion criteria were defined and taken into account in investment. However, the experience that this is not a way to do justice to the multifarious and differently-weighted ethical demands in a modern market economy which is very much based on the division of tasks led many financial institutions and rating agencies to institutionalise reflection processes in which consistent lists of norms were developed and reasoned (and are in some cases being refined on an ongoing basis).

Financial institutions, rating agencies or large (institutional) investors make the basis for the evaluation of enterprises explicit in such lists of norms. This is mostly a matter of reflecting and developing a normative corporate model which has so far subconsciously or more or less intuitively characterised investment and evaluation practice. It also depends on this model how social, ecological and economic goals are inter-related and weighed with trade-offs.

The large number of financial institutions and research agencies which are engaged in ethically-related investment also reflects a plurality of ethical points of view. Even if the representatives of the institutions and agencies sometimes claim to hand down generally-valid moral judgments, their assessments and the moral criteria on which their assessments are based are de facto not generally recognized. The lists of norms of ethically-related investment therefore do not have the status of a moral theory whose norms have all passed a universality test, but are more likely to be settled at the medium level of a de facto moral consensus: It is above all a matter of reflecting corporate guidelines, as well as drafting and reasoning differentiated lists of criteria.

In a particularly important manner, however, the plurality of the lists of norms proves to be a major disadvantage: It makes it more difficult to establish generally-accepted standards for qualitative benchmarks and evaluation methods. The proponents of standardised non-financial benchmarks and quality seals wish to bring a certain order into the jumbled diversity of the lists of norms that are used. Their goal is to guarantee minimum standards, and to provide an orientation to both investors and to the staff of the ethically-related financial intermediaries. Thus, a small number of quality seals have become established in which funds' investment practice in turn is evaluated by ethically-related criteria.

2.5 Investment in the service of social, ecological and development-related goals

When it comes to ethically-related investment, objectives are pursued in addition to economic goals which reflect investors' ethical demands. Such an ethical demand on the part of investors frequently consists of not wishing to provide capital for specific economic activities. The best-known examples of this are probably refraining from investing in the armaments industry or in enterprises producing or selling narcotics. The avoidance of investment in industries suspected of employing child labour or of rain forest deforestation could also be mentioned here. With other forms of ethically-related investment, investors pursue the goal, in addition to financial objectives, of promoting a certain economic activity which they favour in moral terms. This is expressed by talk of a "double dividend" which ethically-related investors wish to achieve, namely a financial and a moral "dividend". The latter relates as a rule to a contribution towards achieving social and/or ecological goals, and hence to something which is to benefit not (only) the investor, but the public, a disadvantaged group or future generations. The investor may even be willing to accept less ambitious financial objectives for this moral "dividend".

Such a positive selection by ethically-related criteria already applies if an investor only provides capital for enterprises which undertake to adhere to environmental and/or social standards or indeed to the principles of fair trade. For investors who, in addition to financial goals, lean above all towards ecological objectives, enterprises which are devoted to the development and generation of regenerative energy, be it water, wind and solar power or geothermal energy should be named as typical examples of suitable investment objects. In order to achieve a moral “dividend” in the social field, investment in enterprises suggests itself whose economic activities benefit a specific disadvantaged population group.

One of the best known areas for investment with which social goals are also pursued is the *microfinance sector.* It is to promote poorer population groups, above all in developing countries, countries in transition and emerging markets, but partly also in industrialised nations. Micro financial institutions claim to open up access to reliable, fair financial services to those population groups which were previously excluded from the formal financial system. Granting micro credits to business people to expand their business, as well as providing access to savings products or to insurance services, can help these people to protect themselves against risks or to bring about changes independently which are to sustainably improve their income situation, and hence their circumstances. The microfinance sector is especially popular among socially-engaged investors, presumably because it has demonstrated in practical terms that financial and social goals can be reconciled. This however does not rule out further sectors becoming established in future whose enterprises manage to cover costs or indeed to make profits, whilst at the same time helping to combat poverty. It can however be stated for the field of microfinance, as well as for other areas whose representatives make special ethical claims, that these claims do not always come true. For instance, a financial institution that is primarily devoted to granting consumer loans which lead poorer households into a dead-end of overindebtedness because their ability to make repayments is not taken into account may attempt to hide behind the label of microfinance.

The examples which have been described make it clear, firstly, that ethically-related investment requires adequate, reliable information on the enterprises which are to be financed. In this respect, a central role is played by independent, ongoing observation of corporate policy. Secondly, however, it also becomes evident that the selection of the potential investment opportunities becomes all the more limited the more targetedly the investor wishes to promote a specific social or ecological goal. The concentration on a small number of individual titles best corresponding to the ethical goal is always linked here to a waiver of the reduction of risks by the broad spread of investment ("diversification"), which already means cutting corners in terms of the financial investment goals.

The conflict between financial and ethical goals can be somewhat relaxed by political measures. For instance, governments may apply statutory minimum social and ecological standards to reduce the probability of enterprises obtaining competitive advantages from failing to account for ethical claims as to their business activity. Conversely, the state can compensate for competitive disadvantages caused by accounting for ethical goals by assuming additional expenses or risks which are caused by following socially and/or ecologically-exemplary business policy. For instance, with the abovementioned microfinance sector the urgently-needed quality assurance, as well as the product advice of poor customers in situ could be supported from development cooperation funds. Political engagement in favour of such arrangements is therefore an important, indeed an indispensable supplement to ethically-related investment, which in turn is able to make an important contribution towards funding ethically-sensible economic activities, such as towards sustainable development financing.

3. Ethical reflection

This chapter places ethically-related investment first and foremost within the overall perspective of the ethics of the financial sector. Then, some principles are formulated which are able to serve as a fundamental orientational framework for the assessment of the sector of ethically-related investment. Borrowing from these principles, finally, concrete, practical criteria are developed that are intended to make it possible to ethically evaluate the various approaches to ethically-related investment.

3.1 Financial sector serving the common good

Institutions are “made” by people; they can also be changed by people. If people understand their communities as a democracy, they demand that their institutions should be independently shaped according to joint ideas. This also applies to economic institutions.

In our society, there exist market economy institutions for the provision of most goods. These are institutions in which the acts of those concerned are coordinated not first and foremost by consensus-formation or all-embracing bureaucratic planning, but above all with the aid of payments: on markets by the payments which are linked with purchases and sales and in enterprises by the management of the enterprise coordinating the actions of all participants in the creation of the service such that a profit is made. In a democratic society, therefore, the self-logic of the market economy is bound by its members’ fundamental consensus: by their wish for the goods which they need and desire to be provided, and for those concerned to treat one another in such a way that the jointly-held or at least largely shared ideas of good business are complied with.

Christian social ethics refers to this binding of all commercial events to the fundamental consensus of citizens as the “common good”. The common good refers, first and foremost, in general terms to the ideas of those concerned for a successful co-existence. In the present, the primary goal is to shape institutions such that all people have as much freedom as possible. Here, the freedom of the one is naturally always restricted by the freedom of the other. Freedom means not only in negative terms freedom from restrictions, but in positive terms the freedom to develop. The social – and international – structures are accordingly to be shaped such that all people now and in the future have optimum circumstances to survive, to develop their own personalities and to participate in the life of society. For the overall goal of positive freedom which is as comprehensive as possible for all there is also a minimum level which is characterised by human rights (such as defensive, political participation and economic, social and cultural rights). Priority compliance is due above all to the interests of those whose human rights are violated. The particular urgency of evaluating society from *this* perspective is also expressed in Christian social ethics with the option for the poor.

If, therefore, the economy as a whole has to serve the common good, this means inter alia that the economic institutions – together with some state institutions – are to provide the goods required or desired by people. Particularly in the interest of the common good, people are free to pursue their own economic benefit in their economical activities within a free area defined by regulations, and in particular by statutory provisions. The limits imposed on this are reached above all when the totality of individual economic acts leads to harm being done to the common good. In this case, as became manifest in the international financial sector as a result of the financial crisis, there is a need to change the social rules. What is more, there is a need for a new voluntary undertaking on the part of the players to adhere to these rules, above all so that the statutory regulations are adhered to not only by the letter but also by the spirit.

The financial sector, which includes the financial markets and financial institutions, is a sub-area of the economy. As the economy as a whole, it is to be orientated towards the common good. Above all, it is to make it easier for enterprises outside the financial sector to produce goods or provide services which are vital to people's survival or which they hope to use to increase their prosperity. In this sense, the financial sector is not an end in its own right, but must serve the real economy!

The financial sector carries out several tasks which are important in the economy as a whole: The commercial banks supply the economic entities with the money without which economic transactions cannot be carried out. They carry out a large share of payment transactions. The financial sector facilitates financial intermediation (cf. section 2.2.1). What is more, it offers to players many possibilities of managing risks, for instance by spreading them over a large number of players. These are risks with which people are confronted in their everyday lives or which make enterprises' business activities more difficult, but also risks linked to financing or investment. Such risk management is offered for instance by insurance companies; partly however it is also made possible by futures markets (markets for transactions to be carried out in the future) and markets for other derivatives (derived financial securities).

Financial institutions which offer ethically-related investment products make a contribution towards the financial sector doing justice to the third macroeconomic task mentioned above, namely financial intermediation; they link this with the further goal of shaping the economic system in an ethically-sensible manner.

3.2 Principles for ethically-related investment

Enterprises make goods or provide services which may be useful to other economic subjects. If in doing so they keep within the boundaries of what is legally permitted not only in the letter, but also in the spirit, they comply with the first prerequisite for their commercial activity serving the common good. For some time, there has been a lively debate under the motto of Corporate Social Responsibility (CSR) on whether boards and staff of enterprises have further ethical obligations concerning ethically-related business strategies. To this end, models of good business are developed which managements are recommended to imitate. As expedient as these concepts are, one should not lose sight of the fact that taking corporate responsibility is contingent on a corporation continuing to exist in the long term: Under the conditions that are found on a market economy, one of the characteristics of enterprises is that the economic dimension is of fundamental significance to them, at least to the degree that they have to assert themselves in competition. For this reason, an attempt is made by means of ethically-related investment to translate ethical goals into monetary values such as financing costs or risk of loss in revenue, and by these means to anchor ethical priorities in enterprises' commercial strategies. Ethically-related investment – together with purchasing goods in a socially- and ecologically-responsible manner and offering labour via trade unions or professional associations – thus provides a further way to socially shape industry which may form an expedient supplement to economic activity, regulation and monetary policy management of state agencies.

3.2.1 Principles for ethical evaluation of the overall strategy

Like any other enterprise, an enterprise in the financial sector is first and foremost to be understood as an association constituted by individuals: employees, managers and investors have come together in order to generate income through financial services. In order to orientate business conduct towards enterprises' goals, they need a certain inner order which can find expression in official statutes, corporate guidelines, manuals, etc. Such governance of corporate activities has been discussed for several years under the motto of Corporate Governance.

Since the intensification of the discussion on CSR in the nineties, company managements have increasingly drawn up their own Codes of Conduct for their enterprises in order to undertake for themselves, the staff and other groups of stakeholders to adhere to values which the enterprise intends to pursue in the long term. With regard to financial institutions offering ethically-related investment, the following relates to the principles by which such guidelines, the internal order of the institutions which they express and the business conduct which is more or less intensively shaped by it can be measured.

- **Credibility**

An enterprise's engagement to the principle of compliance applies today in general terms as a natural standard of corporate ethics. Compliance encompasses measures within the enterprise intended to ensure that formal prerequisites such as statutes, guidelines or indeed voluntary code undertakings are indeed followed by staff.

The demand for ethically-related investment products has given rise to a lucrative market for ethically-related investment. Against the background of intensive competition among financial service-providers which specialise in asset management, this new market is also interesting for classical suppliers. A large number of financial institutions are trying to acquire a new client segment by using nice-sounding terms such as "sustainable", "social-ecological" and the like, without it being possible to ensure that this designation is really reflected in the quality of the investment. Investors are hence faced by a problem of verification, namely of having to ensure that the financial institution implements the investment process according to the criteria on the basis of which he/she has selected the institution as an intermediary. Furthermore, compliance measures alone do not offer investors any guarantee. At best in cases in which a financial institution has unmistakeably committed to a Code of Conduct and a fund manager can be proven to have engaged in deliberate mis-selling, there is a possibility of judicial review. Thus, investors remain reliant on the financial institutions themselves plausibly entering into undertakings with offers of ethically-related investment.

The requirements as to credibility are more stringent when it comes to products of ethically-related investment than with other forms of investment because these promise a special effect, and hence also lead to special expectations which are difficult to verify.

- **Transparency**

In order to comply with this obligation, a financial institution which offers ethically-related investment is indeed obliged to create as much transparency as possible. In general terms, financial institutions as a rule undertake to be transparent towards their investors. From an ethical point of view, the term “transparency” must however also be broadened beyond the client relationship: Anyone who is affected by an act to a relevant degree should indeed be able to be aware of it. Particularly against the background of the high degree of complexity of the financial markets, it is difficult, or indeed impossible, for a financial institution offering ethically-related investment to take the moral demands of all those concerned into account in their investment decisions. This makes transparency all the more important in this context, in the sense of providing guaranteed free access to information without which those concerned are unable to defend their rights themselves.

For this reason, the principle of transparency requires disclosing all relevant information on the investment and one’s own commercial conduct, so that not only investors, but in principle everyone who is affected by a business or investment practice, is able to collect information.

- **Openness to discourse**

The underlying list of norms and corporate guidelines take on a dual function for a financial institution which offers ethically-related investment. Firstly, they provide the basis for the ethical orientation of investment practice and of one's own corporate activity. Secondly, they are also to be understood as a marketing instrument permitting one to heighten the profile of one's own investment products as against those of competing institutions.

Probably in most cases with the support of their advisory councils, the financial institutions will attempt to include only well-founded criteria in their list of norms for ethically-related investment. Nonetheless, the claims to validity of the various ethical approaches remain disputed in de facto terms. Given that there is no independent decision-making instance for diverging claims to validity, the demand of openness to discourse is to be made of the wording and reasoning of the ethically-related investment criteria. Only those lists of norms which are conceptually held open to further development following enquiries by other ethical positions can uphold their ethical claim from this point of view.

3.2.2 The principle of effective management

With the ethical assessment and orientation of practice, considerable weight attaches to the probable consequences of the act. A measure or act is effective if it leads to the complete or partial achievement of a goal which is aspired to. For a financial institution which offers ethically-related investment, it is therefore a central principle of credibility that it should make serious efforts to pursue those goals which are based on its own list of norms. This naturally includes consistently applying the criteria of the lists of norms and in this sense offering a "clean" financial product. A large number of ethically-related investments, however, do not produce any different consequences than do forms of investment which do not have an ethical claim. In ethical terms, however, serious efforts to bring about a relevant governance impact in an industrial sector take on vital significance. Ethically-related investment should aim to encourage the boards of the enterprises which receive capital by means of incentives, and where appropriate by giving advice, to enact an ethically-expedient change in their business strategies or indeed to retain ethically-expedient strategies that have already been selected.

The demands of efficiency range further than the principle of *exerting any impact* on the industrial sector through ethically-related investment. A measure is efficient if it achieves the desired goal with minimal effort (or if it reaches the goals set in the best way possible with a defined effort). Management which promises the *greatest possible* positive effect with a defined resource use is to be preferred. In individual cases, however, it is likely to be difficult to precisely determine the efficiency of attempts at ethically-related governance. That this aspect nonetheless may not be lost from sight is made clear by the following example: Some small or medium-sized enterprises use the relatively cheap venture capital provided by ethically-related investors. They opened up this form of capital for themselves when they urgently needed venture capital for their start-up phase. They have however now progressed so far that they could acquire finance from conventional sources of finance. Because they continue to use the cheap venture capital, firstly, their budget restriction is weakened. Secondly, they make it more difficult for other borrowers who depend on venture capital to gain access to such capital. The lack of institutional mechanisms by which “mature” enterprises are separated once more from the cheap source of venture capital therefore restricts the efficiency of ethically-related venture capital in this case.

3.3 Criteria to evaluate ethically-related investment methods

Against the background of the principles outlined, a number of criteria are now to be formulated with which products and fundamental strategies of ethically-related investment can be ethically evaluated.

3.3.1 Criteria regarding investment products

- **Suitable profit goals together with transparency in terms of risk**

Even if financial institutions offering ethically-related investment have ceased to be orientated solely towards the three financial goals of profit, security and liquidity, this does not mean that they are suspended with these investment products from the obligation of investing the money entrusted to them profitably and at a justifiable risk. A reliable rule of thumb for investment states that higher profit generally entails higher risks in the sense of greater variations in yield (and even losses). The risk that an investor makes an overall loss with an investment, or only achieves a small yield, can also be reduced by buying liquid assets, that is assets which one is likely to be able to sell quickly if need be and with no loss of value.

The suitability demanded here for profit-related goals is a “soft” term. The rule may be used as a landmark that the profit that can be made with financial investment on average cannot sustainably exceed the growth rates of gross world product. Finally, a much higher profit in the long term means a considerable re-distribution of income towards those who have financial assets. An excessive profit is frequently an indication that a price bubble is growing on the asset markets which will burst one day. It can be taken for granted that financial institutions offering ethically-related investment products must disclose all risks known to them underlying the acquired assets. In addition to the varying yields, where there are fewer liquid assets there is also the risk of an unfavourable sale price.

- **Disclosure of the competition of goals between the amount of profit and effective governance**

There is a trade-off when it comes to most ethically-related investment objects between profit that is commensurate to risk and pursuing ethical goals; the number of cases in which they act in a complementary manner is restricted. In some marketing strategies for ethically-related investment products the interested parties are however caused to hope for an “outperformance”. Such an advantage would arise in the long term because ethically-related funds only bought the securities of those enterprises which were particularly well adjusted – because of being exemplary in social and ecological terms – to challenges facing all enterprises in the future. In principle, however, any claim that a specific form of investment makes it possible to make a greater profit in the long term (with the same risk) than with a broadly-diversified portfolio must be regarded as being highly questionable. A trustworthy supplier of ethically-related investment products will hence not claim such outperformance. Over and above this, it should be admitted that investment products with which prospects really exist to achieve a certain effect of governance can achieve a *lower profit* (with comparable risks) than conventional investment products. Finally, in order to achieve an effect of governance investors must either fund the advantage of more favourable financing conditions for enterprises with a part of their profit or the “engagement” activities of the financial institution or corresponding agency commissioned with this.

- **Well-founded lists of criteria**

The initial practice of ethically-related investment, namely that of defining individual exclusion criteria, proved to be too undifferentiated in comparison with the diversity of ethical claims in plural societies. The criteria also contradicted one another in some cases, or the question also arose as to why particularly these criteria were used and not others. For this reason, many institutions with ethically-related investment products and ethically-motivated institutional investors changed their practice. They developed differentiated lists of catalogues, frequently with the support of an ethical advisory council. They now apply them to enterprises and only select the securities of those enterprises which do well all in all in the criteria of their list (cf. section 4.1). Here, both investors and the other stakeholders expect of such a financial institution that its experts do not randomly define the criteria, but that they have subjected them to a fundamental reflection on the basis of a consistent model of good business. The principle of transparency requires making this basis for the reasoning, as well as the lists of criteria derived therefrom, open to the public.

- **Comprehensible evaluation procedures**

Apart from non-public “engagement” activities, financial institutions with ethically-related investment products can try to influence managers’ future decisions by affecting the price of a security (financing costs) or by exerting public pressure (cf. section 2.4.1). All enterprises have a right to be measured by comprehensible criteria. Finally, all enterprises are to have the opportunity to benefit from the favourable financing costs of ethically-related investment or to avoid campaigns that are detrimental to sales.

The financial institutions must consequently disclose their own processes of evaluation or make transparent the basis on which the research partners orientate investment practice. This also complies with the principle of effective governance: Without a clear link between criteria and “sanctions”, there is no incentive for company boards to set processes of change in motion in a specific direction; the intention to steer becomes ineffective. Over and above this, the financial institutions or their research partners should offer a regular exchange and by these means facilitate feedback from the evaluated enterprises to the evaluators.

- **As precise a product description as possible**

The principle of transparency requires that the name and the description of the investment product used when acquiring customers expresses as precisely and comprehensibly as possible the class of the assets involved, as well as the activities of the person administrating the product. To this end, in many cases there will be a need for fewer nice-sounding, more technical-seeming terms. A precise product description would also help to increase the transparency of the market for ethically-related investment overall.

3.3.2 Criteria with regard to the organisational structure and customer relations

- **Existence of an advisory council**

The principle of openness to discourse requires that a financial institution with ethically-related investment products is open for a debate with diverging values. This demand remains abstract and devoid of consequences if no organisational structures are available in order to ensure that such rules-based debates take place within the financial institution. Analysts and investment managers are in most cases so deeply involved in day-to-day business that they do not participate in such debates or in the revision of the investment criteria that they use on an everyday basis.

Many financial institutions with ethically-related investment products have therefore established an advisory council which is tasked to critically reflect on the corporate model and on the lists of norms and to further develop them. The heterogeneous composition of an advisory council makes it possible to combine various strains of expertise: A researcher contributes analytical tools, a finance expert brings in practical know-how, a representative of social movements expounds the actual real world viewpoint through social problem constellations, etc. In structural terms, the advisory council is the place within the enterprise where the ethical basis of the investment is examined. The existence of an advisory council and its plural composition may hence act as an indication of a further development of ethically-related investment practice which is open to debate.

- **Voluntary commitment with regard to one's own goals and criteria**

Adherence to statutory requirements is a natural minimum standard of corporate ethical responsibility for a financial institution with ethically-related investment products. Over and above this, however, it is also a principle of credibility that a financial institution measures itself by the standards which it applies to the enterprises in which it invests. A possibility of verifying the credibility of a supplier is provided by the internal corporate guidelines or Codes of Conduct, with which the company management attempts to orientate its own business conduct towards corporate goals: To what degree do these documents correspond to one's own lists of norms which apply to asset investment?

- **Fairness towards customers**

Financial institutions which offer ethically-related investment must also impose guidelines on themselves for their relationship with customers. In the aftermath of the financial crisis, consumer associations are increasingly claiming that investment advice and products must be designed in a more responsible manner (responsible finance). Pressure from competition and the obligation to earn commissions is said to have led to a situation in which investors were sold products which were unsuitable for them, or that they were not sufficiently informed of the product characteristics. The principle of transparency also requires in the field of ethically-related investment that investors are adequately and comprehensively informed of the probable profit and above all of the risks entailed by the investment. The information must be orientated here towards the existing understanding of the investor. If a customer has not understood the most important characteristics of the product, a transaction can hardly be fair.

When it comes to ethically-related investment, it is also a part of dealing with customers fairly for a financial institution to enter into a critical dialogue on the value orientations underlying its financial products. Whilst some investors' views are highly subjective, the financial institution has the task of investing in line with intersubjectively-comprehensible criteria. It is nonetheless not adequate to simply explain the criteria to those investors who enquire critically. Rather, the ideas of individual investors about good business may prove to be well-founded and further able to form a consensus. Open, critical dialogue hence offers an opportunity to refine the financial products. It is important that such dialogues are not pushed to a hermetically-sealed advice and sales level, but when they lead to meaningful results that they are input into a debate within the institution on the corporate model and the investment criteria.

3.3.3 Minimum content standards regarding the investment criteria

The global financial markets also trade in the securities of enterprises which carry out a considerable share of their transactions in states in which human rights are not respected. Against this background, a number of codes of conduct oblige transnational enterprises in those countries in which human rights are violated in order to promote the full realisation of human rights at least in their own spheres of action. One example of this is the OECD Guidelines for Multinational Enterprises. The majority of the ethically-related investment sector is open to this demand; a large share already explicitly refers to such international codes of conduct in the selection of titles.

In the interest of the option for the poor, Christian social ethics concerned with the ethical orientation of the financial sector place particular weight on the development-promoting structure of the international financial sector. In developing and transformation countries, it is to promote economic development processes which above all improve the prospects of the poor. In line with the convincing fundamental orientation of the "Decent Work Worldwide" concept of the International Labour Organisation (ILO), this is above all a matter of creating the working conditions (in the comprehensive sense) for the gainful employment that has already been done and creating new, dignified jobs. As long as no uniform minimum standards as yet exist for dignified work that are obligatory and sanctioned worldwide, the financial institutions with ethically-related investment products are obliged to include appropriate criteria in their lists of norms and to orientate their investment practice accordingly. A minimal social standard which must be adhered to at all costs is constituted by the ILO Core Labour Standards. These prohibit exploitative child labour, forced labour and discrimination of all kinds and include a guarantee of freedom of association, including the right to collective bargaining.

4. Strategies of investment and of their aimed control

On the basis of the ethical principles and criteria that have been developed, the common strategies of ethically-related investment are ethically evaluated in this chapter.

A small number of financial institutions offer ethically-related variants of the classical bank deposits, such as savings or fixed-term deposit accounts. Ethically-related investment in sustainable – that is above all low-emission – real property is becoming significant in the USA and the United Kingdom. The most important tool of ethically-related investment however continues to be portfolio investment in securities traded on the stock exchange, above all in shares, but also in fixed-interest-bearing bonds. Whilst these strategies of ethically-related investment are restricted to the selective choice of investment objects, investment is combined in newer methods with "engagement" efforts. The considerations on the various strategies of investment and the exercise of influence are concluded by looking at over-the-counter forms of holding.

4.1 Portfolio investment

Those purchases of securities where the buyer does not acquire such a large packet of shares that they have a determining influence on the enterprise in question are referred to as portfolio investments. The investment strategies of the portfolio investments looked at here are based on so-called screening. This is a systematic selection procedure in which those objects which show the desired characteristics (or where the rejected characteristics are missing) are filtered out from a defined investment spectrum using specific criteria. Within these procedures, one can distinguish between a criteria-led and a rating-orientated approach.

4.1.1 Criteria-led screening

Fund managers obtain the criteria which they use to determine their ethically-related investment practice from the explicitly-expressed desires of the investors, from a list of norms or from a corporate guideline. These qualitative standards make it possible to limit the investment spectrum by means of exclusion criteria or to profile them using positive criteria (“qualitative market screening”).

- **Negative lists**

The investment intention with negative lists is *avoidance*. The idea is to avoid using one’s own savings to finance those business methods and production processes which the investors consider to be ethically damaging or reprehensible. The negative criteria are mostly used as exclusion criteria. Hence, specific enterprises, whole sectors or indeed individual countries are deliberately ruled out in which categorically no investment is to be made. Investments to be avoided are mostly those in the armaments industry, nuclear energy and the narcotics industry, as well as in enterprises which violate the ILO Core Labour Standards. So-called “country lists” are to avoid investment in enterprises that are headquartered in an economy with a dubious political system, such as a country in which human rights are systematically violated.

- **Positive lists**

Where positive lists are used in the investment process, it is a matter of the *promotion* of specific manners of conducting business and products which are regarded as being useful or as ethically preferable. The most important and most widespread criteria on positive lists include adherence to social and environmental standards. Over and above this, enterprises are also deliberately promoted which develop or produce technologies for environmental protection, particularly to reduce damaging emissions. To this end, special topical funds are frequently established which only contain the securities of those enterprises which are active in certain areas that are worthy of promotion. Within the investment spectrum thus delimitated, the respective fund managers decide in which titles to invest. Here they take as a de facto orientation the classical financial benchmarks, and profit and risk above all. The stronger the concentration on a sector, a thematic area or an index is, the more such funds form only a (small) part of the market, and the greater the increases in the scale of the variations in yield investors must expect.

When using positive criteria, market transparency is improved if several investment funds refer to a small number of indices. This increases the chance that the promotional criteria are taken up as a strategic factor of the amount of the financing costs (and for the *reliability* of income with future emissions of new securities). If this is the case, one may presume that the boards of enterprises with their (strategic) decisions consider with which of the various available options the criteria are adhered to, and with which they are not. Having said that, a trade-off becomes visible here between the principle of effective governance and the principle of openness to discourse which is typical of criteria-led screenings with positive lists: Ethically-motivated investors can best achieve a worthwhile effect of governance with their savings if the financial institutions which they choose largely use the same ethical criteria and refer to the same ethically-related index or to indices with very similar criteria. The principle of openness to discourse, by contrast, requires that the financial intermediaries are to be open for diverging ethical positions and for the refinement of their own list of norms.

Where investors and suppliers of ethically-related investment products aim to bring about an effect of governance by applying negative and positive criteria, they count above all on enterprises anticipating the criteria and in “pre-emptive obedience”, orientating their corporate strategies towards them in order to be included in the corresponding investment spectrum.

4.1.2 Best-in-class screening

The best-in-class approach initially does without the categorical exclusion of entire sectors and segments of sectors, and is based on relative standards. Those enterprises which set the highest standards in ethical terms are to be identified in a comparison within a sector which is drawn up on request by an ethically-related rating agency: The enterprise is included in the portfolio from a specific threshold position in the ranking. The idea is that because of the selective investment practice in “better enterprises” the “worse” enterprises are given an incentive to improve. In the distribution competition for favourable sources of finance, they are to be orientated in line with the standards of the sectoral pioneer. In this manner, it is hoped to launch or intensify a qualitative competition for inclusion in the best category.

The drafting of an ethically-related ranking encompasses in principle qualitative information on enterprises. The information obtained from the conventional fundamental analysis is however also considered in diverse variants, above all the financial benchmarks of corporate valuation. When a financial institution applies a best-in-class rating, it should hence be borne in mind that this mix places the clarity of ethically-related rating into perspective. Since so far neither relevant qualitative benchmarks are available to examine the ethical effect nor a standardised method to offset ethically-related with classical financial rating, some suppliers of ethically-related investment products claim to be able to measure the impact of the ethical relation indirectly using the financial benchmarks. They presume here that an enterprise which meets certain qualitative standards is better tailored to cope with new social and ecological risks or that ethically-related corporate policy also impacted corporate profits, for instance because the employees are better motivated or the production methods are more efficient, etc. Pursuing ethical goals however does not necessarily lead to a higher profit.

In practice, best-in-class screening is not too different from criteria-led screening; in fact, the screening alternatives are frequently combined. First of all, the rating defines an investment spectrum which is filtered and structured in many ways, but the selection of the titles takes place within this spectrum in which the concrete investment is made, ultimately on the basis of the fundamental analytical benchmarks.

By means of the dynamics of “qualitative” competition, best-in-class screening, more clearly than criteria-led screening, is an active investment strategy: The fund manager always has to react again and again to the competition results, such as if an enterprise is demoted below the threshold value of the rating, leading to more frequent movements within the portfolio. This causes high administrative costs, which ultimately the investors have to pay as the holders of the fund shares. However, active portfolio management may be necessary in order to achieve an effect of governance.

Many financial institutions act in accordance with a multi-tiered selection process in the conception of ethically-related investment products which consists of a combination of various investment strategies: either exclusion and promotion criteria, or indeed exclusion criteria combined with a best-in-class approach. These combined approaches appear to be more ambitious and more highly differentiated than those approaches which are exclusively based on simple exclusion criteria.

4.1.3 Ethical evaluation of ethically-related portfolio investment

The strategy presented here constitutes an attempt to exclusively use ethically-related portfolio investment to influence the financing costs of those enterprises which have already issued securities, and hence to give company boards incentives to manage in a socially- and ecologically-responsible manner. This strategy would have an effect of governance if, under the prerequisite of similar criteria, the funds had a dominant or at least a very strong market position, that is for enterprises which were major sources of finance. Only in this case would acceptance by ethically-related funds result for an enterprise in lower financing costs or exclusion from them in higher financing costs. Because of the low investment volume of the different funds and of the lack of market transparency caused by the multiplicity of criteria applied, one must however presume that portfolio investment pure and simple has not had such an influence so far.

The low degree of effect of the attempts to influence enterprises' financing costs through security prices is also related to the fact that portfolio investment is always based on security purchases on secondary markets. The ethically-related funds' money is hence invested in securities which already exist; it is therefore received by the previous owners of the securities and not by enterprises which have issued the securities. Their financing costs are ultimately only influenced if enterprises issue new financial securities. However, established corporations seldom use the financing option offered by issuing new securities, which are the preferred investment objects of ethically-related investments.

In addition, the effectiveness of the indirect form of management via the enterprise's CSR image appears to tend to be slight with portfolio investment. A certain reputation is needed for this in order to attract public attention to the downgrading or exclusion of an enterprise by a financial institution or a rating agency. However, ethically-related investment does not yet have the necessary weight for this. This applies above all to the public of the capital market participants; ethically-related investment continues to be a small niche on the capital market. The established interpretation patterns and models of the investment sector in which ethical goals do not play a role are dominant in the communications channels of the capital market. This may change if social and ecological aspects are broadly accepted as an integral element of security and risk analysis.

A possibility to increase the slight influence exerted by ethically-related investment on the security prices lies in the participants agreeing on a joint course of action. Individual examples show that cooperation is possible from case to case with the goal of exerting greater pressure on a certain enterprise or a specific sector. On the basis of the principle of effective governance, it is particularly regrettable that little use has so far been made of the cooperation potential.

4.2 Engagement

In contrast to those forms of ethically-related investment where the selection of the securities itself is perceived as being the decisive governance tool, some financial institutions regard purchasing securities of an enterprise merely as a door-opener for further activities. The intention being pursued in investment with these intervening strategies, which are referred to as "engagement", is *exerting an influence*. The players then focus on those enterprises whose business policy comes to notice as being negative but which is considered to be changeable. As (potential) investors, they seek to establish direct communication channels with the decision-makers in enterprises or rely on a reputation effect of their activities which is relevant for enterprises.

Most “engagement” activities aim for a non-public critical dialogue with the board or with the managers of an enterprise. Here, the rights to information or to co-determination acquired by virtue of purchasing shares facilitate communication with the decision-makers of an enterprise by attempting to influence the business policy. This for instance makes it possible to push for in-house remuneration systems also accommodating the social and ecological aspects of commercial activity. Such a dialogue-based “engagement” process mostly takes place in the shape of expert discussions behind closed doors.

Having said that, with this strategy also, the investment volumes are so far too small to be able to exert a major influence on corporate policy. A door-opener for an effective ethically-related engagement process hence exists above all when some of the managers in the enterprise appreciate the specific know-how of those financial institutions or research agencies. They presume that the staff of these institutions and agencies have acquired comparatively precise specific knowledge of an enterprise’s corporate policy, or that of a sector, etc., because they have been working for a long time on the evaluation of enterprises using a differentiated list of criteria. They hope that the latter are able to identify possible approaches for ethically-improved corporate policy. Above all, the staff of the ethically-related institutions or agencies are deliberately consulted by groups within the enterprise (for instance from personnel or environmental management) who are personally interested in appropriate changes within their enterprise. They hope to receive from them support or additional legitimisation through in-house dialogues and negotiation processes. If an institution or agency enters into a dialogue on concrete questions of corporate strategy, however, the danger arises of its losing its independence.

In addition to dialogue-based “engagement”, or after a comparatively unsuccessful dialogue with the managers of an enterprise, a financial institution may also take its criticism to the public – for instance by using voting rights at an enterprise’s annual general meeting and contributing its own position into the debate. A negative reputation effect for the enterprise is aimed for here. The effectiveness of this form of influence may be increased as a result of cooperation with non-governmental organisations (NGOs): Ethically-related investors provide the voting rights, whilst the NGOs attempt to influence public opinion. Shareholder “engagement” is a particularly credible strategy of ethical investment. If the “engagement” is successful, the investment fund in question may even accept temporary losses; ultimately – at least in the short term – it is by no means ruled out that the price of the securities will fall. Because of the special opportunities connected with exerting an influence on the image, shareholder “engagement” appears to constitute a strategy which achieves a certain impact of governance.

Financial institutions with ethically-related investment products which use “engagement” go beyond their function as financial intermediaries and can be better described as an attempt to improve qualitative information intermediation. In some cases they operate in the political and public arenas. As a result of the various communication channels, they attempt to establish good management standards both in the public capital market and in the respective enterprises. Their significance presumably lies less in concrete individual successes than in the dissemination of an alternative model of good business which enterprises and the other players on the financial market can use as an orientation. Initiatives on the part of analysts who endeavour to ensure that the analysis process as a whole is improved by including ecological aspects show that such a change in the financial sector is not ruled out. In fact, so-called mainstreaming has a great potential. This term stands for the budding development that managers of funds which do not include ethics integrate aspects of ethically-related corporate evaluation in their fundamental analysis procedures.

4.3 Over-the-counter forms of investment

The strategies of ethically-related investment which have been discussed so far constitute an advantage to large enterprises, given that only these can issue securities on stock exchanges for the ethically-related investors to include in their investment portfolios. However, it is frequently small and medium-sized enterprises in particular which, firstly, particularly meet the ethical investment criteria because of their activities and, secondly, face particular difficulties when it comes to obtaining capital because of their size and perhaps also because of their innovative field of business. Over-the-counter forms of investment obtain access to sources of ethically-related investment capital for these enterprises.

In principle, as also with security financing, a distinction is made with over-the-counter forms of investment as to whether the capital is provided as equity or liabilities. Furthermore, a distinction should be made as to whether investors contribute the capital to enterprises directly, be it as a loan or as a participation in the equity, or whether financing is provided indirectly via an investment fund acting as a financial intermediary.

Direct over-the-counter investment in the shape of liabilities, such as by providing a loan, entails fewer loss risks for the investor than investment in the same enterprise in the shape of equity, given that income reduction or indeed losses are borne by providers of equity first of all. Liabilities however entail much fewer possibilities to exert an influence than equity, so that a direct holding in an enterprise as an equity supplier best satisfies the desire of an ethically-related investor to exert an influence. Moreover, participation in equity in turn increases the risk buffer, so that enterprises' possibilities to obtain liabilities are also amplified by purely commercial investors. Ethically-related equity investment hence acts as a lever, which provides access to more capital for the eligible enterprise.

Over-the-counter forms of investment, where the investor acts directly as a provider of liability or equity, are not suitable for minor investment sums. The cost of searching, obtaining information and monitoring would be disproportionately high, given the small amounts invested. With a equity holding, the investor should also have appropriate knowledge in order to be able to adequately exercise their rights to control. Given this fact, these forms of investment cannot be considered for small investors.

For small investors, as for investors of larger sums who lack the necessary information or the appropriate know-how for a direct form of investment, there are indirect forms of over-the-counter ethically-related investment channelled through correspondingly orientated funds. Fund management collects investment amounts from a large number of small investors in order to invest them in larger amounts, according to investment criteria which take account of the purpose of the fund. Some of these investments may be ethically-related, and the investment may encompass small and medium-sized enterprises, such as in specific regions or sectors. There are also funds in this field which specialise either in granting loans or in equity holdings, as well as mixed funds which are active in both forms of asset investment. An example which can be named here is the now very numerous microfinance funds, which several years ago were exclusively specialised in providing liabilities to microfinance institutions, but which have now also been established as mixed funds or even equity funds pure and simple. The latter have the leverage effect already described. The equity provided by the funds helps the microfinance institutions to meet equity regulations and to increase the risk buffer, so that they are able to expand their business volume more strongly than were they to provide the same amount in the shape of liabilities.

The risk related to a fund investment is smaller than with a direct holding because of the spread of the investment among several and possibly a large number of borrowers ("diversification"). That said, investors have to meet the costs of the management and the administration of the funds. The choice of a specific fund enables investors to pursue their ethically-related investment goals, given that the selection of suitable investments, their monitoring and where appropriate the desired exercise of influence can be delegated to the fund management. Moreover, funds are subject to the respective statutory provisions of their headquarters country, which in most cases ensures a certain amount of investor protection. In spite of these advantages, however, it is by far not all funds with over-the-counter investment for which an ethical claim is made that are open to or suited for a broad public of investors. There is no secondary trade for the shares of most funds which facilitate ethically-related over-the-counter asset investment, and there is also no possibility to sell the fund share back to the fund at will. The reason for the latter is that the fund would then have to decrease or enlarge its investment volume flexibly and in line with the liquidity wishes of the fund share holders. In this respect, investment in such fund shares entails a relatively high risk for the investor, given that he/she may not sell his/her shares at a reliable price when it is needed (low liquidity) – a risk which is too great for small investors. Some funds also require minimum investment amounts which rule out small investors from the outset.

The latter is the case with almost all hedge funds. For large institutions which also make ethical demands of their asset investment, it should not be categorically ruled out that hedge funds might be useful one day in future as an ethically-related investment vehicle. Investment in hedge funds entails considerable risks, given that the hedge funds increase the financial resources which they collect from large investors as risk-bearing capital with high volumes of liabilities. They are thus able to invest very large sums and may even exert a considerable influence on prices or even on company boards. In reality, hedge funds have so far only pursued speculative investment goals and in this respect are not suited for ethically-related investment. This orientation towards major speculation gains is however not necessarily provided with hedge funds. Rather, the capital of a hedge fund may in principle also be invested in an ethically-related manner: The “power” that is linked to the high investment volumes might also be used to exert the desired ethically-related influence.

5. Perspectives for action

5.1 Considerations on the Churches’ institutional asset investment

The Church can only carry out its mandate to be an effective sign of God’s Salvation for the world in the liturgy, in proclamation and in Caritas in the long term if its institutions do business in a responsible manner. This also applies to dealing with the financial resources which are needed for the Church’s actions. This goal is likely to include in most societies that the ecclesiastical facilities use the usual sound possibilities of investment and liquidity management if these are not linked with ethically-dubious business practices.

The ecclesiastical facilities and organisations are financially significant players. In addition to the dioceses and Church parishes, Caritas, the aid agencies, the Church Banks, ecclesiastical funds and foundations, as well as individual ecclesiastical and quasi ecclesiastical enterprises, all play a major role. The estimation of ecclesiastical investment assets is rather difficult, given that the large number of institutions and organisational structures makes a delimitation more difficult and so far there have also not been any systematic surveys on this matter. All in all, however, the total investment assets of the various ecclesiastical players are likely to be on such a scale that it is relevant for developments on the financial markets.

In order to make financing easier for ecclesiastical organisations, and to administer the money assets in a professional manner, some Church banks have been created in the Catholic area in Germany which are largely organised on a co-operative basis. In addition to this, there is an ecumenical financial institution and a number of ecclesiastical funds. The fund for the Church's old-age pensions takes first place in the latter. Then there are real property funds of ecclesiastical institutions and a number of ethically-related investment funds, some of which are also being developed in cooperation with the ecclesiastical aid agencies.

All in all, the various ecclesiastical organisations have considerable money assets, some of which they are already investing in an ethically-related manner. The "short paths" between Church banks and ecclesiastical aid agencies are also used to guide ethically-related investment in the long term.

The Catholic Church's universal Church law obliges the Church's asset administration to conform to the Church's mission. Consequently, the ecclesiastical facilities must also shape their financial transactions such that they do not promote any activities that are harmful to the common good and also contribute to the worldwide common good where possible. The dioceses, ecclesiastical organisations and foundations add up to a considerable investment volume. Were they to invest a major share of this bundled in suitable ethically-related funds, they could achieve a relevant impact of governance in favour of a socially- and ecologically-responsible way of doing business. If those who have to administer the assets on behalf of the Church were to combine investments in enterprises with “engagement”, the Church would become an investor with a “double weight”: Both because of its investment volume and as a result of its reputation as an ethical authority in society and of its major significance among civil society, the Church could constitute a significant factor which should also not be overseen by primarily profit-orientated company boards in their decisions on business strategies. This would increase the prospects of establishing a new model of good, efficient investment.

Having said that, this concern can only be justified if it is compatible with the trust principles under ecclesiastical law for the Church’s asset administrators: The provisions of ecclesiastical law with regard to asset investment in principle aim to bring about a risk-averse investment policy, given that the assets must finance the pastoral and welfare and social service work in the long term. These trust principles do not rule out ethically-related investment strategies as long as these do not lead to long-term losses. Rather, it is likely that the trust responsibility for long-term, sustainable profitability would be particularly complied with where the investment policy also takes ethical goals into account. There may however be a trade-off between avoiding unnecessary risks through diversification and exerting an effective influence on company managements. In order to remove the burden on the Church’s asset administrators in terms of the task of developing an independent position with regard to this trade-off, the Church leaderships should develop rules for responsible, effective ethically-related investment.

It is significant for effective ethically-related investment that the Churches cease assuming that it is sufficient when selecting the securities to transform the ethical standards of the Catholic Church into individual exclusion criteria which are to be taken into account in asset management. Close cooperation with other investors could increase the effectiveness of the ethically-related investment of ecclesiastical agencies and organisations. For this reason, the ecclesiastical facilities should take the principle of effective governance as an orientation in their investment practice and increase both ecumenical cooperation and cooperation beyond the boundaries of the Christian Churches.

Also for the Church as an institution, ethically-related investment can only be a partial element of its endeavours to bring about justice. In addition to many social, environmental and development policy initiatives and organisations, justice also includes the Church's contributions to political-public opinion-forming which are summed up under the term "social message".

5.2 Consideration of Christians' private asset investment

Ethically-related investment offers to Christians (and non-Christians) who have or are able to form assets a possibility to meet the social obligation which goes hand in hand with their asset ownership. It is a means of orientating economic processes more closely towards the common good.

It should however be taken into account with investment that there is a trade-off between the effectiveness of governance on the one hand and the security of the portfolio on the other. Above all, the less well-off households, who for instance vitally depend in old age on yields from assets, and those who invest savings on their behalf, should always bear in mind that ethically-related investment, whose suppliers seriously aim to exert an impact of governance, taking account of the risks are only able to offer a less attractive interest rate than broadly-spread conventional asset investment. Nonetheless, Christian savers who also want to live by their faith when it comes to money may find it expedient to buy into funds which are exclusively focussed on ethically-related portfolio investment. This applies not only because they have the understandable, justified desire not to be involved as investors in dubious economic practices, but also because investing in such funds might help create an awareness. Finally, their very existence shows the public that the conventional forms of asset investment mostly neglect social and ecological aspects. Above all for prosperous Christians, it may be an expedient, inspiring option to place a part of their assets in ethically-related investment where the suppliers are making serious endeavours to exert an influence on enterprises in ethically-sensible terms. In order to achieve an effect of governance, they may for instance use funds with direct holdings or purchase shares in such ethically-related security funds whose suppliers plausibly propose intensive "engagement" activities. As asset ownership increases, the possibilities open to the asset owners grow, and hence also the degree of their obligation to contribute to the social and ecological orientation of the corporations sector. In the light of faith, the greater risk (with the same profit) or the lower profit (with the same risk expectation) which one must accept for serious endeavours towards achieving a social and/or ecological effect of governance can be understood as an investment in a fairer world.

Dealing with money in a manner meeting the social obligation however does not stop with ethically-related investment. Many activities which promote the common good but do not lead to a profit require money. For instance, independent political awareness-building initiatives and civil society, which provides an important echo for demands for an ethically-expedient re-structuring of the economy, require financial support. Ethically-related investment in this respect is to be regarded as a supplement to classical donations, to supportive memberships of NGOs or to suitable legacies. In fact, the change in the economy towards ethically-expedient business and use of money orientated towards the common good can be supported. Prominent importance as a motor for such developments however attaches above all to citizens' corresponding political engagement. A vibrant democracy lives from citizens exercising their participation rights and playing an active role in those political debates in which the important social, ecological and economical questions are dealt with.

5.3 Demands on the financial institutions with ethically-related investment products

The financial institutions are the key interface of ethically-related investment, mediating both between supply and demand of capital and between issuers and addressees of qualitative information. The staff and boards of these institutions and of the research agencies which they commission are invited to enter into a debate as to the ethical criteria for their practice as put forward here. On the basis of the analysis and of the ethical reflection of the sector that have been put forward here, five central challenges arise:

- *Firstly,* the entire investment practice should be orientated in line with consistent lists of norms, and be reflected within enterprises. Since an intersubjective, or in part even a universal claim of validity is asserted for ethical statements, it is a principle of credibility that an ethically-related financial institution or an ethically-related rating agency makes its own ethical point of view transparent. They can only achieve the ethical demand which such institutions and agencies make of themselves if they retain their independence. This effort may be expressed in a variety of ways: The financial or information intermediary commits him/herself to a reflected corporate model, orientating his/her processes without exception towards an unambiguous list of criteria, disclosing this list and his/her corporate model as a normative basis of his/her work, establishing an independent ethical advisory council which monitors his/her own business conduct in terms of its adherence to the (voluntary) commitment, etc. When applying lists of norms, it should be ensured that the ethical perspective is taken into account both in the composition of the investment spectrum, and in the interpretation of company-related data. The list of criteria should always be comprehensible for the representatives of various moral positions with regard to good business. At the same time, the respective list of criteria is to be kept open for changes and additions if it emerges for instance that it does not yet adequately cover the decisive ethical fields of business.

- Many players who are committed to ethically-related investment demand that the amount of profit and the ethically-related selection of investment objects should complement one another. Trade-offs are only seldom expressed. *Secondly,* therefore, financial institutions with ethically-related investment products are obliged not to hide existing trade-offs such as those between a profit that is in line with risk and serious efforts to exert an influence. Complementarities which exist should naturally be named as such without having to face the suspicion of committing "greenwashing" or juggling with names.

- Additionally, and *thirdly,* the lists of norms should not only reflect the respective in-house model, but also meet some internationally-recognised minimum standards. The ILO Core Labour Standards are particularly important in this respect. Over and above this, however, the topics of tax evasion and corruption from the OECD Guidelines for Multinational Enterprises should also be taken into account.

- With regard to the transparency of the governance impact, *fourthly,* one goal must be for the ethical objectives to also be examinable and measurable ex post. Suitable indicators and measurement tools must be developed to this end. The advantage from an investor perspective would be that the "qualitative performance" of ethically-related investment could also be reviewed and the financial institutions could be compared with regard to the respective influencing effects of their products. Even if incorporating the effects of qualitative benchmarks is extremely difficult, a financial institution offering ethically-related products should take part in efforts to improve the revisability of the influencing effects. The objective of such efforts may be, for instance, to establish external, independent evaluation of the impact.

- The financial markets are among the most difficult-to-comprehend markets now existing. The segment of ethically-related investment is also heterogeneous and plural. The evaluation mechanisms which are used for instance by the ethically-related rating agencies are highly complex so that they can do justice to the diverse reality of the sector of industry. Grey areas in the field of business – such as enterprises which manufacture products which can be used for both civil and military purposes – leave a considerable margin for decision-making and uncertainties as to their evaluation for fund managers and analysts, to which the latter give highly-diverging answers in some cases. So that interested customers do not lose their orientation in the cluttered "landscape" of ethically-related investment, there is a need, *fifthly,* for a serious seal-of-quality initiative covering the entire sector, in the framework of which compliance with minimum standards is examined above all. The various players in ethically-related investment should also play a constructive role in such efforts. In that seals of quality help to establish binding minimum standards and to generally spread them, they make a major contribution towards the transparency of the market, and hence also towards an effective governance of the corporations sector. It also makes sense with ethically-related rating to establish standards for the rating process.

5.4 Political consequences

In addition to its role as an economic player which provides public assets amongst other things, the State is significant in this context above all as a rule-maker. Supervised by the politically-interested public, the State assumes first priority for shaping the economic system in such a way that economic subjects are enabled and even encouraged to do business in a responsible manner.

- Access to qualitative corporate data is decisive for effective ethically-related investment. Only a small number of enterprises adequately report on qualitative aspects of their business in Germany so far. This is caused not lastly by the fact that, in Germany, there is an obligation to report on sustainability so far only for large corporations and groups. Given the high degree of internationalisation on the financial markets today, the regulations for reporting require international coordination. The aim should be to establish common standards at least within the EU.

- Some other European countries prescribe ethically-related investment in various forms for the state-promoted old-age pension funds. For instance, an investment regulation should be introduced in Germany over and above obligatory reporting. The point of reference could be formed by the regulations applicable in Norway or France. Exacting European standards should however be developed here too in the long term.

- The consumer associations have above all reminded us in the course of the financial crisis that more independent advisory and complaint agencies are needed, given financial products' complexity. Looked at from this point of view, there is also a need for an external supervisory institution for ethically-related investment which exercises supervision of ethically-related investment activities and ethically-related rating, and in so doing is also able to resort to specifically ethical expertise.

- It is not the case that every financial product is advisable for any household. In addition to a re-structuring of financial advice, there is therefore also a need for initiatives which promote the education of the citizen in financial matters in the common good. This relates not to the uncritical promotion of the willingness to buy investment products, but to a certain basic knowledge or awareness of the opportunities *and* risks related to the respective financial product. The specific possibilities of ethically-related investment, as well as the concomitant trade-offs, are also to be accommodated here. In principle, the goal pursued here is to acquire those skills that are needed to be able to critically accompany developments in the financial sector as politically-thinking citizens.

The areas which have been outlined are concerned with building or promoting structures by the legislature, thereby making it more likely that ethically-related investment is indeed really ethical. To achieve this, there is a need first of all to consistently regulate all financial markets, products and institutions. Over and above this, the State itself however also acts as an investor on the financial markets. Since the Federal Republic of Germany has undertaken to comply with concrete social and ecological standards (respect for human rights, protection of the environment and the climate, etc.), it is a logical consequence for the State to also accommodate these standards in investment. By these means, the opportunities of ethically-related investment to influence the development of the industrial sector in an ethically-sensible direction increase. Here, and in the regulation of the financial markets, the nation-states' governments are called on to set the stage so that the financial sector can develop once more in future in a manner benefiting the common good. As a rule, this undertaking will only be met if informed citizens acting in the common good do not tire of making a critical contribution in the political debate on the development of the international financial markets and their political governance.

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