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Upfront

Determining Diversity
Do socially responsible funds ask the right questions?

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INVESTMENT

Determining Diversity

Do socially responsible funds ask the right questions?

More and more investors are putting their money into socially responsible mutual funds. According to the Social Investment Forum, a national organization that promotes investment to encourage social and environmental change, $2.1 trillion in assets is now invested in funds that claim to reject the reprehensible. The group also said that assets in these funds grew 40 percent faster than other professionally managed assets from 1995 to 2003.

But a recent report by Donald Schepers, a management professor at the City University of New York's Baruch College, raises questions about the accuracy of screening methods that investment managers typically use. "Social investment funds as they are currently constructed don't give us everything that they seem to promise," Schepers wrote last December in the *Business and Society Review*. "Investors who are out there saying they want their money to go to a better society, instead of just making money, need to be asking more questions."

His study, "A Critique of Social Investing's Diversity Measures," chose one of the criteria used to screen for socially responsible companies – racial and gender diversity – to demonstrate the nebulous nature of these screens. The study focused on three factors commonly used to evaluate diversity: promotion criteria, attainment of diversity goals, and presence of discrimination. Schepers examined the top 14 social investing funds, including the Domini Social Equity Fund, Calvert Social Investment Balanced A Fund, and Ariel Appreciation Fund. He concluded that the screens used to assess diversity were often off the mark, or too vague to give investors an accurate picture. A number of funds, for instance, claimed to eliminate companies with "significant" problems with discrimination, he said, but never defined what "significant" might mean.

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Even when the selection measures are more tangible, Schepers wrote, the funds may not be applying them correctly. For many of the diversity screens, the funds use quantifiable data such as the number of women or minorities in management positions and on boards of directors. But Schepers said these are the wrong questions, that the numbers give a very limited picture of how a company sets and reaches its diversity goals. For example, some factors such as sexual orientation or religion are not immediately observable and may not be reflected in the numbers. Instead, fund managers should ask how companies manage diversity and what concrete steps they take to make their business more diverse. "It's much more difficult to get companies to talk about their processes," he wrote, "but they're the keys to a more diverse workforce and making [diversity] a more lasting feature of the corporate arena."

Managers of socially responsible funds acknowledge that their system is imprecise, but say the numbers are a proxy for the less-measurable factors. "Diversity as a concept is broader than the measurement of how many women are in high places, etc.," said Steven Lydenberg, chief investment officer for Domini Social Investments. "But I do think there's a virtue in looking at the numbers. Counting women on boards of directors does, I think, raise the concept that boards of directors should be attuned to women's concerns."

Schepers said he suspects the monitoring deficiencies would also be found in funds that screen for environmental problems or human rights violations. "Diversity is not being supported as strongly as the funds would like us to believe it's supported," he wrote. "And the validity and reliability of the measures used in other areas is an important question, and one that is very much open."

–Jan Chong