The economic crisis
Towards sustainable economies and livelihoods
A day conference organised by Churches Together in Britain and Ireland (www.ctbi.org.uk)
Tuesday 20th January 2009

Ethical Investment – A Solution to Financial Turmoil?

John Reynolds
Chief Executive of Reynolds Partners, an independent investment bank
and Chairman of the Church of England's Ethical Investment Advisory Group

Ethical decision making by company boards and ethical input from the churches could make a significant impact on corporate and consumer behaviour. At present, the role that true ethical debate plays in corporate decision making is sadly very limited and a far greater – but less valuable – focus is placed on governance.

Ethics and governance are not the same thing – but should be tied more closely together. The boards of major companies, and their various specialist advisers, are required to focus on governance. Governance on its own offers protections for minority shareholders but is a demonstrably poor proxy for genuine ethical decision making. Most major companies – virtually all that I have worked with – try to be ethical. Most, by and large, succeed most of the time.

There are three specific problems in cases where boards do make a serious attempt to consider ethical issues:

1. the tick-box approach of governance codes which can be seen as a board's means of behaving ethically, are generally administered in a very legalistic and technical way;

2. a conflict in incentives below board level in most companies, where short to medium term financial performance is the over-arching target for senior and especially middle management; and

3. a utilitarian approach to ethics. There is a concerning trend with some companies that they apply a utilitarian approach when consciously looking at ethical issues and, in so doing, implicitly do not accept that behaviour can be right or wrong in itself, involving in Kierkegaard's phrase "the teleological suspension of the ethical" (Fear and Trembling).

One of the difficult issues here is that there is no single, accepted definition of ethics. In the ancient world, there is a clear difference in the philosophical approach of Plato and Aristotle. In a modern context, there can be notable differences between a Christian approach and that of utilitarianism.

However, in a practical sense there is a strong body which accords similar applied ethical values to corporate behaviour. At the last meeting of 3iG, the International Interfaith Investor Group, representatives of Christianity, Islam, Hinduism and Judaism were in close accord on major issues of corporate ethical behaviour. In particular, to use the phrase from the Qu'ran, the "people of the book" (5:15; Ahl al-Kitāb) have a remarkable level of similarity in how they approach ethical investment issues. With this level of commonality, churches in particular and faith groups more widely should feel confident about the support for their ethical values.

Proponents of ethical decision making need to continuously advocate their case: specialist SRI funds are small, make limited impact, and often do not pay attention sufficiently to normal business issues; regulators focus much more narrowly on rules. In theory the FSA has a principles based approach to regulation and compliance, which in practice tends to fall back on detailed and sometimes irrelevant prescriptive rules; the churches often seem to think of money and investment as something not really related to their mission. In a world where we are all dependant on industry and commerce, where (at least until recently) most industry and services are privately owned, to marginalise private business as a stakeholder in society and as an object of mission, is to leave too large a lacuna.

Ethics can present an effective framework for long-term decision making for those companies who want to make sound long term decisions: protect brand and reputation, avoid banana skins. But, it needs to be advocated effectively if it is going to fill what is now an obvious need. Ethical debate must focus on major and obviously major issues: if it becomes interfering and prescriptive in all aspects of a company's activities, it will become unfocused and therefore less useful and relevant. Corporate behaviour is both the decision making of Boards, and the actions of all employees of a company.

Could ethical decision making have prevented the growth in trading of secondary mortgage products? Not directly. It could, however, have regulated unfair sales of mortgages to begin with, on the part of those companies actively embracing ethical behaviour. It would not have directly prevented abusive behaviour by companies seeking to make a quick profit at any cost, but such behaviour would have been more noticeably abusive in a more generally ethical environment and with more ethically aware consumers. It is also interesting that the sub-prime crisis, one of the causes of the broader economic crisis (but certainly not the only one) started in the US, a country with a relatively high level of regular attendance at worship.

In many ways single issue lobby groups can help raise awareness of ethical issues, but can also be a cause of problems. In many cases, they can prioritise their own favoured issue at the expense of not being fully informed of all material facts, resulting in misunderstanding relevant business and ethical issues. They may also focus on comparatively trivial issues. All this can undermine the perceived value of ethical input to a Board.

I would propose a five point agenda if ethics is to become part of corporate decision making and stimulate changes in corporate behaviour:

1. Commerce and industry must be seen as an integral part of the churches' mission.

2. There must be a concerted approach to make ethics an integral part of the existing governance agenda.

3. Significant outside ethical pressure must be applied on major issues only.

4. It must be applied fairly and on an informed basis, sympathetic to normal business needs and activities.

5. It must be applied both on companies and (where necessary) on stakeholders, notably consumers, government and regulators.