

Does Socially Responsible Investing Hurt Investment Returns?

A common concern about socially responsible investing (SRI) is that there is a premium to be paid for being socially responsible that necessarily diminishes investment returns. A comprehensive review of the empirical literature questions this premise. At Phillips, Hager & North, we monitor a broad range of financial trends and issues that may influence our clients' decision-making. Periodically, we produce research articles to help provide background for investment decisions on many different levels. This article, an update of an earlier research paper, challenges the myth of lower long-term returns for SRI investors and provides an overview of the current research on the subject.

Introduction

Socially responsible investing (SRI) has been practiced for more than a century. Almost from the beginning, practitioners, academics and the investing public have asked if the inclusion of social and environmental considerations in the investment decision-making process hurts investment returns.

The answer to this question is central to the future of SRI. If it is the case that SRI produces lower investment returns, then SRI will never be more than a niche market, appealing solely to those individuals with strong convictions about the types of companies they want to hold and who are prepared to accept less material wealth in order to satisfy these concerns. If, however, it can be shown that SRI produces superior investment returns, then SRI will move into the mainstream and traditional investment managers increasingly will integrate SRI principles into their investment processes in order to boost returns. Finally, if research shows that there is no material difference between the investment performance of SRI funds and traditional investment funds, then SRI will establish itself as a legitimate investment alternative for those investors who believe companies should be held accountable for their social and environmental practices.

Opponents of SRI argue that the application of non-financial considerations, such as environmental, social, and governance (ESG) factors, to the investment process must result in lower investment returns because the number of investment opportunities is reduced. Relying on modern portfolio theory, this position, stated crudely, says that investment portfolios constructed from an investment universe of, say, 2,000 companies will be more efficient (i.e., they will have higher expected returns and/or lower expected volatility) than portfolios constructed from an investment universe of, say, 1,500 companies. In other words, SRI works with a smaller investment universe and therefore will generate lower expected risk-adjusted returns.¹

Supporters of SRI readily admit that the application of ESG considerations will reduce investment opportunities – after all, the *raison d'être* of SRI is to exclude “irresponsible” companies from consideration – but argue that their integration into the investment process delivers benefits that more than offset the loss of portfolio efficiency caused by the more limited investment set. Socially responsible investors believe that integrating ESG factors into the investment process will eliminate companies that are expected to perform more poorly than their competitors.

Excluded companies are engaged in unsustainable activities or practices that will make them less profitable over time.² In other words, companies that embrace corporate social responsibility (CSR) will deliver better financial performance than competitors that do not, and market participants systematically overlook these positive factors. Therefore, SRI proponents argue that any loss of portfolio efficiency due to a smaller investment universe is more than offset by the more attractive investment characteristics of the remaining companies.

There is a third view, which to date has not received much attention. This view holds that, under normal conditions, there should be no meaningful difference between the long-term performance of a broad universe of SRI funds and a broad universe of traditional investment funds that are managed with comparable mandates. This view is based on three premises:

- The integration of ESG factors into the investment process, providing it employs a “best-of-sector” approach,³ reduces the investment universe on a random basis;
- The number of securities eliminated through the integration of ESG considerations is not large; and
- The smaller investment universe does not produce a material loss of efficiency in portfolios constructed from that universe.

Proponents of this view have divorced themselves from the ideology-laden debates about whether SRI funds should perform better or worse than traditional investment funds. Instead, they believe that there should be no expected difference in performance and that the merits of SRI rest entirely with the wishes of individual investors. According to this view, SRI does not involve a Faustian choice between following one’s conscience and following one’s pocketbook; instead, it is a legitimate investment approach that can be expected to provide investment performance on par with investment funds that do not formally apply socially responsible investment principles.

¹ A useful discussion and more formal treatment of this argument are found in Geczy et al. (2005).

² For example, companies which are heavy polluters have a greater chance of facing litigation over their emissions and will use more inputs in production.

³ Rather than exclude all companies in a sector that is considered “bad”, such as mining, the “best of sector” approach seeks to identify those companies with the best relative ESG performance within the sector peer group.

Given these competing theoretical views, the question of how SRI portfolios perform relative to traditional investment portfolios is, at the end of the day, an empirical one. Research into this question has been approached in four ways:

- Comparing the performance of SRI indices with traditional indices;
- Comparing the performance of SRI funds with traditional investment funds/indices;
- Creating hypothetical portfolios of companies ranked highly against ESG factors and comparing their performance with lower-ranked companies; and
- Comparing the financial performance of companies that score highly on measures of corporate social performance with those that do not.

The remainder of this report provides an overview of the key findings of the empirical research conducted in each of these areas. The main finding from this body of work is that socially responsible investing does not result in lower investment returns.

Index Comparisons

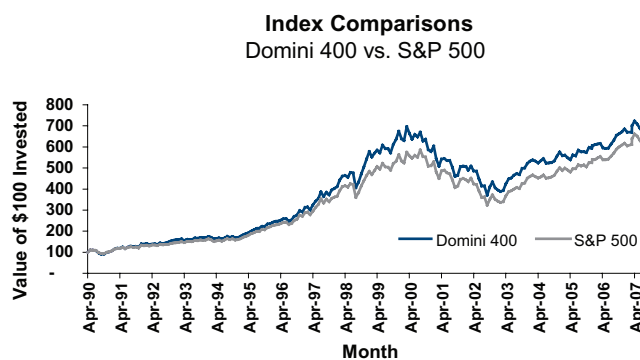
An index is a universe of securities constructed to represent a particular market or asset class. Examples include the S&P/TSX Composite Index, a grouping of about 270 companies representing the Canadian stock market, and the S&P 500 Index, a grouping of 500 companies representing the U.S. stock market. While construction rules differ among indices, two important features of most are that: (i) larger capitalization securities have a higher weight in the index than smaller capitalization securities and (ii) the composition of the index is adjusted regularly, either based on the decisions of an oversight committee and/or through a rules-based formulation.

Stock market indices have been around for more than a century. They serve many purposes, among the most important of which is to permit investment managers to compare their performance with that of the overall market. In the past 25 years, there has been a huge explosion in the number of indices available to investors.⁴

In May 1990, the Domini 400 Social Index (DSI) was created, the first index to measure the performance of a broad universe of socially responsible stocks in the United States. Since then, a number of other SRI indices have been created⁵, including the:

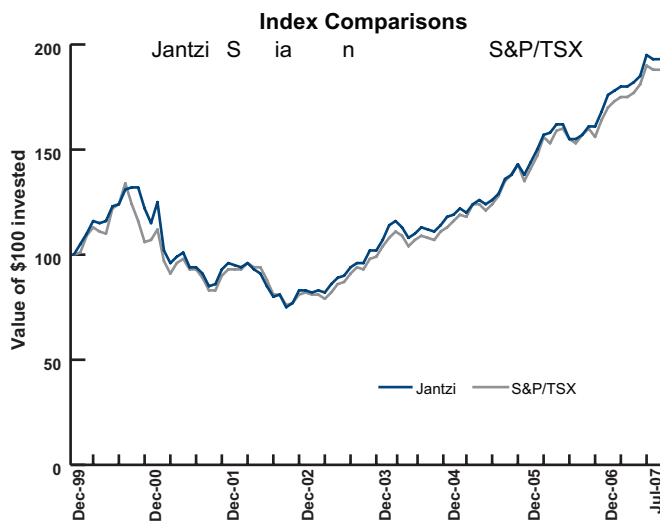
- Citizens Index in the United States (1995);
- Dow Jones Sustainability World Index (1999);
- Calvert Social Index in the United States (2000)
- ECPI Index Family for European and global portfolios (2000);
- Jantzi Social Index (JSI) in Canada (2000);
- ASPI Eurozone Index for European markets (2001);
- Humanix Index for global portfolios (2001);
- FTSE4Good Index for global portfolios (2001);
- Ethibel Sustainability Index Global (2002).
- Dow Jones Sustainability North American Index (2005); and
- KLD Global Sustainability Index (2007).

One method to determine if SRI results in lower investment returns is to compare the performance of an SRI index with a comparable traditional index. This is shown in the charts below and on the next page for the United States and Canada. In both cases the SRI index has slightly outperformed the traditional index, although the differences are small. However, there can be meaningful differences over shorter periods, both positive and negative (e.g., differences of +/-2% over a one year period are not uncommon, and they have been as large as 5%).



⁴ The five main global providers of stock market indices are: Standard & Poor's (S&P), Russell; FTSE, Morgan Stanley Capital International (MSCI) and Dow Jones.

⁵ For a more comprehensive list, including definitions of indices, please refer to Hamid and Sandford (2002).



Looking at SRI indices has the advantage of eliminating the effects of factors like transaction costs, timing, and management skills; that a similar study of SRI mutual funds would have to address. However, a simple comparison of the performance of an SRI index with a comparable traditional investment index, while intuitively appealing, is not sufficient to determine if SRI performs better, the same, or worse than traditional investing. Differences in performance could, for instance, be due to style, industry, or size biases that have material impacts on performance during the comparison period. For instance, SRI indices are widely acknowledged to have a growth bias relative to traditional indices and performance differences between these two indices over any given period could be caused by this factor. This has been illustrated in a study by Statman and Klimek (2005), who found that SRI indices outperformed the S&P 500 in the late 1990s during the technology “bubble”, and subsequently lagged the S&P 500 in the early 2000s.

DiBartolomeo and Kurtz attempted to account for factor biases in their 1999 study. Using BARRA-style factor analysis, they examined the performance of the S&P 500 and the DSI between May 1990 and January 1999. The DSI outperformed the S&P 500 during this period because the DSI portfolio was more sensitive to market movements, had more exposure to better performing industries and had a growth bias during a period when growth investing was in favour. Modifying the DSI to have the same risk characteristics as the S&P 500, they found that the performance of the two portfolios was “not distinguishable to a statistically significant degree”, one from the other.⁶

Other studies examining the relative performance of the DSI have also been conducted.⁷ In an extensive review of this work, ABN-AMRO Asset Management concluded that there are “no indications that, over a longer period of time, the [DSI] will generate lower returns than the S&P 500.”⁸ However, while Schroder (2005) also confirmed this, he found that 20 of the 29 international SRI indices he examined had higher risk (volatility) than their benchmarks. This suggests that, on a risk-adjusted basis, SRI indices may under perform conventional indices.

As the number of SRI indices grows and the length of their performance history increases, we expect to see more empirical research in this area.

Mutual Fund Comparisons

A second body of work has attempted to determine if SRI results in lower investment returns by comparing the performance of SRI mutual funds with traditional mutual funds and/or traditional market indices. This research is difficult because the sample size of SRI mutual funds is small and few have performance histories exceeding 10 years. A third challenge is constructing an appropriate control group of traditional mutual funds. Notwithstanding these methodological issues, several studies have been conducted. The key findings of a selection of these studies are reported in Table 1 on the following page.

The findings to date from these (and other) empirical studies are contradictory, although, with two exceptions,⁹ in all cases where differences were found (higher or lower), the authors concluded that the differences were small and/or statistically insignificant.

Two interesting pieces of research have given some insights as to why the empirical evidence thus far has been contradictory. One study found that while SRI funds perform similarly to conventional funds, conventional funds with a slightly higher SRI tilt tend to perform better than funds with fewer socially responsible companies.¹⁰

⁶ diBartolomeo and Kurtz (1999), p.10.

⁷ See Luck (1998) and Dhrymes (1998).

⁸ ABN-AMRO Asset Management (2001), p. 79.

⁹ Geczy et al. (2003). Under certain conditions, however, Geczy et al. conclude that the impact will be insignificant. Girard et al (2007) found that SRI funds had poorer management and were less diversified than non-SRI funds.

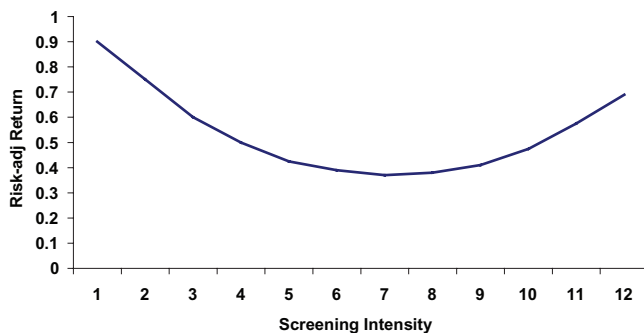
¹⁰ See Plantinga and Scholtens (2001)

Table 1: Summary of SRI Fund Studies

Study	Country/ Region	Data	Time Period	Findings for SRI Funds
Asmundson and Foerster (2001)	Canada	2 SRI funds (over 10-year period) versus TSE 300 Index	January 1990 to December 1999	<ul style="list-style-type: none"> ■ Evidence of both higher and lower returns ■ Lower risk
Bauer et al. (2002)	Germany, U.K. & U.S.	103 SRI funds and 4,384 traditional mutual funds	January 1990 to March 2001	<ul style="list-style-type: none"> ■ Evidence of both higher and lower returns ■ Differences are not statistically different
Bauer et al. (2007)	Canada	8 ethical, 267 conventional mutual funds	January 1994 to January 2003	<ul style="list-style-type: none"> ■ No significant performance differences between funds
Bello (2005)	United States	42 SRI funds, 84 conventional funds	January 1994 to March 2001	<ul style="list-style-type: none"> ■ Risk adjusted returns of SRI funds indistinguishable from returns of conventional funds ■ Fund characteristics did not differ between the two groups
Derwall & Koedijk (2005)	United States	8 SRI bond funds	1987 - 2003	<ul style="list-style-type: none"> ■ SRI bond funds provided returns similar to or superior to conventional bond funds ■ Found to perform in-line during an economic expansion, and significantly outperform during an economic contraction
Geczy et al. (2005)	United States	35 no-load SRI funds and 859 no-load traditional mutual funds	July 1963 to December 2001	<ul style="list-style-type: none"> ■ Lower returns ■ Difference is significant under certain conditions
Girard et al. (2007)	United States	117 mutual funds versus style benchmarks	1984 to 2003	<ul style="list-style-type: none"> ■ SRI funds have less diversification ■ SRI fund managers showed poor stock selection and market timing
Gregory et al. (1997)	United Kingdom	18 SRI funds matched with 18 traditional mutual funds	January 1986 to December 1994	<ul style="list-style-type: none"> ■ Lower returns ■ Differences are not statistically different
Hamilton et al. (1993)	United States	32 SRI funds versus 170 traditional mutual funds	January 1981 to December 1990	<ul style="list-style-type: none"> ■ No statistically significant performance differences
Haveman and Webster (1999)	United Kingdom	15 SRI funds versus peer medians	5-year periods ending June 1998	<ul style="list-style-type: none"> ■ Lower returns ■ Lower risk
Kreander et al. (2005)	United Kingdom	29 SRI funds matched with 29 traditional mutual funds	January 1986 to December 2000	<ul style="list-style-type: none"> ■ Higher returns ■ Lower risk ■ Differences considered insignificant
Mallin et al. (1995)	United Kingdom	29 SRI funds matched with 29 traditional mutual funds	January 1986 to December 1993	<ul style="list-style-type: none"> ■ Higher returns ■ Lower risk ■ Differences considered insignificant
Otten and Koedijk (2001)*	Netherlands	4 SRI funds matched with 4 traditional mutual funds	January 1994 to December 2000	<ul style="list-style-type: none"> ■ Lower returns ■ Similar returns when style biases corrected
Platinga and Scholtens (2001)	Euronext markets (FR, BE, Germ.)	SRI exposure analysis of 784 mutual funds	1994 - 1999	<ul style="list-style-type: none"> ■ Mutual funds with higher SRI tilt experienced slightly higher returns ■ Differences are not statistically different
Scholtens (2005)	Netherlands	12 SRI fund compared to SRI and non-SRI indices	November 2001 to April 2003	<ul style="list-style-type: none"> ■ Slight outperformance of SRI funds vs. the index ■ Slight underperformance of SRI funds vs non-SRI funds ■ Neither result was statistically significant
Schroeder (2003)	German, U.S.A., U.K.	30 U.S. funds, 16 German and Swiss funds, and 10 SRI indices	Minimum of 30 months of data before 2002	<ul style="list-style-type: none"> ■ No significant performance differences ■ Some SRI funds exhibited insignificantly higher returns
Statman (2000)	United States	31 SRI mutual funds versus 62 traditional mutual funds	Periods ending September 1998	<ul style="list-style-type: none"> ■ Higher returns ■ Differences are not statistically different

* As reported in ABN-AMRO (2001).

The second study¹¹ found that there was a curvilinear relationship between the number of screens used by a fund and the financial performance of the fund. In plain English this means that as the number of screens increases the returns of the funds at first decline and then begin to increase again. See the following graph as an illustration of this effect.



Source: Barnett and Saloman, 2006.

The explanation put forward by the researchers is that when you use only a small number of screens you eliminate fewer companies from your portfolio and consequently performance will not be impacted greatly. As the number of screens increases, more companies are eliminated from the portfolio, the portfolio is therefore less diversified and performance suffers. However, once a certain number of screens are reached the companies that remain in the portfolio are of a higher quality and lower inherent risk, and as such the performance then begins to improve.

This research seems to reconcile the current conflicting evidence, and is intuitively appealing. However, this is only one study, and more corroborating research is needed before we can reach any conclusions. Therefore, the evidence to suggest that SRI funds systematically underperform traditional mutual funds is limited, as is the evidence to suggest that SRI funds outperform traditional funds.

In separate reviews of this literature, two investment banks reached strikingly similar conclusions:

“Contrary to theory, most academic studies show that incorporating social screening into a portfolio does not necessarily have detrimental effects on performance. Studies suggested that SRI portfolios have about the same risk-adjusted returns as their normal counterparts.”
(UBS Warburg, 2001, p. 14)

“...the balance of the empirical evidence supports the view that an SRI approach will in general not lead to long run risk-adjusted under-performance compared with a conventional approach.”
(ABM-AMRO, 2001, p. 93)

Comparing Performance of High-Ranked Socially Responsible Companies vs. Low-Ranked Socially Responsible Companies

A third area of SRI research has been focussed on creating hypothetical portfolios of socially responsible companies, using data primarily provided by Innovest Strategic Value Advisors.¹² For the most part these studies have used a company’s environmental rating as the key independent variable.

This area of research has evolved over the last five years, and can be illustrated by looking at two recent studies. The first of these studies by Blank & Daniel (2002) took a portfolio made up of equally weighted positions of top-rated eco-efficient companies, and made three distinct performance comparisons,

1. to an equally weighted universe of all Innovest rated companies,
2. to an equally weighted portfolio of low-rated eco-efficient companies, and
3. to the S&P 500 (a comparison of risk adjusted returns using the Sharpe Ratio was used).

What the researchers observed is that, for all three comparisons, there was clear and significant outperformance by the portfolio made up of top-rated eco-efficient companies for the observed period (1997 – 2001). The authors then went on to adjust these raw results for any kind of style bias, and found that there was still significant outperformance for the “eco-efficient” portfolio. This observation was significant, as such a strong link between an SRI approach and excess returns had rarely been demonstrated so clearly in the past.

The second study in this area took the Blank & Daniel research a step further by taking a closer look at this “eco-efficiency premium puzzle” (Derwell et al. 2005).¹³

¹¹ See Barnett and Saloman (2005)

¹² Innovest is an investment research and advisory firm that specializes in analyzing companies’ performance on environmental issues, on a best-in-class approach, termed “Eco-Efficiency”.

¹³ Derwell, Guenster, Bauer, & Koedijk (2005)

This study took a more in-depth look at the outperformance of the eco-efficient portfolio, and in particular at how this anomaly could be explained. The authors found that a portfolio of high-ranked eco-efficient companies outperformed a portfolio of low-ranked companies, and that the outperformance could not be explained by adjusting for market risk, investment style, and industry effects. The authors then demonstrated how to build an eco-efficient portfolio that would outperform, even when transaction costs were considered. The authors conclude by observing that the superior performance of a portfolio constructed using environmental considerations as a key factor could be an example of the market mispricing information on the ecological performance of companies.

More recent research has also provided some additional general insight.¹⁴ It has been observed that the eco-efficiency premium initially did not exist, but has developed and increased strongly over time. This indicates that environmental factors are having an increasingly significant effect on firm performance, and that environmental risk is increasing as a proportion of total risk.

While this fairly new area of research has provided some interesting results, more empirical testing is needed. In particular, results based on additional data sets and the performance of actual portfolios would be useful extensions to this line of research. Regardless, this will be a fertile and interesting area of SRI research in the coming years.

Corporate Social Performance

The fourth approach to determine if SRI impacts investment returns has been to examine the financial performance of companies that score highly on one or more measures of good corporate social responsibility (CSR) versus those that do not. Proponents of SRI argue that companies embracing corporate social responsibility should deliver superior financial performance. Some of the benefits CSR is purported to deliver include:¹⁵

- An improved ability to attract and retain better employees;
- Competitive advantages in production technology designed to eliminate waste;
- More productive workforces;
- Higher sales and more loyal customers;
- Lower litigation costs;

- Lower environmental costs;
- Enhanced brand value and reputation;
- Better risk and crisis management; and
- Good relations with governments and communities.

Supporters of SRI argue that these benefits will translate into improved financial performance.

Opponents of SRI are skeptical that CSR confers meaningful benefits on companies and, even if such benefits can be shown to be present, they do not translate into better financial performance. At best, according to opponents, there are no financial advantages to corporate social responsibility. Some opponents of SRI would go one step further, asserting that companies pursuing CSR will actually perform worse because such efforts will distract management from their key focus – to maximize profits.¹⁶

Needless to say, this question has been fertile ground for academic research and more than 100 empirical studies¹⁷ can be identified that have attempted to determine if a relationship exists between corporate social performance and financial performance. This research can be divided into two main segments:¹⁸

- **Event studies** – measuring the impact of a major CSR event on the subsequent financial performance of a company. A “CSR event” can be positive (e.g., receiving an award for good environmental management) or negative (e.g., a pollution spill or product recall).
- **Cross-sectional regression analysis** – examining the relationship between one or more CSR indicators and one or more measures of financial performance.

There has also been a number of what can best be described as “anecdotal” studies, which have used selective case studies to illustrate the benefits to companies of corporate social responsibility. For the most part, this “research” has been sponsored or prepared by non-governmental organizations dedicated to promoting the wide-spread adoption of CSR and, consequently, is of limited empirical value.

¹⁴ Guenster, Derwall, Bauer, & Koedijk (2005)

¹⁵ These and other benefits of CSR are put forward by various non-governmental organizations promoting corporate social responsibility.

¹⁶ For one expression of this view, see Friedman (1970).

¹⁷ We have not provided citations for these studies in this paper. Good bibliographies are available from Griffin and Mahon (1997), Kurtz (1997) and ABM-AMRO (2001).

¹⁸ ABM-AMRO (2001), p. 27-8.

While the majority of these studies have found some evidence of a positive linkage between corporate social performance and financial performance,¹⁹ these studies suffer many methodological failings that make it difficult to draw any strong conclusions. Three of the more serious methodological problems are:

- **Definition of the independent variable(s)** – Researchers are attempting to determine if CSR produces better financial performance. Three approaches have been used to specify the independent variable: (i) using one CSR attribute – such as good environmental stewardship or good corporate governance – as a proxy for CSR; (ii) using multiple CSR attributes as separate independent variables; and (iii) converting multiple CSR variables into a single CSR “index”, which is then used as the independent variable. Further, many CSR variables have a strong qualitative element and this makes it difficult to convert them into numerical values, which is necessary to perform statistical analysis. These definitional issues mean that CSR studies are often not directly comparable and this undermines the ability to reach strong general conclusions from this body of research.
- **Improper model specification/omitted variables** – Most often these studies have used relatively simple linear regression models to determine if a statistical relationship exists between CSR and financial performance. Until recently, these studies have often omitted other variables that could affect financial performance. Some of the better work more recently has integrated CSR variables into a more general asset-pricing model.
- **Correlation does not mean causation** – Establishing a positive linkage between CSR and financial performance does not mean that CSR caused this to happen. In fact, the opposite could be true. Perhaps CSR is a “luxury good” that is pursued by companies that are already highly profitable? According to this view, companies with weak financial performance cannot afford to be “socially responsible” but are instead focused on core production activities designed to improve short-term financial performance.

While it is hard to draw conclusions from the research thus far, one study²⁰ has attempted to overcome these and other methodological issues by conducting a “meta-analysis” comprised of large amounts of data from many independent studies. This technique has allowed them to perform a holistic analysis of the CSR and

corporate financial performance relationship rather than looking at each facet of CSR independently and has also helped to eliminate inherent biases found in previous studies. The meta-analysis study was able to make the following conclusions:

- There is generally a positive, bidirectional causal association between good CSR and corporate financial performance across all industries;
- Counter-intuitively, corporate environmental performance has a smaller effect on corporate financial performance than other CSR measures (i.e., managerial principles, corporate reputations for minority hiring, etc); and
- Good CSR is more highly reflected in accounting-based financial performance than market-based financial performance, possibly because the market views over-emphasis of CSR as a deliberate attempt of the company to manage external impressions.

Two more recent studies have also provided some interesting insight into CSR by looking at slightly different aspects of the topic. The first study²¹ looked at CSR on an industry basis. They found that CSR is more prevalent in advertising-intensive (consumer-orientated) industries, and that CSR was positively related to profitability in these industries. This study suggests that for advertising-intensive industries, CSR is a way to establish a competitive advantage in the market, which in turn has a direct impact on corporate financial performance.

The second study²² looked at CSR as it relates to firm-specific risk. The researchers found that firms with good CSR have a lower “ethical” risk, which in turn lowers their total risk. They also found that there was a negative relationship between CSR and firm-specific risk.

So what can we conclude from this research? At this point very little. In short, the empirical literature on the impact of CSR on financial performance is still at an early stage in its evolution and therefore it would not be prudent to draw strong conclusions from the research thus far. Nevertheless, what is relevant to potential investors in SRI funds is that this literature does not provide any compelling evidence that companies pursuing CSR worsen their financial

¹⁹ See Griffin and Mahon (1997) and ABM-AMRO (2001) for reviews of these studies.

²⁰ Orlitzky, Schmidt, and Rynes (2003)

²¹ Fishman, Heal and Nair (2005)

²² Boutin-Dufresne and Savaria (2004)

performance. This finding is consistent with research from the other three areas of inquiry that found SRI does not hurt investment returns.

Summary and Conclusion

This report has provided a review of empirical literature related to the question: Does socially responsible investing produce lower investment returns? Four distinct bodies of research have addressed this question. The first looked at the performance of SRI indices relative to traditional market indices; the second examined the performance of SRI mutual funds relative to traditional mutual funds and/or market indices; the third compared the relative financial performance of hypothetical SRI stock portfolios against conventional portfolios and indices; and the fourth has tried to determine if there is a linkage between corporate social responsibility and improved financial performance.

The chief finding of this research is that socially responsible investing does not result in lower investment returns. This is an important finding because it provides support to individual investors and trustees of institutional funds that they can pursue a program of socially responsible investing with the expectation that investment returns will be similar to those from traditional investment options.

However, we want to point out that we have not addressed the costs associated with *initiating* an SRI program. These costs will arise in establishing an SRI policy that reflects the SRI issues important to the investor; implementing the policy by determining how and who will screen the investment universe to determine which companies are eligible for the portfolio; and the ongoing monitoring of the SRI program, which will involve reporting, overseeing managers, and complying with the SRI policy. Implementing an SRI program may involve consultants, service providers, and additional internal resources for investors, all of which will add to the cost. While the actual costs will vary (depending on the comprehensiveness of the program and assets under management), they are not insignificant and should be assessed fully before adopting SRI.²³

Finally, it is important to note that the question of whether or not SRI reduces investment returns will never be laid completely to rest. This is partly due to legitimate

research-related concerns centring on the quality of data or appropriateness of the methodology; and partly due to the fact that, there are diametrically opposing ideologies firmly rooted around the issue. The challenge for investors is to ignore the rhetorical noise emanating from the extremes and focus on the facts.

²³ For a good discussion of these issues see Sedlacek (2007).

References

- ABN-AMRO Asset Management, *Does Socially Responsible Equity Portfolios Perform Differently from Conventional Portfolios? If So: How and Why?*, September 2001.
- Adam, Greg, John B. Guerard Jr., Mustafa N. Gultekin and Bernell K. Stone, “Socially Responsible Investment Screening: Strong Evidence of no Significant Cost for Actively Managed Portfolios,” 2001 Moskowitz Prize Honourable Mention (June 2001).
- Asmundson, Paul and Stephen R. Foerster, “Socially Responsible Investing: Better for Your Soul or Your Bottom Line?” *Canadian Investment Review* (Winter 2001).
- Barnett, Michael L. and Robert M. Salomon, “Unpacking Social Responsibility: The Curvilinear Relationship Between Social and Financial Performance,” *Academy of Management Best Paper Proceedings* 2002 SIM: B1 (December 14, 2002).
- Barnett, Michael L. and Robert M. Salomon, “Throwing a Curve at Socially Responsible Investing: A New Pitch at an Old Debate,” *Organisation & Environment* 16(3) (September 2003), pp. 381-9.
- Barnett, Michael L. and Robert M. Salomon, “Beyond Dichotomy: The Curvilinear Relationship Between Social Responsibility and Financial Performance,” *Strategic Management Journal*, Volume 27, Issue 11 (November 2005) pp. 1101-22.
- Barnett, Michael L., “Stakeholder Influence Capacity and the Variability of Financial Returns to Corporate Social Responsibility,” *Academy of Management Review*, Volume 32, No. 3 (July 2007).
- Bauer, Rob, Kees Koedijk and Rog r Otten, “International Evidence on Ethical Fund Performance and Investment Style,” Limburg Institute of Financial Economics (LIFE) Working Paper No. 02.59 (March 7, 2002).
- Bauer, Rob, Jeroen Derwall and Rog r Otten, “The Ethical Mutual Fund Performance Debate: New Evidence From Canada,” *Journal of Business Ethics*, Volume 70, No. 2 (January 2007).
- Bello, Zakri, “Socially Responsible Investing and Portfolio Diversification,” *The Journal of Financial Research*, Volume XXVIII, No. 1 (Spring 2005), pp 41-57.
- Beltratti, Andrea, “Socially Responsible Investment in General Equilibrium,” working paper, Bocconi University (October 2003).
- Blank, Herbert and Wayne Daniel, “The Eco-Efficiency Anomaly,” *QED International* (June 26, 2002). (Developed from original working paper by Herbert Blank and C. Michael Carty).
- Boutin-Dufresne, Francois, and Patrick Savaria, “Corporate Social Responsibility and Financial Risk,” *Journal of Investing*, Volume 13, Issue 1 (Spring 2004), pp. 57-67.
- Brammer, Stephen, Chris Brooks, and Stephen Pavelin, “Corporate Social Performance and Stock Returns: UK Evidence From Disaggregate Measures,” *Financial Management*, Volume 35, No. 3 (Autumn 2006), pp. 91-116.
- Derwall, Jeroen, Nadja Guenster, Rob Bauer, and Kees Koedijk, “The Eco-Efficiency Premium Puzzle,” *Financial Analyst Journal*, Volume 61, No. 2 (March/April 2005).
- Derwall, Jeroen and Kees Koedijk, “The Performance of Socially Responsible Bond Funds,” Presented at the 2005 FMA Annual Meeting (October 2005).
- DiBartolomeo, Dan, and Lloyd Kurtz, “Managing Risk Exposures of Socially Screened Portfolios,” Northfield Information Services, 1999.
- Dhrymes, Phoebus J., “Socially Responsible Investing: Is it Profitable?” *The Investment Research Guide to Socially Responsible Investing* (Plano, Texas: The Colloquium on Socially Responsible Investing, 1998).

- Fishman, Ray, Geoffrey Heal, and Vinay B. Nair, “Corporate Social Responsibility: Doing Well by Doing Good?” Working Paper, The Wharton School (2005).
- Friedman, Milton, “The Social Responsibility of Business is to Increase its Profits,” *New York Times Magazine* (September 13, 1970).
- Garz, Hendrik, Claudia Volk and Martin Gilles, “More Gain than Pain – SRI: Sustainability Pays Off,” West LB Panmure Pan-European Equity Research (November 2002).
- Geczy, Christopher C., Robert F. Stambaugh and David Levin, “Investing in Socially Responsible Mutual Funds,” unpublished manuscript, under review by *Journal of Financial Economics* (October 2005).
- Girard, Eric, Bret Stone and Hamid Rahman, “Socially Responsible Investment: Goody-two-shoes or Bad to the Bone,” *Journal of Investing*, Volume 16, No. 1 (Spring 2007), pp. 96-110.
- Gluck, Kimberley and Ying Becker, “Can Environmental Factors Improve Stock Selection,” *Journal of Asset Management*, Volume 5, No. 4 (December 2004), pp. 220-2.
- Gregory, A., J. Mataka and R. Luther, “Ethical Unit Trust Financial Performance: Small Company Effects and Fund Size Effects,” *Journal of Business Finance and Accounting* (June 1997).
- Griffin, Jennifer J. and John F. Mahon, “The Corporate Social Performance and Corporate Financial Debate: Twenty-Five Years of Incomparable Research,” *Business & Society* (March 1997).
- Guenster, Nadja, Jeroen Derwall, Rob Bauer, Kees Koedijk, “The Economic Value of Corporate Eco-Efficiency,” Limberg Institute of Financial Economics, Working Paper 05-09 (July 2005).
- Guerard, John B. Jr., “Is There a Cost to Being Socially Responsible in Investing?,” *Journal of Investing* (Summer 1997).
- Hamid, Nizam and Yvonne Sandford, “Are SRI Indices Responsible?” Deutsche Bank Pan-European Portfolio, Index and Futures Research (October 2002)
- Hamilton, Sally, Hoje Jo and Meir Statman, “Doing Well by Doing Good? The Investment Performance of Socially Responsible Mutual Funds,” *Financial Analysts Journal* (Nov/Dec 1993), pp. 62-6.
- Havemann, Ross and Peter Webster, *Does Ethical Investment Pay?* (London: Ethical Investment Research Service (EIRIS), September, 1999).
- Henderson, David, “Misguided Virtue: False Notions of Corporate Social Responsibility,” Institute of Economic Affairs, (November 5, 2001).
- Hong, Harrison and Marcin Kacperczyk, “The Price of Sin: The Effects of Social Norms on Markets,” working paper (March 2007).
- Kreander, N., R.H. Gray, D.M. Power, & C.D. Sinclair, “Evaluating the Performance of Ethical and Non-Ethical Funds: A Matched Pair Analysis,” *Journal of Business Finance & Accounting*, 32(7) & (8) (September/October 2005), pp. 1465-93.
- Kurtz, Lloyd, “No Effect, or No Net Effect? Studies on Socially Responsible Investing,” *Journal of Investing* (Winter 1997), pp. 37-49.
- Luck, Christopher J., “Domini Social Index Performance,” *The Investment Research Guide to Socially Responsible Investing* (Plano, Texas: The Colloquium on Socially Responsible Investing, 1998).

- Mallin, C.A., B. Saadouni and R.J. Briston, “The Financial Performance of Ethical Investment Funds,” *Journal of Business Finance and Accounting* (June 1995).
- Michelson, Grant, Nick Wailes, Sandra van der Laan and Geoff Frost, “Ethical Investment Processes and Outcomes,” *Journal of Business Ethics*, Volume 52, No. 1, ABI/INFORM Global, (June 2004) pp. 1.
- Milevsky, Moshe, Andrew Aziz, Allen Goss, Jane Comeault and David Wheeler, “Cleaning a Passive Index: How to Use Portfolio Optimization to Satisfy CSR Constraints,” *The Journal of Portfolio Management*, (Spring 2006), pp. 110-8.
- Minor, Dylan, “Finding the [Financial] Cost of Socially Responsible Investment,” *Journal of Investing*, Volume 16, No. 3 (Fall 2007), pp 54-70.
- Orlitzky, Marc, Frank L. Schmidt and Sara L. Rynes, “Corporate Social and Financial Performance: A Meta-Analysis,” *Organisational Studies* 24(3) (2003), pp. 403-41.
- Otten R., and C.G. Koedijk, “Beleggen met een Goed Gevoel,” *Economisch Statistische Berichten (ESB)* (April 2001). A summary of this study is provided in English in ABM-AMRO (2001), pp. 91-2.
- Plantinga, Auke and Bert Scholtens, “Socially Responsible Investing and Management Style of Mutual Funds in the Euronext Stock Markets,” University of Groningen, Research Institute SOM (Systems, Organisations, and Management) Research Report 01E17 (January 2001).
- Scholtens, Bert, “Style and Performance of Dutch Socially Responsible Investment Funds,” *The Journal of Investing*, Volume 14, No. 1, (Spring 2005).
- Schroder, Michael, “Socially Responsible Investments in Germany, Switzerland, and the United States – An Analysis of Investment Funds and Indices,” Zentrum für Europäische Wirtschaftsforschung GmbH (Centre for European Economic Research) Discussion Paper No. 03-10 (March 2003).
- Schroder, Michael, “Is there a Difference? The Performance Characteristics of SRI Equity Indexes,” Discussion Paper No. 05-50, Centre for European Economic Research (July 2005).
- Sedlacek, Verne, “Socially Responsible Investing: More than Meets the Eye,” *Mission Matters, Commonfund Chronicle* (Spring/Summer 2007).
- Statman, Meir, “Socially Responsible Mutual Funds,” *Financial Analysts Journal* (May/June 2000), pp. 30-9.
- Statman, Meir and Glenn Klimek, “Socially Responsible Indexes: Composition, Performance, and Tracking Error,” *Journal of Portfolio Management* (Spring 2006) , pp. 100-109.
- UBS Warburg, *Sustainability Investment: The Merits of Socially Responsible Investing*, August 2001.

PH&N Community Values Funds

Established in 1964, Phillips, Hager & North has been managing socially responsible investment mandates for more than a decade. Until recently, these have been limited to specialized portfolios for some larger clients. In the early days, these mandates focused mostly on avoiding tobacco and alcohol stocks. Over time, our clients' concerns have broadened to include a wide range of environmental, social and governance issues.

In 2002, we launched the PH&N Community Values Funds, a family of four socially responsible funds: PH&N Community Values Bond Fund, PH&N Community Values Balanced Fund, PH&N Community Values Canadian Equity Fund and PH&N Community Values Global Equity Fund. Within their respective asset classes, these funds follow the same disciplined investment processes as our other funds and are expected to provide similar returns over the long-term. Where the PH&N Community Values Funds differ is the extent to which they also consider environmental, social and governance (ESG) records of the companies they may include.

We rely on Jantzi Research Inc. to assist us in assessing the environmental, social and governance performance of the companies in which we invest.

Phillips, Hager & North Investment Management (PH&N) is an operating division of RBC Global Asset Management Inc. (RBC GAM). RBC GAM is the manager and principal portfolio adviser for the PH&N Funds, RBC GAM is also the principal distributor of the Series O units of the Funds. Sky Investment Counsel Inc. (Sky), in which RBC GAM holds a substantial non-controlling interest, is the sub-adviser with respect to non-North American equity assets at PH&N, including those held in all PH&N Funds. RBC GAM is an indirect, wholly-owned subsidiary of Royal Bank of Canada.

"PH&N" and "Phillips, Hager & North" are registered trademarks of Royal Bank of Canada. Used under licence.

Copyright RBC Global Asset Management Inc., 2010.

Publication date: October 12, 2007

PHILLIPS, HAGER & NORTH
Investment Management

VANCOUVER

Waterfront Centre
20th Floor
200 Burrard Street
Vancouver, British Columbia
Canada V6C 3N5

CALGARY

Alberta Stock Exchange Tower
620 – 300 5 Ave S.W.
Calgary, Alberta
Canada T2P 3C4

TORONTO

155 Wellington St. West
22nd Floor
Toronto, Ontario
Canada M5V 3K7

MONTREAL

Tour McGill College
Suite 1640
1501 McGill College Avenue
Montreal, Quebec
Canada H3A 3M8