Wall Street's New "Social Responsibility" Funds

Can investing in corporations that benefit the common good also profit investors? A handful of new Wall Street mutual funds claim the answer is yes.

BY HARVEY SHAPIRO

The founders of a small California medical research and development company called Bentley Laboratories are in business, naturally enough, to make money. But, happily for them, they can serve a genuine humanitarian need while they pursue profits. Bentley Labs produces a medical gadget that serves to detour blood in the human body past the heart during the critical moments of open-heart surgery. So profitable has the making of these gadgets become that during a recent three-month spur of enthusiastic buying Bentley's stock soared from $22 to $44—refreshing proof that a company can both do good and do well in the nation's pragmatic money markets.

It is just such companies as Bentley Labs that growing numbers of a new breed of socially concerned investor are scouring American business to find. Among these investors, of course, are universities, church groups, and foundations that have been prompted by the current trends toward increased social activism and increased social concern to put their huge endowments to work supporting socially desirable enterprises. But "do-gooder" institutions are not alone today in seeking to invest in worthy businesses. Hard-nosed Wall Street investors have also got the message and are exploring what lately has come to be known as "socially responsible investing." Over the past year a group of "social responsibility funds" made debuts in the financial world. Set up as mutual funds, these business organizations sell their own shares to the public, then invest shareholders' money in a diversified portfolio of publicly traded stocks—but with a difference.

The new funds' analysts first of all determine which companies are discriminating in hiring, irresponsibly damaging the ecology, or violating consumer trust with faulty products. Only from among those corporations behaving in the public's interest, as they see it, do the funds then choose investments that they hope will be profitable. Four funds at present are committed to this novel investment approach.

- The bluest chip among them is Third Century Fund, launched last spring by Dreyfus Corporation, a giant money-management firm operating four other major mutual funds. Sponsored by the chairman of Dreyfus, Howard Stein (who was also the principal fund raiser for Eugene McCarthy in 1968), Third Century raised $24 million in capital for investments in its initial sale of shares to the public through underwriters. It has a prestigious board of directors that includes George Harrer and Robert Goheen, outgoing presidents of the Rockefeller Foundation and of Princeton University, respectively. The fund, says David Burke, a Dreyfus vice president and onetime aide to Sen. Edward Kennedy, will invest only in companies with the most acceptable records on pollution control, product purity and safety, and minority relations. It will also be seeking companies doing "breakthrough" work in medicine, mine safety, and other fields likely to effect the quality of life in the next decade.
- Pax World Fund, another fund with prestigious backers, was launched last fall by two staff members of the Board of Christian Social Concern of the United Methodist Church. Its aim is to provide religious groups with an investment vehicle that will enable them to avoid holdings in firms that profit from the Vietnam War. The $250,000 fund (which is extremely small as mutual funds go) also eschews firms with unsatisfactory records on fair employment. It hopes to put 10 per cent of its assets into investments in developing countries. Though founded by two Methodists, Pax has an ecumenical board of directors that includes such prominent laymen of other faiths as Hyman Bookbinder of the American Jewish Committee and C. Lloyd Bailey, who is chairman of the Friends General Conference.
- Social Dimensions Fund, a joint venture of Louis K. Polk, former president of MGM and of General Mills, and Ralph Quinter, a mutual fund manager, is the most recent of the social responsibility funds—so recent, in fact, that as of this writing it has not yet emerged from its registration process with the Securities and Exchange Commission and begun selling shares to the public. Social Dimensions has, however, already contracted to use the research services of the Council on Economic Priorities, a Ralph Naderesque research group that performs industrywide studies on questions involving corporate responsibility. CEP will help the fund find firms with acceptable records on pollution control, equal opportunity, and product quality.
- The oldest and perhaps most unorthodox of the new funds is First Spectrum Fund. Set up last fall by two former brokers from the Wall Street investment firm of Smith Barney & Co., First Spectrum promises not only to invest its present assets of $250,000 in socially responsible companies but also to involve itself actively in the development of responsible corporate attitudes. After Bohack Corporation, a supermarket chain, had signed an agreement with Operation Breadbasket to hire and promote more blacks, for example, First Spectrum bought Bohack shares and prepared and distributed to its shareholders a leaflet urging them to patronize the grocery chain.

Supporters of the social responsibility funds say the creation of such pools of capital to be invested on the basis of corporate good deeds or bad deeds can be uniquely effective in the promotion of enlightened changes in corporate behavior. Talk of buying or selling stock to reward or punish corporate behavior is a kind of language businessmen understand. Fund managers contend that the more "responsible" impulses of executives will be reinforced by the prospect of luring investments from the funds—investments that will help to support or raise the price of a company's stock. Conversely, tough, public-be-damned businesses will think twice about polluting the environment or discriminating against minorities lest the funds shun and/or dump their stocks. The funds financial "activism," if it involved large sums of money, could hold down a company's stock price, eat into the profitability of execu-

Harvey Shapiro is a freelance writer and consultant who recently completed a study on the operations of "social responsibility funds" for a national foundation.

tive stock options, disillusion other stockholders, and perhaps tarnish an otherwise highly polished corporate image. Because of these funds' potential impact on corporations in the stock market, such observers as Prof. Roger Murray of Columbia University's Graduate Business School say that, even though the capital for responsible investing is at present limited, "the funds represent a new and very material form of pressure on managements. Corporations will feel on the defensive with other stockholders if the social funds don't approve their stock."

Less enthusiastic about the potential effectiveness of the funds are a number of politically committed economists. One skeptic, for example, is Philip Moore, head of a corporate-reform pressure group, the Project on Corporate Responsibility, who was also an original sponsor Campaign GM. (The first effort of campaign GM was the attempt to use stockholder proxies in the corporation's annual meeting to elect representatives of the public to GM's board of directors and to create a shareholders' committee to review the effects of corporate policies on the public.) Moore says the notion that the funds can seriously influence corporations through the stock market is "all nonsense." "It's a head-in-the-sand approach just to build a clean portfolio," he explains, and adds, "You've got to go to the companies and raise the issues with them." In response to such criticism, one fund manager replies testily, "Our aim is to be an effective force—not a pain in the ass."

When, on the other hand, free market economists like Milton Friedman oppose the concept behind the funds, claiming that the allocation of financial resources on any basis other than profitability will reward inefficient producers and hamper the effectiveness of a market system, money managers like First Spectrum's Tom Delaney respond by insisting that the assumed conflict between corporate responsibility and healthy profits is fictitious. "Our fund's basic assumption is that for this decade the companies that are the most enlightened in dealing with their social problems will, in fact, be the most profitable, too. Enlightened management is a sign of good management, and good management usually means profits." Third Century Fund's research director, David Bronheim, in agreeing with Delaney, says, "Obviously there's not a one hundred per cent correlation [between responsible management and good profits], but we've looked at quite a few industries, and in general the correlation seems to hold up."

In addressing directly the question of whether the funds' shareholders could find themselves doing financially well by doing good, some fund managers like Dr. J. Elliott Corbett, a Methodist minister who is vice president of Pax World Fund, are cautious. "We hope an investor who seeks to be socially responsible will not have to take a loss," he says. "Now it may emerge that the truth is that he has to. But we hope he won't."

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Other fund managers are less equivocal about their potential for profit. They point to the financial success of do-good companies like Research Cottrell, Inc. One of the best-managed firms involved in the technology of pollution control, Research Cottrell has had an almost 100 per cent growth in net income over the past two years. Its stock, now near $80, has nearly tripled in two years. Damon Corporation, which in 1969 began building a nationwide chain of low-cost, automated medical laboratories, has also nearly doubled its net income from $2.4 million in 1969 to $4.2 million last year.

With these kinds of profit opportunities for investment in responsible companies available, there is no reason why the funds should be "money-losing investment vehicles," says one spokesman for the Third Century Fund.

Obviously, a method of investing that promises to help end abusive corporate practices and to reward beneficial ones without sacrificing investment performance has wide appeal. Even the normally hard-headed securities industry demonstrated support of the idea last fall when the staid Investment Company Institute, an association representing mutual funds with assets of nearly $50 billion, issued a special report declaring that corporate responsibility "should be considered an investment issue and factored into the process of making decisions. . . ." But despite growing acceptance of the concept behind the funds, practical problems remain. How, in fact, can "socially responsible corporate behavior" be determined?

In order to gain approval of their investment plans from the Securities and Exchange Commission, the funds have had to develop legally defensible definitions of socially responsible investing. The SEC is obliged to protect shareholders against the funds' possible misuse of money, and finding investment formulas that the commission feels do, in fact, enable shareholders to determine whether their money is or is not being invested according to expectations is a complex process.

When, for example, Delaney and Flippin first submitted their prospectus to the SEC in May 1971, First Spectrum Fund pledged itself to invest in firms that were "profitably participating in socially constructive trends." But even Flippin now admits, "As we tried to define what 'socially constructive trends' were, we realized that we couldn't do it properly. The SEC wanted objective measures by which investors could judge whether we were living up to our stated aims. In a pluralistic society socially constructive trends are in the eye of the beholder. Some people think the SST is constructive."

After an extensive revision of its investment guidelines, First Spectrum eventually stated it would invest only in companies that comply with federal, state, and municipal laws in the areas of environmental protection, consumer protection, and civil rights—the absolute minimum in corporate responsibility an outsider would assume. But this stipulation will, in fact, eliminate as investment possibilities many hundreds of companies operating in violation of such laws, and the SEC, Flippin explains, felt that with this guideline "shareholders could evaluate our performance." Flippin says that he considers such mere compliance with the law to be only a minimal gauge of responsibility. The fund will continue to seek companies that do more than the law requires of them.

Pax World Fund experienced a similar difficulty in the writing of its investment objectives. The fund's pledge is to avoid shares of firms that derive more than 5 per cent of their gross sales from the Pentagon. Originally the fund's managers did not want this rule to eliminate the possibility of investing in, say, a medical supply company that clearly was serving a social need, but incidentally deriving 6 per cent of its income from the sale of bandages to the Defense Department. "We are obviously *not* against caring for the wounded," says Dr. Corbett. Pax, therefore, tried to include in its prospectus an exception to the 5 per cent rule for companies that, although doing business with the Pentagon, were selling products that might be "ameliorative, positive, and helping to sustain life." The exception was rejected by the SEC because such descriptive terms could not be defined objectively.

While the fund managers admit that settling on what constitutes social responsibility may be somewhat subjective and may change over time, once a fund formulates its definition, managers say they can accurately and objectively determine which companies meet that definition. David Bronheim, a thirty-nine-year-old lawyer who once headed the Center for Inter-American Relations and who has been a fellow at Harvard's Kennedy Institute of Politics, is heading the research effort to measure social responsibility for Third Century. Having determined that pollution control, equal opportunity, and product purity and safety would be the fund's areas of concern, Bronheim concluded that it would be meaningless to attempt to rank all of the 3,000 or so publicly traded companies. Instead, he decided to compare companies only with others in the same industry.

The fund's researchers spent last spring and summer developing their procedures for eliciting and analyzing information about corporate behavior. To measure a firm's impact on the ecology, for example, they devised a system that separates an industry into its various production stages—extraction, manufacturing, transportation, etc. Bronheim's staff interviews company executives to discover their firm's performance in each of these operations. Researchers also look at information on company activities found in government documents such as the requests corporations submit to obtain federal permits to discharge waste into waterways. The analysts then grade a company—usually on a scale ranging from one to twelve—on its performance in each phase of production.

Similarly, when researching discriminatory employment practices, Third Century looks at information submitted by corporations to the Equal Employment Opportunities Commission to find out about company policies. A company will be graded, for instance, on the percentages of blacks, Indians, or Hispanic workers employed relative to the size of those minority groups in the company's geographical area, or on the number of blacks and females in managerial positions.

"A company's score is then tallied for each interest area," Bronheim explains, "and on the basis of the data we chart how it is doing in comparison to others in its industry. The number of companies we will deem suitable for investment in any industry is not decided in advance. If it turns out ten are bunched together with low scores and ten are bunched with high ones, our decision [on how many are suitable] is natural. If there is a more normal distribution, a traditional bell curve, then we have to make a fair, defensible, but obviously moderately arbitrary decision as to how far down into the sample we want to go. Those companies that are approved go on an eligible list from which a portfolio manager selects stocks for actual purchase."

Once the list of preferred companies has been prepared at Third Century and the other funds, traditional securities analysis of the companies' profits, earnings, and growth comes into play. "I've got a lot of companies on back burners because they pass my social criteria, but their business is in a cyclical downswing right now," says Ralph Quinter of Social Dimensions. When the companies' prospects improve, the funds will purchase their stocks.

Some doubters warn that to compare companies' records on social responsibility will unfairly discriminate against those companies in the nation's most basic industries since it is the makers of steel, chemicals, and automobiles, for example, that cannot help creating ecological problems. Ralph Quinter rejects this conclusion. The thirty-two-year-old former political science major from Haverford College and Yale argues: "Social responsibility is a relative business. So no industry is excluded. If you're in a business that by its nature is polluting, well, there's nothing you can do about changing the nature of the business. Somebody's got to make steel; somebody's got to make chemicals. Okay? There's no clean way to do it. But there are ways to control the dirty by-products of those operations," and those companies that try to do so should be considered socially responsible.

Royce Flippin says the funds won't have trouble finding stocks for their portfolios, at least not until they have a great deal of money to invest. Will that day ever come? Several stockbrokers agree that the funds might expand rapidly. They suspect the potential market for the funds is large because the type of people who have money to invest in stocks are precisely the affluent urbanites who are concerned about such issues as corporate responsibility. When Fidelity Trend Fund queried its mutual fund holders on whether social responsibility should be a factor in investment decisions, 12 per cent of investors in the $1-billion fund said yes.

While the managers of the social responsibility funds believe their initial market will be urban and suburban families that now invest in mutual funds, they are hoping ultimately for even bigger game—the management of university, church, and philanthropic endowment funds. "Any number of foundations have been struggling with the problem of building a socially responsible portfolio," says one fund manager. "Endowment managers at many universities are facing student and faculty pressure to look at 'what' as well as 'how' a company is doing. A lot of religious leaders were shaken by a National Council of Churches study that showed some two hundred million dollars of church money was invested in companies that produce military goods. A few years ago these institutions hired professional investment managers to improve investment performance. Now we're hoping some of them will give us a portion of their assets to invest responsibly."

The Glide Foundation and several Quaker groups have already turned portions of their portfolios over to the Pax World Fund for management. If the funds get control of other endowment money on a large scale, then other Wall Street investors might well be forced to follow the funds' lead. Securities analysts would have to watch corporate records in order to predict which stocks the funds were likely to be buying or selling. And some traditional investors would end up buying and selling on the same basis as the funds—not out of any social concern, but simply to anticipate the impact of the funds' investment decisions. Such investors, of course, wouldn't *be* socially responsible; yet they might contribute to the achievement of responsible behavior. When the supporters of the funds sketch this scenario, they are reviving one of capitalism's oldest doctrines. In *The Wealth of Nations* Adam Smith promised a system in which an investor, acting in his own self-interest, "frequently promotes [the interest] of society more effectually than when he really intends to promote it."

Whether or not this new version of the invisible hand manifests itself and whether or not, as Ralph Quinter says, "social analysis is going to become more and more a part of conventional securities analysis" will depend in part on the fate of the first four social responsibility funds. As the research director of one major brokerage house recently summed it up, "We are watching to see how the funds do, and, if social responsibility is what people want to buy, you can be sure that's what we're going to be selling." □

If you want a piece of the action...

Further information on the social responsibility funds mentioned in this article can be obtained by writing directly to the funds:

Dreyfus Third Century Fund, Inc.
767 Fifth Avenue
New York, New York 10022

First Spectrum Fund, Inc.
230 Park Avenue
New York, New York 10017

Pax World Fund, Inc.
224 State Street
Portsmouth, New Hampshire 03801

Social Dimensions Fund, Inc.
562 Fifth Avenue
New York, New York 10017

THE SKYJACKER And How to Stop Him

This new jet-age crime cannot be expected to run its course and fade away. In fact, it is growing and spawning new crime mutants. There *is* a way to stop skyjackings. But it will be expensive.

BY THE EDITORS

D. B. Cooper, although probably a phony name, is one that will live a little in history. The name appears to be an alias adopted by a conservatively attired businessman who boarded a Northwest Airlines 727 last Thanksgiving eve and disembarked, unlike his fellow passengers, by means of a parachute, carrying with him $200,000 in small bills. Cooper, or whatever his real name is, had extorted this sum by threatening to blow up the plane. A four-state manhunt, which included units of the Third Armored Cavalry, was launched, but no trace of the skydiving skyjacker was ever found.

Much like the daring exploits of Dillinger, and of Bonnie and Clyde years before, Cooper's crime captured the public imagination, as well as its admiration. In Seattle a bowling alley advertised a "D. B. Cooper Bowling Sweepstakes"—with cash prizes. There were also "D. B. Cooper" T-shirts that came out in three different styles. One of these carried the words "Skyjacking—the only way to fly" but was withdrawn from the market after objections from Western Airlines, whose copyrighted advertising slogan is, "Western—the only way to fly." Cooper was even celebrated in a country-western song that gained brief popularity on the West Coast:

D. B. Cooper, where are you now?
We're looking for you high and low.
With your pleasant smile
And your dropout style,
D. B. Cooper, where did you go?

"D. B. Cooper, Where Are You?"
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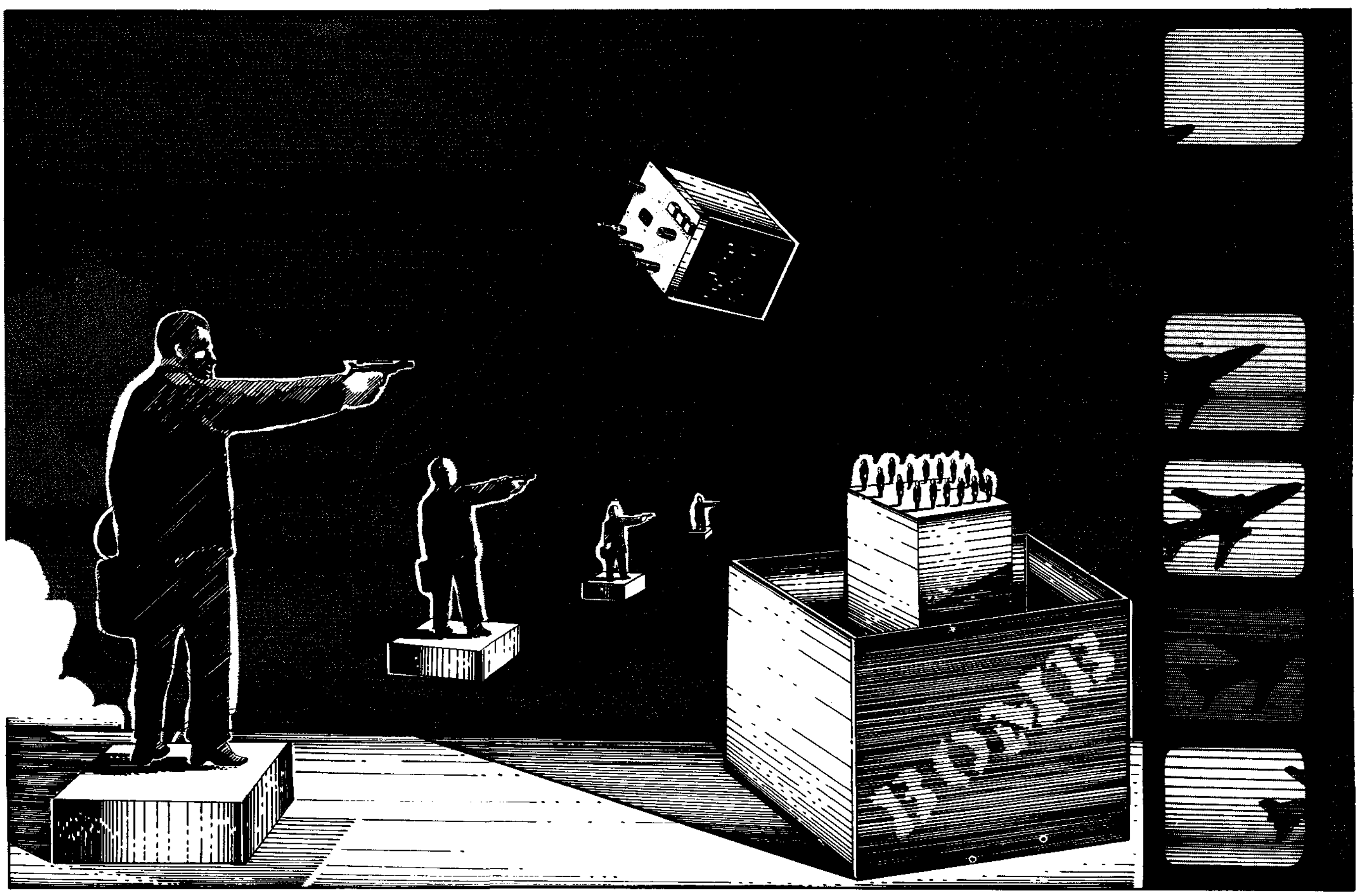
All that was several months ago. But times change. Last month, for example, the bullet-riddled body of a twenty-four-year-old Vietnamese would-be skyjacker was hurled like so much garbage out of a parked airliner by the pilot. "I just couldn't stand to have that person in any part of my airplane," the pilot said wrathfully.

That same week Los Angeles Police Chief Edward M. Davis stunned a group of reporters when he told them how he would like to "get tough" with skyjackers. He put it this way: "I would recommend we have a portable courtroom on a big bus and a portable gallows, and, after we get the death penalty back in, we conduct a rapid trial for a hijacker out there, and then we hang him with due process of law out there at the airport."

Quite obviously, emotions have got the better of reason. The young Vietnamese skyjacker who had five bullets pumped into his body while he was held by the plane's pilot—after having been disarmed—was carrying only a knife and a "bomb" that turned out to be a bunch of lemons wrapped in tinfoil.

What all of the above-mentioned extreme reactions to the crime of air piracy reflect most deeply is our inability as a society to understand and to know how to cope with this new-found vulnerability in one of the prides of our technology. Being confused and frightened, we see the problem one day as a caper and the next as a wicked menace, and by turns we poke black humor, then rail, and finally blaze away



DRAWINGS BY PAUL SPINA