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# ethics and socially responsible investment

a philosophical  
approach

William Ransome  
and Charles Sampford

# Ethics and Socially Responsible Investment

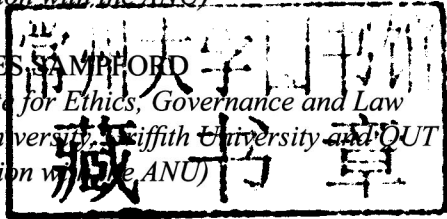
## A Philosophical Approach

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Published by

Ashgate Publishing Limited  
Wey Court East  
Union Road  
Farnham  
Surrey, GU9 7PT  
England

Ashgate Publishing Company  
Suite 420  
101 Cherry Street  
Burlington  
VT 05401-4405  
USA

[www.ashgate.com](http://www.ashgate.com)

#### **British Library Cataloguing in Publication Data**

Ransome, William, 1976–

Ethics and socially responsible investment : a philosophical approach. – (Law, ethics and governance series)

1. Investments – Moral and ethical aspects. 2. Investments – Moral and ethical aspects – Australia.

I. Title II. Series III. Sampford, C. J. G. (Charles J. G.)

332.6'042–dc22

#### **Library of Congress Cataloging-in-Publication Data**

Ethics and socially responsible investment : a philosophical approach / by William Ransome and Charles Sampford.

p. cm. – (Law, ethics and governance)

Includes index.

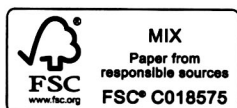
ISBN 978-0-7546-7581-5 (hardback : alk. paper) 1. Investments – Moral and ethical aspects. I. Ransome, William, 1976– II. Sampford, C. J. G. (Charles J. G.)

HG4515.13.E84 2010

174'.4–dc22

2010048574

ISBN 978-0-7546-7581-5 (hbk)



Printed and bound in Great Britain by the  
MPG Books Group, UK

# ETHICS AND SOCIALLY RESPONSIBLE INVESTMENT

# Law, Ethics and Governance Series

Series Editor: Charles Sampford, Director, Key Centre for Ethics, Law,  
Justice and Governance, Griffith University, Australia

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# Acknowledgements

This book emerged from a pair of successive ‘linkage projects’ funded by the Australian Research Council and relevant NGOs. The first project was a linkage with the Total Environment Centre, the second a linkage with Tiri.

The authors wish to acknowledge the contribution made by other researchers during the project. These include:

- Dr Doug Magendanz who made initial contact with David West at the Total Environment Centre and made major contributions to the drafting of the grant application
- Dr Virginia Berry, first as a research assistant and secondly as a Research Fellow with major responsibility for the day to day work on the grant and, in particular, the stakeholder interviews
- Carmel Connors, the publications manager at IEGL, who assisted at every stage of the process.

At the Total Environment Centre, we appreciate the support and input from Dave West and, later, Geoff Angell, the Director and the key stakeholders to whom they introduced us.

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# Introduction

## Ethics and Socially Responsible Investment

Socially responsible investment (SRI) is an emerging global investment movement, the ethical and philosophical foundations of which – in sharp contradistinction to its comparative financial performance – have not been much investigated, discussed or debated, either in the finance sector or academia. One aim of this book is to encourage the broadening and deepening of ethical and philosophical discussion within and of SRI, and another is to help put SRI on a somewhat firmer ethical footing. We seek, moreover, to construct a philosophical overview of SRI that throws light on its unique and arguably crucial role in ethically enlightened global markets.

### **Socially Responsible Investment: A Nascent Global Movement**

In chapter 1 we offer a general definition of socially responsible investment, and place it in its economic, historical and social context as the contemporary outgrowth of a long-standing liberal democratic (especially US and UK) tradition of concerned and ethically-aware investors campaigning in favour of greater social responsibility in business. *Inter alia*, we debunk a pervasive ‘market fundamentalist’ view within economics and finance, represented most memorably by Nobel economics laureate Milton Friedman, to the effect that (to quote the title of Friedman’s well-known article) ‘The Social Responsibility of Business is to Increase its Profits’ – observing that Friedman’s argument fails on its own terms and instead reinforces a socially responsible view. Behind the contemporary corporate social responsibility (CSR) movement towards making business more socially responsible, we claim, is a basic principle: that the power modern corporations wield over human societies and the global environment ought to be balanced with social responsibility for its effects. To date, corporations have overwhelmingly treated CSR as external to, rather than an intrinsic part of, doing business well. We argue that SRI has an important role to play in these circumstances, through helping businesses to identify and internalize their social responsibilities.



## **Non-Financial Values: From Oxymoron to Tautology**

In chapter 2 we expand on the case against a ‘single-value’ approach to business and investment, arguing that both companies and investors maintain plural extra-financial goals and values in light of which they act within human societies and the natural environment, and that to be successful in pursuing these values and also in making satisfactory financial returns requires significant *trust*. We highlight two prominent global examples of failures of trust and the single-value approach to business and investment: the global financial crisis and human-induced climate change. We argue that businesses and investors need to display trustworthiness in respecting, pursuing and protecting their plural extra-financial values as intrinsic rather than external and reductively prudential ends.

In order to secure social trustworthiness, corporations need to explicitly state the values they share with broader society and publically live up to them. Making and keeping such a commitment, we argue, exemplifies institutional integrity, and requires adopting principles of social responsibility as foundational corporate values. We draw attention to two examples of the global movement towards integrating social responsibility in this way, the United Nations Global Compact and the United Nations Principles for Responsible Investment (UNPRI), and point out that the SRI principles contained in the UNPRI structure constitute formal requirements for investment managers, under which substantive values-based investment policies are to be shaped. The current growth of the CSR and SRI movements, along with multilateral institutional, government and NGO coordination across the globe, is bringing to public light many of the value-based problems that the global economy confronts. We argue that this is undoubtedly a positive development, not only for societies and nations, but also for the economic agents – including corporate executives, fund managers and financial market analysts – who have until recently been trapped within a financial sector echo-chamber of reductive single-value thinking.

## **SRI and What Ethics Means**

In chapters 3 and 4, we introduce and discuss ethical theory with respect to SRI, an element that appears not to have had much prominence in the development of SRI principles such as those embodied in UNPRI. We argue that ethical foundations are required if such principles are to have real world meaning, and especially if actions in their name are to be defended as ethically sound ones. Yet mention of ‘ethics’ and ‘morality’ in financial markets generates nervousness and doubt. We believe that much of this discomfort stems from unfamiliarity in contemporary finance and economics with the broad field of ethics and moral philosophy, discussion of which has in recent history been excluded from mainstream economics, which

has been pursued by and large in the manner of ‘hard science’. What ‘ethics’ and ‘morality’ mean and how these relate to SRI does not seem to be at all well or widely understood in the financial sector. We have therefore devoted a significant portion of the book – throughout chapters 3 and 4 – to shedding light on, answering criticism of, defending and explaining some of the philosophical dimensions of candidate ethical theories, and to opening up a channel of communication between ethical theory and SRI practice.

This analysis begins with a clear account of what ‘ethics’ and ‘morality’ mean, and a discussion of legitimate philosophical criticism that has been aimed at the concept and practice of ethical investment. As we point out in chapter 3, rival ethical theories compete with each other to be considered the code of conduct that would be put forward by all rational persons. Normative morality concerns a particular code of conduct, grounded in moral theory, which makes value judgments, e.g. between good and bad, right and wrong. We also observe that most people hold views about morality in the normative sense derived from one moral theory or another, and think and act upon them or against them every day, whether or not they are aware of the fact. As we discuss in chapter 3, philosophical criticism of ethical investment by ‘The Social Affairs Unit’ has focused on the putative ethical claims of SRI. At the core of the criticism is the claim that ethical investment constitutes a grave misuse of the term ‘ethical’ – that SRI funds allegedly inappropriately and even deceptively deploy ‘ethical’ in a sense to which their investment approaches do not answer.

We argue that the legitimacy and effectiveness of SRI as an alternative to existing single-value mainstream investment relies on the ability of its supporters and practitioners to put their case clearly and defensibly in ethical terms. SRI proponents and practitioners thus need to understand the basics of ethical theory and to be capable of valid reasoning from normative foundations to their own SRI policies, actions and investment decisions. As we explain, ethics *qua* philosophical study of morality is concerned with making sense of normative concepts, aiming broadly to account for the ‘value’ side of the fact/value divide. Philosophical ethics asks questions such as what normative, value-laden concepts like ‘good’, ‘bad’, ‘right’ and ‘wrong’ mean, what grounds and determines their correct usage, how they are related to one another, and how different ethical theories explain and account for them. As we point out, ethical theories aim not just to explain but to guide us – usually in terms of right and wrong action and good and bad states of affairs – in a prescriptive sense, by telling us what is good and bad, right and wrong, and *why*. Ethical theories take their own accounts to be true and accurate explanations of the source and justification of our basic normative values.

## **A Philosophical Foundation for SRI**

In chapter 4, we introduce and discuss the three dominant contemporary philosophical approaches to ethical theory and try to explain a little of their significance for SRI theory and practice. We observe that a defining feature of deontological theories is that they treat the moral status of an action as deriving directly from the nature of the act itself, regardless of its consequences, whereas teleological or consequentialist theories trace the moral rightness and wrongness of actions to a prior view about what is objectively good, and how our actions stand in relation to securing that value. We claim in chapter 4, however, that a recent turn to virtue ethics – the third approach – has accompanied a widespread frustration with the way that ethics has been pursued, and especially its strong ‘deontic’ preoccupation with the moral status of actions.

Each of these ethical theories holds the common assumption of moral objectivism: the view that morality in the normative sense is objective, meaning that the ethical values stipulated by the ‘correct’ theory are true of the real world. This is taken to be so independently of anything people happen to believe. Yet we recognise in chapter 4 that there is an opposing modern tradition in moral philosophy that rejects objectivism and ethical facts. These views, because perhaps of their ethically controversial nature, have not until recently been socially widespread. However, it is increasingly the case that views of this type are being adopted in mainstream society, with generally low levels of ethical comprehension. Strictly speaking, we point out, sceptics who reject objectivism in ethical theory are not putting forward ethical theories in the sense that we canvass, because they reject the core assumption that morality has any objective foundation in the first place.

We admit in chapter 4 that the sheer variety and number of disagreements both within and between ethical theories could tempt practitioners of SRI to abandon altogether any attempt to become informed about the ethical foundations of the approaches to which they are nominally committed. There arises the temptation to take up a sceptical, relativist or even nihilistic view of morality, and to re-brand SRI purely as a financial market alternative, absent any overt normative dimension. In this case, however, attempts to bring ethics into public practice in areas where there has not been explicit attention in the past, such as the SRI movement, can be vulnerable to intense (and often justified) criticism. Yet such harsh criticism is not always warranted, and the cynical, nihilist view of morality is far from an inevitable consequence of the ethical confusion that has affected SRI theory and practice in the past.

We argue that there is a far better and more fitting response to the plurality of ethical theories, and of the practical justification for the values they espouse, than the overwhelmed rejection of them all: a commitment to pluralism about values. Pluralism, we hold, whilst embodying a rejection of nihilism, also avoids a lurch in the opposite direction, where rigid moral absolutism about ethical

criteria is adopted that will brook no argument. We set forth a pluralist view of ethical values for SRI, which is willing to accept variety, but not at the cost of abandoning reflective rigour or accountability, or the basic capacity of recognizing and distinguishing between values. On the pluralist account, it is in attempting to drown out alternative accounts that ethical theories go wrong and distort our moral judgment. Moreover, while no single view taken as exclusively correct yields a view of the world or a set of principles that pluralists consider a complete account, yet a space is cleared under pluralism for each ethical approach to offer its perspective on the normative dimensions of our world, lives and actions.

However, we also argue in chapter 4 that effective value pluralism requires the cultivation of reliably good, fine-grained moral judgment in often complex and ethically-contested circumstances. Reliably good moral judgment in turn requires the habit of careful, well-informed and detailed examination of the practical circumstances in which our moral judgment is to be deployed, in light of our plural values. This complex and difficult task requires a morally reflective approach to SRI investment. To be morally reflective, we explain, is to strive in our ethical deliberations to understand and account fully for the moral judgments we make and our reasons for making them. Moral reflectiveness in ethical agency and judgment expresses a genuine commitment to coming to grips with the normative dimension of our own and others' conduct, to understanding ethical theory and its application, and to directing our lives through our own reflectively endorsed values.

If we are genuinely to consider ourselves ethically responsible individuals, we argue, in avowing our values we must also commit ourselves to understanding their provenance and meaning through their foundations in ethical theory, and to defending and endorsing them throughout our practical deliberation, action and judgment. Being genuinely ethical, we hold in chapter 4, requires of us that we reflect critically on the ways we can best put our values into practice. As individuals, we can only plausibly consider ourselves ethical beings if we live by our values, and the only way we can be sure that we do live by our values is to be willing to critically reflect on our own practical choices, judgments, conduct and circumstances – our lives seen from an ethical point of view – in the light of those plural values, and commit ourselves to acting by them. Again, we argue, to achieve this is to act with integrity.

## **SRI in Australia**

In chapters 5 and 6 we examine Australian SRI, and argue for a range of changes to the way SRI has been treated by the Australian finance sector in the past. From a practical perspective, we find that SRI in Australia appears to have suffered from a lack of clear understanding about ethics, and confusion over both definitional issues and practical approaches to SRI. In chapter 5 we point out that public

consciousness of issues traditionally at the heart of SRI in Australia has been accompanied by increasing public and legislative interest in the area of social responsibility in markets. Meanwhile, corporate Australia is beginning to find ways of reflecting a global push for socially and environmentally sustainable business practices. However, the views of SRI practitioners in Australia, as we find in chapter 5 via semi-structured interviews with Australian SRI fund managers, can differ markedly from some of the rosier prognostications for the sector. Within the Australian SRI sector, we argue that while there is broad agreement over the small size, lack of clear definition, and currently limited influence of the sector, there was little accord between fund managers over definitions, approaches, and the future prospects of the SRI sector. Indeed, there appears to have been significant uncertainty and disagreement within the sector itself over the meaning and proper role of SRI in the Australian financial sector.

### **SRI Engagement in Australia**

In particular, we find that SRI ‘engagement’ as an approach in Australia does not appear to have been as effectively pursued as it could be, and there appear to be major impediments within Australian SRI to its ‘mainstreaming’ in the financial sector, especially through techniques of engagement. In chapter 6 we suggest how some of these barriers might be overcome. We argue that engagement as an SRI strategy is multifaceted and multidimensional: its various techniques ‘engage’ investors and companies through fund managers in a dynamic exchange, opening up potential for promoting social change of a magnitude far greater than either screening alone or community investment can offer. Yet, underpinning each of these varieties of engagement, we claim, is a single key strategy: well-directed and effective research.

The pursuit of essential research – into the actual nature and practices of companies in the light of funds’ stated values – provides crucial information upon which all SRI fund judgments are to be made and decisions implemented. Yet, as we argue in chapter 6, advanced engagement techniques, such as collaborative pressure and social change partnerships not only require a significant sector-wide forum for the exchange of ideas; they require, first and foremost, clear ethical self-definition on the part of SRI funds. If SRI fund managers cannot state with precision and confidence what ethical values their funds stand for, then they cannot hope to engage effectively with each other, or with the market. We argue that simply clarifying ethical foundations and having a clear view of what values they stand for – and how these values relate directly to company behaviour – can make a huge difference to SRI fund managers’ willingness to take up more sophisticated engagement strategies.

## **Fiduciary Responsibility and the Global Growth of SRI**

Running throughout our analysis of Australian SRI in chapters 5 and 6 is a perceived conflict between SRI fund managers' legally enforceable fiduciary responsibilities and the practical implementation of SRI investment policies. As we explain in chapter 7, the perceived legal obligation to 'maximise' financial returns is often thought to be incompatible with the pursuit of any extra-financial values whatsoever, including those embodied in SRI approaches. In fact, we argue that uncertainty about fiduciary responsibility is a central unifying symbol of financial sector reticence to embrace SRI. Yet, as we point out, it has already been convincingly shown that when properly understood, exercising fiduciary responsibility is not incompatible with SRI. Indeed, it has been cogently argued in a 2005 UNEP-FI (United Nations Environment Program Finance Initiative) research paper (also known as 'The Freshfields Report') that, in discharging the twin fiduciary duties of prudence and loyalty, paying attention to SRI criteria may in fact constitute a *requirement* of financial fiduciaries.

In chapter 7 we argue that the financial fiduciary relationship, like all fiduciary bonds, is fundamentally one of trust. We find that there are two fundamental fiduciary duties underpinning the legal and ethical responsibilities of financial fiduciaries: a duty of prudence and a duty of loyalty. As we explain in chapter 7, these two principles combined capture the reasonable expectations of any person who transfers discretionary power over their finances to an investment professional: that financial fiduciaries will act on currently accepted standards of prudent investment, and that they will make investment decisions according to the purpose for which the discretionary power has been granted. Much hesitation, fear and misunderstanding about SRI has been expressed through doubts about the rectitude of pursuing SRI criteria in financial markets. However, we argue that the fiduciary prejudice against SRI has no firm basis in either ethics or common law. We believe the 2005 UNEP-FI report establishes that typical SRI criteria based on ESG (environmental, social and governance) considerations not only *may* be taken into account in many cases, but may in fact constitute *obligatory* fiduciary considerations in terms of both financial value and beneficiary consensus. On this basis, we argue that well-run SRI funds should be considered future financial fiduciary exemplars.

### **SRI: First Link in the 'Ethical Chain'**

Finally, in chapter 8 we weave the various strands of the overall SRI story together and place SRI within the broader framework of an ethically well-grounded global economic order. We conceive of SRI as the first link in an 'ethical chain' which reconnects the owners of global business with their extra-financial values.

An SRI approach is required in mainstream investment, we argue, because it represents the first link in the ethical chain – *explicitly* connecting the ultimate owners of businesses with the ethical impact of their activities – without which the chain cannot be effective. SRI is now in a position to offer comprehensive and satisfying answers to a grave agency problem that has emerged in modern investment markets. Owners have been ethically disconnected from the corporate activities undertaken by others on their behalf; intermediaries, in seeking to maximise financial returns, have rarely responded to the extra-financial values of their beneficiaries.

Too often, we conclude, financial intermediaries have not been held ethically accountable beyond enforcement of the letter of the law, and many very obvious extra-financial values on which there is a clear consensus – non-exploitation of the vulnerable, environmental sustainability, responsibility to future generations, good governance – have been trammelled in a reductive quest for financial reward. Yet this inadvertent trammelling of values can only occur when links in the ethical chain are missing or broken. SRI offers a compelling candidate for the first link in this chain; a first link which also acts to monitor, repair and strengthen the other links by re-connecting owners with their own values in global markets. Yet SRI can only perform this crucial function in the ethical chain if it is pursued with integrity: if those offering SRI are willing and able to examine, critically reflect on, publically state and transparently execute an ethically well-founded approach to integrating investors' extra-financial values into their investments.

# Chapter 1

## Socially Responsible Investment: A Nascent Global Movement

### Seeking Conceptual Clarity

What precisely is meant by ‘ethical investment’, ‘social investment’ or ‘socially responsible investment’ (SRI) has not been discussed with the same close attention that has been paid to more immediate practical issues, such as the relative financial performance of self-styled ‘ethical’ or ‘SRI’ funds. Indeed, the nature and proper definition of the core ideals that lie behind this tangle of competing terminologies remains a largely neglected topic (see Sandberg et al. 2009; Schepers and Sethi 2003; Monks 2002; Sparkes 2001; Cooper and Schlegelmilch 1993). Such neglect might seem strange given the dramatic growth of this particular sector in developed world financial markets over the past decade and more, and the surge in media, government, NGO and broader financial market attention. One reason for an apparent reticence to confront questions of conceptual clarity may be that many commentators and analysts, being predominantly financial and business experts but not necessarily philosophers or ethicists, are loath to step outside what they might regard as their disciplinary boundaries. Whatever the case may be, there are sound reasons – practical as well as theoretical – to aim at a level of conceptual clarity appropriate to a thorough understanding of the subject. Once we are clear about what is meant by the concepts and terminology we are using, much potential confusion and contention can be resolved. Indeed, the call for greater attention to definitional clarity has been made by one of the sector’s most prominent practitioners and commentators, Russell Sparkes, in his 2001 article ‘Ethical Investment: Whose Ethics, Which Investment?’:

As a practitioner working in the field I have been surprised at the relatively low level of attention paid to this subject in the business ethics community. Surely here is an area characterised by at best loose terminology, at worst by conceptual confusion that would benefit from the rigour of academic analysis (Sparkes 2001, 194).

There have been scattered attempts made in the literature to clear up this ‘loose terminology’ and ‘conceptual confusion’, and one of the most critically reflective and sustained attempts is due to Sparkes himself. He argues for a distinction to



be made between ‘ethical investment’ and ‘SRI’, where the former applies ‘to investment carried out on behalf of values-based organizations such as churches and charities, with the term ‘socially responsible investment’ (SRI) used in all other cases’ (2001, 199). Sparkes’s rationale centres on justifying the use of the term ‘ethical’. He believes that legitimate use of the term in investment requires that candidates for the description meet explicitly ethical criteria, including altruism – i.e. being not-for-profit – a demonstrable consistency with professed ethical codes and principles, clear ethical decision-making bodies to tackle dilemmas, and public transparency, including disclosure of ethical deliberations. Church-based investment funds would meet these criteria, along with ‘any non-government organization (NGO) that holds some investments, as long as it is based around a coherent code of beliefs, such as environmentalism, social justice, or animal rights’ (Sparkes 2001, 199). According to Sparkes, there is one necessary condition behind the distinction: ‘clearly the basic motivation of the organization must not be to make money’ (2001, 199). This leaves ‘SRI’, on Sparkes’s view, to be applied in the retail investment fund sphere, where investment is explicitly for-profit: ‘the key distinguishing feature of socially responsible investment lies in its combination of social and environmental goals with the financial objective of achieving a return on invested capital approaching that of the market’ (2001, 201).

### **Defining Socially Responsible Investment (SRI)**

While we recognise that Sparkes locates a genuine point of qualitative difference between what he calls ‘ethical investment’ and ‘SRI’, we do not believe that the distinction he identifies is at the heart of the matter, conceptually speaking. Moreover, its background interpretation of the meaning of ethics and morality, and distinction on the basis of intended returns, may expose the view to undesirable – and we believe unnecessary – controversy. We advocate a different angle of approach to the required conceptual clarification, which we believe is precise, is not unnecessarily ethically loaded, and which is conceptually and practically fitting. First, as far as terminological differences are concerned, whether the core activity is called ‘ethical investment’, ‘socially responsible investment’ – or anything else with ‘ethical’, ‘social’, ‘responsible’, or cognate terms in its title associated with investment – need not in our view be considered particularly significant. Historical, cultural, political and geographical influences have resulted in a variety of names gaining currency at different times and in different places, but we take it that the core activity is essentially the same. For the sake of convenience and narrative