What’s in a definition?

Exploring the language of investment, value and impact
About ShareAction

ShareAction is a non-profit working to build a global investment sector which is responsible for its impacts on people and planet. We mobilise investors to take action to improve labour standards, tackle the climate crisis, and address pressing global health issues, such as childhood obesity. Over the last 15 years, ShareAction has used its powerful toolkit of research, corporate campaigns, policy advocacy and public mobilisation to drive responsibility into the heart of mainstream investment. We want a future where all finance powers social progress.

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Introduction

Investment, value and impact - exploring definitions

Anybody with a connection to investments (an individual with pension savings, an asset owner like a university or charity, or an investment professional), who has an interest in improving outcomes for people and the planet, will quickly encounter a dizzying range of terminology. While people new to this space may assume they can use the terms ethical, social, responsible or impactful interchangeably, those who stick around for longer will notice the particular ways that the terms are used by professionals, and the politics of word choice. This piece provides the inside story on the history of terms that draw connections between financial value, moral/ethical values, and the effects of investment activity on people and the environment.

The words we use to explore this area are contested. These words are flags in the shifting sand of a battleground of ideas, used by different actors to claim and expand territory. Through an approximate chronological overview of these concepts, the ‘textbook’ definitions can be seen as part of debates about the purpose of this sector. We focus on language used within institutional investment in the UK: the same terms are used differently by retail investors and in other places.

The use of adjectives as standard terms often leads to confusion because the words ethical, social, responsible or impactful mean quite different things when used within the sector. The terms discussed have been used both to signify ways to invest (ethical investment), and to describe groups of asset owners and managers (ethical investors), and as a particular lens or framework for thinking about investment (investing ethically).

Through soliciting feedback and review from actors across this space, this piece attempts to shine light on both widely held differences of opinion, and areas of collective confusion and uncertainty around language use.

The piece was written as an education resource for the Responsible Investment Network – Universities, as part of the inaugural Work Plan.

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1 As a rough translation:

In the US, ethical and responsible are very rarely used; SRI is used in a similar way to the UK, and is seen as ‘nice but niche’; and ESG, social and sustainable investment are the most comfortable and interchangeable terms, because they tie in a financially material case for action. Investors also use the term mission-aligned to describe values-based investment without the old-fashioned connotations of SRI.

In a continental European context, the term sustainable investment is principally used, and in the same sense as responsible investment.
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What’s in a definition?

A starting place

Finance and ethics have been discussed at least since Aristotle, but our focus on shared terms and understanding those terms leads us to the second half of the 20th century. The post-war financial system was for first time dominated not by elites, but by pension and retail funds, representing individual savers. This new situation, combined with anxiety about the state of global inequality and a recognition of the role of finance in geopolitical events (South Africa, Vietnam), meant that professionals within the sector began to question the intersection between the ‘real’ and the ‘financial’ economy. In parallel, the forces of financialisation made the financial services sector dominant within Western economies.

This situation raised the question:

When and how should the needs of the ‘real’ economy take precedence over the financial sector’s primary goal of growing money out of money?

Ethical

Ethical investors don’t invest in companies or sectors that do not match their moral standards. Although this concept has deep roots, they attached to this term in particular from the 1970s. Language such as ‘sin stocks’ (gambling, alcohol, pornography, etc) shows the strong role that church investors played, and continue to play, in ethical investment.

This term was, and is, principally used by value-driven institutional investors interested in making money, but not at any cost – they are content to do without the returns that might be achieved via sin stocks. This mostly means mission-driven asset owners like charities, and the ethical fund provided by pension funds.

Ethical has public strong name recognition, but is now seen as niche within the industry, in terms of both size of offering and audience.

This points to a wider picture – while actors within the sector have frequently changed the language used to describe their activities, the retail sector is less concerned about terminology.

These investors are mission-driven, and their enquiry into this space starts with an interest in aligning their investments with their organisational mission. This engagement with purpose and how to make it manifest in investments follows such investors through the different terms used across the latter part of the 20th century and the dawn of the 21st.

The way that organisations understand and act on their purpose has evolved alongside the presenting factors that have changed in the outside world. What constitutes ethical has changed over the last 50 years, with some core ethical concerns becoming mainstream investment
norms: for example, very few funds now invest in weapons banned under global conventions, while universities and other bodies that conduct cancer research often avoid tobacco stocks. Regulation has also caught up on some baseline expectations: The Law Commission advised pension trustees about appropriate assumptions about things the public would think are morally wrong, including, “activities which contravene international conventions, such as manufacturing cluster bombs.” This guidance has filtered into the charitable investment sector.

SRI was developed in the 1980s and involved a significant shift from the ethical approach, for three core reasons:

1. The target market went beyond mission-driven investors, to encompass those with a baseline expectation of commercial returns.
2. Asset selection included tilts as well as screens, often with a specific environmental focus (such as renewables investments), and some social investment.
3. SRI saw the start of company ratings, and consequent investor engagement with corporates.

Socially responsible

This term was particularly popular in the first half of the 2000s, coinciding with a surge in engagement with environmental issues. Because SRI developed at the same time as the tech boom, there was often a heavy natural tilt to the technology sector, due to its perceived low-carbon credentials. This played a role in the strong financial performance of SRI funds during the late 1990s.

Today, SRI is used principally in two ways. Within the contemporary responsible investment industry, ethical and SRI are often conflated, and characterised by some investors as clunky processes operating at fund level only, which simply screened out harmful practices.

The term SRI is rarely used by asset managers and others in the industry today.

In the charity and university investment world, SRI remains in use today, but is used in two slightly contradictory ways. Some investors who were involved in the transition from ethical to SRI to responsible see the word as an umbrella term that includes terms such as ESG, responsible and ethical, as well as social investment. For this reason, we see charity and university policies on this topic frequently called ‘SRI Policies’. The second usage puts SRI as the midpoint on a transition through the past 50 years from ethical to responsible, and from an approach focussed on negative screening (ethical), to also taking into account the potential to encourage positive corporate outcomes (SRI), towards an integrated approach attempting to link up company values and value (responsible). This understanding of the term rarely uses it except in a historical sense.

II The environmental impact of the technology sector has also changed over time: as the online world has expanded, the industry faces its own dilemmas about how much carbon it uses.
ESG and responsible

Environment, Social & Governance (ESG) and Responsible Investment (RI) are sibling terms that mark a shift that started in the 00s, away from funds targeting value-led investors, towards the attempted mainstreaming of ESG issues within the traditional investment industry. RI is used as an umbrella term to describe the sector and the toolkit, and ESG describes the process of quantitative analysis about different issues – but most actors in the space use the terms interchangeably. They have become the umbrella terms of this space.

The key distinction to previous terms is the focus on demonstrating the positive financial results of incorporating environmental, social and governance (shortened to ESG) factors into investment decisions. We therefore see a much closer relationship with corporate actors, and an increased focus on investor engagement with companies. While screening continues, the purpose and focus is different: ethical investors conduct screening due to moral concerns, responsible investors because there is an investment risk that they judge they can best manage through ceasing to hold the stock. Despite different rationales and intentions, this can lead to an overlap in outcomes between ethical and responsible.

The genesis of the term ESG was the “Who Cares Wins” report coordinated by UN Global Compact, published December 2004. It argues that ESG investing will develop “stronger and more resilient financial markets”, and that a positive by-product of this process is a “contribution to sustainable development”. The other core founding report of ESG was commissioned by asset manager members of the UNEP FI Asset Manager Working Group, who had a strong presence in SRI funds. It is known as the Freshfields Report (October 2015). The report explores the topic of fiduciary duty, and argues that institutional investors should engage with ESG issues across all of their investments, not just specialist funds.

The report demonstrates the baseline conceptual confusion within ESG/RI. It frames ESG issues as descriptors of the inefficiency of the market: topics and risks that are not yet legible in terms of financial materiality, but which investors should ‘integrate’ into decision-making, based upon the argument that these issues already are financially material. It is the role of investors to mitigate this information gap through engagement with the affected companies, with the reward of improved market efficiency and stability, and achieving strong returns.

There is therefore a strong focus in ESG on improving corporate disclosure and data accessibility. This is underlined by a belief that more data makes a ‘more perfect’ market: investors will make better decisions on ESG topics where they have more complete access to information about good and bad corporate practices which could affect investment returns. This puts a lot of pressure on timing for responsible investors – to have the relevant information about ESG factors in companies and sectors early enough to be able to use it for commercial advantage. However, leading too quickly may mean an overexposure to risk or a loss of returns, and ‘band-wagoning’ behaviour works nearly as well as leading the pack in terms of avoiding ‘stranded assets’.
Action on climate change is therefore justified not because of the overriding imperative to assure a liveable planet for future generations, but because of the risk of high carbon intensity assets being ‘stranded’.

This term refers to assets such as fossil fuels rapidly losing their value and becoming no longer able to earn an economic return, for example due to regulation and consequent changes to market demand.

Responsible investment (RI) rose to prominence with the launch of the UN-backed Principles of Responsible Investment in 2006. We can draw a straight line from UNEP-FI’s Asset Manager Working Group to the genesis of the PRI. The PRI say today that RI aims “to combine better risk management with improved portfolio returns, and to reflect investor and beneficiary values in an investment strategy. It complements traditional financial analysis and portfolio construction techniques.”

Responsible investment and ESG captured the imagination of certain professionals within the mainstream finance industry, forming a sub-industry of its own with a regular spread of sector conferences, trade bodies, and a booming market in funds (growing by 34% between 2017-19).

Proponents of responsible investment succeeded in making the agenda relevant for investors of all types, including those without a strong values basis.

So where does real-world impact come in? As the PRI put it: “where many [other terms used] make moral or ethical goals a primary purpose, responsible investment can and should also be pursued by the investor whose sole focus is financial performance.” Positive real-world impacts are framed as by-products to be welcomed.

Professional investors and civil society campaigners may find themselves talking about being concerned about the same things, with each focusing on quite different reasons for caring. At worst, responsible investors feel they have to perform a conflicting piece of double-talk; arguing that values are not relevant to decision making, but simultaneously talking only about value-laden topics - such as workforce issues and climate change - using the language of financial materiality. This requires a hard-nosed focus on gradually expanding the domain of what investors understand to be financially material, to include social, environmental and governance issues.

Responsible investors may feel conflicted between their personal or organisational values and motivations for activity, and their professional focus on the language of materiality. This has led some responsible investors to ask, “is it a problem that we can only engage with a moral issue where it will reduce risk or expand return?”

The global financial crisis of 2008 brought with it greater understanding of the interconnected and unstable nature of the financial system. Following this, investors saw that the real world impacts of their investments had become so severe that they directly threatened the stability of not only the investment system, but also global society. Investors started to use a systemic risk framework, initially focussed on climate change, but more recently linked to ecosystem collapse, soil degradation, automation and artificial intelligence.
The critical question increasingly shifted from “what could investors do to make the same money while not damaging the world?” to “what must investors do, to address these threats and thus protect the value (and growth) of their capital?”

This necessitated a shift from thinking about protecting the financial value of specific companies, to protecting the financial value of the wider investment universe – particularly for ‘universal owners’, those large and diversified investors who own a stake in all parts of the global economy, and therefore have an interest in supporting overall stability and prosperity.

The shift since 2008 has been towards understanding that social and especially environmental threats shaping investment, as opposed to investment externalities affecting social and environmental issues. The corona virus crisis is a particularly powerful manifestation of this new way to position responsible investment. Some responsible investors, including the PRI, have argued that real-world impact should become the ‘third dimension’ of investment decision-making, taking the sector beyond risk and return. More broadly, there is significant confusion in RI about what the term impact means, which has created false barriers to having this conversation. We explore this confusion further below.

Fossil fuel divestment

The fossil fuel divestment movement started in 2010 as an intervention led by US liberal arts colleges, followed by churches and NGOs. It grew in size and profile, spread to the UK and other countries by 2013, and now includes major asset owners and even countries.

With its focus on removing fossil fuel stocks from investments, this framework drew heavily on the values-based framework of ethical investment. However, the main purpose of the activity was quite different. Ethical investors divested from ‘sin stocks’ due to a moral objection to making money from what they saw as “evil and tainted sources”. The fossil fuel divestment movement, in contrast, uses divestment primarily to inflict damage on the fossil fuel industry, and has had success principally in putting into question the social license of these firms to operate.

The movement echoed the South African divestment - powered by moral outrage, but focussed on a goal of systemic change.

Talking to an industry caught up in conversations about ESG/RI, and aiming for wider uptake, by 2017 divestment advocates adopted the argument that divestment served as a form of risk management in avoiding potential stranded assets (see above). In this way, the divestment movement became an increasingly mainstream - and less controversial - proposition, often speaking in the same language of financial materiality as responsible investment and ESG, and becoming a question that all managers feel obliged to answer. We increasingly see investors...
with responsible investment policies that include divestment as the final stage of an engagement strategy – but also others who take ongoing muscular engagement, with escalation plans and clear milestones, as their preferred way to force change.

Dispersal

The advent of the divestment movement named the elephant in the room. Some participants in the RI/ESG ‘industry’, and onlookers from outside, started to look across this 30-year history, and ask questions.

“What impact have we had in all this time?” “How have we done all this hard work, but global carbon is still increasing?” “Is this all just window dressing?”

Investors started to see RI/ESG as a project that aimed to capture the mainstream industry by not talking about values and outcomes. Without being value-led, they felt that it was not having the significant real-world outcomes that participants had nevertheless still hoped for. From 2015, a dizzying array of new terms started to emerge, in efforts to fill this conceptual gap. Words like purpose, sustainable, future-proofed, mission-led, positive, intentional and impact became banners around which participants in this conversation gathered. A common theme was a re-centring of the purpose of investment activity; language familiar to ethical investment but now repackaged under the umbrella of responsible investment. This often took the form of focussing attention back at organisational mission and purpose.

“They’re just finding new ways to market the old system!” was one accusation – from both long-term responsible investors, who saw the new terms as a re-packaging of their ongoing work, and, on the other side, from the adopters of these new terms, who saw responsible investors as classical capitalists in green suits. As with the ethical - responsible shift, we see a tension between purity and pragmatism.

As we have seen throughout the development of terminology in this space, a time lag existed between the forefront of exploration, and the core institutional and retail industry. A patchwork of different approaches developed, often featuring inconsistencies between language and activity. Responsible investment remained an umbrella term, though two uncertainties about it remained:

*It is difficult to distinguish responsible investment from ‘doing a good job as an investor’.*

Good investment practice involves prudent asset allocation, with awareness of financially material issues – which is a core message of responsible investment. Yet RI/ESG struggled in cases where the financial risk of ignoring an ESG factor was unclear or insignificant. For example, if one of the reasons to account for climate change in investment decision-making was that regulation might come in and make carbon more expensive, when politics changed and it became clear that no such regulation would appear soon, should the responsible investor have to do anything?
Secondly, the mainstreaming of the responsible investment sector aligned with the growth of socially conscious consumerism, and led to the sale of investment products because of their value-oriented labelling, not necessarily because of the good they did to people and planet.

*The boom of this new market led to allegations of ‘impact-washing’ and ‘green-washing’.*

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**Impact**

Impact as a term is currently heavily contested, but most actors using the term describe a focus on intentional investment in carefully vetted private projects, with an intended social or environmental outcome, and a focus on measurability.

The term social investing came to the fore in the late ‘90s, with a focus on addressing the under-provision of mainstream finance to communities in need. The concept boomed in the mid 2010s, in part due to a move by the Conservative Government of the time to seek alternative methods to fund public services, including by sponsoring entities such as Big Society Capital. There is not agreement about whether the term includes environmental goals alongside the initial social focus. The term has mostly been used by charitable foundations, the government, and in a legal context.

Impact investing has origins in the US in the 2000s, and has become widely used by a range of actors globally, including ‘finance-first’ institutional investors. The definition from the GIIN has gained considerable international traction: “investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.” But what does ‘alongside’ mean here – how much of a return should investors expect?

The ‘Bridges Spectrum of Capital’ has become the dominant framework helping investors understand the relationship between impact and return. Recent iterations show a universe of investment opportunities where higher impact may necessitate lower return – but not always. It allies with GIIN definition, which states that “impact investments target a range of returns from below market to market rate, depending on investors’ strategic goals.”

Many have reached the ultimate conclusion that while some investments make good money, and some make a better world, some can be neither, others can be both. Others feel that this is simply an unhelpful question to ask.

However, not only have the obvious similarities between impact and social investment led to significant confusion about terms within this sphere, but this has been made worse by more recent interest from outside, as ethical and responsible investors have started to use the language of impact following the dispersal described above.
Responsible investors (now part of the world's largest asset managers and owners) have started to capture the language of impact: it gives a sense of clear, measurable and intentional change that is appealing to the muddied waters of the responsible sector.

Conversely, impact investors have drawn on concepts used within responsible, as the dominant term within the mainstream financial sector.

The 'deep' approaches of social/impact contrast with the ‘breadth’ of the global methods of responsible investors, which rely on a chain of intermediaries, and aim to coordinate engagement with major global companies about systemic threats. The Bridges spectrum is therefore not a tool to use in understanding the effects that macroeconomic and physical changes (such as climate change) can have on the investable universe. On these topics, impact and responsible investors have struggled to find shared language. The Impact Management Project has worked to build a consensus about the language used in impact measurement and management, bridging between the impact and responsible communities of practice, but both communities remain confused about how the word ‘impact’ is used in the other camp.

Yet again, we see different compromises struck between purity and pragmatism, depth and breadth, differences that have triggered periodic rebranding efforts. Part of the dilemma for those concerned about genuinely values-aligned investment is whether to attempt to reform existing approaches, or to define and develop new ones. The politicisation of terms used, and their fluidity within and between different communities of practitioners, has made it hard to develop clear policy and practice.

A pausing place

At this stage in the story, seven terms in, we must ask – is this repeated skin-shedding a way for practitioners to avoid answering critical questions about what they and their clients really want, and what they think it is worth?

Terminology aside, asset owners and their managers must continue to wrestle with the fundamental question:

In a sector dedicated to making money, who is responsible for deciding when the needs of the ‘real’ economy takes precedence over this dedication – and what should they do?

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III A recent piece of ShareAction research about defined contribution pension schemes in the UK showed that they largely use responsible rather than ethical, and have now started using the language of impact. Pension schemes, like charities, seem to be acknowledging that their investments have an impact on the real world – the world into which their members will retire. There is growing awareness that these impacts are both positive and negative, and often global in scale and systemic in complexity. What is yet to happen is for that thinking about impact to translate in to action and changes to investment portfolios. https://shareaction.org/wp-content/uploads/2019/12/Master-Trusts-Review.pdf
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