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Socially responsible investing and student managed investment funds: Expanding investment education

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Abstract

Social investing has grown to become a significant part of the investment world, but is still an often-ignored concept in investment education. This article discusses the history and trends in social investing and discusses how the concepts of social investing can be incorporated in student managed investment funds. Specifically, the design of a socially responsible investing student fund at one university is discussed. Although there are many challenges to overcome in integrating socially responsible investing in the finance curriculum, student managed investment funds may provide a useful vehicle for addressing the ethical and social issues faced in today's investment environment.

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1. Introduction

The purpose of this article is to examine the role of social or ethical investing in student managed investment funds and to discuss the development of funds that are specifically designed to reflect the growth of socially responsible investing (SRI) in portfolio management. The inclusion of social criteria for student managed investment funds is not a new phenomenon. Student funds at Catholic universities have to meet the investment standards of the Catholic Church and social criteria have occasionally been included in student funds

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when there is widespread agreement in society (e.g., the exclusion of companies doing business with South Africa during the period when apartheid policy was followed by the government). These criteria are generally exclusive in nature, barring investments in certain types of companies. There have been very few student managed investment funds that have also included a major inclusive component for social investing or are designed specifically to reflect the full nature of social investing. This article will examine the components of social investing and the role of social investing is student managed investment funds including the advantages and disadvantages of social investing. In addition, the specific design of a new socially responsible student fund will be presented. The discussion will include the challenges and benefits of establishing a social fund at a university, the specific design of the fund, and the learning opportunities provided to students.

2. Socially responsible investing

SRI, or ethical investing, requires investors to broaden their selection approach from the classical economic risk or return analysis to the inclusion of criteria such as ethical, societal, and religious concerns. Although SRI receives little, if any, attention in traditional investing courses, social investing is an important part of the investment world. According to the 2010 Report on Socially Responsible Investing Trends in the United States by the Social Investment Forum Foundation, social investing now accounts for over three trillion dollars or approximately 12% of the investments in the United States. In addition, the report indicates that over 250 mutual funds and 26 exchange traded funds (ETFs) apply at least some social criteria in their selection process.

2.1. History of social investing

Social investing has a long history that finds its early roots in religious philosophy. Early Jewish teachings included ethical investing in businesses as well as early Methodist, Quaker, and Catholic teachings (Schueth, 2003). The religious basis for many areas of social investing are still seen today as reflected by the investing standards promulgated in various religions. For example, United States Conference of Catholic Bishops published guidelines for socially responsible investing in 2003 that includes excluding investment in companies that are deemed detrimental to the general good (i.e., "Do no harm [avoid evil]"), promotion of shareholder advocacy to achieve economic justice, and investments in organizations that "promote the common good." Similar guidelines can be found in other religions such as the Methodist and Jewish faith. These requirements have significant implications for student managed investment funds at private faith-based universities that need to follow the guidelines established by their faith.

Social investing found additional support in the social activism of the 1960s. The antiwar sentiment of the 1960s and the growth of social issues such as nuclear power, human rights, and the subsequent growth of environmental concern all contributed to growth of social investing (Entine, 2003). Further, the corporate governance crisis epitomized by companies such as Enron and World Com and the subsequent passing of Sarbanes–Oxley enhanced the importance of ethics in corporations to many investors. The rise of these more secular issues combined with the religious foundations of social investing have all contributed to the growth and importance of SRI.

Although the social activism helped contribute to the growth of social investing, it also may have hurt the acceptability of the role of using social investing criteria in traditional portfolio management. Many people disagreed on the social issues that served as growth factor in social investing during the 1960s, 1970s, and 1980s. These political and philosophical disagreements led to the disparagement of social investing (e.g., Entine, 2003). In addition, academic studies have generally found little economic gain from social performance (Hickman, Teets, and Kohls, 1999). Because of these reasons, the inclusion of investment criteria outside of the classical risk or return framework are often ignored by both educators and practitioners even though SRI is playing an ever more significant role in the investments world.

2.2. Implementation strategies for SRI

SRI normally encompasses one or more of following three broad strategies: security screening, shareholder advocacy, and community investment. Security screening is used to filter the broad universe of available securities and apply either an exclusionary or inclusionary screen based on social criteria. Shareholder advocacy is not used for the selection of stocks but to use the ownership interest in currently held stocks to advocate social issues through shareholder proposals and communicating with the management of the company about social issues. Community investing directs investment money to local business and community foundations. The primary purpose of community investing is not to apply specific social screens to publicly traded companies but rather to direct investment capital to support local communities.

The most common of these strategies is security screening. One of the earliest approaches to security screening was based on the religious foundation of excluding "sin stocks" such as alcohol and tobacco. The social activism of the 1960s led to additional exclusionary screens such as defense companies. The growth of environmentalism led to the inclusionary screen of finding "green" and the more recent emphasis on sustainability and the triple bottom line. Today screening is often based on the ESG (Environmental, Social and Governance) position of companies. ESG scores are readily available from investment information sources such as MSCI and Bloomberg. Both inclusionary and exclusionary screens are often used in social or ethical investing.

Shareholder advocacy is primarily exercised through shareholder resolutions and talking with company leadership. Resolutions are presented for shareholder votes on issues that are considered socially important to the SRI advocate. More recently these have included growing numbers of resolutions concerning executive pay and the environment. Institutional social funds will also try and open communication with company leadership to ensure that the company is implementing the SRI philosophies that are important to the particular fund.

The final approach to social investing is community investing. Community investing encourages the flow of investment capital to local communities that are underserved by the capital markets. Direct investment in small businesses and community funds are designed to enhance the vitality and services provided in a local community. Both the Forum for Sustainable and Responsible Investment and the United States Conference of Catholic Bishops encourages the direct investment approach used in community investing.

2.3. Classic investing and SRI

Even given the size of social investing and its importance to many individuals, little mention of SRI or ethical investing can be found in traditional investment textbooks. As mentioned previously, the lack of focus on SRI is primarily driven by the concentration on the classical modern portfolio concepts of risk or return analysis, the lack of broad academic evidence supporting economic benefits to social investing (Hickman, et.al. 1999) although they did report possible diversification benefits to including social funds as part of a broad investment strategy and disagreement on what are the appropriate social criteria to use in selecting investments. These reasons, although valid, are not sufficient to explain the lack of coverage that SRI receives in investment education. In today's environment of concerns about ethics and sustainability and the growth of social investing in the marketplace, educators should seriously consider including SRI concepts in investment education. One way to accomplish this is through the use student managed investment funds.

3. Student managed investment funds

Student managed investment funds (SMIFs) have seen rapid growth in the last 10 years with over 150 active programs in the United States (Macy, 2010). These student funds range greatly in size and structure, but are all designed to enhance the investment educational experience of students through active or experiential learning. The structure of the funds that range from relatively informal extracurricular investment clubs to formal classes can have a significant impact on the learning goals established for the students. Most SMIFs concentrate on stock investments (Neeley and Cooley, 2004) and may or may not have a specific Investment Policy Statement (IPS). At a minimum, most funds try to enhance students understanding of the securities markets and, at least to some degree, security analysis and selection. The learning objectives normally identified for SMIFs include security analysis, teamwork, communication skills, and decision-making skills (Grinder, Cooper, and Britt, 1999; Kahl, 1998; Macy, 2010; Neely and Cooley, 2004). SRI concepts are normally not identified as playing a role in the either the learning objectives or decision-making of student funds apart from faith based universities that follow the guidelines of their church.

SMIFs provide an excellent opportunity to include at least a discussion of socially responsible investing to students. From including social screens such as ESG in the security selection process to the discussion and voting on shareholder resolutions, SRI concepts can be easily introduced to students with the context of student managed investment funds. The exposure to SRI may be limited to simply raising the awareness of the students to social or ethical investing to a more formal program as outlined in the next section.

4. Design and implementation of a SRI SMIF

There are many ways to incorporate the concepts of social investing in SMIFs from simply adding a discussion of social investing to the current student fund to forming a dedicated social portfolio. The following discussion addresses the creation of a dedicated social fund at one university. The purpose of the SRI SMIF is to introduce students to the use of social criteria in the screening and selection of securities while maintaining an emphasis on security analysis and the concepts of portfolio theory. In addition, exposure to shareholder advocacy is provided through the discussion of shareholder resolutions. Community investing is also indirectly addressed through additional screening criteria. Specifically the purpose of the fund is as follows:

1. To enhance the portfolio management skills of the students through the use of real-world application and modern portfolio theory.
2. To maintain and control a successful, socially responsible investment portfolio.
3. To gain further understanding of socially responsible investments.

Initial funding of 50 thousand dollars for the social investment fund was obtained to expand the teaching of ethics within the College of Business.

4.1. Design

A traditional SMIF that is structured as a class and follows a classical portfolio management approach while managing funds from the University's foundation already exists in the College. The SRI student managed fund was established as an additional and separate student fund. The social fund has been incorporated in the normally offered portfolio management class. The portfolio class has investments as a prerequisite. This gives students a basic background in the investment process before managing the student fund. The use of an existing course allows more students to gain the experience of conducting security analysis and managing a fund of real money than the current, limited enrollment, SMIF, while incorporating the social aspects of investing.

Once initial funding was obtained, the first step was the development of an investment policy statement that incorporated SRI. The students in the class were put into teams and each team was responsible for researching and developing a broad social investment policy statement. Each team then presented their results and the class then merged the different investment policy statements into one IPS for the class. The class determined that all stocks purchased for the fund had to meet minimum standards of corporate governance. In addition, the companies selected for investment have to be a leader in at least one of the following social categories: Green, Human Rights, Community Involvement, Fair Trade, and Family Friendly. After the IPS was developed the students identified specific screening criteria for each of the social categories. The IPS for the fund is presented in Appendix A.

The IPS was designed to consider both security screening strategies and indirectly the community involvement strategy. The screening guidelines capture the ESG screens typically found in social portfolios. In addition, because students are not allowed to directly invest in small business or local community foundations, an indirect approach to community investing is used through the community involvement category in the IPS. Instead of directly investing in the community, students screen for companies that are heavily involved in community activities as evidenced by donations, community activities, and outside recognition and invest in those companies.

The class also addresses shareholder advocacy by requiring the students to discuss and vote on all shareholder resolutions for the stocks held in the portfolio. One student is responsible for summarizing the shareholder resolutions and presenting them to the class. The class discusses the proposals concentrating on the social implications and then decides how the class will vote the shares owned by the fund.

The general operating structure of the fund was derived from Kahl (1998). Students are required to complete a written security analysis and present the buy or sell proposal to the class. The class then acts as the investment committee and approves or rejects the proposal. In addition to a discussion of the social criteria, the company analysis has to include the more typical components expected in a top down security analysis. Students are expected to include analyses such as determining a target price through valuation analysis and conducting a financial analysis of the company. The general format for the company analysis is presented in Appendix B. In addition to the analysis and stock selection, students are required to monitor the performance of individual securities during the semester and report on the overall performance of the portfolio. Students are required to conduct the analysis of securities using a three to five year holding period. In a one semester class students have tendency to think in the short-term and are primarily concerned about performance during the semester. To overcome this potential bias the students are required to use a longer time horizon for their analysis. The requirement to use a three to five year time horizon encourages the students to take a long-term approach to the analysis that is consistent with many social funds. One issue faced by student funds in classes is the management of the fund when the class is not in session. The fund can either be liquidated at the end of the academic year (if the class is not offered in the summer) or passively managed. If the fund has sufficient diversification and a long-term approach was used in security selection, a passive approached may be used when the class is not in session. The fund discussed in this article is passively managed during breaks.

5. Benefits and challenges of the SRI SMIF

In addition to the normal experiential learning benefits associated with student managed investment that were discussed earlier such as teamwork, security analysis, communication, and decision-making, an SRI fund adds exposure to the social and ethical issues that are an important part of the investment environment. Students gain experience in screening using ESG and become aware of the issues surrounding social investing. The discussions and disagreements on whether companies are socially responsible enhance the students understanding of some of the controversial elements of social investing and raises their awareness of ethical issues through these discussions.

The challenges of starting and operating a SRI student managed fund are many and varied. The first challenge is obtaining funding for the portfolio. University foundations may be very hesitant to provide funding for a SRI portfolio, with the exception of faith-based universities, since this type of portfolio may be outside their normal operating guidelines. However, with the growing emphasis on ethics in the business curriculum, there are opportunities for funding from outside foundations and individual donors that want to emphasize ethics in business education.

Another challenge faced when incorporating a SRI portfolio in an existing class is restructuring the class while still maintaining the integrity of the course content. In the portfolio class, students were already required to do analyses on individual companies. The inclusion of a student managed investment fund enhances the learning of security analysis because now the student's analysis and recommendation has a real impact on the performance of a portfolio. The most difficult part was allocating class time for the discussions and presentations. This challenge has been addressed by requiring students to post their company analysis on Blackboard before presenting. All students have to read the analysis before class. The use of Blackboard and requiring students to read the analysis before class allows us to minimize the class time needed for the presentation votes. In addition, students are encouraged to use the discussion forum on Blackboard to discuss issues about the social portfolio.

Interestingly, one of the major challenges to overcome is the resistance from other finance faculty and traditional investment professionals. Instead of viewing social investing as just another aspect of the investment environment that students should be aware of, many faculty and investment professionals may still view SRI as fringe area that ignores traditional risk/return analysis. To address this concern, a SRI fund should not concentrate only on social issues but require the traditional risk or return analysis as well as the social aspects of the investment decision.

6. Conclusion

Social investing has grown to become a significant part of the investment world, but is still an often-ignored concept in investment education. This article has discussed the trends in social investing and discussed how the concepts of social investing can be incorporated in SMIFs. Specifically, the design of a SRI student fund at one university was discussed. Although there are many challenges to overcome in integrating SRI in the finance curriculum, SMIFs may provide a useful vehicle for addressing the ethical and social issues faced in today's investment environment.

Appendix A

Executive Summary

Current Assets:
Approximately $50,000

Time Horizon:
For the planning and investing purposes the time horizon will be 3 to 5 years to protect from losses as a result of uncertainty within the market.

Return Expectation:
CPI-U + 3.5%

Return Goal:
To earn a return greater than that of the MSCI KLD 400 Social Index.

Risk Preference:
The portfolio will be constrained to a moderate level of risk.

Asset Allocation:

Asset Class	Lower Limit	Upper Limit
Large Cap Equity	40%	75%
Mid Cap Equity	10%	25%
Small Cap Equity	0%	15%
International Equity	0%	25%
Domestic Fixed Income	0%	20%
Cash	0%	10%

Portfolio Benchmark's:

Asset Classification	Benchmark
Large Cap Equity	MSCI USA Large Cap ESG Index
Mid Cap Equity	MSCI USA Mid Cap ESG Index
Small Cap Equity	MSCI USA Small Cap ESG Index
International Equity	MSCI EAFE Index
Domestic Fixed Income	Barclays U.S. Aggregate Bond Index
Entire Portfolio	MSCI KLD 400 Social Index, S&P 500

Purpose

1. To enhance the portfolio management skills of the students through the use of real-world application and modern portfolio theory.
2. To maintain and control a successful, socially responsible, investment portfolio.
3. To gain further understanding of socially responsible investments.

Portfolio Performance

The portfolio is constrained to a moderate level of risk and investments are to be treated accordingly. The target performance of the portfolio is to exceed the returns of both the KLD 400 and the S&P 500. During a single semester, the target minimum return is not to exceed a loss of 15%.

Social Diversification Requirements

The following classifications are required for every company.

Corporate Governance and Ethics: A company with policies that address employees' actions, requiring them to operate in an ethical manner. The company also has policies to promote investor relations and management practices.

The socially responsible classifications are defined as follows. These definitions are to be used as guidelines when screening companies. Every company must fall into at least one of the categories below.

Green: A company which strives to operate, at every level, in a manner which promotes sustainability, to reduce its impact on the surrounding environment.

Human Rights: A company that prohibits operating with or employing child labor, promotes a civilized business environment and upholds humane business practices.
Community Involvement: A company that works to improve the community through community outreach as well as charitable contributions.
Fair Trade: A company that supports workers and producers in developing countries through improved trade lines.
Family Friendly: A company that acknowledges the importance of family by offering benefits including maternity and paternity leave, on-site child care, flex time, and so forth

Management Constraints

1. The portfolio is to be actively managed during the semester.
2. The professor of the Portfolio Management class will execute any and all trades.
3. The performance of the fund will be reported on a semester basis to necessary parties.
4. The fund will be subject to proper auditing standards.
5. Each equity asset will be limited to 5% of the overall portfolio value.
6. The portfolio is to be invested in a variety of asset classifications as well as social classifications as previously defined.

Fees

Up to 2% of the portfolio value will be used to support the management of the portfolio per semester with a maximum of 4% for a year.

Monitoring the Portfolio

On the last day of the week, in which the class meets, there will be a 30 min meeting to discuss relevant issues pertaining to the portfolio. Additional time may be granted at the discretion of the professor of the Portfolio Management class. Meetings are to be conducted by students; each student will have the opportunity to run a meeting. Buy and sell offers may be proposed during the weekly meeting. A buy proposal must be approved by a 2/3 majority to be passed; a sell proposal must be approved by a simple majority to be passed.

Management During Breaks

The fund will be passively managed by the professor of the portfolio management class during class breaks.

Appendix B

Company Analysis Format
Social Fund

Company Name: **Date:**
Analyst(s): **Recommendation:**
Target Price:

Company Overview

Description of Business
Sales and Earnings–Domestic vs. International and Major Product Lines
Major Competitors

Corporate Governance

Social Activities

Financial Analysis

Liquidity, Debt, Asset Management, Profitability
Position Relative to the Market–P/E, Dividend Yield, Book to Market, Market Relative
Sustainable Growth Analysis

Valuation

Target Price:

DCF Value:
Key Assumption in DCF Valuation:

Relative Value:
Key Assumptions in Relative Valuation:

Special Factors

Management, Products, etc.

Basic Strengths

Basic Weaknesses

Risks

Downside

Overall Risk of Investing in the Company

Return Potential

Short Term
Long Term

Investment Summary

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