

# An Introduction to Dual Benefit Investing (DBI)

A new approach to bringing together investing and philanthropy.

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March, 2007

We propose a new category of investing with social benefits called Dual Benefit Investing (DBI). DBI is an investing method that brings together traditional investing and philanthropy. It does this by letting investors allocate a portion of the funds generated from money management services to social impact projects.

This white paper deals with the following topic areas as a first step to defining DBI:

- We place DBI in the context of larger consumer trends toward socially conscious consumption.
- We set out a process for how DBI can work and as well discuss the key defining characteristics that should be used to determine whether an investing method qualifies as DBI.
- We explore why DBI is necessary against the backdrop of socially conscious consumerism in general and other socially beneficial investment mechanisms in particular. We assert that DBI provides benefits that existing investing products with social aspects do not.
- As this is an initial exploration of DBI, we end with key questions that we feel need further examination and that are raised by our discussion.

# Background

## *INTRODUCTION TO SOCIALLY CONSCIOUS CONSUMPTION*

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"Eat first, morals after." These words were penned by German playwright Bertolt Brecht in his musical, "The Three Penny Opera." Written in 1928, the line reflects the necessary preoccupation with self-survival that reverberated in a world gripped by poverty. Fast-forward to the 21st century. More people than ever before are reaching living standards that free them from worrying about basic needs such as food and shelter. These individuals are finding that ethical behavior and morality can play a part in their consumption choices.

A 2001 study revealed that "79% of Americans take corporate citizenship into account when deciding whether to buy a particular company's product and 36% consider corporate citizenship an important factor when making purchase decisions."<sup>i</sup> And a 2007 study found that "consumers in five of the world's leading economies believe business ethics have worsened in the past five years and are turning to 'ethical consumerism' to make companies more accountable." Of note, among citizens of the five countries surveyed, the U.S. consumer had one of the highest levels of dissatisfaction with corporate practices (over 55%) and almost one in three consumers responded that purchasing ethical products made them "feel good."<sup>ii</sup>

Simply put, many consumers are demanding that a company provide them with more than a quality product. To meet this increasing consumer demand, a category of practices and products that combine consumption with values and ethical behavior have emerged. From 'ethical consumerism', where consumers buy products they believe are ethically produced (such as fair trade coffee or

organic food), to 'cause-related marketing,' where companies donate funds from revenue generated by product sales (for example, Bono's RED campaign), companies are increasingly looking for ways to meet the amplified interest.

## *EXTENSIONS TO INVESTING*

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Although it may have its roots in consumer products, socially conscious consumerism is by no means limited to the retail world. The desire to marry profits with positive social change has long been part of the investing space, in large part due to Socially Responsible Investing (SRI), an investment category that has grown to nearly \$2.3 trillion in assets under management as of 2005.<sup>iii</sup> SRI is a rather broad category that can include a wide range of activities. For most investors it has meant one of two things: either investing only in companies that are "socially responsible" (either through mutual funds or separately managed accounts); or it has meant actively pursuing shareholder actions and resolutions that seek to make companies more accountable in their practices.

SRI has not been the only category of investment product to integrate social benefits. Pooled Income Funds (PIFs), for example, offer individuals or families the ability to invest funds for philanthropic purposes while receiving income over time.

As we will explore later in this paper, SRI and PIFs each have their own characteristics, advantages, and limitations. Either way, it is clear that as interest in socially conscious consumption grows so does the need for new investing methods and products that build on these existing schemes. We offer DBI as one such alternative.

# Dual Benefit Investing Defined

DBI is a methodology that combines traditional investing (investor profit being the primary motive) with philanthropy. It does this by letting investors allocate or lend a portion of the management fee generated from their investment to social impact projects.

DBI seeks to create two kinds of value:

- First, value for investors through profits generated off of assets;
- Second, value for the causes and issues that investors care about through varied social impact projects with definitive, visible, and accountable results.

## HOW DBI WORKS

The flow chart below summarizes a real-world example of how DBI would play out in a managed account. Note, however, that while this example looks at DBI in the context of a managed account, it can just as easily occur in the context of a mutual fund.



1. Investors put money into a DBI managed account, much like they would any other investment account.
2. Investors receive 100% of their returns net of fees, as they would in any other managed account.
3. The investment advisor is paid a fee commensurate with standard managed account fees.

4. The advisor dedicates a substantial percentage of the fees it makes towards social impact projects (causes can range from cancer, AIDS, child welfare, gender equity, educational or environmental among others.)
5. Investors allocate or lend (to microlending projects) the dedicated fee pool to social impact projects or projects based on what they care about from a menu that the advisor provides.

## DEFINING CHARACTERISTICS OF DBI

There are five specific elements that come out of the above process that need to be present for an investment method to qualify as DBI, each of them addressing a key area of the value that DBI offers to investors seeking social benefits. These elements can be remembered with the acronym P A C I S, which reflects what we believe to be the overall commitments or *pacts* that DBI companies need to make with their investors:

### Performance:

DBI options must plausibly provide social benefits without sacrificing performance, quality, or other key functional product attributes. In our view this means investing assets in the marketplace for optimal

*performance* (investing returns must not take a backseat to the social mission).

DBI does not require (although it is an option) that certain screening criteria be brought to bear during the investment process. From this perspective, profit within DBI occurs much in the same way as it does for any other investment account. DBI seeks to maximize profit and therefore benefit to investors. Placing this as one of the five key factors defining DBI emphasizes its importance and central role in the process.

Access:

DBI options must broaden the *access* of investment products with social benefits beyond the limited target markets to which they have been available to date. As DBI seeks to fill a current market need, it should be widely available to investors of many income levels.

Many investing vehicles with social or philanthropic angles such as Pooled Income Funds are available only to the wealthy. This leaves incalculable investment dollars on the table and limits the impact that investors of all income levels can have on society through their investments. Similarly, traditional SRI funds tend to cater mostly to investors with very limited and specific social impact interests thereby leaving others out.

Choice:

DBI options must provide investors a choice with regards to the kind of social benefit to be pursued. The social benefit should be less a reflection of management values and more a reflection of investor values.

Although at the top level DBI does allow investment advisors to pick a menu of projects, the final allocation of funds rests

with the investor. The funds allocated toward these projects must come from a percentage of the investment advisor fees or profit rather than from a percentage of investor assets since the goal is to not detract from investor profitability and returns. The idea is to encourage the corporation to do good and not pad the social aspect in product price.

Transparency:

Ensuring the *transparency* of the entire process is a requirement of DBI offerings. This includes the transparency of investments to the transparency of projects offered and the ways funds are used to make a positive impact.

Although the intensity of project visibility (i.e. updates, photos, reports) may differ across different investment advisors, it is vital that the investor be able to see the results of their allocation and choice to invest with a certain advisor.

Substance:

DBI options must allocate *substantial* percentages of the money made by the Fund managers (*not* the investor returns) associated with the investment toward positive social impact causes.

DBI is not a marketing gimmick. To that end, small allocations of revenue should not be included as DBI. Organizations that do not make substantive commitments to this goal should not be considered DBI firms.

We propose that any DBI products need to address these five elements (PACTS) directly and hope that in this way, DBI will provide standards for companies to implement 'double bottom line' strategies that are transparent, substantive and have broad mass market potential.

# Why Dual Benefit Investing

The four reasons that we propose DBI and that we believe that the market needs an additional method for combining investing with social benefits are as follows:

1

DBI addresses the proven consumer desires and needs when purchasing products with social benefits

- Consumers/Investors do not want to sacrifice product quality or pay significant premiums to affect change:

“Consumers purchase products to fulfill specific needs and wants. They will not sacrifice functional features for socially acceptable ones.”<sup>iv</sup>

“...if CSR plays a role at all in purchase, it matters at the margin and they are unwilling, even if they view the CSR initiatives positively, to trade-off CSR for product quality and/or price.”<sup>v</sup>

DBI allows investors to invest assets as they normally would thus assuring that they do not feel that they are sacrificing functional benefits for social ones. This is why **Performance** is one of the key defining characteristics of DBI.

- Consumers/Investors must be provided with causes or given a choice of causes that they know and care about:

“Consumers must be informed in a way that fits with the issues they care most about...consumers concerned about child labor are more likely to respond to a campaign focused specifically on child labor than to a general labor rights issue campaign.”<sup>vi</sup>

DBI allows investors to pick the causes they want to support via their purchases. This is why **Choice** and **Transparency** are two of the key defining characteristics of DBI.

2

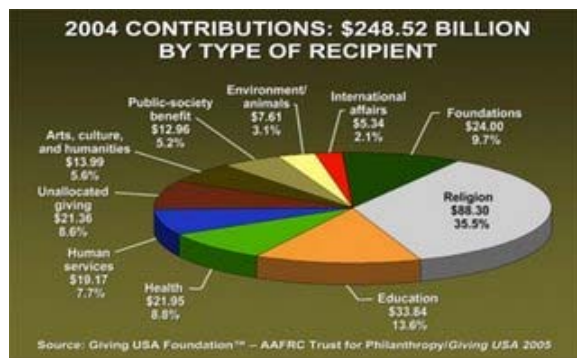
DBI can address the common criticisms and disadvantages of existing methods of investing with social benefits.

We suggest that non-investing businesses have reacted to the above-mentioned consumer needs, albeit slowly, by allowing choice across multiple social causes without charging a premium for doing so (affinity credit cards, online shopping, etc.). Yet the investing world has been slow to offer products that speak to the realities outlined above. A detailed discussion of how DBI addresses common critiques of these methods follows in the next section, but we will highlight just a few here.

The two investing vehicles with social benefits that are most widely available to investors are Socially Responsible Investing (SRI) and Pooled Income Funds. SRI can certainly be viewed as an attempt at bringing ethics to bear on investing but the practice is often critiqued for a number of reasons including under-performance when compared with the market<sup>vii</sup>, the lack of choice offered to investors in terms of which social agendas are pursued, and the lack of transparency or clarity with regards to the effects of SRI activities. While Pooled Income Funds for their part allow for choice, they require that the investor pay (sometimes substantially) to affect their cause and for this reason are often limited, in terms of reach, to wealthy individuals.

**3 DBI can help increase philanthropic activity, particularly through people and to causes that are under-represented.**

In 2004 total US charitable donations exceeded \$248 billion. In 2005, that number grew to about \$260 billion. Individuals tend to give about 75% of these donations. The table below indicates where these donations go.



While \$250 billion is a substantial amount of money, nearly half of these funds go to only two places: churches and education. While both these areas are very deserving of the funds they receive, after subtracting amounts that go to foundations or endowments and unallocated amounts, only about one third of the total remains for health, the environment, social services, animals, and arts and culture ( <http://www.socialedge.org/blogs/fine-on-funding>). Clearly, the opportunity for DBI is to help increase the size of the pie overall and also to provide projects that are underrepresented in addition to those that are more commonly supported.

**4 DBI promises to increase the size of invested assets being managed that have social benefits attached.**

All of the reasons mentioned thus far supporting adaptation of DBI lead to one goal: to try and increase the amount of invested assets being managed that generate a social benefit. It is our claim that by addressing all the points above, DBI has the promise to do just that. Indeed, we believe that DBI, particularly when applied to managed accounts, provides a unique combination of product attributes that are actually valued by the investor.

## *A BRIEF EXAMINATION OF SOCIALLY RESPONSIBLE INVESTING (SRI)*

For a more detailed examination of existing methods that combine investing with social benefits, we turn our attention first toward SRI and later toward PIFs.

While SRI is sometimes viewed as having had a positive impact on social and corporate responsibility, it has also been the target of criticism. The criticism arises from claims that SRI funds (the SRI form most readily available to retail investors) are either ineffective or hypocritical, or based on claims that SRI tends to under-perform other investment types.<sup>viii</sup> For our purpose, the criticisms can be grouped into four main types.

### 1. SRI does not effectively create a positive social impact.

- Screening methodologies are at times very loose and *often non-transparent*, allowing most publicly-held corporations to pass the standard.<sup>ix</sup>
- Share price of companies is unaffected by SRI activity.<sup>x</sup>
- Activism tends to be minimal.<sup>xi</sup>
- More than half of SRI assets are labeled such based on the fact that they have only between one and four screens.<sup>xii</sup>

### 2. SRI funds are not transparent in their activities.

- The screening criteria used by Funds are often viewed as the intellectual property of the fund and, therefore, are not shared with investors.

### 3. SRI hurts fund performance.

While there have been many different studies on this topic, the results tend to vary dramatically based on the methodologies used. The conclusions, after many years of attention, are at best imprecise. In either case, two things are clear:

- The average SRI fund has lagged the broad market for the last three years<sup>xiii</sup>
- Performance remains a common ongoing criticism of SRI.

### 4. SRI funds do not provide choice.

Investors putting money into SRI funds do not control or have a choice in setting the agendas pursued by Fund managers.

Taken together, these criticisms of SRI can lead to somewhat troubling results where Funds that are not leading to effective social change and are not transparent end up investing in companies that we might speculate, their individual investors would object to. Paul Hawken generates just such a list in a major study, and we provide only a few examples here<sup>xiv</sup>:

- Exxon Mobil was held by 40 Funds out of those analyzed by the study, including one Fund called “ABF Green Planet”, underscoring a stark contrast between the marketing and reality of the Fund.
- Cigarette maker Altria was held by 12 SRI funds.
- Wal-Mart was held by 33 SRI Funds, including the Ethical Global Equity Fund, despite well documented criticism of its labor and environmental practices.

The table below illustrates some of the key limitations of SRI when screened against PACTS.

SRI Limitations	How DBI Addresses
<b>Performance:</b> SRI occurs at the expense of maximum returns and investment profitability.	Although evidence points to different conclusions as to whether or not SRI hurts returns, DBI seeks to place investor returns and profitability back at the center of the value proposition.
<b>Access:</b> As SRI typically has normal management fees, it has few limits in terms of access.	Similarly, DBI is characterized by normal management fees.
<b>Choice:</b> SRI does not allow investors to focus on the social issue they care about.	To the extent reasonable, DBI gives the power of choosing which causes and issues are important to individual investors.
<b>Transparency:</b> There is no transparency in the process of determining which criteria and methodology are used to determine investments.	DBI places less emphasis on screening as a way to make a difference with investing. As such, DBI does not <i>require</i> that screens be used. In the event that they are used they would need to be 100% transparent to investors.
<b>Transparency:</b> There is no transparency in the actual impact made by SRI investment dollars	DBI seeks to make a positive social impact through allocating invested dollars to concrete projects and organizations that the investors choose. As a result, there is little doubt as to how the money is being used to generate social returns.
<b>Substance:</b> SRI does not make a widely visible and meaningful impact on society.	The visible change that can be spurred by DBI is only limited by the investment dollars that such funds attract.

Most people today would agree that companies should seek to conduct their activities in a way that is socially responsible. However, reasonable people may disagree on the standards that should be used to determine which activities qualify as being responsible. As such, focusing on such broad questions as ‘Is socially responsible investing good or bad’ is in itself counterproductive and denies the complex reality and context within which companies and investors operate. Irregardless, one thing is clear: that the investment community should seek out new and improved ways for investors to contribute to social change via their investments.

#### ***A BRIEF EXAMINATION OF POOLED INCOME FUNDS***

Pooled Income Funds have grown in popularity over the last decade. These instruments are similar to mutual funds in that they involve “pooling” of assets into a fund. Pooled Income Funds adequately address some of the shortcomings (lack of choice, performance) that SRI presents. However, with this option, an investor is forced to irrevocably donate their principal investment amount while receiving income from their share of investment returns (net of fees).

However, it must be noted that with pooled income funds, an investor’s charitable choice is non-binding for the investment manager – this means that final discretion rests with the manager. As well, such funds often do not allow for project-level choice thereby restricting an investor to broad organizational causes.

The table below illustrates some of the key limitations of Pooled Income Funds when screened against PACTS.

Pooled Income Fund Limitations	How DBI Addresses
<b>Performance:</b> While Pooled Income Funds do not necessarily screen and thus can achieve maximum profit, investors must forfeit the principal amount invested thereby cutting into total returns. Further, if an investor is unhappy with a manager’s investment performance, recourse can be difficult.	Particularly when applied to a mutual fund, DBI looks similar to Pooled Income Funds in terms of choice. However, DBI leaves ownership of fund shares with the investor allowing for maximum profit.
<b>Access:</b> While many in America seek to make a difference, Pooled Income funds are typically only offered in earnest to the wealthy.	DBI does not cut into investor profits and therefore investors of all income levels can engage in DBI offerings.
<b>Choice:</b> Pooled income funds most often, though not always, allow for choice (an investor’s choice is non-binding for the investment manger in such funds).	DBI provides a wide-level of project options and gives the investor the ultimate and final choice in allocation.
<b>Transparency:</b> With Pooled Income Funds, the donated amount is not disbursed to the designated cause until the death of the giver and thus the results cannot always be monitored. And as such gifts are irrevocable, if the organization or cause changes and becomes less transparent, the donor has no recourse.	DBI contributes to causes on a frequent basis (typically annually at most) during the life of the investor. As well, the donor has the choice to switch projects/causes virtually at will.
<b>Substance:</b> Pooled income funds can have a direct and substantive impact on projects based on and depending on the choices of the donors.	

## Summary

It is not fair or realistic to postulate that DBI should replace SRI or Pooled Income Funds. To the contrary, some investors may choose any one, or a combination involving multiple strategies. DBI simply represents an expansion in investing options to serve an underserved market. While SRI has been somewhat successful in attracting investment capital, many investors/consumers are likely left underserved by SRI offerings due to the deficiencies described above.

Clearly the strongest argument for the efficacy of Pooled Income Funds is that they provide the necessary high level of choice that SRI lacks. With such funds, investors are able to pick the exact cause that is near to them. And despite some of the shortcomings mentioned above, Pooled Income Funds represent the easiest, most transparent and personally relevant method of ethical/philanthropic investing available to date. Nevertheless, many investors are

not in a position to forfeit investing capital and therefore, Pooled Income Funds are not the stopgap to fill this void in the investing market.

Simply put, there is currently no widely accessible investing vehicle that combines investing with visible philanthropy and brings it to the masses. This is despite clear

evidence that choice plays an immense role in engaging investors with a desire to act ethically. While DBI may not be a “catchall” solution to an underserved ethical investing market, it can provide a previously unavailable platform for change. DBI is a step towards marrying the desire to do good with the desire to do well in investing.

## Questions & Further Research

This white paper has only begun to explore how investing and philanthropy can be connected in the investing space, a methodology we have given the name Dual Benefit Investing. There are many questions that are raised by this initial work that will benefit from being a part of the conversation around social change and investing.

### ***Have Consumers Been Slow to Respond to CSR Initiatives?***

Yes, but we would assert that consumers are often not given a choice to affect a cause of personal importance.

### ***How Much Money is Enough?***

Clearly, the amount of money the fund manager or advisor dedicates to social change might be a central issue. Funds that dedicate only 1% might be deemed radically different than a fund that dedicates 25% or more. Are both products considered DBI Funds? Is only one? Additionally, what fees are appropriate – fees typically charged for SRI?

### ***How Much Choice is Enough?***

As we have seen, having a choice in the causes that will affect social change is a key defining aspect of DBI. How much choice is actually enough? Should this choice happen on a project level? On a Foundation level?

### ***Is there a Net Positive Effect of DBI?***

Perhaps one of the most important and difficult questions that we expect to come out of this initial exploration is that of assessing the net positive effect of activities related to DBI. That is, since DBI does not *require* (although it certainly is an option) that assets be invested in companies that meet strict social criteria, can one say that more damage is generated via investments than good is generated via the donations?

### ***Is DBI a New Form of SRI? How Does it Relate to Current SRI Activity?***

We expect that some may consider DBI to be another method or sub-group under SRI (like social screening, community investing, etc). Answering this question will involve in part defining more clearly what makes up SRI and (perhaps more importantly) what does not.

### ***Should DBI replace personal giving?***

Absolutely not. DBI is simply a response to an unmet consumer call. It is a way for consumers to take a common business service (investing) and leverage service providers to impact more change in the world. The method is not expected to, nor should it, replace personal giving.

### *How can DBI apply to non-investing verticals?*

Providing a choice in what social good is derived from a product purchase has already been explored. We would assert that DBI could be readily extended to many services and/or products. The reality of socially conscious consumerism overall is becoming more complex than the terms 'ethical consumerism' or 'cause-related marketing' suggest. As consumer interest in socially conscious consumerism increases so do the methods, mechanisms, and messages that address this interest.

A thumbnail sketch of Dual Benefit Consumerism would entail a consumer being able to buy a product at the prevailing market price, having the company fund causes that can be impacted and giving the consumer a choice where the funds ultimately go.

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<sup>i</sup> 2001 Cone/Roper Corporate Citizenship Study. November 2001.

<sup>ii</sup> 2007 Ethical Brand Report. March 8, 2007. GFK NOP.

<sup>iii</sup> 2005 Report on Socially Responsible Investing Trends in the United States. January 24, 2006. Social Investment Forum.

<sup>iv</sup> V. Kasturi Rangan, Sohel Karim, Sheryl K. Sandberg. "Doing Better at Doing Good." May 1 1996. Harvard Business Review.

<sup>v</sup> V. Kasturi Rangan, Sohel Karim, Sheryl K. Sandberg. "Doing Better at Doing Good." May 1 1996. Harvard Business Review.

<sup>vi</sup> Devinney, T. Auger, P. Eckhardt, G. Birtchnell, T. "The Other CSR." Fall 2006. Stanford Social Innovation Review.

<sup>vii</sup> Yang, Jia Lynn. "New Rules for Do-Good Funds". 2007. Fortune Magazine.

<sup>viii</sup> Kurtz, Lloyd. "The Best Opponent: Social Investing and Its Critics," a presentation given to a Haas School of Business class. 2005. <<http://www.sristudies.org/html/commentary.html>>.

<sup>ix</sup> Hawken, Paul. Natural Capital Institute. "Socially Responsible Investing: How the SRI industry has failed to respond to people who want to invest with conscience and what can be done to change it". 2004.

<sup>x</sup> Plumer, Bradford. "Is Socially Responsible Investing a Sham?" The New Republic Online. 2007. <<https://ssl.tnr.com/p/docsub.mhtml?i=w070115&s=plumer011607>>.

<sup>xi</sup> Hawken, Paul. Natural Capital Institute. "Socially Responsible Investing: How the SRI industry has failed to respond to people who want to invest with conscience and what can be done to change it". 2004.

<sup>xii</sup> Calculations below are based on: 2005 Report on Socially Responsible Investing Trends in the United States. January 24, 2006. Social Investment Forum.

<sup>xiii</sup> Yang, Jia Lynn. "New Rules for Do-Good Funds". 2007. Fortune Magazine.

8.5% for SRI Funds vs 10.4% for the broader market.

<sup>xiv</sup> Hawken, Paul. Natural Capital Institute. "Socially Responsible Investing: How the SRI industry has failed to respond to people who want to invest with conscience and what can be done to change it". 2004.