nef

economics as if people and the planet mattered

Going Green?

How financial services are failing ethical consumers

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We aim to improve quality of life by promoting innovative solutions that challenge mainstream thinking on economic, environmental and social issues. We work in partnership and put people and the planet first.

economics
real wealth means well-being

environment
lifestyles must become sustainable

society
communities need power and influence

nef (the new economics foundation) is a registered charity founded in 1986 by the leaders of The Other Economic Summit (TOES), which forced issues such as international debt onto the agenda of the G7/G8 summit meetings. It has taken a lead in helping establish new coalitions and organisations such as the Jubilee 2000 debt campaign; the Ethical Trading Initiative; the UK Social Investment Forum; and new ways to measure social and economic well-being.

People in the UK are choosing to manage their finances in accordance with their values in greater numbers than ever before. There is clearly an appetite amongst the public for an 'ethical financial choice', yet as this report finds, it is not always an easy option. Most notably, there is an absence of simple, low-risk products from established high street names. This gap in mainstream ethical financial products – current accounts, savings, loans and mortgages – means that the options for the average consumer are very limited. Consumers who wish to invest according to their values don't, because ethical finance products aren't easily accessible.

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Project description

Jessica Brown, Head of Access to Finance at **nef** (the new economics foundation), carried out this report with funding from the Friends Provident Foundation. Petra Kjell provided input through supporting research. The findings are a product of extensive secondary research on ethical finance in the UK and internationally. In-depth interviews were conducted with 26 key industry figures, including representatives from ethical consumerism, SRI funds, ethical investment FAs, ethical finance networks, ethical finance initiatives, and high street banks. We also carried out a mapping of the sector to review of the range ethical finance products available in the UK and completed four case studies on ethical finance products to consider the strengths and weakness of existing initiatives.

Executive summary

This report sets out a number of steps which, if taken, could begin to move ethical finance into the mainstream by both broadening and deepening its appeal. We make clear recommendations that could both encourage an expansion of high-impact ethical finance initiatives and extend the commitment of high street banks to develop new products that address social and environmental issues.

Ethical finance is a significant and growing part of the overall ethical consumer movement. The *2006 Ethical Consumerism Report* valued the total market for ethically produced goods and services at almost £30 billion. Ethical consumerism in the UK has grown exponentially – and continues to grow four times faster than household expenditure in UK.

In response to social and environmental problems, a significant number of people in the UK have begun to use their investments to avoid negative activities and positively influence the behaviour of corporations. Ethical finance – including Socially Responsible Investment (SRI), ethical banking, and credit union deposits – now represents a £11.6 billion market according to the *2006 Ethical Consumerism Report*.

Demand for ethical options is not always matched by easily accessible products and services. If the financial services industry is to move with the times, much remains to be done to increase the range of ethical products available to consumers, and to improve the ethical performance of our financial institutions. This involves both broadening access to ethical finance for the average consumer, and deepening the range of ethical finance initiatives that appeal to well-off individuals engaged in social investment.

Our report explores the extent to which ethical consumers will affect the financial services industry as a growing number of people question the way in which their money is invested and seek assurances that their investments don't conflict with their values. Our objective is to determine what will encourage greater availability of ethical finance products, and extend the commitment of high street banks to address social and environmental issues through finance.

We ask:

- What does a review of the existing UK ethical finance industry indicate about the gaps and challenges this sector faces?
- How can banks and financial institutions address consumer demand for ethical finance?
- What are barriers and opportunities to meet the financial needs of ethical consumers, while directing funds to the social or environmental sector?

We set out a number of steps which, if taken, could begin to move ethical finance into the mainstream by both broadening and deepening its appeal. We make clear recommendations that could encourage greater scale for high-impact ethical finance initiatives and extend the commitment of high street banks to develop new products that address social and environmental issues. This would significantly improve the ethical performance of mainstream financial institutions.

Sixty-five per cent of people would like to invest their money ethically, according to a 2004 poll by Friends Provident. There is significant demand for ethical investment among the UK public. Given increased concern in the UK over climate change it is likely that this will continue to rise.

However, consumer behaviour is notoriously complex. Purchasing decisions are guided by a range of factors that involve, among other things, considerations of price, quality, value, brand, and convenience. Decisions will also be based on the clarity of information available.

Consumers require practical, simple and well-designed products that they can trust. Ethical finance products have to be easy to understand, easy to access, and offer relatively low risk and a reasonable financial return.

Ethical investors are likely to be affluent individuals with a higher-than-average education, and a greater willingness to purchase financial products with added ethical features; in some cases even if they have to pay more. These are attractive clients for financial institutions to have.

There is now a range of ethical financial products available in the UK. A record number of new SRI funds were launched in 2006, and there is a diverse group of high-impact ethical finance initiatives that offer means to channel finance to social or environmental projects. A small group of ethical banks has successfully developed social or environmental savings accounts, bonds, and share offerings. Community wind farms, social purpose businesses, and ethical companies represent new opportunities for equity investment. But, although the sector has come a long way, ethical finance still faces many challenges.

There are significant gaps in the ethical finance product offering. Most notably, there is an absence of simple, low-risk products from established high street names. The high street banks are notable by their absence from the ethical roll-call. This gap in mainstream ethical financial products – current accounts, savings accounts, loans and mortgages – means that the options for the average consumer are very limited. Consumers who may wish to invest according to their values don't, because the options aren't easily accessible.

Ethical finance initiatives in the UK remain modest in scope. Those that have the greatest impact – those that directly finance environmental and social projects - although growing in size, remain small. Limited resources results in scant marketing, which in turn creates a lack of awareness, particularly among the high-net-worth individuals with the funds to engage in social investment.

SRI has demonstrated substantial growth and proven its potential for financial performance. SRI investment funds have made significant progress to bring social, ethical and environmental (SEE) issues into financial services. But these gains are still fragile, and require a stronger commitment from financial services institutions to drive SRI forward. Existing Financial advisers (FAs) can be resistant to adoption of ethical finance, and there is still only a limited number of ethical- investment FAs.

Ethical finance has a long way to go if it is to affect the mainstream financial services industry. Our report finds that consumers are seeking ethical criteria in financial products. The time is right for banks to broaden access to ethical financial products, increasing their availability to the conscientious consumer. At the same time, high-impact ethical finance initiatives need to be more appealing to social investors. Both broadening and deepening the reach of ethical finance will extend its impact on the mainstream financial services sector.

In order for this to happen, ethical consumers:

- Need an expanded range of practical, simple and well-designed ethical products from finance providers. Given a choice, consumers will increasingly seek alternatives to existing bank products, driving ethical finance up the agenda.
- Need a more visible range of alternatives: enhanced marketing from both SRI funds and smaller ethical finance initiatives is key to increase uptake.
- Should be willing to embrace ethical finance through pension fund holdings.

- Are already responding to clear product choices to address environmental issues.

Based on our research we make a series of proposals which, if taken up, could begin to meet consumer demand and move ethical finance products firmly into the mainstream.

In order for this to happen, Banks need to:

- Lead on social responsibility by moving beyond the minimum corporate social responsibility (CSR) commitment.
- Focus on ethical finance products with added social or environmental benefits. Banks that establish ethical products are likely to be the market leaders of the future.
- Introduce greater transparency across all operations.
- Apply ethical guidelines to lending and investment decisions.

Large investment houses should introduce SRI retail products, and existing SRI funds need to:

- Expand marketing of SRI funds with social and environmental features.
- Form partnerships with high street retailers to introduce SRI products to a broader audience.
- Apply SEE engagement strategies across all investment portfolios to maximise impact.
- Make SRI engagement practices more transparent and measurable.

Smaller, high-impact ethical finance initiatives need to:

- Focus on attracting high net worth social investors.
- Improve marketing initiatives.
- Consider collective action and better use of the media to raise awareness.
- A central website with comprehensive, up-to-date information would advance the sector.

Introduction

To what extent do personal financial decisions about where and how to invest, save and borrow reflect people's principles? How should the financial services industry respond to the growing importance of social and environmental issues? These questions form the basis of the ethical finance sector, which has generated broad interest in recent years. Ethical finance encompasses a broad range of products that includes SRI funds, ethical current accounts, green mortgages and credit union deposits. This space represents a £11.6 billion market according to the *2005 Ethical Consumerism Report*.[i] Ethical investment refers to activities of social investment and socially responsible investment (SRI) funds, and is therefore a subset of ethical finance. According to Ethical Investment Research Services (EIRIS), an estimated £7 billion is allocated to SRI retail funds in the UK. In response to the increasing urgency of social and environmental problems – poverty, trade injustice, climate change, and environmental degradation – a significant number of people want to avoid negative activities and influence the behaviour of corporations through finance.

Consumers are seeking to deposit and invest their money in ways that are consistent with their views on the environment and society. In this sense, ethical finance is one part of the ethical consumer movement. Consumers increasingly reflect their values in purchasing decisions, with a large number buying organic, fair trade and environmentally friendly products. The likes of L'Oreal, Unilever, and Marks & Spencer have recognised the power of the 'green pound' by snapping up ethical brands and investing in the ethical consumer revolution. For a growing number of consumers, environmental and social considerations are now as relevant as price and quality. UK consumers have led the way internationally and are among the most aware and critical of corporate practices, seeking out ethical brands. This phenomenon is pushing ethical factors into the realm of product development, with fair trade, organic, environmental and social product features beginning to appear on the shelves of Levis, Topshop and the Gap, to name a few. Ethical consumers have been recognised as evidence of a new twenty-first-century mindset that will bring values of sustainability to the market.

So, what does this mean for the financial services industry? A better understanding of the spectrum of ethical consumers, their motivations, and expectations with respect to finance is required. To do this, a re-consideration of the ethical finance sector in the UK is in order. Socially responsible investment funds have been developed as a means of avoiding or influencing the activities of large corporations listed on stock markets. In addition to ethical investment, ethical finance encompasses a variety of products and initiatives – ethical banking, credit unions, social investment funds, and unlisted equity offerings – that direct finance to co-operatives, community ventures, social enterprises, and ethical businesses. This range of high impact ethical finance initiatives pursues SEE objectives through finance. The emergence of this sector raises questions about its future: most importantly, how best to build on positive steps and scale up existing institutions. In addition, banks and financial institutions are becoming more active in the social and environmental arena, but could do more to increase transparency, introduce new initiatives, and develop ethical financial products.

This report explores the extent to which ethical finance can affect the financial services industry by tapping into a growing number of ethical consumers. We consider what steps are required to move ethical finance into the mainstream and to move financial institutions into ethical finance. The objective of the research is to determine what will encourage greater breadth and depth of ethical finance and extend the commitment of high street banks to adopt social and environmental objectives through finance. Key questions that underpin this report include:

- What does a review of the existing UK ethical finance industry indicate about the gaps and challenges this sector faces?
- How can banks and financial institutions effectively address consumer demand for ethical finance?
- What are barriers and opportunities to meeting the financial needs of ethical consumers, while directing funds to the social or environmental sector?

Emergence of ethical finance

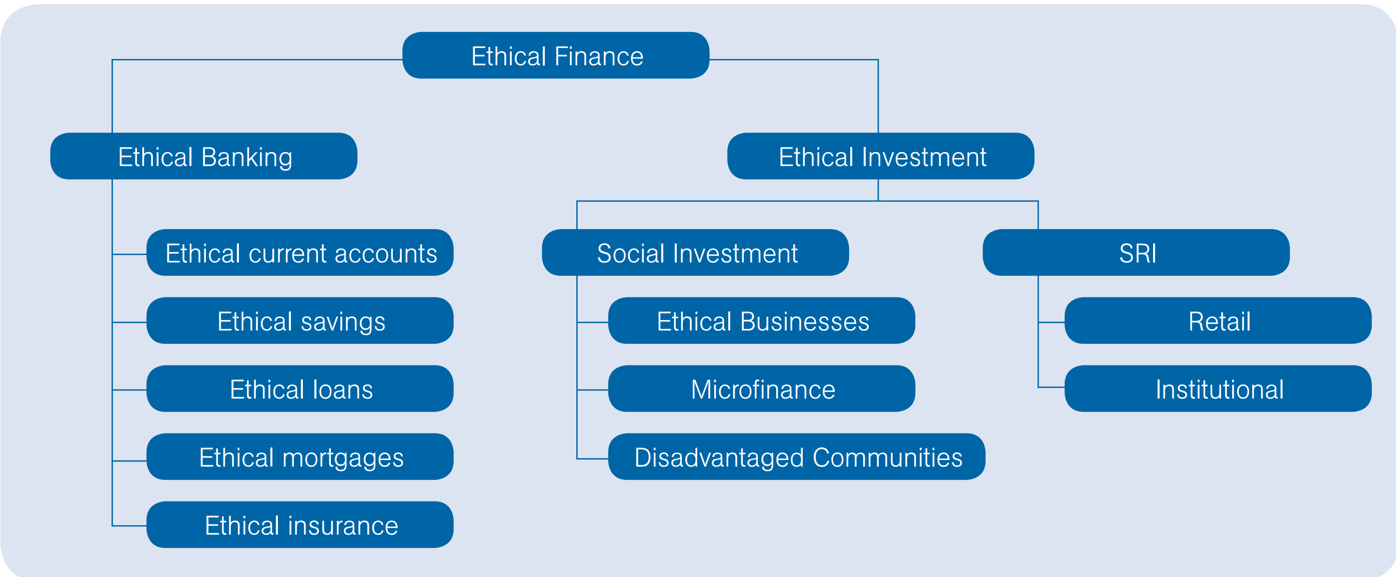
Key points

- While there are multiple activities in ethical finance, this report focuses on the provision of financial products that produce a return along with positive social or environmental outcomes.
- Ethical finance encompasses two key areas of activity:
  1. Ethical banking: the provision of ethical current accounts, savings accounts, loans, and insurance.
  2. Ethical investment: the commitment of finance to social investment or SRI funds.
- Consumer awareness has largely focused on ethical investment through SRI funds.
- Ethical finance began in 1970s and 1980s when demands for enhanced financial transparency, along with the conviction that finance could be used to achieve social change, achieved greater emphasis.

What is ethical finance?

Ethical finance refers to financial products or initiatives that combine investors' interest in achieving financial return with a concern for SEE issues. Ethical finance encompasses a broad range of financial activities including ethical banking – the provision of ethical current accounts, savings accounts, loans and insurance – and ethical investment, which involves both social investment in high impact initiatives and SRI in equity funds. Ethical finance can be understood as a response by consumers to the negative outputs of a global economy that can have devastating impact on local communities, the climate, and ecosystems. Innovations in ethical finance may also reflect a concern about the limitations of capitalism to provide solutions to issues of social justice, such as the widening gap between rich and poor. Awareness of the cost of climate change, environmental damage, and child labour violations – to name a few – have galvanised support for not-for-profit organisations and provoked consumers to re-examine the activities that their finances support.

Figure 1: Map of ethical finance



In short, ethical finance encompasses two key areas of activity:

1. Ethical banking: the provision of ethical current accounts, savings accounts, loans, and insurance.
2. Ethical investment: the commitment of finance to social investment or SRI funds.

To date, consumer awareness of ethical finance has largely focused on ethical investment through SRI funds. These funds invest in publicly listed companies that are screened to form a portfolio: either to exclude those that produce negative impacts or to select those with positive performance in specific areas of interest. Broadly, there are three main approaches to SRI investment: negative screening, positive screening, and engagement. Negative screening has been used to avoid financial support for unsustainable activities or industries deemed unethical. Factors for which an SRI fund might screen include, for example, the arms trade, tobacco, alcohol, pornography, and extractive industries as well as companies with unethical business practices: infringement on human rights, labour standards, and unfair terms of trade. Positive screening seeks to channel finance to companies selected for being more responsible. These include, for example, companies developing new technologies for renewable sources of energy or companies that are particularly good corporate citizens and lead the way in social responsibility. Finally, SRI funds also carry out varying levels of 'engagement', designed to convince companies to change their behaviour and to become more socially responsible through shareholder activism or meetings with senior management. This approach requires more involvement from the fund manager, and may range from a simple approach to a complex, active strategy to effect change. Many think that this direct approach to intervention, based on the fact that shareholders are owners of the company, is more effective to influence companies than simple screening processes.

Alongside SRI funds, a range of ethical finance products has emerged. As part of ethical investment, an increasing number of high-impact ethical finance initiatives exist to direct finance to ethical businesses, microfinance or development of disadvantaged communities. Ethical banking, through the offering of ethical current accounts, mortgages, savings accounts, or insurance also represents a significant extension of the ethical financial landscape.

Ethical finance in the UK is now a broad space that encompasses a range of initiatives. But development of these ethical product areas can be inconsistent: while there are over 90 SRI retail funds in the UK, there are few options for ethical current accounts. In other areas, such as ethical insurance and ethical mortgages, there is an equally limited selection of available products. The purpose of many of these financial products is to help meet the capital needs of organisations that have a strong social or environmental mission: charities, social enterprises or ethical businesses, which may struggle to raise finance through traditional channels. Alternatively, these products may seek to limit climate change or environmental damage by contributing to carbon offset or green projects.

In addition to financial products, another aspect of ethical finance is the role of financial institutions to promote sustainable banking. Sustainable banking has largely focused on the integration of social, environmental and corporate governance objectives into internal operations. In practice, this means that banks have begun to measure and reduce their carbon footprint; identify environmental and social risks; and explore market opportunities to support renewable energy projects or to facilitate carbon trading.[ii] Some banks have taken the first steps in this area. For example, HSBC has been heralded as a sustainable bank because of its commitment to becoming carbon neutral and reducing its environmental footprint. This involves reducing energy use, buying green electricity and trading in carbon credits. A select group of forward-thinking banks are extending this to develop new business opportunities in carbon finance, water projects and waste management.[iii]

As part of the drive to adopt sustainable practices, some banks have signed the Equator Principles, a voluntary code that commits financial institutions to addressing environmental and social issues that arise in financing projects. This focuses on the way in which a bank's funds are invested, in order to limit the negative social or environmental impact that financing decisions can have.[iv] These considerations are particularly relevant in light of the significant role that banks play to finance, for example, large-scale infrastructure projects in developing countries. However, the principles apply narrowly to project finance investments, and are not a broad ethical policy that encompasses the range of a bank's lending activities.

Finally, banks engage in ethical finance to the extent that they emphasise transparency of operations, promote clarity in communications, and prioritise fair treatment of customers. The importance of treating customers fairly has been emphasised by an ongoing programme of the Financial Services Authority (FSA). This concern is reflected more broadly in the efforts of the National Consumer Council and Which? to challenge banks on practices such as payment protection insurance (PPI), unauthorised overdraft charges, and delays in cheque clearing times. Recent reviews by the Competition Commission and the UK press have highlighted negative bank practices. High street banks have increasingly come under pressure to address public mistrust on these issues.

Thus, ethical finance can be categorised into four areas of activity:

1. Developing financial products or initiatives that combine financial return with a means to address social or environmental issues.
2. Promoting sustainable principles in internal operations.
3. Incorporating social and environmental considerations into investment and financing decisions.
4. Treating customers fairly through transparency and clarity.

We will focus on the first area: financial products that produce a return along with positive social or environmental outcomes. While the other areas of ethical finance are equally important, they are outside the scope of this report, which focuses on how best to increase consumers' access to ethical financial products.

By any other name

While we acknowledge that there are problems with the term 'ethical finance', we have chosen it because of its general use in the UK. The use of the term 'ethical' in conjunction with finance is complicated by the nature of values, which vary significantly by individual. This threatens to dilute the meaning of the phrase: if 'ethical finance' can encompass all things, it becomes meaningless. Engaging in debates about 'what is and is not ethical' is unproductive. Some individuals take issue with the implied assumption that all other forms of finance are 'unethical' and question the appropriateness of the phrase. On a practical level, several industry representatives we interviewed highlighted the challenge of marketing products on the basis of 'ethics' and have suggested that 'social', 'sustainable' or 'environmental' finance might be better suited. In reality, ethical finance has evolved under different names according to the particular strategy and objectives of the country or industry segment in which it has developed.[v] Attempts to create a universal definition of 'ethical', 'social', 'alternative', or 'solidarity' finance – terms often used interchangeably – have proven challenging given the variety of perspectives from across varying contexts.

History of ethical finance

Ethical finance has historical roots in religious organisations' concern for the manner in which their funds were being invested. As early as the eighteenth century, the Quakers in the UK refrained from investing in industries they morally opposed, such as tobacco, alcohol, and gambling. In its more modern form, ethical investment emerged from decisions of the Methodist Church in North America in the 1920s to invest in the stock market. Its concern to screen out negative activities encouraged development of formal methods of SRI. This resulted in early examples of SRI funds such as the 1928 Pioneer Fund, a US ethical investment fund that was among the first to incorporate negative screens on stocks.

Ethical finance evolved further in the 1960s and 1970s when demands for enhanced financial transparency, along with the conviction that funds could be used to achieve social change, achieved greater imperative. In response to the Vietnam War, the US public demanded new ethical investment vehicles, such as the Pax World Fund launched in 1971. In this era of social engagement some investors began to question how their money was being used, resulting in shareholder activism, such as challenges to Dow Chemical's production of Agent Orange. In the UK, this new awareness was exemplified by the attempts of Charles Jacob, an investment manager with the Methodist Central Finance Board, to establish an ethical investment fund. He prepared a proposal for the first ethical fund in 1973. These preliminary efforts resulted in the formation of an informal ecumenical ethical investment network, the Church Investors Group, bringing together Christian groups to discuss and share experience on ethical investment.

With the arrival of the 1980s, a growing opposition to apartheid resulted in a boycott of businesses operating in South Africa, and fuelled the ethical investment movement in the UK. Friends Provident became the first financial institution in the UK to launch an SRI fund in June 1984. Friends Provident, originally established to provide life assurance to members of the Society of Friends, offered to manage an ethical fund with the investment criteria determined by an independent committee. This led to the launch of the Stewardship Unit Trust, Stewardship Life Fund and Stewardship Individual Pension Fund. Charles Jacob, who had led previous attempts for an ethical fund, was appointed as a founder member of the Stewardship Committee of Reference. In the same period, Ethical Investment Research Services (EIRIS) was established to provide critical research and information on companies' social, environmental and ethical performance. The launch of the Merlin Ecology Fund, now known as the Jupiter Ecology Fund, soon followed in 1988. This reflected an increasing preoccupation with issues linked to sustainable development, and presaged the development of additional environmental funds in the field.

These early efforts to address SEE issues in finance primarily took the form of negatively screened SRI funds. For much of the 1980s and 1990s, ethical investment in the UK primarily involved SRI activities; SRI continues to dominate media and public attention in the UK as the most well known form of ethical investment. The formation of the UK Social Investment Forum (UKSIF) in 1991 to promote and encourage the development of SRI throughout the UK lent further momentum to this growing sector.

Throughout this same period, initiatives in ethical banking and other social investment vehicles gained a foothold. The first social bank in the UK, Mercury Provident Society (now merged with Triodos Bank) was established in 1974, and led efforts to provide finance for socially beneficial projects. It was also responsible for the 1978 launch of the Mercury Provident Pension Scheme. Such efforts were followed by the founding of the Ecology Building Society in 1981, providing mortgages and loans for ecologically sound homes and conversions. The Unity Trust Bank opened its doors in 1984 to serve trade unions and not-for-profit organisations, followed by the creation of Shared Interest in 1990 to help provide finance for fair trade cooperatives in developing countries. In May 1992, the Co-operative Bank adopted its ethical banking policy. By the late 1990s, a number of community development finance institutions (CDFIs) evolved to channel loans to micro and small businesses in deprived areas, social enterprises, as well as to financially excluded individuals. The CDFI sector was promoted by the recommendations of the Social Investment Task Force which also led to the creation of the Bridges Community Ventures in May 2002. Bridges is the first UK public-private venture capital initiative to invest in growing businesses in deprived areas, thereby creating a social benefit through community regeneration. Building on the Charities Aid Foundation project *Investors in Society*, the Charity Bank opened its doors in September 2002. The first bank to also be registered with the Charity Commission, Charity Bank seeks to help fund the growth of the charitable sector.

As evidenced, ethical investment in its present state encompasses a wide range of varying initiatives that address social, environmental or ethical factors as part of their objectives. The evidence is that this will continue to grow, with over 10 new ethical funds open to the general public launched in the UK in 2006 alone.[vi]

The importance of ethical consumers

Key points

- Ethical consumerism in the UK has grown exponentially, valued at £29.3 billion in 2005. It is likely that the number of ethical consumers will continue to grow.
- UK consumers are among the most conscientious internationally and market surveys provide strong evidence of support for ethical products.
- Companies have largely underestimated ethical consumption as a phenomenon and have been slow to recognise that demand for ethical products is not just restricted to a niche group.
- Ethical products trade on the added benefit they bring to society or to the environment, but also have to be attractive, easy to access and good value for money. Consumers require practical, simple and well-designed products.
- Companies taking the lead in meeting the needs of the new ethical consumer will be the market leaders of the future.
- Every ethical consumer is a potential customer for the ethical financial services sector.
- Ethical investors are likely to be affluent individuals with a greater willingness to purchase financial products with added ethical features; in some cases even if they have to pay more. These are attractive clients for financial institutions.
- There is significant demand for ethical investment among the UK public. This could be met by broadening the pensions, savings, and lending products with ethical features on offer by financial institutions.
- Ethical investment could also be 'deepened' to appeal to a greater number of well-off individuals with the resources to commit to high-impact social investment.

Rise of ethical consumerism

Ethical consumerism has evolved as a means for individuals to influence corporations through purchasing decisions that reflect environmental or social principles. This involves buying products that are produced ethically or are not harmful to the environment and society. An ethical consumer might make positive decisions to purchase fair trade, organic or ethically certified products or take the decision to boycott goods produced under harmful conditions. Products which fall into the ethical category include organic produce, fair trade goods, free range eggs, ecological washing powder, energy-efficient light bulbs, renewable energy, and recycled paper, among others.

The phenomenon of 'shopping with a conscience' has evolved significantly from its roots in the boycott of South African apartheid and the growth of environmental awareness in the 1970s. The entry of ethical consumerism into public consciousness coincided with the launch of *Ethical Consumer* magazine in the late 1980s. Since this time, ethical consumerism in the UK has grown exponentially, valued at £29.3 billion in 2005.[vii] In the UK, 50 per cent of baby-food sales are now organic, and according to the *Financial Times*, sales of Fairtrade products have grown at 40 to 50 per cent per year for the last five years.[viii] There are now 108 Fairtrade coffee brands and 364 different products on offer.[ix] By way of example, Fairtrade hot drinks company Cafédirect now has retail sales of over £23.5 million and is the fourthlargest coffee brand in the UK.[x] According to the *Ethical Consumerism Report*, the market for ethically produced goods and services is growing four times faster than household expenditure in UK. This is clearly no small trend.

Much of the growth of ethical consumerism has been seen as a response to the globalisation of markets and the weakening power of national governments to regulate multinational corporations. This has taken place alongside a shift in market power towards consumers. At the same time, many individuals feel alienated from the political process and have turned away from the ballot box. Aware of the power of corporations, consumers seek to influence them directly through the market where it counts – on the bottom line. It takes a small proportion of shoppers, perhaps just one in ten, to change buying behaviour in order for companies to notice.[xi] Ethical consumption is a means to express personal principles and opinions, such that one individual can make a difference. This makes sense in a consumer society in which, for better or worse, consumption is championed as the path to self-realisation and the market has swallowed civil society.

Ethical consumerism represents a practical and positive step that people can take in a consumer society. It is an effective means for individuals to ensure that their purchasing decisions reflect their environmental or social values. As such, it is likely that the number of ethical consumers will continue to grow. UK consumers are among the most conscientious internationally, evidenced by a recent five-country study carried out by NOP reported in February 2007.[xii] The head of brand strategy at NOP, Chris Davis, confirmed this finding, "The UK is the hothouse for what is coming. If a brand is going to do well in the ethical market, it should probably look at the UK."

Untapped demand

There is overwhelming support for the concept of ethical purchasing among the UK public. Market surveys consistently provide strong evidence of consumer support for ethical products and socially responsible corporate action. In the UK, the number of people indicating that when deciding to buy a product or service, it is 'very important' that the company shows a high degree of social responsibility has increased from 28 per cent in 1998 to 44 per cent in 2002.[xiii] Similarly a study conducted in 2002 reported that 53 per cent of UK consumers have considered switching brands due to issues of CSR, and 19 per cent have actually purchased as a result of a company's ethical reputation.[xiv] The *2005 Ethical Consumerism Report* identified that 58 per cent of UK consumers have avoided a product or service because of the company's reputation.[xv] More recently, Friends Provident found that 70 per cent of survey respondents take ethical considerations into account in deciding where to shop.[xvi]

The consensus is that more and more conscientious consumers are factoring environmental and social issues into their decision-making. There is a strong and growing market for 'green' or socially responsible products, with significant opportunities for those companies that are first movers to build a competitive advantage. In addition, about one-third of respondents to the February 2007 NOP poll indicated that they would pay a 5 to 10 per cent premium for many ethical products.[xvii]

Companies have largely underestimated ethical consumption as a phenomenon. The mainstream corporate community has been slow to recognise that demand for ethical products is not just restricted to a niche group of 'green' consumers, but includes a broader group who is prepared to pay more for brands that they perceive to be responsible. A recent report by the WWF on ethical consumption argues that there is a new consumer appetite for responsible brands and a shift in market values at a deep level.[xviii] Rather than being a marginal niche, there is a broad group of consumers that are increasingly environmentally and socially conscious, and expect these values from their corporate brands.

This is supported by the perception of marketing professionals who track emerging trends in the consumer space. The Chief Executive of JWT London, Alison Burns, noted, 'Consumers are suspicious of companies' silence on the environment. This isn't restricted to a particular industry. It is increasingly pervasive. There is an underlying expectation that we are asking more questions about companies' intentions.'[xix] The Chairman and Chief Executive of Saatchi & Saatchi UK also confirmed that 'Companies which do not live by a green protocol will be financially damaged because consumers will punish them. In the longer term, I do not think they will survive.'[xx] Another professional, James Murphy, Chief Executive of RKCR/Y&R, concurred, 'In time a strong environmental brand…will also allow you to increase customer loyalty and charge a premium.'[xxi] Some innovative companies are starting to respond to this changing business context by developing plans for new ranges of 'green' products. Companies taking the lead in meeting the needs of the new ethical consumer will be the market leaders of the future.

Complex consumers

It is important to note that ethical spending is spread over a wide range of products and services. In very few markets have social and environmental products become the norm. Ethical brands currently have small market shares. Overall, spend on ethical foods still only accounts for 5 per cent of the typical shopping basket, indicating that most people pick and choose a few selected ethical products.[xxii] An individual may purchase fair trade chocolate at the same time as other brands. Organic fruit might be purchased in the same basket with regular dairy milk. It would be a mistake to assume that because someone shops organic or fair trade, they have wholly transformed their lifestyle to embrace sustainable living. Many consumers purchase organic foods on the basis of perceived health benefits for themselves and their family, rather than simply because of benefits for the environment, though this may also be a factor.

Consumer behaviour is notoriously complex. Purchasing decisions guided by a range of rational and emotional factors that involve, among other things, considerations of price, quality, value, brand and convenience. When ethical motivations are added to the mix, consumer decision-making becomes even more challenging to map. As some studies point out, there is often a gap between what consumers say and what consumers do. A recent Times/Populus poll highlighted the fact that an overwhelming majority of Britons say that they recycle, purchase energy-saving light bulbs, and try to avoid unnecessary car journeys.[xxiii] The reality is complex: while a majority of Britons do recycle, only 22.5 per cent of household waste is recyclable, less than 20 per cent of bulbs are energy saving, and 63 per cent of all journeys are by car in the UK.[xxiv] Focus groups carried out by the Co-operative Bank demonstrated that ethical consumption is an activity with multiple dimensions: consumers behaved in different ways and each held different opinions as to what being 'ethical' actually meant.[xxv] Ethical consumers can be further segmented on the basis of the issues that they support, choosing to avoid cosmetics tested on animals, or just purchasing organic. Real consumer motivations for purchasing a product are likely to involve a variety of different factors and regularly involve contradictory or inconsistent behaviours. Perhaps only part of the decision to purchase an ethical product is a desire to protect the environment or to produce social benefit.

Despite how they are often represented, ethical consumers are not a uniform block of individuals with predictable, regular purchasing behaviour. The Fraser Consultancy's *Ethical Reputation Index 2005* shows that up to 47 per cent of UK consumers still buy products they disapprove of on ethical grounds.[xxvi] They may buy these products, but they would rather not. An individual **nef** interviewed for this report observed, 'People don't think they can do all, but they will do what they can.' Where alternatives are available with similar product features, but with added ethical factors, these products are likely to have a competitive advantage in the market. Increasingly consumers are likely to switch products on the basis of something they have heard, read or seen about a company's ethical track record.

Considerations of price, quality and convenience will never entirely disappear from the equation. Ethical products trade on the added benefit they bring to society or the environment, but they also have to be attractive, easy to access and good value for money. Consumers require practical, simple and well-designed product solutions. As another interviewee noted, 'Consumers need to understand what the issues are and be able to buy products that have a greater contribution to make without suffering from a price premium, or having to spend time figuring it out. Producers should make it very easy for them to clearly understand and choose.' These products can bring additional factors of 'doing the right thing', joining a community of like-minded individuals, and aspiring for higher meaning through product purchase by incorporating environmental or social features. These are many of the intangible elements of brand development and packaging that advertisers seek to tap into. They are powerful human emotions that further suggest ethical consumerism is a lasting and largely untapped phenomenon with significant commercial potential.

What this means for ethical finance

Many ethical consumers are also interested in ethical finance. Currently there are more than 440,000 ethical investors in the UK, as estimated by EIRIS in 2005.[xxvii] Ethical investment in the UK has increased significantly, with a record number of new SRI funds launched in 2006. EIRIS confirmed that growing concern over issues such as climate change mean that more and more people are beginning to think about the impacts their investments can have.[xxviii] Ethical consumers who choose products on the basis of social and environmental features are also likely to be concerned with the way in which their money is invested, and the companies that this supports. With the growth of ethical consumerism, there is significant potential for many more individuals to be ethical fund investors, savers and current account holders. Every ethical consumer is a potential customer for the ethical financial services sector.

But given the complexity of financial products, and consumer hesitancy in financial decision-making, ethical finance is a more challenging prospect than ethical consumption. Purchasing a consumer product such as a fair trade chocolate bar is a straightforward decision with a limited timeframe and risk. By contrast, making a financial decision, such as where to invest one's pension, involves complicated factors of risk, return and long-term planning. Financial products can be confusing, complicated and difficult to compare. 'People are not that interested in the financial services industry generally and it is complicated further by a general lack of trust and transparency that exists between consumers and banks. To part with savings or make an investment is a huge risk for many people,' observed one of the individuals interviewed. This is further complicated by research findings indicating that many people do not shop around for financial products. One in five individuals makes choices without seeking information or independent advice first. Almost half of people do not consider either price or product features when making a financial decision.[xxix]

Ethical finance requires a higher level of financial literacy and awareness of how ethical issues can be addressed through financial products. This makes ethical finance information intensive. Ethical consumption often involves awareness raising and campaigning that proves an entry point – for example, better conditions for farmers in developing countries, organic food for better environment and health – whereas this link is less direct with ethical finance. Unlike with ethical consumer products, financial decisions must often be taken within certain time periods, and unless the consumer comes across an ethical option at that time, he or she will need very strong incentives to switch or change once the decision is taken.

The reality is that awareness of ethical options in the finance sector is relatively low among consumers. As one of the individuals that we interviewed noted, 'Ethical consumers are not always aware of the ethical financial option in the same way as they are aware of organic food. There are few ads about ethical finance products and the financial advisers know little about it. In contrast, in supermarkets and farmers markets you are exposed to organic and fair trade.' A survey carried out by financial advisers Charcol Holden Meehan in 2004 showed that 82 per cent of people doubt their investments will meet their own ethical standards, and almost one-third did not realise their savings could be used to support companies they would consider unethical.[xxx] These points suggest that while ethical consumers are inclined to ethical finance, the sector has attracted a smaller number of people. Specific steps are required to make ethical finance more accessible to a broader range of ethically minded individuals. Financial decision-making is a more complicated undertaking, and therefore a greater range of transparent, accessible and relatively low-risk ethical financial products is required. As one commentator noted, 'The Fairtrade Foundation has been smart about getting people to eat fair-trade goods, but how do you do the same for ethical investment?'

The potential for engaging individuals in the UK with ethical finance is clear. More than 75 per cent of adults think their pension fund should operate an ethical policy.[xxxi] Other market research confirms that many people, if offered the choice of investing ethically, would do so. A MORI survey in June 2000 confirmed that nearly 66 per cent of pension scheme holders wanted their trustees to actively apply social, environmental and ethical criteria to their investment decisions. This survey also found that three out of four scheme members wanted pension fund trustees to adopt engagement policies to use their voting power to encourage greater environmental, social and ethical accountability from the companies in which they hold investments. A more recent poll on ethical investment carried out by Friends Provident in 2004 indicated that 65 per cent of individuals indicated they would like to have their money invested ethically.[xxxii] Such a large response indicates that there is significant demand for ethical investment among the UK public. This could be achieved by broadening the pensions, savings, and lending products with ethical features on offer by financial institutions.

Who are ethical investors?

Ethical investors share many of the objectives of mainstream investors in seeking financial return, security, stability and long-term growth. Most individual investors are conservative by nature, with a long-term investment horizon that makes them reluctant to take on additional risk. Ethical investors' requirements of financial products still involve standard factors of risk and return. As such, many ethical investors hold only part of their total funds in ethical investments. A Friends Provident survey of its ethical fund holders in 2001 indicated that 51 per cent of respondents had less than a quarter of their money invested ethically, with only 12 per cent having more than 75 per cent of their money invested ethically.[xxxiii] Many ethical investors have diversified portfolios, where only a section can be defined as ethical. In addition, for most investors, ethics needs to be balanced with investment performance. That said, there is still a substantial group of ethical investors for whom ethics is more important than financial return.

Ethical investors have a high level of interest in social and environmental issues, and seek to reflect their views in their investment choices. As such, they tend to be discerning, politically aware individuals with higher levels of education and financial literacy. On average, ethical investors are from a higher income bracket. Ethical finance requires a greater degree of wealth and financial sophistication in order to invest, particularly in riskier equity products. In general equity ownership is skewed towards the most affluent socio-economic group, where the bulk of wealth in the UK is concentrated. This is a key point, as it indicates that ethical investment could be 'deepened' to appeal to a greater number of well-off individuals with the interest and resources to commit to high-impact social investment.

Ethical consumers cut across socio-economic criteria; however the most active consumers tended to be the upper middle and middle class groups.[xxxiv] Confirming this profile, a survey by Mintel in January 2004 indicated that those consumers in the AB socio-economic group (upper middle class and middle class) most strongly agreed that they are willing to purchase ethical investments, with the C1 group (lower middle class) following.[xxxv] The Friends Provident unit-holder survey identified that many respondents were also likely to be retired individuals, suggesting that there is an increasing opportunity to tap into the growing ageing population with ethical investment products. In the Mintel survey, it was young people aged 18–34 who expressed the strongest interest in ethical financial options. This was confirmed by a DWP report in December 2006 indicating that to encourage young people to save, the Government would offer ethical funds as part of a mandatory savings scheme, resulting in about £8 billion per year flowing into new personal savings accounts from 2012.[xxxvi] Whether young or old, ethical investors are very attractive target clients for financial services institutions. Ethical investors are likely to be affluent individuals with a higher-than-average education, and a greater willingness to purchase financial products with added ethical features; in some cases even if they have to pay more. These are attractive clients for financial institutions to have.

Table 1: Socio-economic grouping of ethical investors

A	B	C1	C2	D	E
Upper Middle	Middle	Lower Middle	Skilled Working	Working	Subsistence

Source: NCC

There is also evidence that ethical investors are more loyal to their choice of fund than the average mainstream investor. A study carried out in 1997 by the University of Exeter suggested that ethical investors generally stayed 'loyal' to an ethical investment, even if it performed badly.[xxxvii] This finding is confirmed in the 2001 Friends Provident survey of over 8,000 of its clients, half of whom indicated that they had held their investments for between 4 to 10 years.[xxxviii]

The investment criteria of ethical investors vary enormously since each individual has a different approach to what is ethical. However, there tends to be common issues that are of concern to ethical investors. In its regular Ethical Investor Survey, Standard Life Investments found that the key preference of its investors is to favour companies that encourage, maintain and improve the quality of working conditions in their global supply chains.[xxxix] The second and third top issues involved investment in companies that are producing or providing products or services which control pollution, and the development or use of renewable energy, respectively. Investors consistently rated environmental concerns highly. In the case of Friends Provident investors, the key issues they felt were important included avoidance of investment in nuclear weapons and arms manufacture, as well as avoidance of companies with poor pollution records or manufacture of environmentally damaging chemicals and companies with operations in countries with oppressive regimes.[xl] On the positive side, they favoured investing in companies with good human rights policies, effective environmental management, and positive relationships with suppliers in developing countries. This suggests that the environment and human rights are among investors' top concerns; however there will likely continue to be a range of issues that concern investors.

As a greater number of individuals engage with ethical finance, there is an increasing shift away from its roots in 'dark green' environmental concerns, to a greater occurrence of 'light green' and social objectives. As one ethical investment FA noted, 'The biggest change that we have seen in our customer base it that previously many had very strong specific concerns, and were 'dark green' investors. Increasingly people are light green, but want to feel that their money is invested ethically.' Ethical finance has slowly begun to broaden its appeal beyond a small group of environmentalists to address a wider group of conscientious consumers. As one representative noted, 'Human beings are selfish and to reach a large number of people it is necessary to go light green, as dark green only reaches a small amount. The future is promising if we can reach the larger group, which will require marketing and products that translates ethical concerns into things that people buy. Products need to be easy, accessible, secure, reliable and professional. Positive investment will appeal to the light green.' Individuals in the UK care about the environment and want to do something about climate change. The market for financial products with positive environmental objectives is significant. Ethical finance will be able to broaden its appeal by tapping into general concerns many individuals in the UK have about the environment.

The picture of ethical investors that emerges is of educated, conscientious individuals with a higher degree of financial literacy and above-average income. Ethical investors share many of the same objectives of mainstream investors, but care about the environment, climate change or social issues, and what they can do about it. This broader group of individuals is open to new financial products that offer simple, straightforward features that incorporate social and/or environmental solutions. They are increasingly willing to commit a portion of their pension, savings, or mortgage to financial products that offer an environmental or social alternative. To capture an increasing range of consumers, ethical finance needs to both broaden its appeal to the average consumer, and to deepen its impact by increasing opportunities for the high-net-worth individuals to engage in social investment.

Ethical finance in the UK

Key points

- There is a growing range of financial products for UK ethical consumers. But there are key gaps in product availability.
- Limited mainstream ethical financial products provide few options for the average consumer.
- Banks have a clear gap in their ethical product offering, missing a 'win-win' outcome for consumers and financial institutions alike.
- There are high-impact ethical financial initiatives for social investment, but many of these products are high risk or have limited liquidity.
- A further challenge is the limited scale and marketing of these products, and a lack of awareness among the public.
- High-net-worth individuals increasingly seek to support ethical businesses, or invest in social or environmental investment funds.
- New ethical products are required that offer reasonable risk and return. There is a need for simple products from known financial brands that individuals trust.

Perspectives on the industry

- Aspects of ethical finance are beginning to enter the mainstream financial services industry, but there is still a long way to go.
- A majority of SRI funds are concentrated in the top 350 FTSE companies. As such, they are limited in their direct social and environmental impact.
- Current high-impact social investments are not designed to compete with mainstream financial products, and represent a small niche.
- There is a need to galvanise the financial services sector to move beyond SRI and innovate with ethical financial product alternatives.
- Financial advisers play a key role to promote or limit consumer access to ethical financial products, but most have not been exposed to ethical finance.
- Banks are not doing enough. CSR initiatives are not sufficient to respond to the social and environmental problems facing society.
- Banks are missing out on a market opportunity to develop new ethical finance products. Banks that move first will have a competitive advantage, establishing a strong presence in this market.

Mapping UK ethical finance

There is a growing range of financial products for the ethical consumer in the UK. Increasingly a diverse group of high-impact ethical finance initiatives offer the means to channel finance to positive social or environmental projects through social investment. A select group of ethical banks has successfully developed social or environmental savings accounts, bonds, and share offerings. Community wind farms, social purpose businesses, and ethical companies represent new opportunities for equity investment. Pioneering building societies offer green mortgages that incorporate environmental features to address climate change. Even a few insurance providers are responding to environmental issues by incorporating ethical features into their products.

On the whole, however, there are key gaps in product availability. Some product areas are well developed and others less so: there are over 90 ethical funds in the UK, yet there is only one provider of an explicitly ethical current account for individuals. Provision in other areas, such as ethical insurance and green mortgages, is also limited. Most notably, there is an absence of simple, low-risk products from established financial brand names. A gap in mainstream ethical financial products – current accounts, savings accounts, loans and mortgages – means that there are limited options for the average consumer. These are the products that consumers are most likely to seek out.

A map of the UK ethical finance sector (Table 2) demonstrates the financial products available to the ethical consumer. A review of the landscape of ethical finance will identify where gaps in provision and opportunities for new product development exist. This exercise highlights where product provision is shallow, lacking in number of providers, or limited in scale.

Table 2: UK ethical finance sector

Financial product	Examples of providers	Est no.	Risk	Focus	Sector classification
					Ethical banking
Current account	Co-operative Bank/Smile	1	Low	Ethical policy	Ethical current accounts
	Independent building societies	63	Low	Social	
Savings account	Charity Bank, Tridos Bank, Ecology BS, Unity Trust	4	Low	Social & environmental	Ethical savings
	Co-operative Bank	1	Low	Ethical policy	
	Credit unions & Independent building societies	1,400	Low	Social	
Personal Loans	Co-operative Bank/Smile	1	Med	Ethical policy	Ethical loans
	Zopa.com	1	Med	Social	
	Credit unions & Independent building societies	1,400	Med	Social	
Mortgage	Ecology BS, Norwich & Peterborough BS, Universal BS	3	Med	Environmental	Ethical mortgages
	Co-operative Bank	1	Med	Ethical policy	
	Independent building societies	63	Med	Social	
Insurance	Naturesave	1	Low	Environmental	Ethical insurance
	Co-operative Insurance	1	Low	Ethical policy	Ethical insurance
					Ethical investing
Investment (equity)					
Equity (unlisted) in start-up	No network exists yet	?	Very High	Social & environmental	Social venture capital
Equity (unlisted)	Cafedirect, Ethical Property Co, Traidcraft	20	Very High	Social & environmental	Social investment: Ethical businesses
	CDFIs	60	Very High	Social	Social investment: Community finance
	Shared Interest, Oikocredit	4	Very High	Social	Social investment
	Community wind farms & ventures	20	Very High	Environmental	Social investment
Equity (listed) in ethical business	Educ, health, wellbeing, environment	25	High	Social & environmental	Social investment: Ethical businesses
Equity (listed) in unit trusts	Friends Provident, Henderson, Jupiter, CIS	90	High	Social & environmental	SRI equity unit trust
Investment (debt)					
Community bond (general)	Natwest, Citylife	2	High	Social	Community bond
Ethical issue bond	Golden Lane Housing, Triodos Ren Energy	2	High	Social & environmental	Ethical bond
Social housing bond	Housing Finance Corporation	1	Low	Social	Ethical bond
Bond fund	Standard Life	1	Med		SRI bond fund

We have included building societies and credit unions as part of the ethical finance landscape in the UK. These organisations have not usually been considered as part of the ethical finance industry, but they have a history of providing financial services on the basis of mutualism for the benefit of members. Building societies do not have external shareholders, and channel all profits back into the society for the benefit of members. Building societies and credit unions offer simple products that may appeal to individuals from average and below-average income levels, suggesting a means to broaden the base of consumers engaged in ethical finance. Many mutual organisations remain embedded in local communities, with a strong social mission to encourage local saving and asset building through home ownership. With 63 building societies in the UK and an extensive network of over 2,140 branches, these institutions could offer a basic entry point for channelling finance to ethical initiatives. Credit unions, on the other hand, remain relatively small. At the end of 2004, there were 779 credit unions in the UK with a membership of approximately 815,000, representing less than 1 per cent of the population.[xli] Despite the focus on social responsibility, almost no building society offers financial products with specific environmental or social features. There is a clear opportunity for building societies to offer ethical finance as a potential growth area.

Ethical current accounts are offered by the Co-op Bank and its Internet affiliate Smile, one of the few banks with an explicitly ethical policy. Consumers also have the option of a credit union or building society account, which lacks an explicit ethical policy but is managed according to the principles of mutualism. These two options represent the only ethical current account products available in the market. This suggests that the Co-op Bank has a virtual monopoly on the ethical current account market. The Co-op was very successful in re-launching itself in 1992 as a bank with an ethical policy. The adoption of the ethical policy, and the Co-op's engagement with its ethical client base, has been a key factor in its turnaround. Yet few competitive current account offers are available for ethical consumers seeking an alternative.

In the area of savings accounts, there is a select group of ethical banks in the UK that offers products linked to specific social or environmental issues. Triodos Bank, Unity Trust Bank and Charity Bank feature savings products for individuals seeking to direct funds to the charitable or social sector. These banks use funds from individuals' savings to finance business, voluntary organisations or charities that benefit society and the environment. Both Triodos and Charity Bank are standard bearers for transparency, with a complete list of organisations lent to, allowing depositors to know where their funds are being invested. Unity Trust Bank has a history of financing the trade union movement, and indicates that it will not support organisations inconsistent with the bank's values. The Co-op Bank offers a variety of savings products that fall under the bank's ethical policy, which pledges not to invest in a series of unethical activities, such as the arms trade, human rights violation, genetic modification, and negative ecological impact. The Ecology Building Society offers depositors a savings account that will apply the funds towards mortgage lending on sustainable building projects. To these five institutions, one might also add the wider range of building society and credit union savings accounts, which are managed for the express benefit of the saver, and often run democratically. Notably there is an absence of savings products with ethical features from high street banks.

Personal loan products with ethical features are very limited. The Co-op Bank offers several basic consumer loan products that fall under the umbrella of its stated ethical policy. Otherwise, individuals seeking loans will have to turn to building societies or credit unions in the hope of getting a better interest rate. Both of these options have limited direct impact on society or the environment. Alternatively, individuals could opt for the web-based lending and borrowing exchange, Zopa. Launched in 2005 by the founders of the Egg Internet bank, Zopa was developed according to a social lending model, designed to circumvent the banks as middle men and facilitate the direct flow of funds from savers to borrowers. A 'win-win' situation results: savers choose their level of risk and receive higher interest rates, while borrowers in return achieve more affordable access to credit. Zopa makes money by charging users an annual 0.5 per cent fee of funds lent or borrowed. Zopa is novel idea that builds upon the social networking phenomenon of the Internet to challenge the dominance of high street banks, attracting over 75,000 members to date.

Home buyers seeking green mortgages will have to choose from four providers: the Co-op Bank, Norwich & Peterborough Building Society, Universal Building Society and Ecology Building Society. These mortgages have slightly higher interest rates and are likely to cost borrowers more. The benefits of these home loan products are that providers will make payments to organisations tackling climate change or commit to plant trees to offset carbon dioxide emissions. Some also offer new customers a review of their home to cut energy waste. Both the Ecology and Norwich & Peterborough will only lend to specific properties that meet defined sustainable principles, such as a home with a high-energy efficiency rating or ecological renovations. Mortgages remain a core product of the building societies, which can often offer more favourable rates by not having to pay dividends to shareholders thereby operating within narrower margins. With the increasing focus on climate change, green mortgages are of particular interest to consumers and policy-makers alike. The All Party Parliamentary Climate Change Group has urged more banks and building societies to develop green mortgage products, with a particular desire to see the top 100 mortgage lenders develop environmentally friendly financial products.

In the field of insurance, there are relatively few ethical options. Naturesave stands out as an ethical insurance company seeking to promote sustainable development. This insurance company allocates 10 per cent of all premiums into a fund to benefit specific environmental and conservation projects. The company also facilitates free environmental reviews for commercial clients, and encourages small and medium enterprises (SMEs) to offset their carbon emissions. Naturesave also works to achieve greater awareness within the mainstream insurance industry of the long-term impact of pollution, climate change, and environmental degradation. Another option for ethical consumers is to insure with the Co-operative Insurance Group. A new eco-insurance product for motorists will offset 20 per cent of an individual's automobile carbon emissions by investing in projects like reforestation, renewable energy sources and developing country education schemes. All other insurance products do not have specific environmental or social features, but are subject to the Co-op Group's ethical policy. Ecclesiastical Insurance, specialising in churches, charities and educational institutions, offers a range of insurance products that advances the company's social mission, which involves allocating a large proportion of its profits to charity and churches.

Investors have a greater range of ethical financial options at their disposal. There is increasing diversity in high-impact ethical financial initiatives available for social investment. Alternative share offerings, community bonds, or Industrial and Provident Society shares offer a positive means for consumers to channel their funds directly to environmental and social projects. High-net-worth individuals are increasingly seeking to support ethical businesses, or to participate in social investment funds. Currently there is no established network for such private investors, but Rathbone Greenbank, Coutts and Triodos Bank are experiencing heightened interest in social investment among this client group. High-net-worth individuals have a growing interest in ethical investment because of the diversification these funds may offer. Opportunities to channel funds to microfinance, sustainable forestry, or renewable energy technology can be attractive. This is a key factor driving innovation in ethical financial products, and opening up new opportunities for social investment. A study carried out by UKSIF in 2005 found that £1.2 billion in funds (from a total of £20 billion) was managed under a bespoke SRI mandate for high-net-worth individuals by a select group of asset managers.[xlii] An increasing number of ethical venture capital opportunities are brokered by private client specialists. Since 2001, the Triodos group has raised three venture capital funds totalling €75 million (£53 million). The Triodos Innovation Fund is actively seeking investments to support innovative companies in the fair trade, organics, renewable energy and other social sectors. The challenge is that many of these products are high risk, and in the case of unlisted equity shares, may have limited liquidity. It may not be an option for individuals seeking long-term savings or income protection, but social investment is an attractive opportunity for well-off individuals seeking new ways to maximise the social and environmental impact of their wealth.

Investing in the unlisted shares of ethical businesses, such as the Ethical Property Company or Cafédirect, can also bring benefits for the investor and organisation alike. Ethical Property Company shares have achieved some capital appreciation and have consistently paid dividends to shareholders at an average yield of 2.8 per cent for the past six years.[xliii] The funds investors allocate to Industrial and Provident Societies such as CDFIs or Shared Interest, a fair trade financing company, are limited to £20,000, and do not include deposit insurance. With these high-impact ethical investments, members may receive below-market rates of return. But the funds received contribute to the direct benefit of local communities, generating a high social value. Likewise, shares in wind farms or local environmental projects have a direct positive impact, helping to promote renewable energy or sustainable development.

Many investors in the unlisted equity of social enterprises or community projects are not seeking to maximise financial return. They are supporting a project which resonates strongly with their environmental and social values. Many see this as an extension of their philanthropic giving. This is evidenced by the fact that many investors waive dividends or interest payments to further the cause of the organisation. These investments are not typically included as part of fund portfolios. The unlisted nature of many high-impact ethical investments means that they are often closed to institutional investment funds, and rely on a broad base of individual shareholders. The average holding of individual shareholders is around £1,500. Unlisted shares are traded infrequently through a matched market process, brokered by organisations such as Brewin Dolphin Securities. These unlisted shares offer high-impact ethical investment, but with higher risk and the likelihood of lower return. High-impact ethical investments may be the most effective means to invest directly in positive social and environmental initiatives, but they are relatively unknown among the wider UK public. These investments may appeal to high-net-worth individuals or people with disposable income that prioritise social or environmental impact.

Increasingly organisations are innovating by offering bonds as a financing mechanism. Among the few mainstream banks to offer an ethical finance product, NatWest has developed a fixed interest Community Savings Bond that provides affordable finance for community projects throughout the UK and offers an interest rate of 4.8 per cent. Citylife has developed a related community bond product. It offers zero interest coupon bonds to those prepared to forgo capital growth and interest income, with a guaranteed return of principal after five years. Bonds invest the interest from investments to regenerate local communities. Social housing bonds are offered via ABN AMRO on behalf of The Housing Finance Corporation (THFC), a not-for-profit lender to UK housing associations. Rated AA- by Standard & Poors, the bonds issued by THFC trade via the London Stock Exchange Professional Securities Market and offer market rate returns making a stable and attractive investment. Triodos Bank has pioneered the use of bonds to finance renewable energy or community housing development for people with disabilities. The Golden Lane Housing Investment Bond launched in April 2003 represented the first such issuance by a UK charity, and successfully raised £1.6 million. The bonds pay annual interest at 1 per cent above the UK headline inflation rate, to a maximum of 6.5 per cent. More recently, Triodos offered a renewable energy bond, structured as a savings product, with a return of 4.5 per cent over a two-year term, seeking to raise £12 million. Money deposited in the bond will be used to finance renewable energy projects in particular, from small, environmentally sensitive hydro-electric projects to community-backed wind farms. These bond offerings represent one of the few ethical products with high impact, reasonable financial return and limited risk to the investor. The challenge is the limited number of these bonds on offer, and a corresponding lack of awareness among most members of the public.

By contrast, SRI funds are increasingly recognised as an investment option, and the number available is steadily growing. These ethical funds are moving into the mainstream, with increasing awareness of their availability. Old arguments about under-performance are withering away as a number of outstanding ethical funds consistently demonstrate financial return. The average UK equity ethical fund achieved a gain of 16.8 per cent during 2006, compared to the 10.7 per cent gain for mainstream funds.[xliv] Among the top performers, the Co-op Sustainable Leaders Trust significantly outperformed the UK FTSE All Share, beating out over

320 standard equity funds. Other top-ranking ethical funds in 2006 included Jupiter Environmental Income and Jupiter Ecology, F&C Stewardship Growth, and Aegon Ethical Equity.[xlv] This is further proof that ethical funds can incorporate social and environmental principles without sacrificing financial performance. Ethical property funds, such as Standard Life Property Income and Armstrong Investors Residential High Yield Fund, are also beginning to emerge. These channel funds to regenerate brownfield sites or invest in social housing. There are also funds focused on microfinance that allow investors to direct funds to micro-entrepreneurs in developing companies. SRI funds represent the first point of entry for many ethical consumers seeking to invest their money in a socially responsible manner. Many consumers continue to seek a simple method to avoid investing in activities they deem unethical, and negative screened funds are effective to meet this objective.

In general, however, there are still significant gaps in the range and number of ethical financial options available to consumers. As the mapping of ethical finance in the UK highlights, in most product areas there are just a few ethical products from which to choose. While a series of ethical finance initiatives has evolved, they remain quite modest in scope. All too often, this coincides with a small market share and meagre marketing resources, resulting in a lack of consumer awareness of these ethical finance alternatives. Smaller ethical brands with strong products need to focus on marketing and building public recognition. There are other practical challenges for ethical finance. Issues of risk and return need to be addressed if ethical finance initiatives are going to reach the broader consumer base.

As Figures 2, 3, and 4 below indicate, those financial products with high SEE impact are most likely to fall into quadrants with higher risk, low to moderate financial return, and limited public awareness. These figures illustrate the key practical problems faced by the ethical finance sector in the UK. With the exception of social venture capital funds, SRI funds, and SRI bond funds, most ethical financial products with high risk are offering relatively low return. Likewise, most ethical products have very low awareness among the general public.

- Ethical savings account
- Ethical mortgages
- Social venture capital fund
- Ethical business shares (unlisted)
- SRI equity unit trust
- Ethical issue bond
- High street bank account
- Ethical bank account
- Ethical loans
- Ethical insurance
- Community finance shares
- Ethical business shares (listed)
- Community bond
- SRI bond fund
- Building society account
- Credit union

Figure 2: SEE impact vs risk

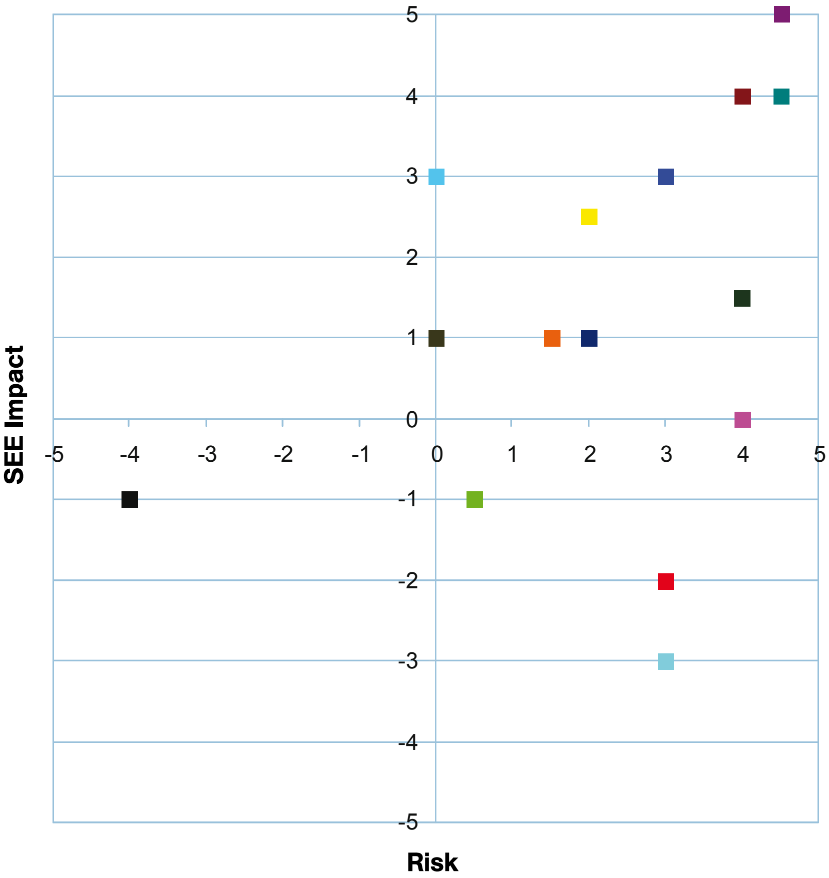


Figure 3: SEE impact vs return

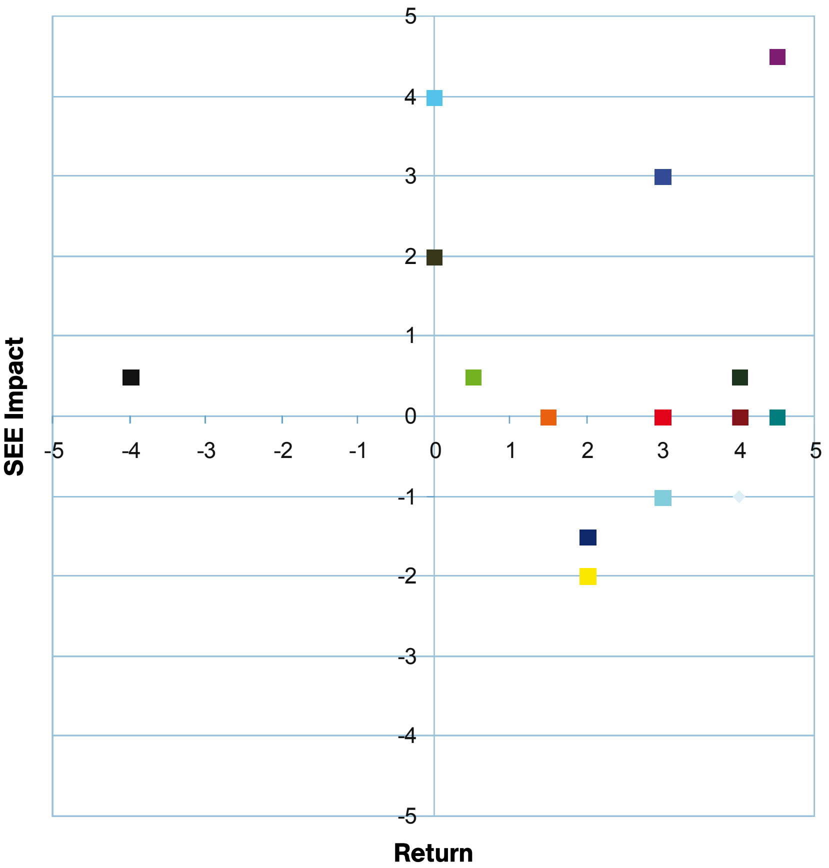
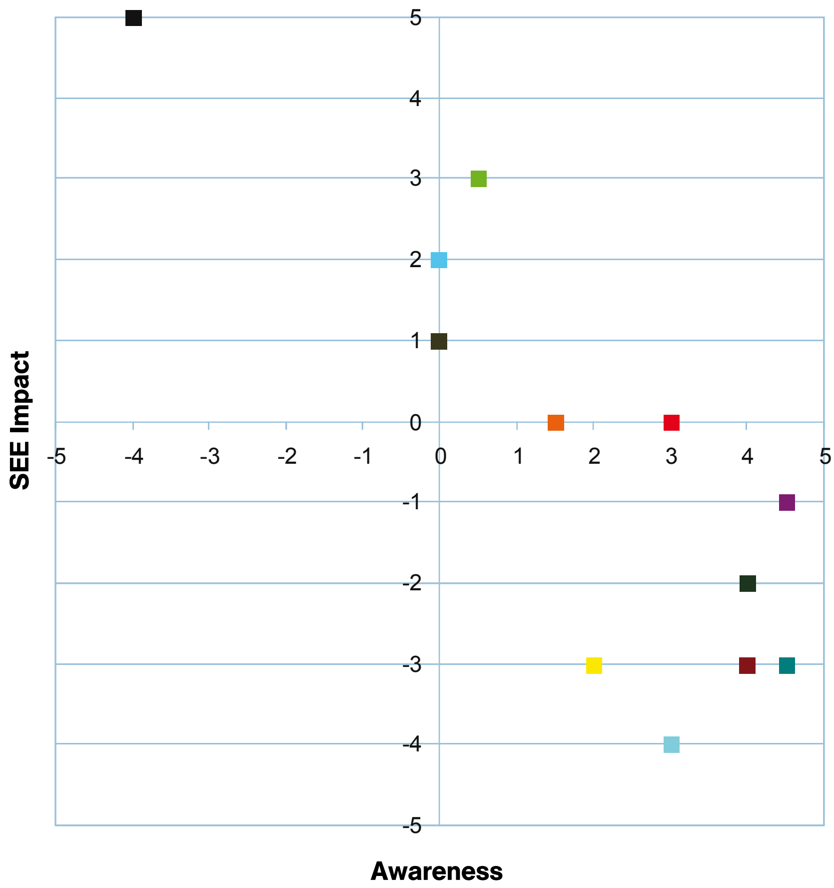


Figure 2: SEE impact vs public awareness



As Figure 3 demonstrates, ethical savings accounts, community bonds or unlisted equity shares tend to pay lower-than-average rates of interest or dividends, which can deter most investors who are focused on the practical realities of retirement, saving, or taking out a mortgage. Lack of liquidity may also be a factor for those who invest in unlisted shares or bonds. Once investors have purchased these products, there is a limited secondary market, making it difficult to trade or dispose of stocks and bonds. For current holders of ethical shares, these factors may be minor considerations in light of the social return created by the social or environmental project. But if these ethical financial products are to scale up and appeal to a broader section of society, these practical factors can't be ignored. New ethical products are required that offer palatable amounts of risk and return. There is a need for simple products that can be marketed under known financial brands that individuals trust.

A key question is: Why do high street banks not offer ethical financial products? The high street banks are notable by their absence. None of the 'big five' high street banks offer ethical current accounts, savings accounts, loans or insurance products. These are the financial products that most consumers understand and use on a regular basis. Consumers prefer to buy financial products from recognisable brands. The lack of social or environmental products is a clear gap in the banks product offering, missing a win-win outcome for consumers and financial institutions alike. Consumers need products that are straightforward and readily available. High street banks have an established presence, name recognition, and the capability and infrastructure to bring new financial products to market. Conscientious consumers are a substantial and growing component of the market, and represent an opportunity to attract target clients willing to pay a premium for superior products with social or environmental features.

At the same time, UK banks continue to struggle with negative press and growing public discontent resulting from mis-selling of payment protection insurance and the imposition of fees on unauthorised overdrafts, late credit card payments, and ATM usage. Banks are also challenged by how to move away from the 'free-if-in- credit' current account model, seeking to introduce new premium accounts. A focus on products with added benefits for the environment or society could be strategically effective for banks. Consumers are showing a willingness to switch account providers, particularly given the greater ease with which standing orders and direct debits can be transferred. Those banks that act first to establish ethical products could build a powerful brand with positive associations, attracting premium, higher-income ethical consumers that are loyal to institutions. The development of ethical financial products is a clear opportunity for UK banks.

Perspectives on the industry

Our analysis of the state of the ethical finance sector in the UK is based on interviews with 26 industry representatives from high street banks, ethical finance networks, SRI funds, ethical consumer organisations, ethical independent FAs and ethical finance initiatives. In general, interviewees felt that elements of ethical finance are beginning to enter the mainstream financial services industry, but there is still a long way to go. The state of the sector is mixed. SRI funds have an increasing influence on the market, but market share remains relatively small, representing just over 1 per cent of total retail funds under management.[xlvi] The successful financial performance of a number of SRI funds evidences that social and environmental issues have direct relevance to long-term company performance, but these funds are still considered niche within financial institutions. There are a growing number of ethical products for consumers, but they are largely unknown to the general public. Significant progress is being made to incorporate SEE issues into the decision-making of financial professionals and company management, but no high street banks offer specific ethical financial products. Climate change is increasingly recognised is a critical issue, but the financial services sector has been slow to act. An interviewee observed, 'There may be a push for tackling climate change, but the industry won't lead, it will follow the money.' UK banks have made progress on sustainable reporting, but primarily engage with social responsibility through limited forms of CSR: charitable giving and community volunteering of staff members. One interviewee noted, 'In terms of the financial services sector, they are making more out of what they are doing than what they are doing in reality.' As a whole, there is a need for the financial services sector to move beyond SRI and innovate with new ethical financial product alternatives.

SRI funds

SRI investment funds are recognised for having made significant progress to bring SEE issues into financial services. They have grown steadily over the past 10 years, and continue to attract increasing funds under management. From the small base of £1.5 billion in 1997, SRI retail funds alone now manage over £7 billion of clients' savings.[xlvii] Institutional investors are also increasingly getting in on the act, with around £550 billion in funds subject to some type of SRI activity, whether screening or engagement, in the UK.[xlviii] The July 2000 SRI Pensions Disclosure Regulation amendment to the Pensions Act was a key factor in compelling occupational pension schemes to disclose their statement of Investment Principles, motivating many to adopt an SRI approach. Additionally, superior financial returns from top funds bear out what the sector has been saying for some time: that social responsibility does not have to be at the cost of financial performance. With these successes, SRI funds are seeking to attract more conscientious consumers, increasing the number of investors along the way.

There is a concern that existing SRI screening methods are not effective in creating change in corporate behaviour. Although only 18 per cent of funds practice screening alone, many investors opt for the screened option to maintain a clear conscience with respect to the negative business activities they support. SRI screening funds that buy or sell a small percentage of the company are unlikely to have a demonstrable impact on corporate decision-making. Many interviewees also pointed out that the majority of SRI funds are invested in many of the same companies as standard funds. An individual observed, 'Ethical investors assume that their investments in SRI funds are good, but what does it actually mean? I think many investors would be surprised to find out where their funds are actually invested.' The vast majority of SRI fund investments are concentrated in the top 350 FTSE companies, with Vodafone, Pfizer, Johnson & Johnson, Citigroup and Microsoft the most frequent stocks in SRI portfolios.[xlix] As such, existing SRI funds are restricted in their direct social and environmental impact. One individual commented, 'The SRI approach is very limited, and open for people to be sceptical and for cynicism, as they are often [invested in] the same companies as other funds and there is a question regarding what they are presenting to consumers.' While some funds have selected investments in small companies, an interviewee noted, 'The major impact of SRI is not on small start-ups and renewable energy initiatives but large corporations and established companies. Engagement and dialogue with established companies has the greatest potential to effect change.'

Engagement strategies are highlighted as the best means to bring about gradual adoption of social and environmental practices by large publicly listed corporations. According to Eurosif, over £480 billion in assets under management in the UK are subject to an engagement policy, or roughly 87 per cent.[l] Shareholder engagement strategies are also increasingly used among UK pension funds, with almost half having internal resources devoted to this activity.[li] Engagement involves working with company management to bring about integration of SEE factors into corporate governance, investment decision-making and/or operations. A key issue in engagement, of course, is the degree and quality of the influence exerted by fund managers. At present, there is limited transparency or comparability of engagement approaches across the range of different funds. A more systematic approach to reporting engagement practices is required in order to enhance its strength as a tool for change. Without transparency, engagement may be watered down or lack credibility. There can be a strong collusion of interests between fund managers and management; as one individual noted, 'When share price is doing well, there is little incentive to change management approach.'

Many of those we interviewed observed that there is significant untapped potential for pension funds to exercise their power with companies. Collective action of pension holders could bring about positive change on human rights, environmental and labour issues. UK pension funds are a significant force in the UK financial market, with approximately £1,414 billion in assets under management at the end of 2005.[lii] Institutional investors sometimes hold upwards of 1–3 per cent of a company's stock, making them a significant shareholder with a powerful degree of influence. Many pension holders are unaware of the latent power that their shareholdings confer to influence company management. Through insurance companies, pension funds and individual shareholdings, 72 per cent of capital in the market is invested directly or indirectly on behalf of individuals.[liii] Fair Pensions is leading a public campaign to promote engagement by UK investors to bridge a lack of awareness about shareholder action and the power it confers as an owner of the company. As this charity points out, companies are legally required to listen to their shareholders and investor action holds the key to achieving corporate behavioural change.

SRI has had an increasing impact on mainstream financial services by introducing SEE and corporate governance issues to corporations, investment banks and equity research reporting. Large institutional investors, such as the Universities Superannuation Scheme, are adopting engagement approaches to incorporate social responsibility into investment strategies. New SRI retail funds are being introduced to the market. However, many large investment houses still lack an SRI product offering, and ethical funds are perceived by many to be a niche activity. They are often viewed as 'the funny guys in the corner', rather than being integrated into the core operations of the institution. As one individual noted, 'They are driving change, but are still seen by many in the financial services sector as marginal.' As a result, some financial institutions are moving too slowly to respond to a real market opportunity. 'In general, financial institutions are not engaging enough. The SRI sector is under-resourced and is missing a major opportunity.' New product development and innovation have been slow. Resourcing of areas related to product development and marketing has been low across the market. There has not been enough focus on the delivery mechanism for SRI products, which may partially explain why products are not getting out of the pipeline. Sales people and advisers are often poorly trained, as almost no training on SRI has been available. There is limited focus on ethical product features as an added value for potential investors. This impacts the way in which SRI funds are marketed by financial institutions, with advertisements largely confined to the specialist press, and focused on financial return rather than specifically social or ethical features. 'The reputation [of SRI] relies on good performance of funds and [financial] intermediaries prepared to talk about it, which they are often not.'

On the whole, interviewees painted a mixed picture of the SRI area. As a sector it has come a long way, demonstrated substantial growth and proven its potential. The SRI sector is experiencing uplift due to increasing interest in social and environmental areas for investment. Similarly, media interest in ethical issues has increased, and is helping to make the business case for product development in these areas. But these gains are still fragile, and require a stronger commitment from financial services institutions to drive SRI forward. There is likely to be increasing demand from both institutional and individual investors for environmental and social investment alternatives, which should continue to be a key driver for growth and development in SRI.

Financial advisers (FAs)

Financial advisers (FAs) are key intermediaries that recommend ethical finance products to potential investors. They act to distribute financial products, whether ethical funds or ethical savings accounts. For individual investors, most investment decisions are made in connection with advice from an FA. FAs play a key role to promote or limit consumer access to ethical financial products, and particularly dominate sales of investment funds, where they represent 68 per cent of origination.

For this reason, UKSIF has sought to develop a series of training programmes and toolkits to expose a greater number of FAs to ethical investment. UKSIF was instrumental in lobbying for the introduction of questions relating to ethical investment to the standard qualifying exam for FAs. In addition, an international standard for FAs is being developed under ISO22222 which determines the baseline for competency of a personal financial planner. In order to receive the kitemark, an FA will be required to take social, environmental or religious considerations into account with clients. The UK financial advisor syllabus now also includes a section on SRI investing to raise awareness for future practitioners. In January 2007, UKSIF launched a free online training programme on green and ethical investment along with a new practical guide to assist FAs in greening their business. Along with the previous Responsible Investment Toolkit, these initiatives seek to reach the majority of FAs who are not well informed about SRI, much less other ethical finance products.

FAs will have to improve their advisory skills to cope with demand from consumers for ethical finance. IFA Promotion, the industry's professional organisation, reported in 2006 that the number of individuals asking FAs about ethical investments increased by 100 per cent in the year. The number of FAs incorporating ethical products has risen accordingly, with 840 FAs offering ethical investments, compared to 633 a year ago and 593 three years ago.[liv] But only a small number of FAs specialise in ethical finance. These represent a total of perhaps 40 to 60 individuals.

Interviewees felt that most FAs were disengaged from ethical investment and not proactive on social, environmental and ethical issues. One individual noted, 'The community of FAs in the UK need to change. Many FAs are not persuaded by ethical funds and have the attitude that their job is difficult enough without introducing a new series of factors.' Most FAs have not been exposed to ethical finance issues, which limits their ability to give advice on the topic. 'One of the main barriers is the knowledge base of FAs and their unwillingness to introduce the topic as part of a standard conversation with clients. Ninety-five per cent of FA qualifications do not cover ethical finance, and they had no training. As such they are ignorant on the topic.' There is the sense that many FAs are stuck in their ways and resistant to new concepts that ethical finance represents. 'The average age of

FAs is 55. What we need is for this current generation of FAs to retire. Most FAs have a lack of willingness to promote ethical investment.'

As FAs receive growing interest from investors about ethical options, they will have to adapt to develop an understanding of ethical finance products. 'You can be lucky enough to have an FA that understands ethical finance, and the rate is improving. Hopefully there will be new training and a new generation of financial advisers that are better informed.' The work of UKSIF to promote awareness of ethical finance among FAs has helped to expand the knowledge base of the FA pool. Research carried out by UKSIF demonstrates that the tools and support system it has developed are beneficial for FAs seeking new information. New FAs will be aware of ethical finance concepts through qualifying exams and international standards. But the bulk of the FA community still has to improve its knowledge and awareness if consumers are to receive broader access to ethical finance.

Ethical finance initiatives

While interviewees point to the development of a wide range of ethical finance products, many high-impact social investments are not designed to compete with mainstream financial products. These ethical finance initiatives represent a small niche with a limited share of the market, attracting a select group of informed ethical investors. 'Ethical finance initiatives are largely a marginal field dominated by small players.' Such ethical initiatives have a small number of staff and limited marketing resources. 'We are a small organisation of five people, and struggle to do enough marketing to carry out a successful offering. We have a very niche intention to support local communities.' A key issue is the general lack of awareness of these small ethical banks, community bonds, and alternative equity offerings among consumers. 'There are not enough alternative equity offerings, and most people do not think of this as a route to ethical investment.' There is very limited understanding of these high-impact investments beyond a very engaged community of ethical investors. 'Currently we have hard core supporters, but we need to reach out to a larger group.' Too often these investments are perceived as a form of charitable donation, rather than an investment. And the trade off between social and financial return is also not well understood.

Interviewees indicated that issues of risk, liquidity and lack of marketing may limit the scope of existing ethical finance initiatives. Given the early stage nature of many social or environmental businesses, investment is viewed as high risk or not likely to yield a return. Individual investors are therefore likely to invest in small increments. While this increases the range of stakeholders in a venture, it also raises the marketing and transaction costs of raising funds for ethical businesses or environmental projects. On the whole, the mainstream financial services sector remains largely sceptical of social investment. 'Currently mainstream investors think social investors are off of their trolley. They think that unless you are trying to maximise wealth you have a mental health problem.' Those few SRI funds with interest to invest directly in ethical businesses are limited by regulations that restrict illiquid, unlisted investments. Ethical initiatives should focus on attracting high-net-worth investors that are interested in social investment as a new option. Well-off individuals are increasingly seeking alternative ethical and social investment opportunities.

Ethical finance initiatives with strong products and bigger ambitions may be able to reach a wider audience. Key will be effective marketing strategies and development of user-friendly products to reach a broader consumer base. One organisation noted, 'By developing the internet presence, plus additional product offerings, we are overcoming physical barriers and by marketing strategies it is possible to reach a larger number of people. The right products are needed for the mass market, and not just dark green products.' If small ethical finance initiatives want to scale up, there is a consensus that they need to adopt new practices. This could be done by re-designing product features and focussing on marketing campaigns that address issues that the public cares about: climate change or the environment. Providers will have to seek out new avenues for promotion, and consider forming marketing partnerships with like-minded organisations.

Ethical finance initiatives are varied and not easy for ethical consumers to find. With no central information point, consumers have to seek out ethical investment opportunities on an ad hoc basis. 'What is lacking is a one-stop-shop resource for information. There would be bigger take-up if people knew about it.' Many ethical initiatives focus on a specific issue, such as fair trade, renewable energy, or community regeneration, and resist being grouped under a general label of 'ethical finance'. To date a small, focused client base has responded because of an affinity for a specific issue, making many organisations reluctant to lose this distinction. But it would be more productive for ethical finance initiatives to work together to bring awareness of ethical finance options, perhaps through joint press campaigns. Fair trade was effective because of a common, identifiable objective. To attract a broader range of followers, ethical finance initiatives need to pool their resources, form a common network and emphasise their common objective through targeted marketing.

Banks

High street banks are important in expanding the range of ethical finance products available to consumers. They have taken some positive steps, but are not doing enough. Banks are not engaging in ethical finance, and have been slow to respond to social and environmental issues by introducing new products.

On a positive note, banks have made some progress to adopt sustainable banking practices, through carbon footprint reduction, trading of carbon credits, and reporting on CSR activity. HSBC has been recognised for its adoption of sustainable banking practices, including its commitment in 2005 to go carbon neutral. More recently, ABN AMRO was awarded the FT Sustainable Bank of the Year in recognition of its leadership in environmental and social risk management.[lv] As one individual observed, 'Most banks now produce a sustainability report. These were not in existence 5 to 10 years ago. Many banks have employees as high as at the Board of Director level who work on CSR issues. Ethical finance has had impact far beyond the mere numbers suggest.'

Banks are responding to new commercial opportunities that climate change and environmental technologies represent. As one bank representative noted, 'Many activities begin in the corporate banking market and slowly filter through to the consumer, retail market. For example, in carbon trading, our bank is trading and selling carbon credits to companies. Financing renewable energy is also a commercial business proposition.' In areas of product development, banks are likely to act where they see a profit potential. 'For smart businesses, any change in the operating environment gives commercial opportunities as well as supporting something that is positive for the company's brand and public relations.' Banks are keen to promote a positive image and develop a reputation based on social responsibility. Representatives from the banks we interviewed emphasised that they are focused on ethics as part of their reputation and commitment to customers. 'It is central to the way we do business. We have an explicit ethical policy with customers on our website and in branches.' They continue to emphasise the role of CSR initiatives to drive charitable giving, employee community involvement, and energy savings internally. But short-term CSR strategies have been the primary mechanism through which banks have addressed social or environmental concerns.

Banks are still not doing enough. CSR initiatives are not sufficient to respond to the social and environmental problems facing society. Increasingly banks will need to integrate sustainability across their operations, including through new ethical product development. But some interviewees find that banks are reluctant to innovate in this area. 'Banks do not want to be perceived as being negative. They know that they need to respond to increasing ethical concerns, but they won't go down the path of proactively innovating in ethical products.' CSR strategies are viewed as part of marketing or brand development, rather than substantive commitments to introduce ethical finance as part of the product offering, or to change operating procedures through commitment to an ethical policy. 'Banks are influenced by the Co-op ethical policy and have seen the impact of this, but they are more defensive than really embracing ethical principles. Quite a lot of their CSR and actions are cosmetic in order to protect the brand.' In the best case, interviewees felt that the CSR approaches of banks were positive, yet ultimately ineffective. Others felt more strongly: 'In many cases the larger banks may be using a focus on ethics or CSR to detract from negative action they take part in. They are seeking to bolt on a bit of tinsel.'

Banks are not engaging in ethical finance. Almost none of the high street banks offer ethical finance products to consumers. The isolated exception is the NatWest community bond and the short-term HSBC 'Green Sale' products, which provide a charitable contribution to conservation initiatives for a limited time-period. 'Banks are also product and sales oriented rather than customer focused. Banks are not thinking about product development for ethical reasons.' Banks are not engaging with ethical consumers and developing new product offerings to capture this growing market. 'Not all financial institutions see the ethical consumers as potential customers yet.' Bank representatives admit to being sceptical about the impact of the ethical consumer movement: 'Environmental and social issues are becoming more important to ethical consumers, but we are not at a point where the interest has changed consumer purchasing behaviour. It has growing importance, but we are not yet at the tipping point.'

On the whole, banks have been very slow to respond to the new realities of climate change, environmental degradation, and concern over social issues through product initiatives. They are reactive rather than proactive. Part of this reluctance may be due to the challenging nature of adopting an ethical policy or specific ethical financial products. 'Banks that adopt an ethical policy open themselves up to greater scrutiny and require more transparency, which can be challenging.' Banks are disinclined to commit the resources required to train employees, adapt current systems, and overhaul evaluation and measurement procedures in order to put new products or ethical policies in place. Once banks open themselves to scrutiny they will have to be more transparent about all of their operations. 'If you are [an ethical consumer] supporting a cause, there is an expectation of more information, transparency, and involvement required, which is more resource intensive.' But the longer the delay, the more banks are missing out on a market opportunity. Ultimately, bank representatives agree: 'As things change, businesses will react.' The banks will likely follow where other businesses lead. Once the ethical consumer has been established as a market opportunity, the banks will slowly respond. 'An example is the response of banks to the Internet. Once it was proven as a commercial model, banks were willing to develop online banking.' Ethical consumers will generate increasing demand for ethical finance products in the future. This target market is attractive for banks, particularly as they struggle to find new ways to make a profit in the UK retail market. 'Banks are interested to attract more up-market, wealthy clients, with more sophistication for which ethical finance has appeal.' Those banks that move first will have a competitive advantage, establishing a strong presence in this market of discriminating consumers.

Challenges and opportunities

Key points: Challenges

- There are still significant gaps in the ethical finance product offering. Most notably, the high street banks are not introducing ethical financial products. Factors that influence this are:
  - Banks with an ethical policy are subject to a greater level of scrutiny, requiring improved transparency.
  - Banks are large organisations that have established IT, employee structures, and ways of operating: it is difficult to change course.
  - Systems for reporting, decision-making, customer service, staff training and incentives may need to be re-designed to accommodate ethical finance, requiring additional resources.
- The SRI sector remains under-resourced and new product development and innovation has been relatively slow.
  - There has not been enough focus on the delivery mechanism for SRI products: products are not getting out of the pipeline.
  - Sales people and advisers are often inadequately trained on SRI.
  - There has been limited marketing of ethical product features as an added value for potential investors.
- Financial advisers can be resistant to adoption of ethical finance, remaining sceptical of its value.
- High-impact ethical finance initiatives have limited resources for marketing, and are not well known.
- The level of risk involved in smaller, high-impact initiatives, and the associated issue of lack of liquidity, hampers scaling up of these products.
- Consumers are confused about who or what is ethical: What does 'ethical' finance mean?

Key points: Opportunities

- Ethical finance represents an opportunity for banks to establish a competitive advantage and introduce premium products that attract conscientious consumers.
- There is demand for well-designed ethical finance products that can be packaged to appeal to a broader range of consumers.
- High-net-worth individuals are increasingly interested in ethical investment.
- Offering a strong ethical finance product can attract a greater number of investors to the firm's broader product offering.
- Diverse ethical finance initiatives would benefit from a common label and central point of information.
- There is untapped potential for pension funds to exercise their power with companies. Collective action of pension holders could bring about positive change.
- Well-designed tax incentives, or government personal savings initiatives, could attract finance to ethical investment.

Gaps, barriers, and challenges

While the sector has come a long way, there are still many challenges for ethical finance in the UK. Our report has identified a number of outstanding issues. Some of the barriers to mainstreaming ethical finance are supply driven, relating to the limitations in existing institutions or initiatives, and others relate to the nature of consumer demand.

On the supply side, there are still significant gaps in the ethical finance product offering. Most notably, the high street banks are not innovating in this market or introducing new ethical financial products. There are very limited examples of simple, identifiable product options for ethical consumers offered by well-known financial brands. With a 70 per cent market share, the 'big five' high street financial institutions are best placed to bring ethical finance to the UK retail market. Banks have underestimated the ethical consumers as a niche market, and are not exploiting this demand. Given increasing concerns about declining margins in the UK retail banking market, ethical finance represents a prime opportunity to establish a competitive advantage, enhanced brand image, and introduce premium products that attract higher income conscientious consumers.

But there are challenges for financial institutions that take on an ethical approach. Banks with an ethical policy are subject to a greater level of scrutiny. Systems for reporting, decision-making, customer service, staff training and incentives may need to be re-designed. This represents an additional expense and resource requirement, as well as a commitment to enhanced transparency and communications. Banks are conservative institutions. They are also large organisations that have established IT systems, employee structures, and ways of operating: it is difficult to change course. A lead institution willing to be the first mover or innovator in this market is required.

The system for distributing financial products through FAs represents another challenge. Existing FAs can be resistant to adoption of ethical finance, remaining sceptical of its value for clients or adherent to the misperception that it will result in sub-optimal financial return. There is still a limited number of ethical investment FAs, with only 30 to 40 firms specialising in this area. For FAs not familiar with the sector, meeting the additional ethical requirements of investors can seem like additional work. One ethical investment FA also noted that, 'Compromise is a key factor in carrying out ethical investment whilst at the same time meeting the financial planning needs of the client.' Some FAs do not have the incentive to promote ethical products. The system of incentives that drives much of product selling may discourage FAs from introducing SRI funds or other ethical products to clients.

Ethical finance initiatives face a variety of challenges. They have limited resources for marketing, and are not well understood beyond a small group of dedicated ethical consumers. They have a tendency to rely on a core of dedicated supporters, rather than devising marketing strategies to attract conscientious consumers. These initiatives would benefit from deepening their appeal to high-net-worth investors, for whom ethical investment is attractive. Likewise, charitable foundations are also increasingly interested in maximising the social and environmental value of their endowments by investing in high-impact ethical finance initiatives. But with limited staff resources, ethical finance initiatives would be challenged to cope with greater demand, even if they were able to generate it. 'It is going to be difficult for ethical finance initiatives: there is no shortcut to make them more mainstream. Some of the issues they face are: risk, the rarefied nature of products, and lack of awareness. Given the limited resources and marketing budgets of organisations, it will be difficult for them to raise awareness.' As a sector, they are resistant to adopting a general common definition for ethical finance, similar to fair trade. Ethical initiatives cite differences in their focus issue, level of risk, and product features that distinguish each offering. A common identity or brand, however, would function to raise consumer knowledge and identification of ethical finance as a collective movement. The diverse nature of ethical finance initiatives means that, at a minimum, a common point of information is required. The new Investability website launched by UKSIF and EIRIS is a step in the right direction. The level of risk involved in smaller, high-impact initiatives, and the associated issue of lack of liquidity, also hampers the scaling up of these products. Institutional investors can not allocate funds to unlisted offerings. And many individuals view purchasing unlisted shares in social enterprises or community projects as a form of charitable giving, foregoing the dividends or interest generated. This approach limits the development of a broader, robust market for social investments and restricts the development of these products as a specific asset class.

On the demand side, the sector faces a number of issues relating to the nature of consumers, and their relationship to financial services. Consumers are confused about who or what is ethical: What does 'ethical' finance mean? 'A lot of customers haven't got a clue about the ethical finance products. They don't understand how the products are structured and what they entail. The financial literacy among consumers is not good, let alone how the ethical aspect comes into it.' In general, financial decisions are difficult to make for consumers, and many would prefer not to engage with the detail. As one individual noted, 'You want it to work. You don't want to understand why it works.' Finance is an area where people tend to be naturally conservative. Making decisions about pensions, mortgages, loans, and savings has long-term implications for oneself and one's family. Consumers require simple, straightforward options. In addition, once decisions are made, consumers are reluctant to change. Existing ethical finance products require a degree of financial savviness and a level of disposable income that is not open to most individuals outside of the top socio-economic brackets. As it currently stands, most high-impact ethical finance initiatives attract only committed ethical consumers. This needs to change to reach the wide range of conscientious consumers that represent a real market opportunity.

What works?

Some ethical finance products have attracted a wider market and established a strong following. Many of these products are offered in international markets, where different regulatory environments, consumer preferences, or historical social contexts influence product outcomes. We have carried out a series of short case studies to consider what features make these products effective. These ethical finance products still struggle with many of the challenges evident in the UK. The objective of each case study is to highlight positive and negative aspects to draw out relevant points for the UK market.

Calvert High Social Impact Investments, United States

The Calvert High Social Impact Investments (HSII) programme directs investment capital to non-profit organisations with the goal of ending poverty through investment. Certain Calvert funds invest up to 1 to 3 per cent of assets in this programme, depending on the fund.

Calvert achieves this through Community Investment Notes (CINs) administered by the Calvert Social Investment Foundation. The Foundation is a non-profit charity that invests in low-income communities while maintaining professional portfolio management with security enhancements, diversification, due diligence, and ongoing monitoring. This reduces the risk of the investments, while ensuring that they have high social impact. CINs are designed to pay a fixed below-market rate of interest, determined at the time the investment is made, for the term of the note. Typically these are 1–10-year notes earning up to 3 per cent interest.

As of March 2006, the Calvert Social Investment Fund had approximately US$18 million (£9.5 million) invested in this programme domestically and abroad. In addition, Calvert had US$1.7 million (£900,000) directly invested in community development bank notes (certificates of deposit).

HSII invests in five different community development lending areas, including: affordable housing, microcredit, local non-profits and co-operatives, small business loans, and a social innovation fund to finance social enterprise, fair trade, and environmental initiatives.

The design of the Community Investment Note is a flexible and ingenious mechanism to ensure that smaller, community-based financial initiatives can be packaged to a broader range of investors. High-risk investors can purchase the notes directly, while mainstream investors can incorporate the notes as one component of a mutual fund portfolio. Calvert has also been savvy in the marketing of the product, designing a range of brochures and a website that clearly features the offering.

Pros	Cons
• High social impact product with mainstream appeal • Allows for diversification within mutual fund (1 to 3 per cent of fund assets) • Limited risk • Scalable mechanism to channel significant funds • High transparency and quality of information • Well marketed and positively linked to wider product range	• Dependent on investment-ready community finance sector • May require legislative support (e.g. existence of CRA in the USA) for development of robust sector

Finansol, France

Finansol is a non-profit organisation based in France that manages a network of finance initiatives offering 'solidarity' or social finance products. Finansol operates a web-based network and manages a labelling system for approved financial products. The Finansol label distinguishes financial products that promote social or environmental objectives. Finansol encourages savers to subscribe to these funds by providing regular information about the products and the fund managers.

To qualify for the Finansol label, at least 5–10 per cent of a fund's assets must be invested in projects that promote social objectives, which often have lower returns, or 25 per cent of the income must be given to a non-governmental organisation (NGO) or other social organisation. Schemes must meet basic requirements regarding transparency and reporting. Finansol endorses a wide range of financial products, including current and savings accounts, bonds, equity funds and direct equity investment. Products can be bought directly from finance institutions, and are widely available from high street banks and mainstream financial outlets, and through 'save-as-you-earn' schemes.

The number of people with solidarity savings is rising, bolstered by a 'save-as-you-earn' scheme, which has opened up a new market. Savers have increased from around 20,000 in 1999 to 68,000 in 2005. Solidarity savings rose 45 per cent in 2005 to reach €888 million (£634 million). The last six years have seen average growth of 50 per cent in the amount of savings channelled to these products.

Solidarity finance is a specific French concept for financing social economy organisations, including co-operatives, mutual benefit insurance companies, trade unions, works councils, social housing organisations, and SMEs. While these investments tend to be less profitable, most attract tax advantages that result in moderate returns. Most solidarity savers (89 per cent) benefit from tax breaks. Around 20,000 received a tax break of 25 per cent in the investments. Those who choose 'profit-share' investments, whereby 25 per cent of the income goes to an NGO, receive a tax break of between 66 and 75 per cent of their investment income. The majority of investors were enrolled in 'save-as-you-earn' schemes which are tax-free.

Pros	Cons
• Labelling raises awareness and simplifies choice • Tax credit drives investment • Payroll-linked saving mechanism • Available through high street institutions • Website is useful common point of information	• Solidarity finance has specific history and appeal in France • Profit-share funds are simply another form of charitable giving, not investment • Finansol-labelled products still a small market

CITR Savings, Charity Bank, UK

Charity Bank opened in October 2002 as the UK's first not-for-profit bank to provide affordable loans to charities and social enterprises, including CDFIs. Charity Bank provides savings and deposit accounts for individuals and organisations to channel capital for loans to social organisations. Some of its accounts appeal directly to philanthropy, offering a lower interest rate of 2 per cent, which many savers opt to waive, allowing Charity Bank to further reduce the rate of interest charged to borrowers.

Historically, Charity Bank offered accounts to both individual savers and corporate clients, where deposits attract Community Investment Tax Relief (CITR). CITR accounts allow individual savers and corporate clients to claim tax relief of 5 per cent on their deposits. The tax relief is worth 8.33 per cent at the higher rate of income tax bracket (40 per cent), 6.41 per cent at the standard tax rate (22 per cent), and 7.14 per cent at the main rate of corporation tax (30 per cent). These returns represent a premium over that available in mainstream savings accounts. Currently CITR is only available for the first five years of an investment. The minimum investment in a CITR account was £1,000, with no upper investment limit. There are restrictions on withdrawals from accounts that attract CITR, because this can jeopardise eligibility for CITR. Thus CITR accounts are only suitable for longer-term savings. The CITR accounts raised £29 million prior to closure in 2005.

The terms governing CITR require qualifying funds to be invested in CDFIs that provide enterprise loans in disadvantaged communities. As its loan book is fully funded, Charity Bank has closed the CITR accounts to new deposits for the foreseeable future. Along with other CDFIs, Charity Bank is seeking a relaxation of the terms governing CITR, because current terms are too onerous, making it difficult to loan out funds received within the given timeframe.

The success of the Charity Bank CITR account is largely dependent on the terms of the tax relief, as well as the structure of the current UK CDFI sector. The CDFI sector Charity Bank lends to remains young, with limited capacity to absorb a significant amount of investment at this early stage.

Pros	Cons
• Above-market financial return on savings • Significant funds raised of £29 million • High social impact investment • Highlights role of incentives to drive investment • Demonstrates effectiveness of simple, well-designed products	• Investment readiness of UK CDFI sector • Inflexible terms of CITR incentive

In summary the case studies identified the following:

- There is demand for well-designed ethical finance products that can be packaged to appeal to a broader range of consumers.
- Appropriate ethical finance products with attractive features can attract significant funds for social purposes.
- Social investment can be wrapped into a wider fund so as to limit risk and channel substantial funds to direct social or environmental outcomes.
- Offering a strong ethical finance product can attract a greater number of investors to the firm's broader product offering.
- Innovative products have managed to overcome issues of risk, limited return, lack of awareness and liquidity.
- Creating products with broader appeal may require an established financial institution with credibility, professional management, reporting and due diligence.
- Savvy marketing can make a difference.
- There is value in a common label to attract individuals to ethical finance, exemplified by the Finansol mark in France.
- A common information point, basic standards for product labelling, and ease of comparability through a website proved to be a successful model.
- A 'save-as-you-earn' feature is a practical means to attract additional investors to ethical finance.
- Well-designed tax incentives work well to attract finance to ethical investment. For example, a higher tax-adjusted return on savings, with limited risk due to deposit insurance, along with high social impact is a 'win-win' option.

Findings for the UK

Recommendations

This report highlights a number of challenges and opportunities for the UK ethical finance sector. Ethical finance has grown substantially from its beginning in the 1970s. SRI funds have begun to enter the mainstream. Climate change, depletion of natural resources, and environmental degradation are increasingly viewed as business opportunities. Financial institutions recognise that they must adapt to SEE risks. Selected banks have taken the first steps towards sustainable practices, and are improving reporting on these activities.

But ethical finance has a long way to go if it is to impact the mainstream financial services industry. Demand for ethical financial products is evident in the growing number of conscientious consumers. UK consumers are frustrated with the status quo banking model that is solely focused on extracting profits from customers. But ethical financial products to address the growing ethical consumer market are missing. What should be done to move ethical finance products into the mainstream?

Banks

Lead on social responsibility by moving beyond the minimum CSR commitment

Banks are not doing enough to engage in ethical finance. Many banks' social responsibility activities are limited to ad hoc charitable donations and employee volunteer programmes. CSR initiatives are not sufficient to respond to the social and environmental problems facing society. Banks need to integrate sustainability across their operations, including new ethical product development.

View ethical consumers as a dynamic market opportunity

Companies taking the lead in meeting the needs of the new ethical consumer will be the market leaders of the future. Ethical investors are likely to be affluent individuals with a greater willingness to purchase financial products with added ethical features; in some cases even if they have to pay more. These are attractive clients for financial institutions

Focus on ethical finance products with added social or environmental benefits.

Ethical finance represents an opportunity for banks to establish a competitive advantage, enhance brand image, and introduce premium products that attract conscientious consumers. A lead institution willing to be the first mover is required.

Introduce simple, low-risk ethical products that are easy to understand and well-marketed

Creating products with broader appeal requires a financial institution with credibility, professional management, and an established brand. Consumers require practical, simple and well-designed products that they can trust. Ethical finance products have to be easy to understand, easy to access, and offer relatively low risk and a reasonable financial return.

Introduce greater transparency across all operations

Consumers expect more information from banks about how their money is being used. Banks have come under public pressure because of practices such as PPI, unauthorised overdraft charges, and delays in cheque clearing times. Banks should emphasise transparency of operations, promote clarity in communications and prioritise fair treatment of customers in order to win public trust.

Apply ethical guidelines to lending and investment decisions

A key action for banks is to reflect environmental and social considerations in lending and investment decisions. Social, environmental and ethical issues are important risk factors. Banks should apply ethical guidelines as part of investment decision-making to avoid supporting companies or activities that are unsustainable or socially irresponsible.

Develop a robust ethical policy to distinguish the brand in the market

A comprehensive ethical policy makes a clear statement about the social and environmental values of the bank. Adopting an ethical policy will distinguish a bank from its competitors. Only the Co-operative Bank currently has an ethical policy, which has resulted in a strong market share among conscientious consumers. An ethical policy results in implementation of social and environmental standards to inform all of the banks' activities.

Building societies should offer ethical finance products

As mutual organisations, building societies have a well-developed social mission and are run for the benefit of their members. Building societies offer simple financial products that may appeal to individuals from average and below-average income levels, suggesting a means to broaden the base of consumers engaged in ethical finance.

SRI funds

Expand marketing of SRI funds with social and environmental features

Marketing is crucial. There has been too little focus on ethical product features as added value for potential investors, rather than simply financial return. SRI fund advertisements should move beyond the specialist press to attract to a wider audience by emphasising social or environmental factors.

Make SRI engagement practices more transparent and measurable

At present, there is limited transparency or comparability of engagement approaches across different funds. A more systematic approach to reporting engagement practices is required in order to enhance its strength as a tool for change.

Apply SEE engagement strategies across all investment portfolios to maximise impact

Engagement and dialogue with established companies has the greatest potential to effect change. Engagement can bring about integration of SEE factors into corporate governance, investment decision-making and operations by large publicly listed corporations.

Form partnerships with high street retailers to introduce SRI retail products to a broader audience

SRI funds represent the first point of entry for many ethical consumers seeking to invest their money in a socially responsible manner. SRI funds should seek to attract more conscientious consumers, broadening the number of investors along the way. This might be achieved by forming partnerships with established high street brands, exemplified by the new M&S ethical fund.

Ethical consumers

Require an expanded range of practical, simple and well-designed ethical products from finance providers

Considerations of price, quality and convenience will never entirely disappear from the equation. Ethical products trade on the added benefit they bring to society or to the environment, but they also have to be attractive, easy to access and good value for money.

Need to see the link between ethical consumption and finance

With the growth of ethical consumerism, there is significant potential for many more individuals to be ethical fund investors, savers and current account holders. Every ethical consumer is a potential customer to the ethical financial services sector. Awareness of ethical options in the finance sector is still relatively low among consumers, requiring better marketing and targeted campaigns.

Increasingly seek alternatives to existing bank products

High street banks have increasingly come under pressure from consumers as a result of PPI, bank fees and unauthorised overdraft charges. Consumers are seeking new options for financial products. Growing concern over issues such as climate change mean that more and more people are thinking about the impacts their savings and investments can have. This is an opportunity for banks to introduce new ethical financial products.

Will need a higher level of financial literacy

Ethical finance requires a higher level of financial literacy and awareness of how ethical issues can be addressed through financial products. Financial literacy programmes, such as carried out by the FSA, could introduce ethical finance to consumers

Need greater awareness of SEE issues in finance. Government and financial adviser engagement are key

Many ethical consumers are interested in ethical finance, but only a limited number are aware of ethical financial product options. Financial advisers play a key role to inform clients about ethical finance. Government initiatives to improve financial capability and build long-term personal savings should also incorporate ethical finance as an option.

Would be willing to embrace ethical finance through pension funds

More than 75 per cent of adults think their pension fund should operate an ethical policy. Pension fund trustees should use their voting power to encourage greater environmental, social and ethical accountability from companies in which they hold investments. Collective action of pension holders could bring about positive change on human rights, environmental and labour issues.

Respond to clear product choices to address environmental issues

There is overwhelming support for the concept of ethical purchasing among the UK public. There is a broad group of consumers that are increasingly environmentally and socially conscious, who are prepared to pay more for brands that they perceive to be responsible.

Ethical finance initiatives

Likely to remain niche, but can focus on attracting high-net-worth social investors

Ethical initiatives should focus on attracting high-net-worth investors who view social investment as a positive option. Well-off individuals are increasingly interested in making an impact on social and environmental projects, which leads them to explore social investment opportunities. Charitable foundations are also increasingly interested in maximising the social and environmental value of their endowments.

Improve marketing initiatives

There is very limited awareness of high-impact ethical investments beyond a very engaged community of ethical investors. Selected ethical finance initiatives with strong products and bigger ambitions may be able to reach a wider audience. Key will be to reach a broader base of conscientious consumers through effective marketing strategies and development of user-friendly products.

Consider collective action and better use of the media to raise consumer awareness

High-impact ethical finance initiatives have limited resources for marketing, and are not well known. They would benefit from partnering with like-minded organisations to adopt a common label or mark to raise awareness. A collective strategy to communicate through the mainstream press would improve consumer awareness.

A central website with comprehensive, up-to-date information would advance the sector

Ethical finance initiatives are varied and are not easy for ethical consumers to find. With no central information point, consumers find ethical initiatives on an ad hoc basis. A one-stop website for information would promote bigger take-up of ethical finance initiatives

Issues of risk, liquidity and lack of return will need to be addressed if seeking to expand appeal

Issues of risk, liquidity and lack of return may limit the scale of existing ethical finance initiatives. High-impact ethical investment is viewed by the average consumer as too risky or not likely to yield a return. Innovative international products have managed to overcome these issues to broaden appeal by designing new mechanisms.

Appendix 1: Glossary

Asset class	A specific category of investments, such as stocks, bonds, cash or property. Assets within the same class generally exhibit similar characteristics, behave similarly in the marketplace, and are subject to the same laws and regulations.
Bonds	A debt instrument issued for a specific period to raise capital by borrowing from a group of lenders.
Building society	A mutual financial institution that offers personal financial services. Societies have no external shareholders requiring dividends and are not companies. They are run for the benefit of members, who have rights to vote and receive regular information.
CDFIs	Community Development Finance Institutions are independent organisations that supply capital and business support to individuals and organisations whose purpose is to create wealth in disadvantaged communities or under served markets.
Credit union	A co-operative financial institution owned and controlled by its members. Credit unions differ from banks and other financial institutions in that the members who have accounts in the credit union are the owners of the credit union.
Engagement	An investment strategy designed to convince companies to change their behaviour and become more socially responsible through shareholder activism or meetings with senior management. This approach requires direct involvement of the fund manager, on the basis that shareholders are owners of the company and can influence company decisions.
Ethical banking	The provision of ethical financial products, such as current accounts, savings accounts, loans, and insurance
Ethical consumers	Individuals who reflect their social or environmental values in the decision to purchase or avoid certain consumer goods; for example, by buying organic, fair trade or environmentally friendly products, or by boycotting unsustainable products or companies.
Ethical finance initiatives	Financial products that channel funds directly to social or environmental projects or enterprises in order to have a high impact; for example to support community wind farms, social enterprises, microfinance or development of disadvantaged communities.
Ethical finance	The provision of financial products or initiatives that combine investors' interest in achieving financial return with a concern for social, environmental and/or ethical (SEE) issues. Ethical finance encompasses a broad range of financial activities including ethical banking and ethical investment.

Ethical investment	The allocation of finance to social investment or socially responsible investment (SRI) funds.
Financial adviser	A person employed by an individual or financial institution to manage assets or provide investment advice.
High-net-worth individuals	A type of investor with significant wealth: typically individuals with a minimum of £1 million in financial assets to invest.
Institutional investors	An entity with large amounts to invest, such as investment companies, mutual funds, brokerages, insurance companies, pension funds, investment banks and endowment funds.
Liquidity	The extent to which an asset to be converted into cash quickly and without any loss of price.
Matched market	A facilitated forum in which a broker connects buyers with sellers and to organise a transaction in shares.
Negative screening	The practice of removing companies from an investment portfolio to avoid financial support for unsustainable activities or industries deemed unethical. For example, this might include: the arms trade, tobacco, alcohol, pornography, and extractive industries as well as companies with unethical business practices: infringement on human rights, labour standards, and unfair terms of trade.
Positive screening	The practice of allocating finance in an investment portfolio to companies selected for being more responsible. These include, for example, companies developing new technologies for renewable sources of energy or companies that are particularly good corporate citizens and lead the way in social responsibility.
Private equity	Finance provided in return for an equity stake in potentially high-growth companies that are not listed on the stock exchange (unlisted equity). Often involves investment in a portfolio of companies, with the objective of changing company strategy to improve financial returns.
Public equity	Finance achieved by selling stock to investors through the stock exchange.
Social investment	The allocation of funds to high-impact social or environmental businesses either by directly buying shares or making loans to an enterprise or investing in a fund that makes such investments.
Socially responsible investment	Funds that invest in publicly listed companies that are screened to form a portfolio: either to exclude those that produce negative impacts or to select those with positive performance in specific areas of interest. Broadly, there are three main approaches to SRI investment: negative screening, positive screening, and engagement.
Sustainable finance	Sustainable finance has focused on the integration of social, environmental and corporate governance objectives into internal operations. In practice, this means that banks have begun to measure and reduce their carbon footprint; identify environmental and social risks; and explore market opportunities to support renewable energy projects or facilitate carbon trading.
Unlisted equity	Shares in a company that are not listed on a public stock exchange.
Venture capital	Finance provided to start-up firms and small businesses with exceptional growth potential in return for an equity stake. Managerial and technical expertise is often also provided.

Appendix 2: Research method

Our analysis of the UK ethical finance sector relies upon multiple research methods. We carried out an initial literature review to provide a comprehensive assessment of scholarship in the ethical finance field. This analysis was supported by semi-structured interviews with key industry figures, including representatives from ethical consumerism, SRI funds, ethical investment FAs, ethical finance networks, ethical finance initiatives, and high street banks. Specific questionnaires were developed for each of these groups in order to review the perception of ethical finance in the UK and expectations for the future of the sector. Twenty-six interviews were carried out lasting approximately 30 to 45 minutes each. These were targeted to capture information on and to gain an insight into the state of the industry. Data from these interviews have been summarised and incorporated into our analysis to identify recurring themes and to highlight key observations. In addition to these interviews, we have mapped the sector and reviewed the range of ethical finance products available in the UK. To further inform our analysis, we completed four short case studies on ethical finance products to consider the strengths and weakness of existing initiatives, and to draw out lessons applicable to the UK ethical finance sector. Finally, we benefited from an advisory group of relevant experts and practitioners to inform our findings.

Interviews

- Philip Acton, Head of Savings, Triodos Bank
- Dr Martin Clark, Development Director, Citylife
- Richard Scanlon, Finance Director, Cafédirect
- Jamie Hartzell, Founder and Managing Director, Ethical Property Company
- Jim Brown, Independent Consultant, Baker Brown Associates
- Jennifer Rhodes, Ethical Consumer Research Association
- Professor Melanie Howard, Co-founder and Director, Future Foundation
- Stephen Hine, Head of International Relations, Ethical Investment Research Services (EIRIS)
- Matthew Connolly, Founder, Enable Interactive
- Mick McAteer, former Principal Policy Adviser, Which?
- Alice Chapple, Director Centre for Sustainable Investment, Forum for the Future
- Dr Clive Barnett, Reader in Human Geography, Open University
- Alastair Camp, Head of CSR, Barclays
- John Swannick, CSR Manager, Lloyds TSB
- Barry Clavin, Ethical Policy Manager, Co-operative Bank
- Penny Shepherd, Chief Executive, UK Social Investment Forum (UKSIF)

- Duncan Exley, Campaigns Manager, Fair Pensions
- Oliver Dudok van Heel, Associate Director, SustainAbility
- Mark Campanale, Director, London Bridge Capital Limited
- Mark Mansley, SRI Advisory Services, Rathbone Greenbank
- Julia Dreblow, SRI Fund Manager, Friends Provident
- Colin le Duc, Founding Partner, Generation Investment Management
- David Gait, Senior Portfolio Manager, First State Investments
- Greg McCrave, Director, Profit with Principle
- Alan Kirkham, Director, Investing Ethically Ltd
- Dr R W Keyte APFS, Director, Towers of Taunton (Financial Services) Ltd

Advisory group

Individual	Title	Organisation
Brigid Benson	Senior Partner	EIA/GAEIA Partnership
Julia Dreblow	SRI Fund Manager	Friends Provident Stewardship Fund
Lee Coates	Director	Ethical Investors Group
Malcolm Hayday	CEO	Charity Bank
Mark Campanale	Director	London Bridge Capital Limited
Penny Shepherd	CEO	UKSIF
Jenny Edwards	Financial Sector Specialist	Ethical Consumer Research Association
Rod Schwartz	Founder	Catalyst Fund Management
Stephen Hine	Head of International Relations	EIRIS
Charles Middleton	UK Managing Director	Triodos
Danielle Walker-Palmour	Foundation Director	Friends Provident Foundation
David Carrington	Consultant	Independent

Appendix 3: Further reading

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One of the other things we do

environment
lifestyles must
become sustainable

Photo: Marcelo Alves

Tackling climate change: We are living beyond our means. Conventional economic growth based on the profligate use of fossil fuels threatens to bankrupt both the global economy and the biosphere during this century. **nef** believes that improving human well being in ways which won't damage the environment is real growth. Only that can ensure the planet is a fit place to live for generations.

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nef works to confront the destructive reality of climate change in many ways: building coalitions to halt climate change and get those under threat the resources they need to adapt; proposing legal and economic action against rich countries who refuse to act; calling for protection for environmental refugees, and for a worldwide framework to stop global warming based on capping dangerous emissions and equal per person entitlements to emit. With original research we expose new problems and suggest solutions.

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