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COMMENTARY

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What Should Bill Gates Do?

By JON ENTINE

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It's January 2000. You manage a philanthropy that's decided to "do well by doing good." It has bowed to advocacy groups and agreed to invest its endowment in only "good" companies -- corporations that pass ideological litmus tests on the environment (no nuclear plants), corporate governance (independent boards), diversity (gay rights), and the like.



What companies do they recommend? Well, Enron has independent directors. Krispy Kreme gives tons of money to charity. Cendant is renowned for its diversity. HealthSouth is actively involved in communities. Check, check, check, check. The list goes on: Tyco, Adelphia, WorldCom, Rite Aid, Arthur Andersen, Qwest, Global Crossing, Martha Stewart, Bristol-Myers-Squibb, Lucent, Kmart.

Of course we know what happened. Every one of those "socially responsible" supernovas flamed out or are worth a fraction of what they once sold for, victims of self-inflicted ethical wounds. The big losers have been credulous pension funds, religious groups and liberal investors who put their hearts where their heads should have been.

Ken Fallin

Bill Gates might keep this history in mind today, when he meets with the media at the World Economic Summit in Davos and responds to a screed, masquerading as an investigation, directed at the \$35 billion Bill and Melinda Gates Foundation portfolio. Three weeks ago the Los Angeles Times ran a series accusing the foundation of reaping "vast financial gains" from corporations with "environmental lapses, employment discrimination, disregard for worker rights, or unethical practices" that "contravene its good works."

It's "blind-eye investing," the Times seethed. Within hours, words like "appalling" and "giving with one hand, taking with the other" ricocheted through the blogosphere and into dozens of newspapers around the world. At a minimum, critics said, Mr. Gates should avoid companies that counteract its stated mission. What should Bill do?

Social investors claim that this 800-pound philanthropic gorilla could change the world by adopting mission investing. Only the realities of capital markets and the stark truth about social investing interfere with that equation. U.S. stocks have an aggregate capitalization of \$16 trillion. With all due respect to even the Gates Foundation's billions, its funds, spread over many hundreds of stocks, have no effect on the market value of any single stock. Selling a "bad" company would have no more impact than scooping a thimble full of water out of the deep end of the pool; it goes back in the shallow end when the person on the other side of that transaction buys it.

The social investing community also suffers from the hubris that it can separate the good guys from the bad guys. The Times report mentioned that half of the children attending a high school in South Africa suffer from asthma and other respiratory disorders that the Gates Foundation is committed to eradicating. It noted that a nearby refinery that spews out pollutants is owned in part by a foundation-held company, BP. Outrages like this would not happen, the Times suggested, if only the foundation would use socially responsible rating services of firms like the Calvert Group in Bethesda, Md. So much for investigative reporting. Calvert not only invests in BP, it praises the company as an environmental leader. For the record, Calvert added Enron to its approved list in March 2001, just as its ethical house of cards was collapsing, and also owned HealthSouth, ImClone and other ethically-challenged firms.

The dark secret of "social investing" is that it is neither art nor science: It's image and impulse. It reflects perceptions, not performance. Years ago I did a report on the Body Shop, the U.K.-based cosmetic company whose founder, Anita Roddick, was hailed as the Mother Teresa of Capitalism. In the early 1990s, the Body Shop was the world's most popular "socially responsible" investment. It was touted for its natural products, charity, fair trading and integrity. I discovered that Ms. Roddick had stolen the name, concept, product line and even its brochures from the San Francisco-based Body Shop that started seven years before she opened her copycat version. Ms. Roddick fabricated her history; she gave almost no money to charity over the company's first 11 years, and has given meagerly since. The Body Shop's products were made mostly from water and cheap petrochemicals; it had a record of exploiting poor Third World producers; and its franchise system was riddled with mismanagement, which eventually resulted in the

company paying more than \$500 million to buy out dissidents and diffuse fraud suits. My report sent the company's stock down by more than \$600 million -- causing great anguish to social investors -- and contributed to a 10-year tailspin that resulted in its being sold.

The market has proved remarkably efficient in determining what marks a corporation as "good." Customers and investors vote on that every day. It should come as no surprise that a recent Wharton study calculated that funds that layer on ideological screens often perform worse than the general market by about 31 basis points a year, a huge discrepancy. Domini Social Equity Index, considered the gold standard of social index funds, rates a lackluster C- in Business Week's latest ratings. Calvert's Social Index Fund has lost 1.82% since its inception in 2000, ranking it in the bottom 15% of all funds. Now Bill and Melinda Gates are being asked to turn over investment for billions of dollars to these same social researchers?

The Gates Foundation does have one social screen -- it will not invest in tobacco companies. But even that supposedly moral position is suspect. While social investments have slid in recent years, tobacco firms have thrived. The value of Altria has increased by 450% since 2000. If one is genuinely antismoking, which is the more moral position: cashing in on well-run corporations like Altria and using market profits to fund critical causes, or satisfying one's conscience by investing in lackadaisically performing but politically correct companies?

The use of social criteria may be fine for affluent investors or activists who gamble their own money and assume the extra risk to achieve their perceived political goals, but the Gates Foundation has set a higher standard. Let's hope it keeps it.

Mr. Entine, an adjunct fellow at the American Enterprise Institute, was recently asked by the Gates Foundation for research on "socially responsible" investing.

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