DISCUSSION OF:

"CORPORATE ESG PROFILES AND INVESTOR HORIZONS "

by Laura Starks, Parth Venkat, and Qifei Zhu

Discussion by:

Adair Morse
University of California, Berkeley

June 2018, WFA

Contribution

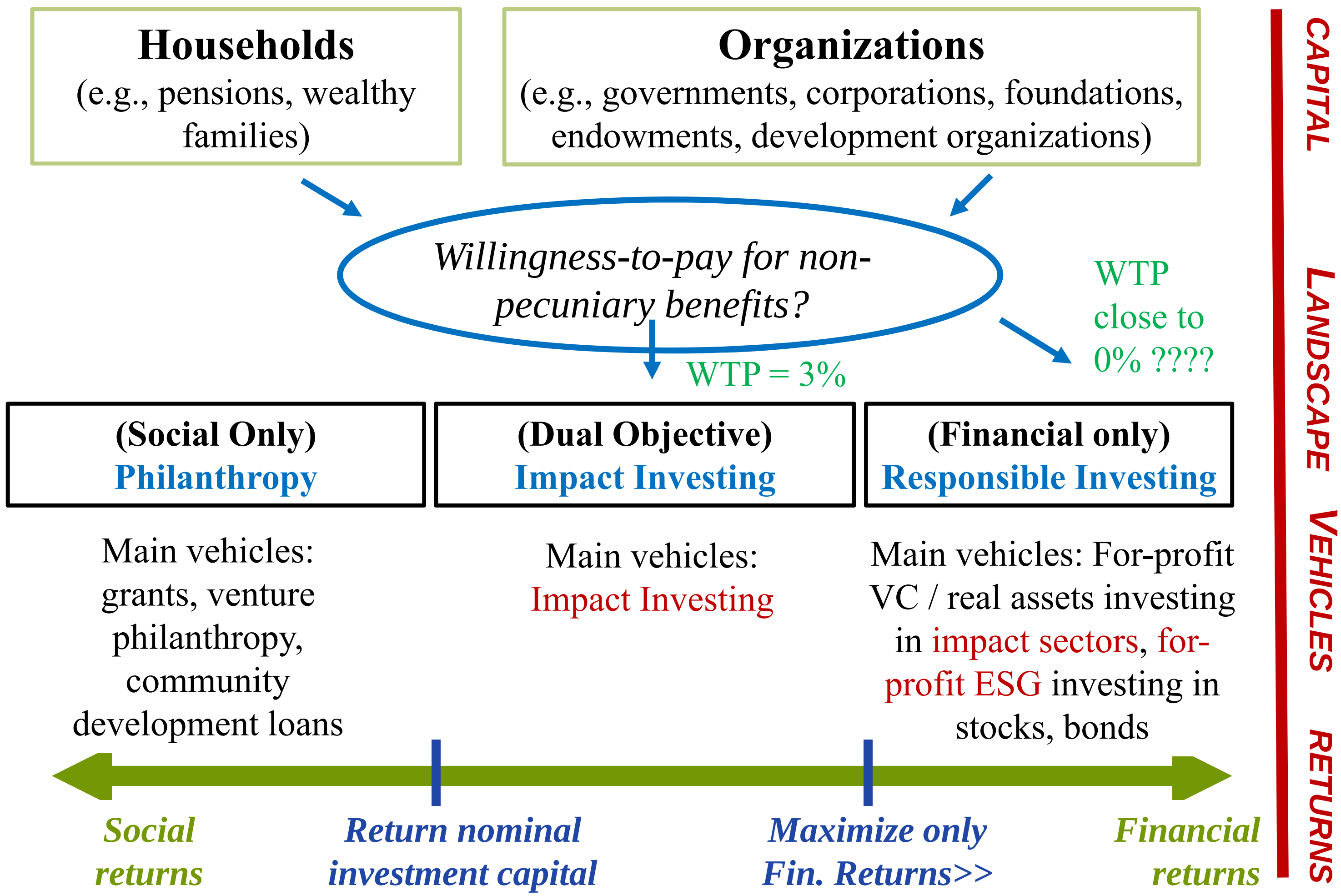
- Investors with longer horizons prefer to invest with more EGS exposure
  - Main plausibly causal estimates are around FTSE4Good index inclusion and the holdings of LT versus ST investors
    - Importantly, the inclusion is about ESG scoring, not valuation.
    - I'd like to hear more of this process of FTSE4Good inclusion.

<u>Big picture:</u>

Absolutely we need to know about <u>who</u> is doing Responsible Investing and <u>why</u>.

- Personal interest: Barber, Morse, Yasuda (2017) on Impact Investing
- UNPRI - $81 trillion in AUM for signatories that claim some notion of being responsible

Landscape of responsible-to-financial investing



Comments

1. Framing the analysis
2. Analysis Flow

Framing the analysis

- Authors link *long termism* to ESG as if the literature has converged on a fundamental that firms with better ESG practices can increase firm value through…
    - Avoiding myopic decisions
    - Attracting customers and employees in LT
    - Decreasing firm risk to (e.g.) LT climate factors

- Is it that LT investors are investing in ESG because of a investing strategy aimed at LT returns.
- Or are they investing in ESG because LT constituents want them to do so and thus their implementation objective is to avoid losing risk-adjusted returns?

- Horizon may be about who the constituents are that demand ESG loadings rather than whether the ESG is profitable in LT strategies

Quick Aside: Returns from Empirical Studies of ESG

Beyond not knowing whether LTism is about constituents or strategy,
… we don't really know if LT ESG profiles <u>are</u> value-creating (or, don't lose money)

<u>Evidence on ESG returns is a mixed bag</u>

- See references in Bialkowski Starks (2016)

- SRI indexes perform statistically no different than traditional indexes

- My view: it is most instructive to understand the pieces of ESG

Returns: Empirical Studies

- **<u>“G” has done well</u>**
  - Investing in better governed firms (well grounded in theory) + new information
  - Servaes Tamayo (2013), Hong Liskovich (2015), Ioannis Serafeim (2015), Lins Servaes Tamayo (2015)…

- **<u>“Internal S” has done well</u>**
  - Defined as social returns about firm treatment of labor and thus ability to attract best employees (akin to G), not about society impact (child labor, poverty, etc.):
  - Edmans (2011), Baron, ….

  - Note: Activism in G and Internal S associates with higher valuation
    - Denes Karpoff McWilliams 2016, DelGuercio Tran 2012, Dimson et al 2013
    - **Implication:** Likely that activism has already eroded these cross-sectional distinctions

- **<u>“E” & “External S” has probably (?) not done as well</u>**
  - Sin stocks do well (Hong and Kacperczyk, 2009)
  - Evidence is very limited/weak because of short time series
    - More research emerging – many climate risk working papers

Comments on Frame

- Authors could
  1. **Do a return analysis from the over-allocations to ESG firms by investors**
     - This would not necessarily disentangle constituent versus strategy but would be provocative
  2. **Consider the ESG allocations by different types 13F investors**
     - Some constituent types are longer term. Some may not have nonpecuniary utility for ESG.

Note: I personally think all of the mutual fund results should be taken from the paper. Mutual fund investors are really hard to categorize and frankly the results being parallel for "active" mutual fund investors make me think all of the 13F institutional results are about the extent to active or factor investing

  3. **Map 13F investors to ESG fit with either a strategy or constituent story**
     - Example: Among university endowments, some have pledged (publicly available) to implement climate-friendly investment strategies to satisfy constituents

Comments on Analysis (Flow)

Authors start their "results" by presenting a lot of associations to build arguments of relationships

FundESG = Fund horizon (fund churn) + characteristics

Investor horizon = Investor ESG + characteristics

- Opinion: **Move these to "figures" or correlational motivation (describing data) that set up the causally-motivated tests**

Comments on Analysis (Flow)

<u>Then authors move to Portfolio Choice-Motivated estimations:</u>

<u>Should be something akin to:</u>

- (Δ) Holding in a firm = (Δ) Firm ESG by Exogenous shock * Investor Horizon
  - Meeting all the counterfactual assumptions, etc.

- My suggestion: write the paper this way.
- Laying out analysis flow in thinking about
  - Portfolio choice considerations and
  - Conditional independence assumptions to make plausibly causal estimation

Comments on Analysis (Flow)

The authors estimate important *patience result:*

*Dummy(Sell by Mutual Fund) = ExcessReturns + ExcessReturns*ESG(firm)*
+ mutual fund-quarter f.e. + controls

- Finding: Investors investing in high ESG firms are more patient
- Paper uses (perhaps too) conservative language, but should address possible Omitted Variables:
  - ESG score of a firm might be correlated (?) with valuation changes that induce selling by active investors

Comments on Analysis (Flow)

Finally, the authors end with the FTSE4Good shock framework

Identification seems reasonable, especially if comparing

"a LT investor holding shift in a ESG shocked firm

relative to a LT investor holding in other firms that match in portfolio covariance properties and

relative to the ST investor shift in that ESG shocked company"

- More here …

1. Is my red above compared? (Again, the LT investor might vary on factor exposures or other features that lead to rebalancing properties)
2. Delve into which 13F investors to disentangle constituent vs strategy
3. Work on WHY

Conclusion

Already very influential paper. Deservingly.

My discussion comments are about making it cleaner:

1) Frame: Constituents versus LT Returns Strategy?

2) Analysis: Center paper more on main portfolio choice estimations (not associations)
   - Tell us what might violate causal interpretation
   - Delving into "by whom" and "why"