Discussion of:

Investor Tastes, Corporate Behavior and Stock Returns: An Analysis of Corporate Social Responsibility

by Hwang, Titman and Wang

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Authors’ Main Take-Aways

1. Stocks that experience an increase in SRI ownership (SRIO) tend to increase CSR
2. Increased SRI holdings are associated with negative excess stock returns
   - Consistent with the hypothesis that an anticipated increase in CSR harms shareholders
3. Hedge fund holdings tend to be associated with lower CSR growth even when they are classified as SRI

Empirical Innovation: Focus on Investor

Two types of institutional investors: II and SRI

- NSRI: maximize financial performance.
- SRI: max financial performance & adhere to social responsibility

- When NSRI accumulates shares in a particular stock , market will react favorably (if at all) because market infers cash flow news is positive

- When SRI accumulates shares, the market considers whether the SRI is rebalancing shares because of expected future change in KLD
  - If negative stock reaction, “must be” negative value information about future KLD
  - If positive stock reaction: unclear if KLD is changing with positive effect or if CF news is emerging with positive effect

MAIN RESULT

Panel B: DGTW adjusted returns

	$\Delta SRIO\_NONHF_q$		$\Delta NSRIO\_NONHF_q$
1(Low)	1.318		0.880
2	0.687		0.537
3	0.487		0.496
4	0.360		0.154
5	0.487		-0.048
6	0.258		0.225
7	-0.363		-0.086
8	-0.166		-0.055
9	-0.326		0.018
10 (High)	-0.509		0.090
High-Low	-1.826***		-0.790
	(-3.87)		(-0.95)
Diff in Diff		-1.036*	
		(-1.90)	

- I really appreciate this pattern

<u>I have concerns with / comments on:</u>

- measurement of SRIO
- HF analysis
- mechanism
- the take aways / restructure

Comment 1: Suggested re-structuring

Returns

- Increased holdings by SRI-investors are associated with negative excess stock returns
- Robust to alternative definitions of SRI investors (Comment 2 suggestions)

Mechanism

- Then evidence on mechanism: Current negative returns reflect an anticipated increase in CSR which harms shareholders (comment 4)

(I would order the paper this way, starting with the diff-and-diff table 6.)

But, can you show this?

Comment 2: Measurement of SRIO

Definition SRI:

- For each institutional investor, take portfolio-weighted average of (KLD – mean (KLD, size decile)):
- Above-median investors are SRIs (seems too large).
- SRIO = sum of ownership % for all investors deemed SRIs

Concern : KLD scores are correlated with other firm attributes (labor, environmental) that systematically sort by micro-industry, by region, by exposure to government contracting, etc.

Any change in ΔSRIO exposure to a firm could be due to:

1) Firm capitalization growth into a new size decile (growth in P/E, M&A, issuances)
2) Investors adjusting portfolio with market… what if SRI are more like indexers? (or vice versa). ΔSRIO may reflect market updating of a sector or of a sector exposed to policy, etc?

Fixes: Issues are not easily handled by industry-year f.e. Strategy level-benchmarking is better, but still concerning. Factor benchmarking? (Sharpe, 1992, Gerakos, Linnainmaa, Morse (2016)

Comment 2: Alternative measures of SRI

You are not going to be perfect on the prior slide. Thus, you need to swamp the reader in other, also non-perfect definitions of an SRI

Alternative SRI definitions

- UNPRI checkboxes
- Historical SRI investors
- Investors investing in other social asset classes (impact investing)
- Just looking at foundations and development organizations

Note: Foundations and development organizations are those that Barber, Morse, and Yasuda (2016) found to have positive utility (willing to forgo return)

Comment 3: No HF split

- The HF split is a bit of a distraction from your main finding.
- I'm not going to go into details here, but you just do not have the data to say anything with confidence, especially the mechanism and the results are not internally consistent.
- e.g. 1: Your tertile analysis with 126 SRI_HF.
  - Persistence is 0.77 – thus most do not even change from being KLD = 0. (median is 0)

	ΔKLD	Num of investors	Num with changes
Tertile 1 of SRIO_HF	0.001	42	0
Tertile 2 of SRIO_HF	0.116	42	5
Tertile 3 of SRIO_H	0.132	42	6
	0.083	126	

- e.g. 2: Your monthly return estimation result is not consistent with the story you are pitching about hedge funds.

Comment 4: Mechanism
Regress ΔKLD$_{t \text{ to } t+1}$ on institutional ownership types and controls

	(1)
$IO_{q,t}$	-0.5097***
	(-10.70)
$SRIO_{q,t}$	0.7120***
	(8.52)
$Yret_t$	0.0228**
	(2.34)
ROA	0.2124***
	(4.81)
$Logasset$	0.1782***
	(22.80)
KLD_t	-0.1426***
	(-23.09)
$Intercept$	-0.7286***
	(-16.72)
Year-Industry Dummies	Yes
Observations	20,806
R-squared	0.151

- **Dependent variable ΔKLD has a mean of 0.083**
  - **Most observations are zero**
- **SRIO and IO are very collinear**

Magnitudes:

- 1 standard deviation change in SRIO => 0.111 larger KLD
- But by adding up, a 1 sd larger SRIO means decrease in IO
  - Thus, overall effect is 0.19 larger KLD
  - **200% increase over 0.08**

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Furthermore, I am not sure we should learn something here

Problem 1: Isn't the prediction about ΔSRIO not SRIO?

Problem 2: ΔKLD is not the best variable: Very little action

KLD Strength Scores	No. of Indicators	Min	Median	Max
Community Issues	8	0	0	5
Corporate Governance Issues	8	0	0	3
Diversity Issues	9	0	0	7
Employee Relations Issues	13	0	0	9
Environment Issues	17	0	0	5
Human Rights Issues	4	0	0	2
Product Issues	12	0	0	3
All Strength Issues	71	0	1	22

Comment 4: Mechanism: Solution (?)

So far, all I have done is to say that I am skeptical about your mechanism results

<u>The paper absolutely needs to show this channel.</u>

Ideas:

1. Alternative measures of CSR used in the now vast literature
2. Perhaps use consequences to "bad CSR" – board changes, manager turnover, negative press
3. Or, maybe think in a 2SLS system where you predict returns that were related to ΔSRIO and then use this predicted return to forecast ΔKLD
   - Need exogeneity condition (example in Dyck, Manuel, Morse, Pomorski 2017)
4. Or, at a minimum, do a discrete choice model (improve power)

Conclusion

Need to keep the agenda simple based on your idea about change in holdings

- Restructure. Lead with your best results (portfolio diff-in-diff) and then convince the readers of robustness and of the mechanism
  - I'm still not convinced on what might be driving the result, but I am intrigued

- Under this clean structure, evidence would be compelling for more research to understand more details about heterogeneity of investor utility functions