Corporate Social Responsibility, ESG Investing, and Climate Disclosures

Markets vs. Mandates: Promoting Environmental Quality and Economic Prosperity

Hoover Institution, Stanford University

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What should be the objective of a corporation?

Shareholder primacy (Milton Friedman)

Maximize company's long-term value,
while conforming with the laws of the land
(labor laws, environmental laws)

Stakeholderism Corporate leaders should give weight to well-being of stakeholders as independent objectives

- customers
- employees
- suppliers
- communities in which the corporation operates in
- long-term shareholder value

Stakeholderism

Being promoted by

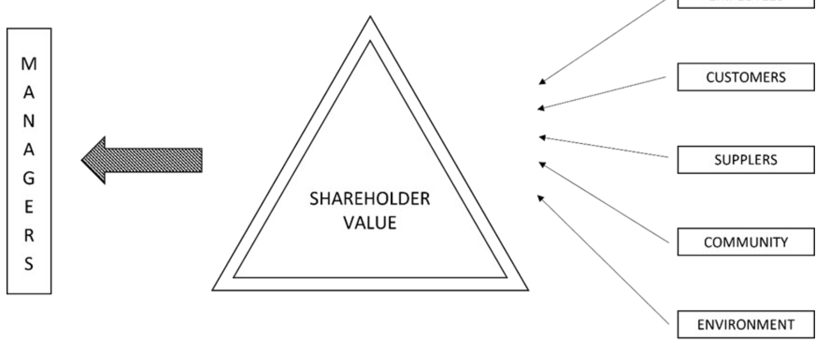
The Business Roundtable

The World Economic Forum (Davos)

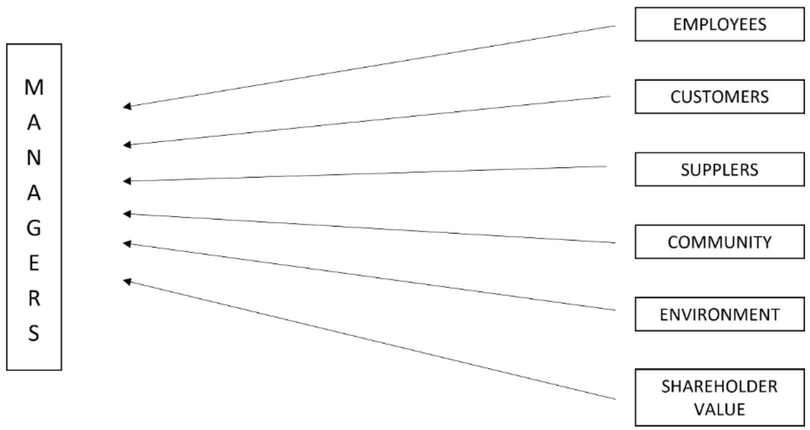
BlackRock

American Law Institute

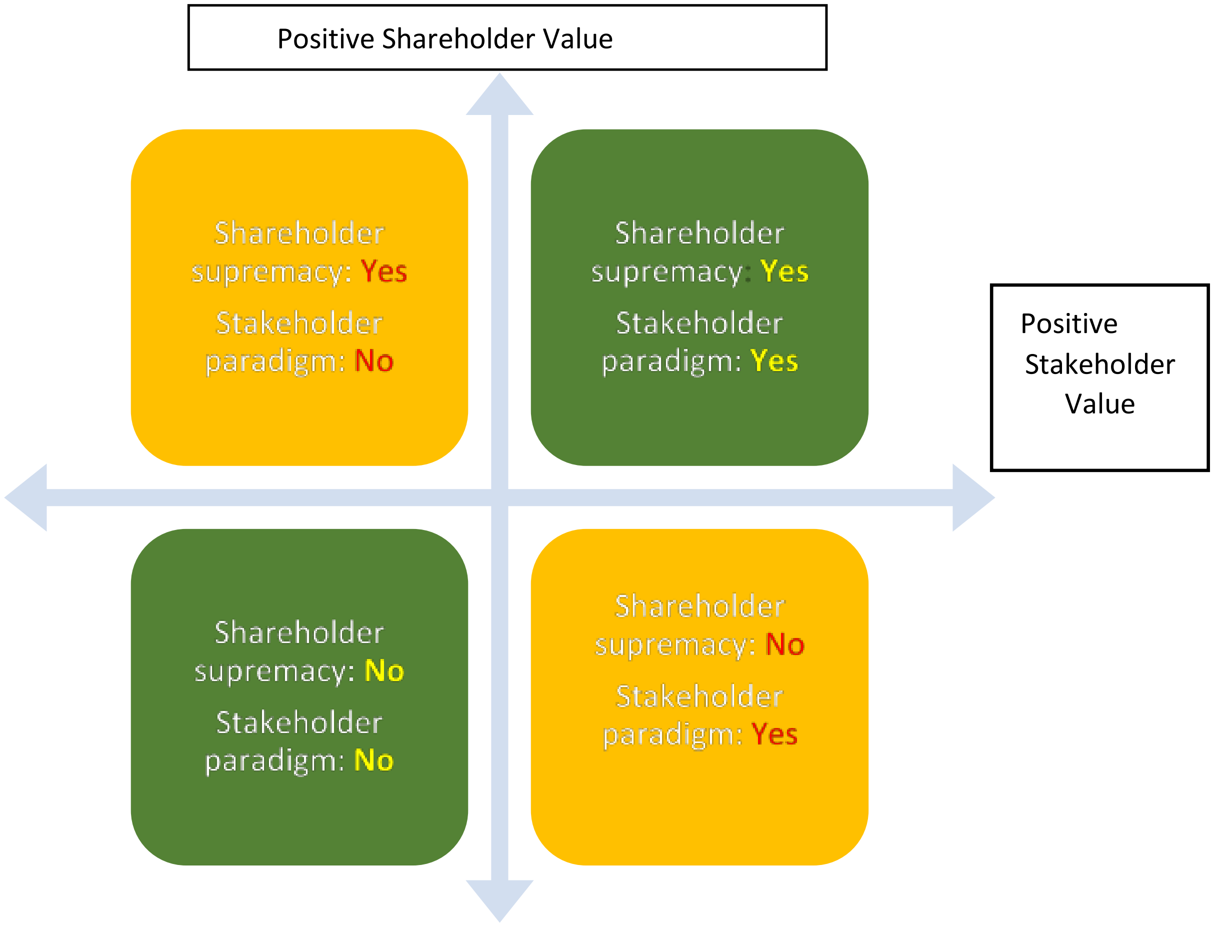
SHAREHOLDER VALUE MAXIMIZATION



STAKEHOLDERISM



Shareholder primacy versus stakeholderism



Markets vs. Mandates

Competitive labor markets, Competitive product markets =>
No difference in corporate decisions

Quarterly Global Sustainable Fund Flows ($ billions)

Source: Morningstar Direct, Manager Research. Data as of September 2022.

- **Sustainable Funds: Mostly European phenomenon**
- **Peaked in Q1 2021**
- **2021-2022: Dramatic decline in investor interest**

Do Investors Value Sustainability?

Journal of Finance

https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12841

March 2016: Morningstar initiated ratings for 20,000+ funds based on the ESG records of the portfolio companies

Funds with top ESG ratings received **five globes**

those with bottom ESG ratings received one globe

Five globe funds had **lower returns** and **higher risk** compared to **one globe** funds

ESG investing and investor returns

Thousand+ studies
positive relation, negative relation, no relation

July 2022 paper, researchers surveyed
1,141 primary peer reviewed papers and
27 meta-reviews (based on ~1,400 underlying studies)
published between 2015 and 2020
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3708495

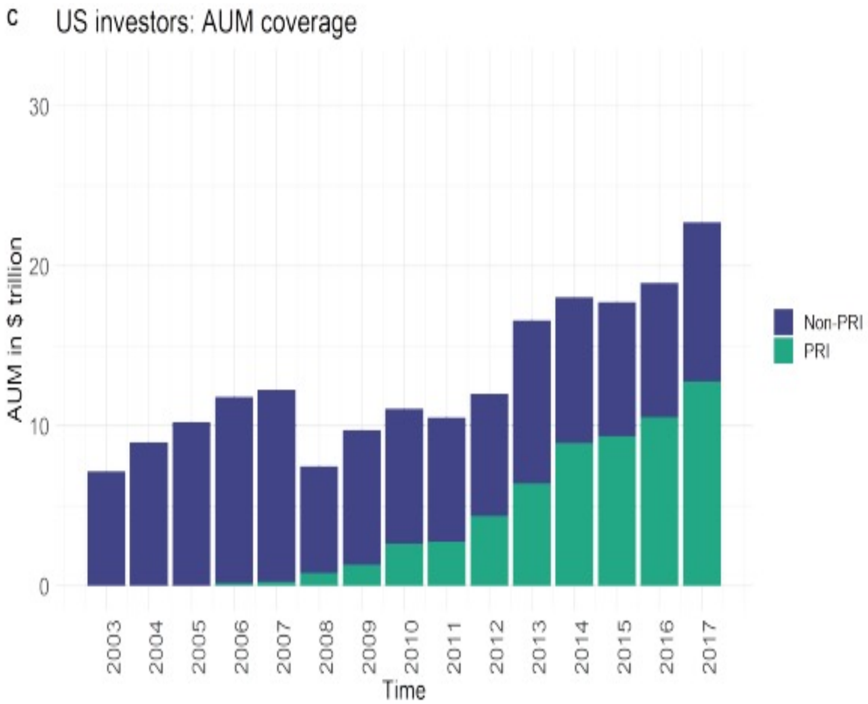
After controlling for potentially mitigating variables
Statistically significant negative relation

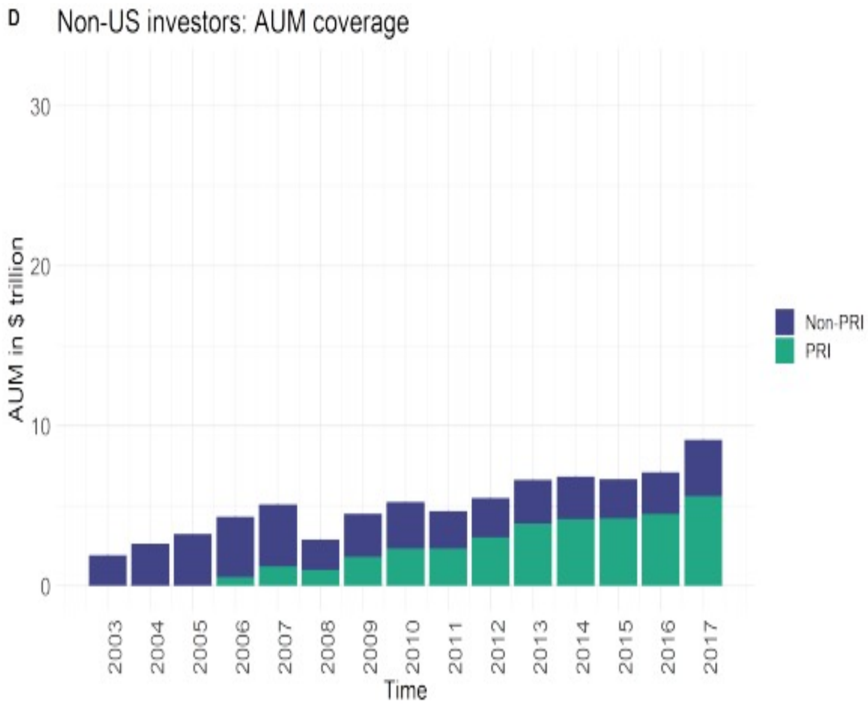
Climate change theme: No significant impact on
financial performance

United Nations launched the Principles of Responsible Investment (PRI) in 2006

#1: We will incorporate ESG issues into investment analysis and decision-making processes.
#2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
#3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
#4: We will promote acceptance and implementation of the Principles within the investment industry.
#5: We will work together to enhance our effectiveness in implementing the Principles.
#6: We will each report on our activities and progress towards implementing the Principles

Spectacular Growth of PRI Signatories





Do U.S. Institutional Investors' invest in companies with better ESG scores after signing the PRI?

2013-2017, 684 PRI, 6481 non-PRI

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3525530

NO

Do U.S. Institutional Investors' Portfolio ESG Scores improve after signing the PRI?

NO

Why Do US Institutional Investors sign the PRI?

Perhaps to deflect attention
from their poor investment performance
"Greenwashing"

Do U.S. ESG mutual funds invest in companies with better labor/environment records?

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3826357

2010-2018
147 U.S. ESG mutual funds
2,428 U.S. non-ESG mutual funds

NO

Do U.S. ESG mutual funds improve the labor/environment records of companies they invest in?

NO

Investment returns of U.S. ESG mutual funds less than non-ESG funds.

Another problem with Stakeholderism

Convenient excuse for financial underperformance

Companies that issue GREEN BONDS are performing poorly (financially)

http://leeds-faculty.colorado.edu/bhagat/gbonds-January-2023.pdf

CEOs that talk a lot about ESG in their quarterly teleconferences with analysts are performing poorly (financially)

https://ssrn.com/abstract=3725828

Should the SEC enforce mandates to disclose compliance with climate goals?

Two surveys of individual investors

NORC (University of Chicago) and FINRA Investor Education Foundation

1228 retail investors

Investment returns of potential investment: Most important factor

Environmental aspects of potential investment: Least important factor

Gallup poll of 953 US adult individual investors

Most prioritized investment return and risk
over environmental losses

Should the SEC enforce mandates to disclose compliance with climate goals?

Third survey of individual investors

Stanford University (Hoover/GSB/Rock Center)
2470 individual investors

Older (>58 years) workers: **Unwilling** to tradeoff investment returns for ESG

Younger (18-41 years) workers with <$50,000 savings: **Unwilling** to tradeoff investment returns for ESG

Younger (18-41 years) workers with >$250,000 savings: **Willing** to tradeoff investment returns for ESG

Should the SEC enforce mandates to disclose compliance with climate goals?

[Columbia Business School paper](http://dx.doi.org/10.2139/ssrn.3800193)
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Carbon Emissions and Stock Returns: No relationship

Carbon Emissions and Operating Performance:

No relationship

Questions?