

Sustainable Investing in Practice: Objectives, Constraints, and Limits to Impact

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- 509 active equity portfolio managers
 - 479 completed every question
- 290 “traditional” investors
- 219 “sustainable” investors
- 223 US funds, others mostly EU & UK
- Asset managers, not asset owners
- Only PMs: no analysts, ESG professionals, senior executives
- Focus on how PMs consider ES performance of portfolio companies

Why a survey?

In order to access the underlying and unobservable beliefs, objectives and constraints of portfolio managers

As a complement to archival research and to identify potential future areas of research

Beliefs

Rank the following by their importance for the long-term value of companies in your investment universe in aggregate

	Mean rank	
	Traditional	Sustainable
Strategy and competitive position	1.62	1.73
Operational performance	2.22	2.54
Governance	3.76	3.65
Corporate culture	3.92	4.41
Capital structure	4.08	4.18
ES performance	5.41	4.49

ES is ranked comfortably lowest by both traditional and sustainable investors*

*But 85% of investors (including 78% of traditional investors) consider at least one ES issue to be material or highly material

In aggregate, investors think investment in ES is broadly value maximising

Do you expect good ES performers typically to outperform or underperform in long-term risk-adjusted TSR?

-2 = strongly underperform, 0 = neither, 2 = strongly outperform

	Mean	Under-perform	Neither	Out-perform
Traditional investors	0.36	11%	44%	45%
Sustainable investors	0.85	4%	23%	73%

45% of traditional investors believe in ES alpha, 27% of sustainable investors do not

Why?

Good ES performance is correlated with other characteristics that cause long-term outperformance

Do you expect bad ES performers typically to outperform or underperform in long-term risk-adjusted TSR?



-2 = strongly underperform, 0 = neither, 2 = strongly outperform

	Mean	Under-perform	Neither	Out-perform
Traditional investors	-0.67	61%	32%	7%
Sustainable investors	-0.73	67%	25%	8%

Traditional and sustainable investors agree that bad ES performance can signify downside risk

Objectives

How much long-term risk-adjusted TSR would you tolerate a company sacrificing to improve its ES performance?

	Traditional	Sustainable
Zero - I would not tolerate any sacrifice	41%	22%
No sacrifice is necessary since there is no trade-off	35%	47%
1-10 bp per year	12%	16%
11-50 bp per year	9%	10%
>50 bp per year	2%	5%

Fiduciary duty prevents sacrifice of value

Similar findings for voting on shareholder resolutions

“I’m a fiduciary, with clear investment directives”

“We are fiduciaries and cannot deviate from our mandate unless so instructed”

“We have a fiduciary duty to our clients. We could never accept lower risk-adjusted returns out of the goodness of our hearts”

“A mutual fund is an investment vehicle designed for the public. Its purpose is to maximize risk-adjusted returns for the public. It would be unethical and illegal if I deviated from that purpose. It is my fiduciary duty.”

“The answer for asset managers has to be zero long-term sacrifice. Ultimately we are managing other people’s money.”

Constraints

Have firmwide ES policies, your fund mandate, your clients' wishes, or concern for your reputation or sustainability rating ever caused you to do any of the following?



	Traditional	Sustainable
Avoid stocks that would improve portfolio diversification	30%	49%
Avoid stocks we believed would outperform	29%	51%
Engage with companies on ES issues that do not add shareholder value	25%	32%
Focus on visible dimensions of ES performance at the expense of more important ES issues	20%	21%
Avoid owning ES leaders in a laggard industry	15%	30%
Vote for ES resolutions that do not add shareholder value	15%	23%
Avoid owning ES laggards whose ES performance we could have improved	14%	33%
Hold stocks we believed would underperform	4%	10%
None of the above	38%	15%

Causes and consequences

Causes	Traditional	Sustainable
Firmwide policies	32%	54%
Fund mandates	21%	60%
Client wishes	32%	38%
Concern for reputation or sustainability rating	19%	37%
Any of the above	62%	85%
Consequences of constraints*	Traditional	Sustainable
No or positive impact on returns**	55%	30%
Negative impact on returns	23%	38%
Impossible to quantify	21%	32%

"Hard" constraints are around twice as likely for sustainable funds

At least 38% and up to 70% of sustainable funds have experienced return penalties from these constraints, nearly twice the rate of traditional funds

*Percentages include those PMs reporting they had faced no constraints

**A small proportion (2%) of investors reported constraints had a positive impact on returns

Actions

Do you underweight poor / overweight good ES performers for any of the following reasons?

0 = never, 4 = very often

Motivation	Action	Traditional		Sustainable	
		Mean	% 3,4	Mean	% 3,4
Constraints	To be consistent with our fund's mandate	1.59	28%	3.04	75%
	To be consistent with our firm's values or policies	1.70	34%	2.58	60%
	To be consistent with our clients' values	1.65	24%	2.56	60%
Financial	To avoid downside risk	1.91	40%	2.40	57%
	To improve returns	1.80	36%	2.46	56%
	To avoid stocks that are volatile	1.11	15%	1.39	23%
Marketing	To improve our fund's sustainability rating	0.96	12%	1.83	36%
	To improve our fund's reputation	0.93	11%	1.69	30%
Impact	To reward companies for improving ES performance / penalize companies for not doing so	0.98	13%	1.77	30%
	To affect companies' cost of capital	0.91	9%	1.43	19%

51% of traditional and 76% of sustainable PMs often weight stocks based on ES for financial reasons – link to beliefs

Key takeaways

- Financial objective dominates
- ES performance not the most material factor
 - ➔ Asset managers unlikely to lead charge on ES
- Constraints matter for traditional as well as sustainable funds
- Beliefs on ES alpha are heterogeneous and drive stock selection
- Constraints and beliefs do not split neatly between fund types
- Traditional and sustainable funds are not so different
 - ➔ Constraints and beliefs matter more than labels

Future research areas?

- Models of sustainable investing under delegated portfolio management incorporating ES constraints
- Sustainable investing models based on heterogenous beliefs, not just preferences