Walking the Talk? Do ESG Investors Invest Responsibly?

Fabrizio Ferraro

Professor and Head of the Strategic Management Department at IESE Business School. He received his PhD in Management from Stanford University. His current research explores the emergence of responsible and impact investing in the financial sector.

As Environmental, Social and Governance (ESG) investing is going mainstream and moving from the world of institutional investors to retail investors, the specter of greenwashing is haunting the sector. Critics have argued that despite the grandiose claims made by investors, investment practices have not changed, and ESG investing is little more than a marketing ploy to attract (or keep) investors.

It is undeniable that after brewing for decades at the periphery of the asset management industry, ESG investing is now mainstream. By March 2021, 3.404 investors from all over the world had signed up for the PRI and pledged to integrate ESG in their investment processes, for a total of US$ 121 trillion of Assets under Management (AUM). This number is close to the total amount of financial assets professionally managed (and larger than the total AUM of the Asset Management Industry, roughly above $100 trillion). Furthermore, while in 2016 retail investors only accounted for 20% of AUM, by 2020 they were up to 25%. For instance, the AUM in sustainable ETFs soared from US$ 24bn in 2018 to US$ 174bn in 2021.

This success has invited, perhaps unsurprisingly, more scrutiny of ESG investment practices leading to several critics questioning their efficacy. Especially media-worthy have been the comments of individuals formerly working in the industry. Some of them suggested that ESG investing was primarily motivated by commercial interests. It might even be a "deadly distraction," slowing down our progress in getting more effective government measures to tackle climate change.

Much of this criticism is based on anecdotal evidence and hearsay rather than rigorous research evidence. It is thus difficult to assess what is actually going on. However, the question of whether ESG investors are walking the talk is essential, and fortunately, some rigorous empirical evidence is starting to appear that can shed light on it.

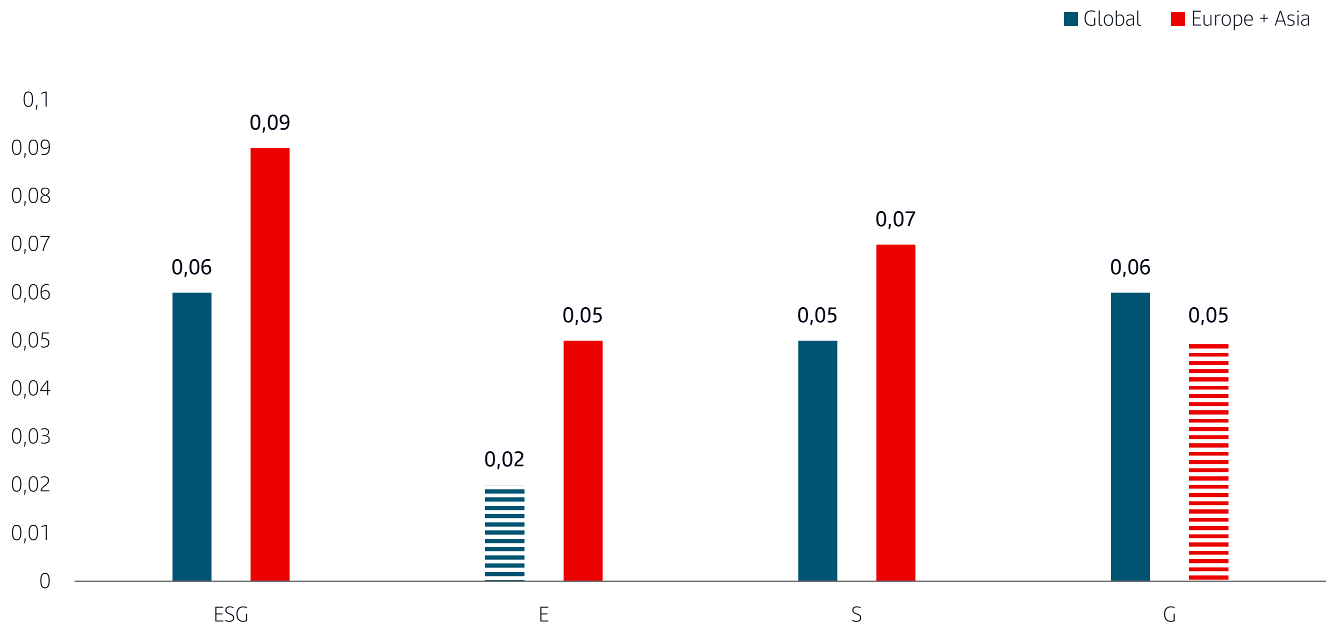
One academic study, primarily, might provide the most accurate insights we currently have on this question. The authors, five academics from top European and American Universities, combed through the data obtained from many years of the PRI reports signatories have to file, linked it with data on portfolio ownership and ESG ratings, to assess the extent to which PRI signatories' portfolio are any different in terms of their ESG ratings from non-signatories. The study covers more than 10.000 institutional investors globally, from 2006 until 2017, and constructs a global ESG score for each investor's portfolio, and specific E, S, and G score (based on the most widely used ESG rating providers).

At the global level, PRI signatories appear to have better Social (S) and Governance (G) scores than non-PRI investors but similar Environmental (E) scores. Thus, overall, it seems that if we randomly picked a PRI signatory, their portfolio might have companies with better social and governance profiles but would be indistinguishable from an environmental perspective. The ESG rating of the portfolio of investors does improve after joining PRI. This finding supports that PRI signatories seem to implement the principles and start integrating ESG in their investment process (at least concerning the S and the G). In Europe and Asia the results are even better, as the portfolios of PRI signatories have better E, S, and G scores than the ones of non-signatories.

The study also tries to explain differences across investors in different countries and show that investors domiciled in countries more concerned about social and environmental issues are more likely to sign PRI and fully incorporate ESG.

ESG Footprint of PRI Signatories

Source: Author, based on Gibson, Glossner, Krueger, Matos and Steffen (2021)
Pattern bars show non-statistically significant results.



Ultimately, the study of PRI signatories does show that in Europe and Asia ESG investors are walking the talk. Thus, while still in its infancy and still quite imperfect in terms of practices, it is undeniable that ESG investing is shifting capital allocation towards companies with better ESG profiles. Another fascinating but underappreciated effect of ESG investing might be purely cultural. In a study I conducted with colleagues at IESE and City University of Hong Kong, we show that countries with a more significant ESG asset management sector are more likely to have better environmental corporate performance (not only in investee companies but more generally in the economy). ESG investors, we conclude, play a role in signaling to the corporate sector the materiality of environmental performance and thus might affect the environmental performance of all companies, not just the ones in which they invest.

To Learn More

- Gibson, R., Glossner, S., Krueger, P., Matos P., & Steffen, T. (2022). Do Responsible Investors Invest Responsibly? European Corporate Governance Institute – Finance Working Paper 712/2020 Read more

Available at: Read more

- Yan, S., Ferraro, F., & Almandoz, J. (2021). The Impact of Logic (In) Compatibility: Green Investing, State Policy, and Corporate Environmental Performance. Administrative Science Quarterly, 1-42. Read more

Available at: Read more

Other Interesting Resources:

The Secret Diary of a 'Sustainable Investor' — Part 1 Read more

The ESG Mirage Read more

The fallacy of ESG investing Read more

GFund Managers Feel Heat in SEC Crackdown on Overblown ESG Labels Read more