

Values versus Value in Sustainable Finance

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A major issue in sustainable finance: *Values versus value*

- *Values* perspective:
Sustainable corporate activities and sustainable investing
develop from nonpecuniary preferences

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Example: investor does not want to be complicit in supporting “objectionable” corporate products or behavior

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Example: investor does not want to be complicit in supporting “objectionable” corporate products or behavior

- *Value* perspective:

Sustainable corporate activities and sustainable investing should focus on the risks or return opportunities that arise from sustainable finance considerations because these can affect firm value.

Need to separate the motivations for sustainable investing to understand it

Motivations define the investment approach.

Values

- Preferences
 - Avoidance of complicity
 - Supplying capital
- Making an impact
 - Supplying capital
 - Engagement/stewardship

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- Risk management
 - Reducing/understanding sustainable finance risk exposures
- Return opportunities
 - Investment selection
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But these are not clear boundaries as many investors have combined motivations.

Evidence on retail investor motivations for sustainable investing: Values versus Value

- Surveys and experiments on Dutch investors and pension fund participants:
 - SRI funds are held primarily due to social preferences and signaling, with limited financial motivation
 - Pension fund participants think their plans should engage in more responsible investing activities based on the participants' nonpecuniary preferences.
 - Investors' Willingness-to-Pay (WTP) increases in their altruistic attitudes

Riedl and Smeets (2017),
Bauer, Rouf and Smeets (2021),
Brodback, Guenster and Mezger (2019)

Evidence on retail investor motivations for sustainable investing: Values versus Value

- Surveys and experiments on U.S. population:
 - Among Vanguard investors, beyond the 42% with no interest in ESG investing, there exists heterogeneity, which is split between motives based on nonpecuniary preferences, hedging climate risk and financial return expectations.
 - An asymmetry exists between investor views on negative versus positive externalities. Their asset allocation decisions are more affected by their views on negative externalities.

Giglio, Maggiori, Strobel, Utkus, and Xu (2022)

Humphrey, Kogan, Sagi and Starks (2022)

Empirical evidence reflecting investor preferences: *Values* and *Value*

Evidence suggests that both retail and institutional investors select higher ESG funds and stocks due to both values and value considerations. For example,

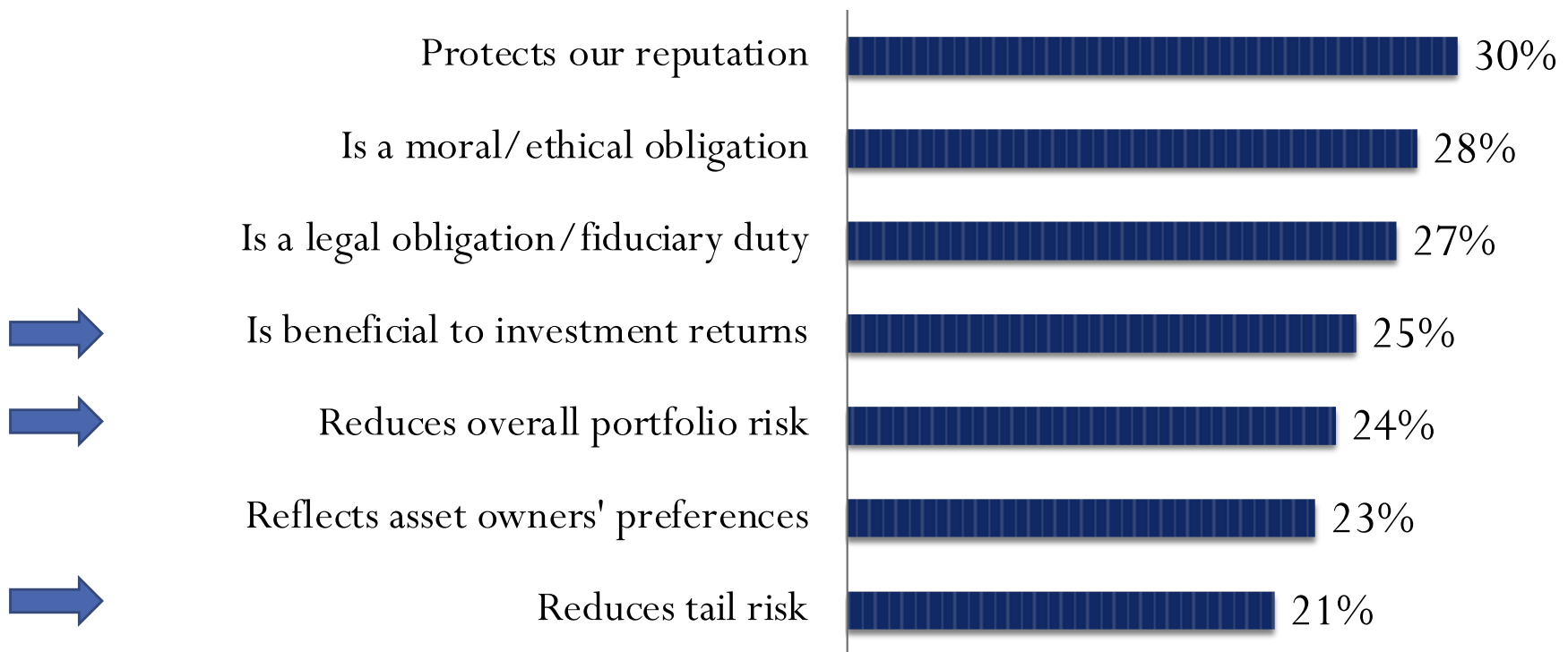
- Shocks to funds' sustainability reputations suggests investors react to changes in ESG scores.
- Longer-term investors have stronger apparent preferences for the higher rated ESG stocks as compared to other investors.
- ESG/SRI mutual funds exhibit less flow-performance sensitivity than other types of mutual funds.

Hartzmark and Sussman (2019); Starks, Venkat and Zhu (2022)




Bollen (2007), Benson and Humphrey (2008), Renneboog et al (2011), Bialkowski and Starks (2016).

Institutional investor sustainable investing motivations as reflected in climate risk motivations

Top motivations for incorporating climate risk into investment decisions



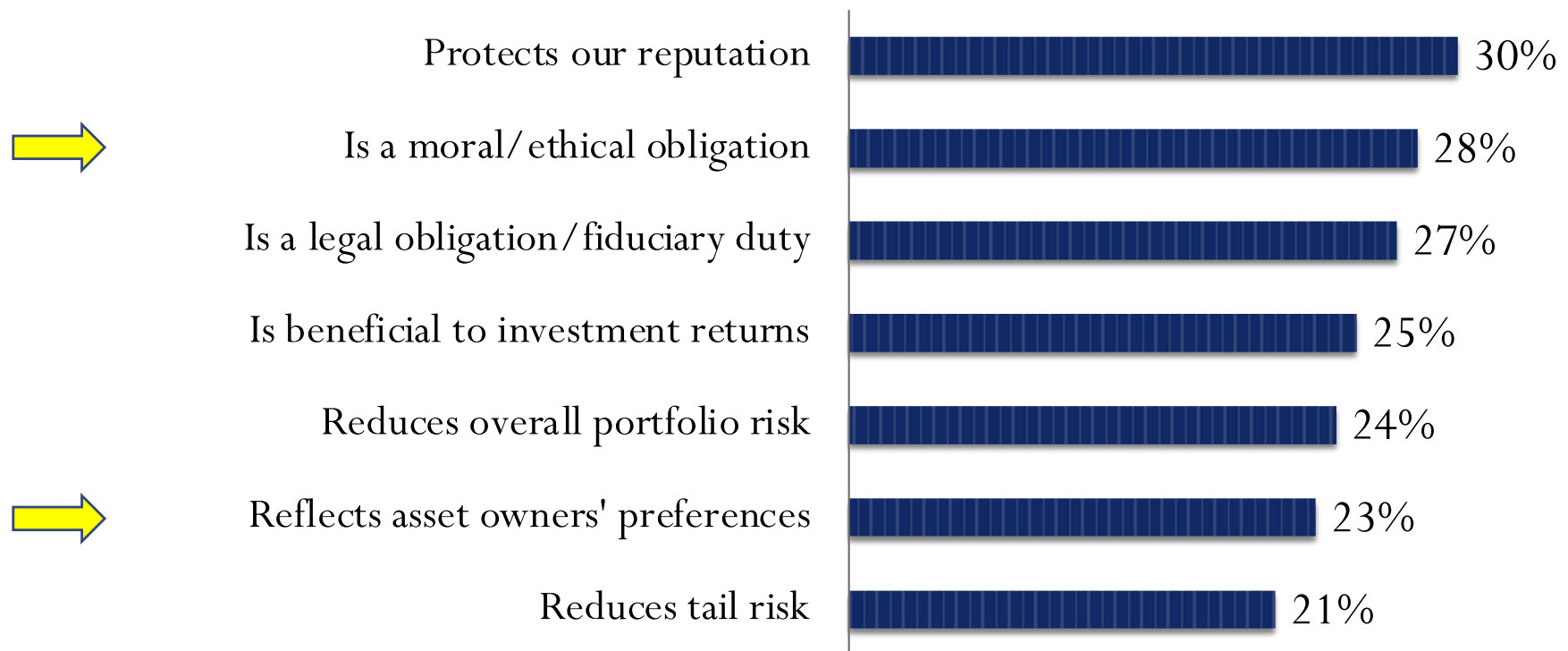
These are not mutually exclusive.

- Value 
- Values 
- Blend 




Krueger, Sautner, and Starks (RFS, March 2020)

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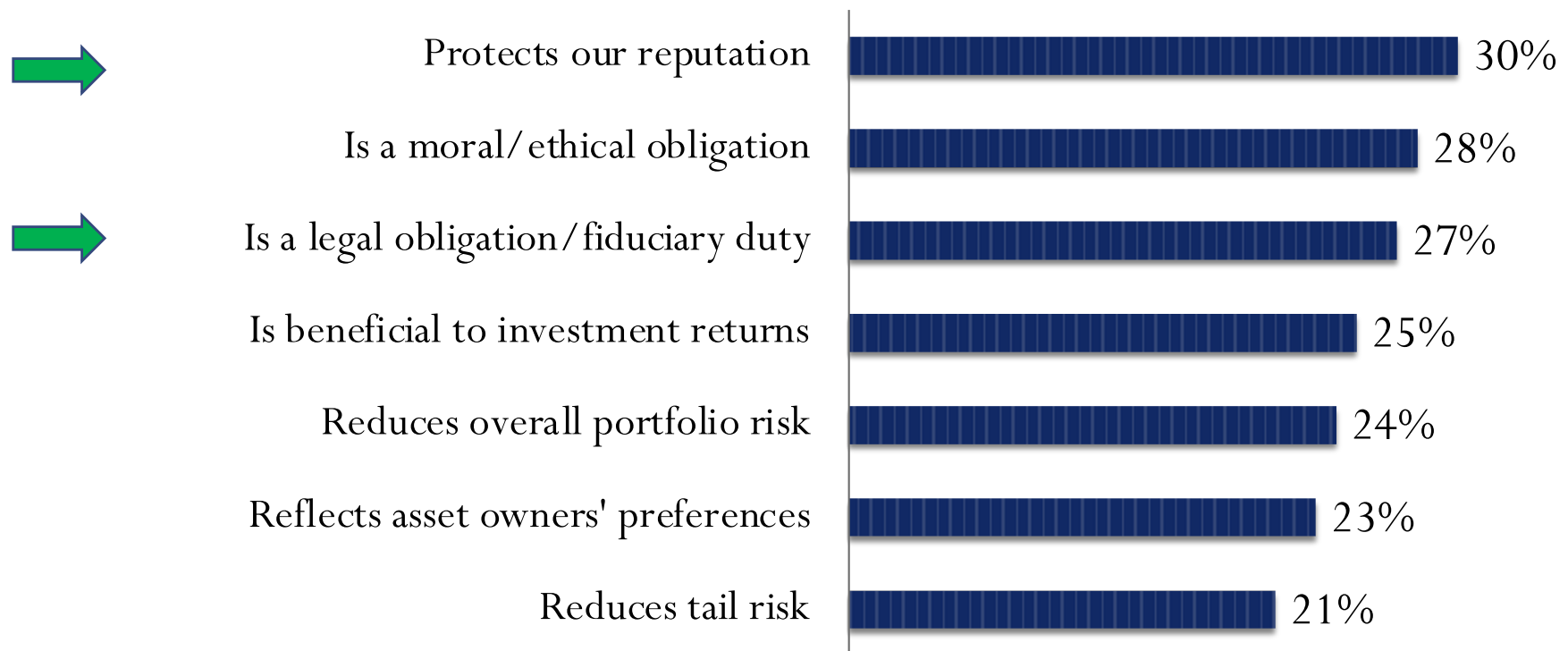
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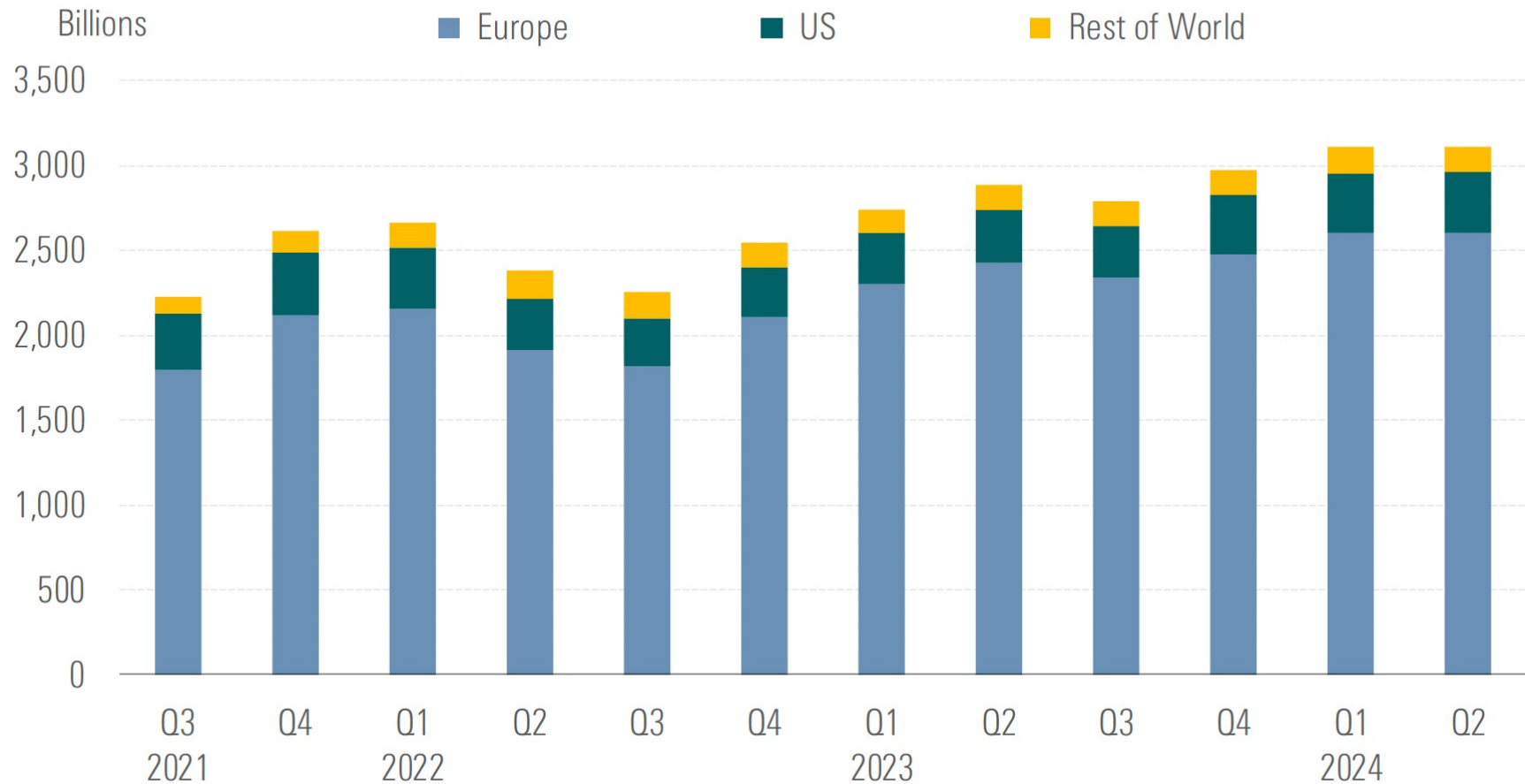
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Geographic differences in ESG mutual fund assets over recent years

Exhibit 3 Quarterly Global Sustainable Fund Assets (USD Billion)



Source: Morningstar Direct. Data as of June 2024.

Geographic differences in recent ESG mutual fund flows

Exhibit 6a European Sustainable Fund Flows Compared with Conventional Fund Flows (USD Billion)

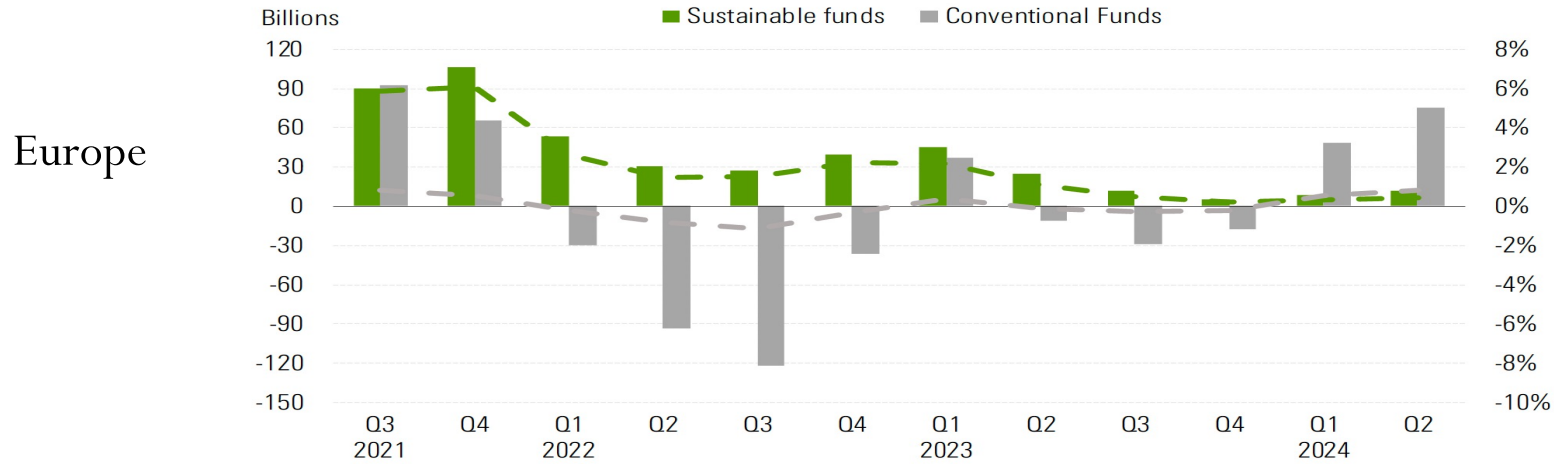
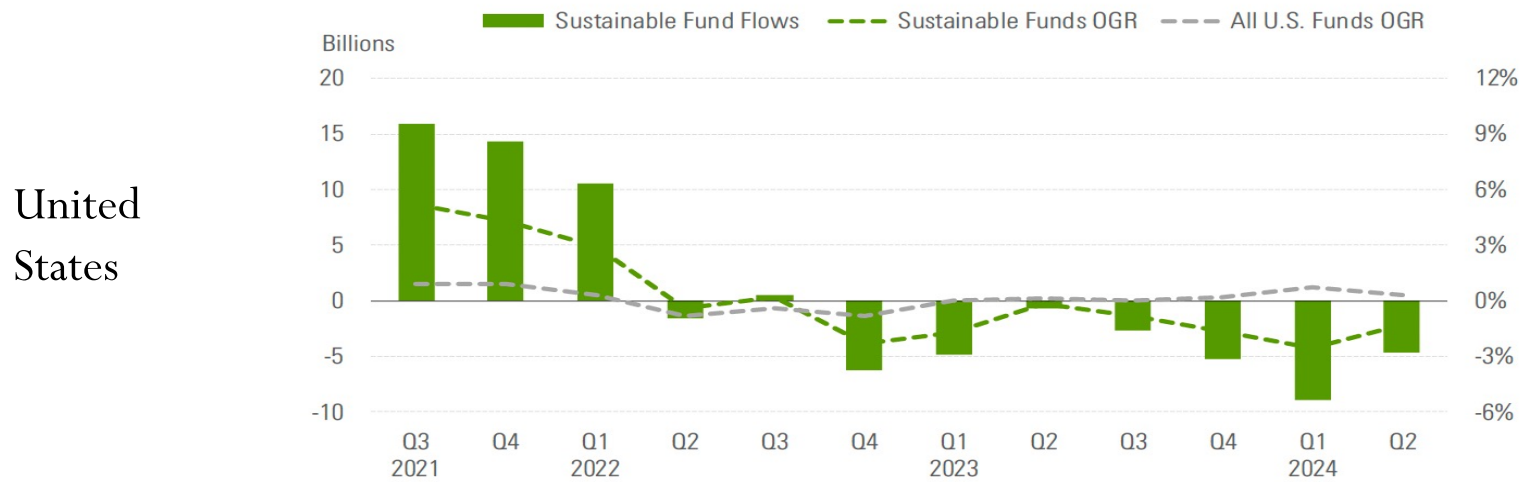


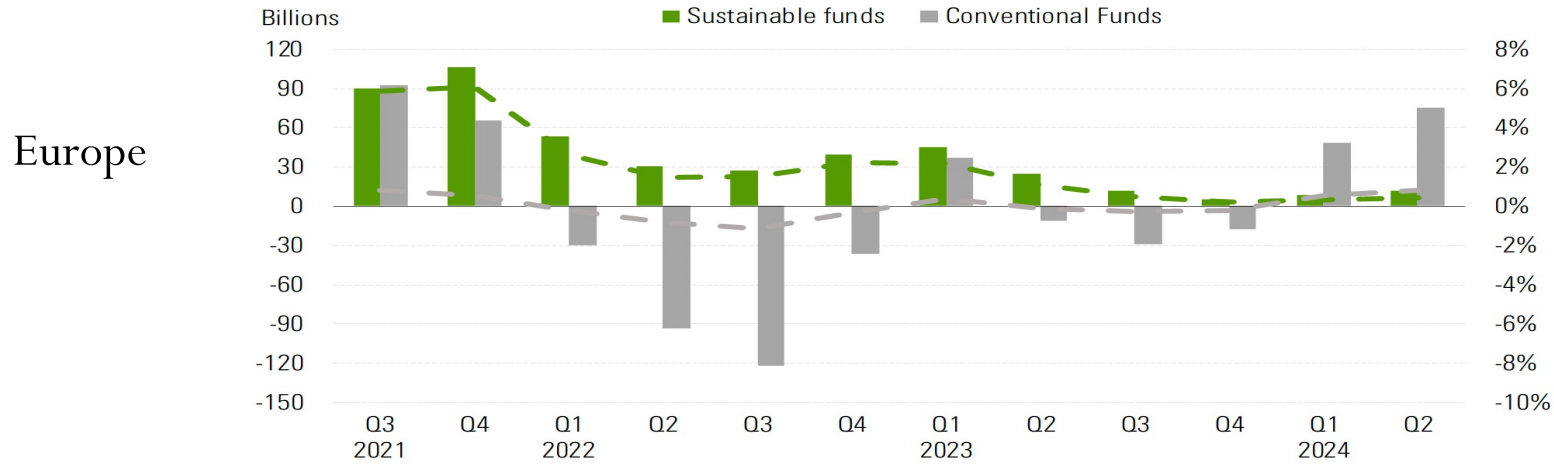
Exhibit 12c US Fund Flows: Sustainable Vs. All US Funds (USD Billion)



Note that these are on different scales.
OGR – organic growth rate

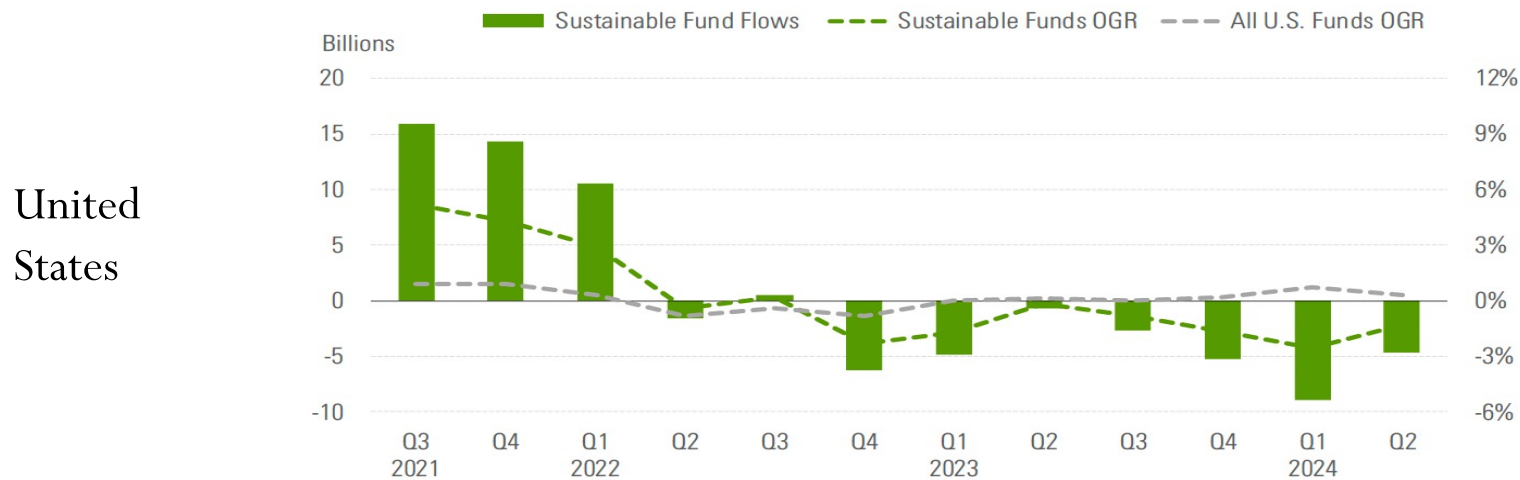
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Business processes versus outcomes: *Values* and *value*

Focus of *Values* investors

- Values investors
 - More focus on the ultimate outcomes of businesses on environment and society
 - Environmental and social externalities = damage
 - Often want to align with the Sustainable Development Goals

17 Sustainable Development Goals

1 NO POVERTY	7 AFFORDABLE & CLEAN ENERGY	13 CLIMATE ACTION
2 ZERO HUNGER	8 DECENT WORK & ECONOMIC GROWTH	14 LIFE BELOW WATER
3 GOOD QUALITY HEALTH AND WELL-BEING	9 INDUSTRY INNOVATION AND INFRASTRUCTURE	15 LIFE ON LAND
4 QUALITY EDUCATION	10 REDUCED INEQUALITIES	16 PEACE, JUSTICE AND STRONG INSTITUTIONS
5 GENDER EQUALITY	11 SUSTAINABLE CITIES AND COMMUNITIES	17 PARTNERSHIPS FOR THE GOALS
6 CLEAN WATER & SANITATION	12 RESPONSIBLE CONSUMPTION AND PRODUCTION	

Focus of *Value* investors

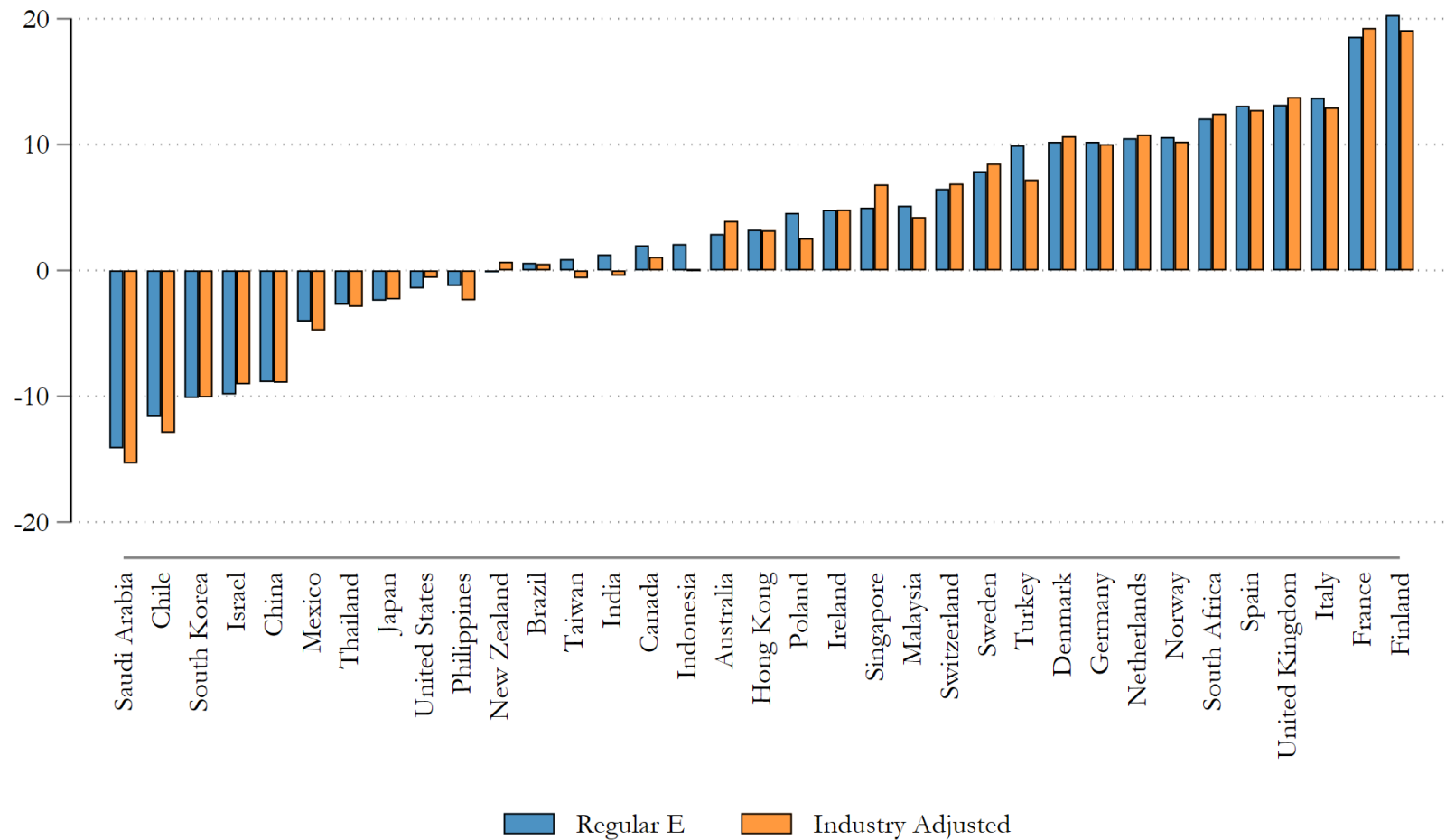
- Value investors
 - More focus on the business processes and the risks and returns from those processes
 - But SDGs could lead to risks for companies, e.g., reputation or regulatory risks
 - An example would be biodiversity risk

Country differences: *Values and Value*

Can we understand more about investor and corporate manager motivations and activities by examining country differences from *Values* and *Value* perspectives?

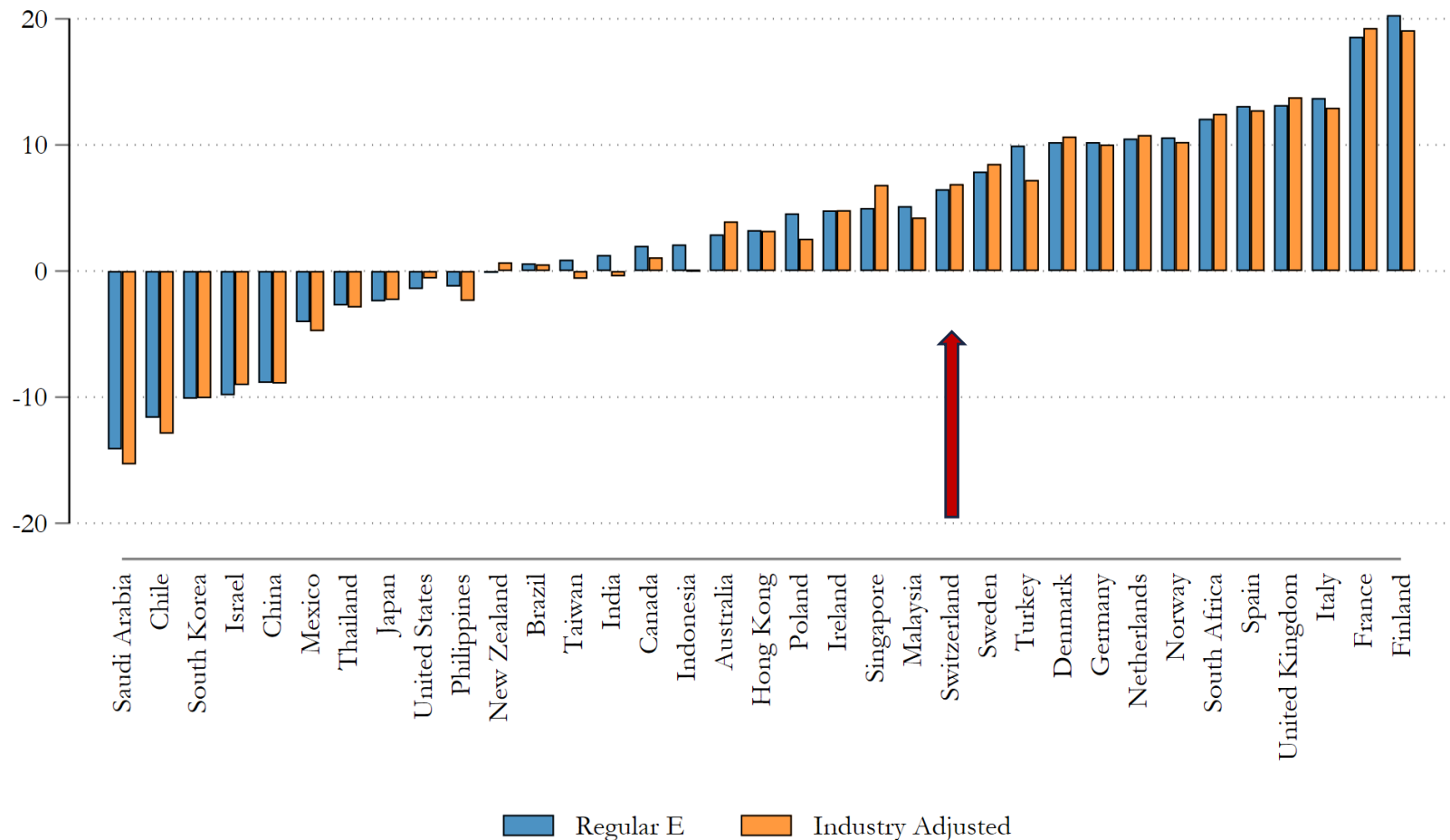
Average company environmental score by country

Average Environmental Score by Country



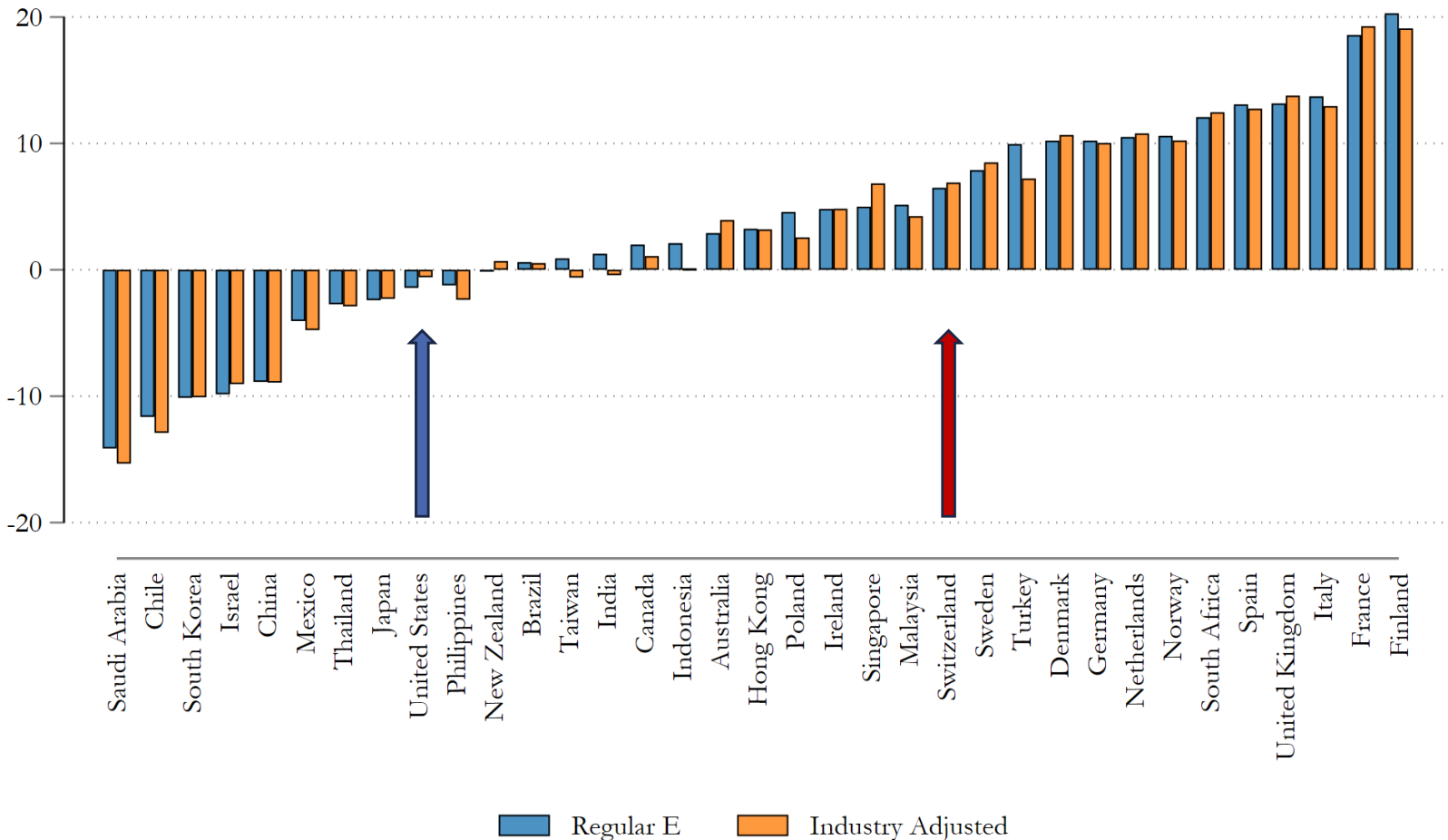
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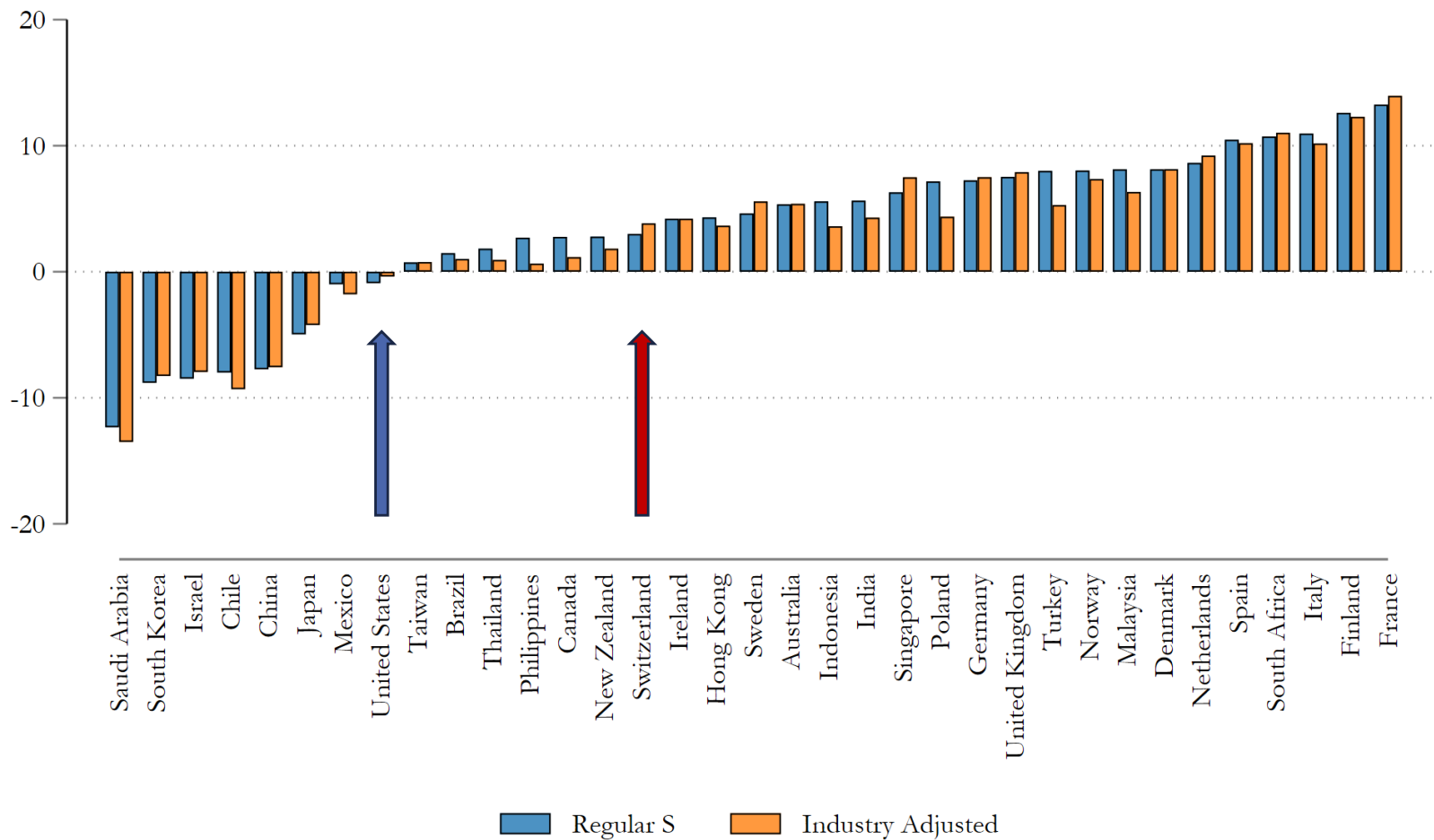
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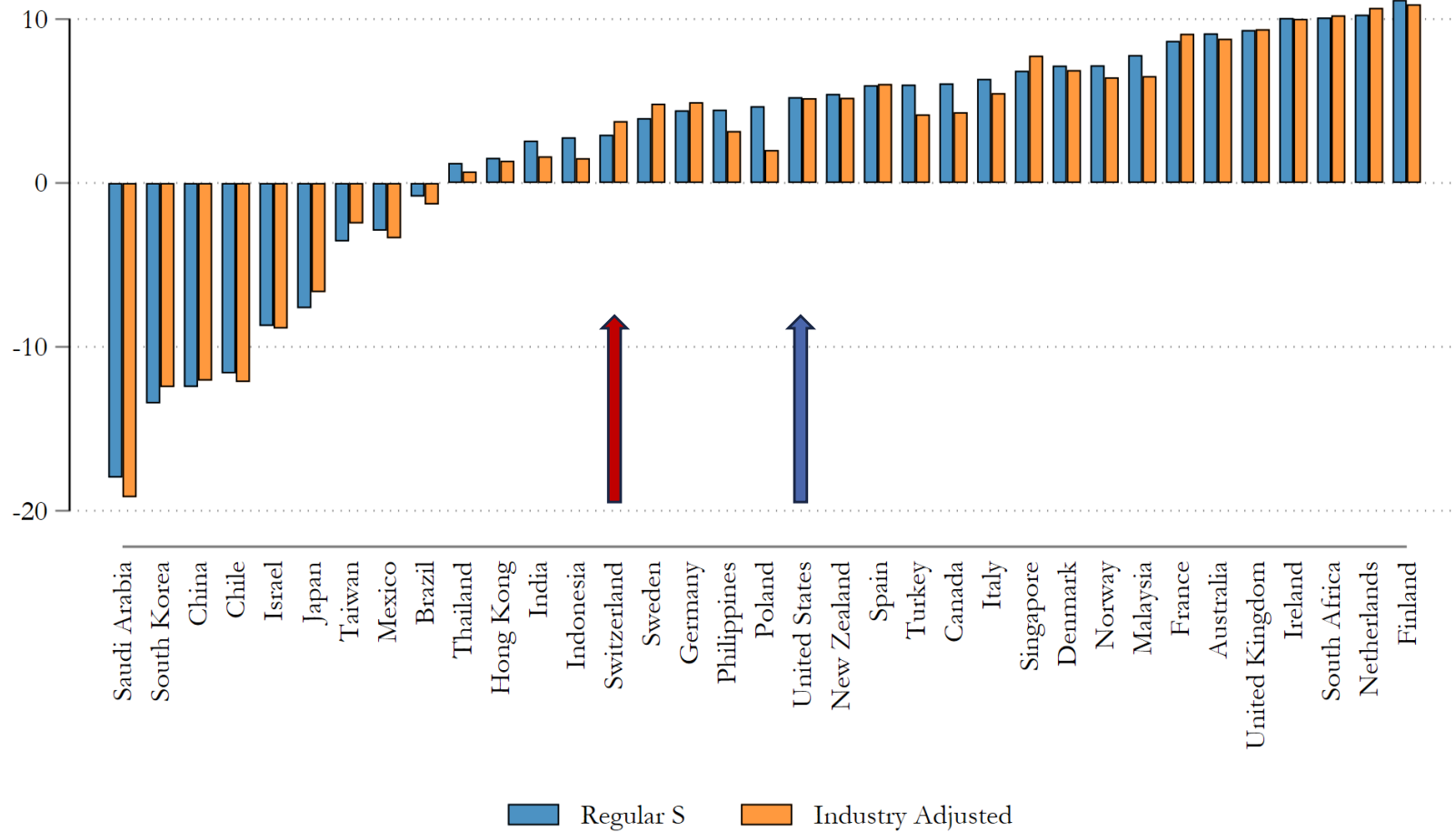
Average company social score by country

Average Social Score by Country



Average company governance score by country

Average Governance Score by Country



Why the differences in recent ESG interest across countries?

My hypothesis: Driven in part by differences in cultural and social norms, including politics

Cultural and social norms affect firms' environmental and social decisions

- **Foreign institutional investors** affect company
 - **ES performance** when they come from countries with strong norms toward ES

Dyck, Lins, Roth, Wagner (2019)

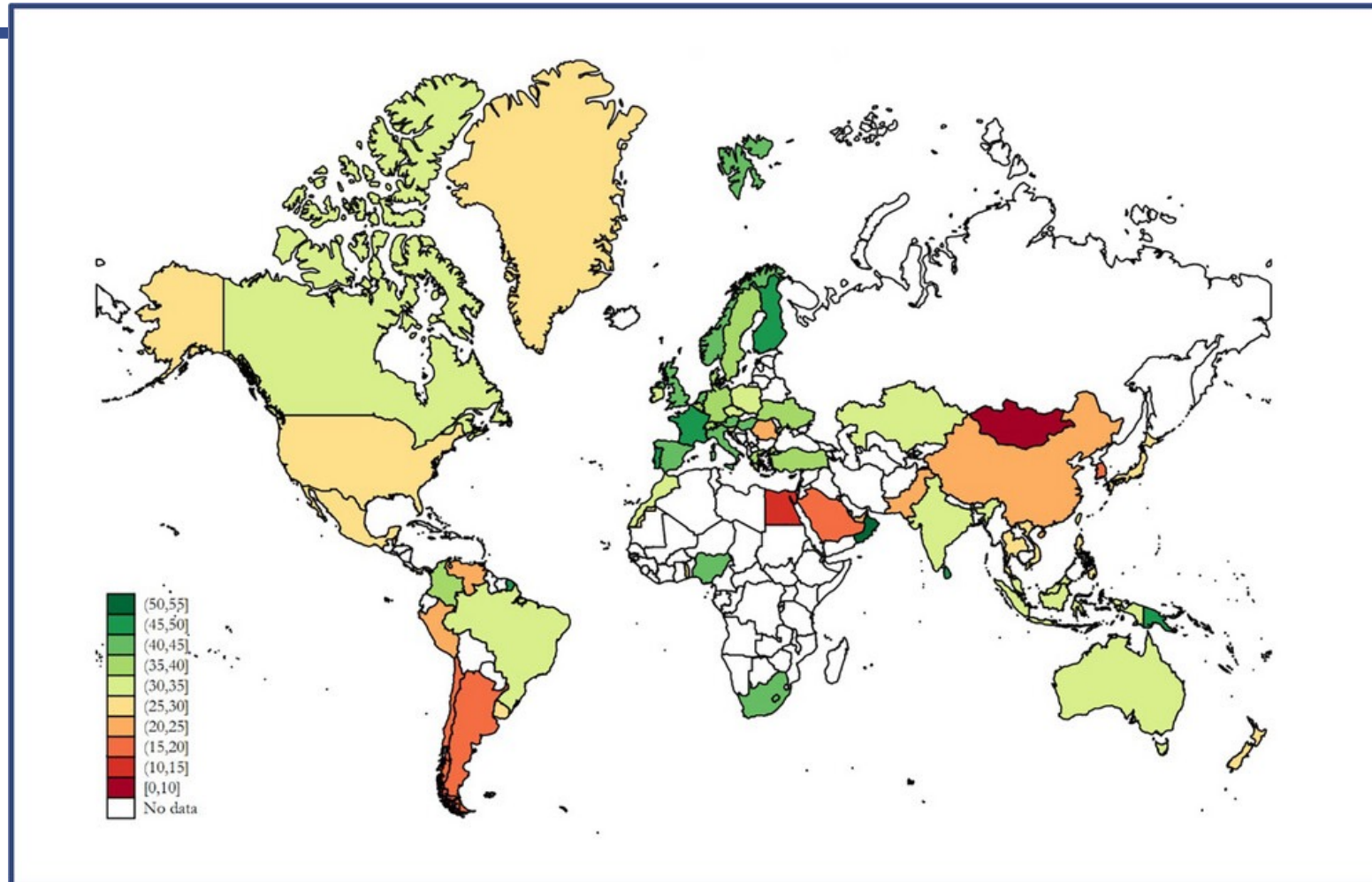
- Firms' **ES performance** is related to **country characteristics**: economic development, law, and culture

Cai, Pan and Statman (2016)

- Firm **ES ratings** are correlated with a **country's legal origins**

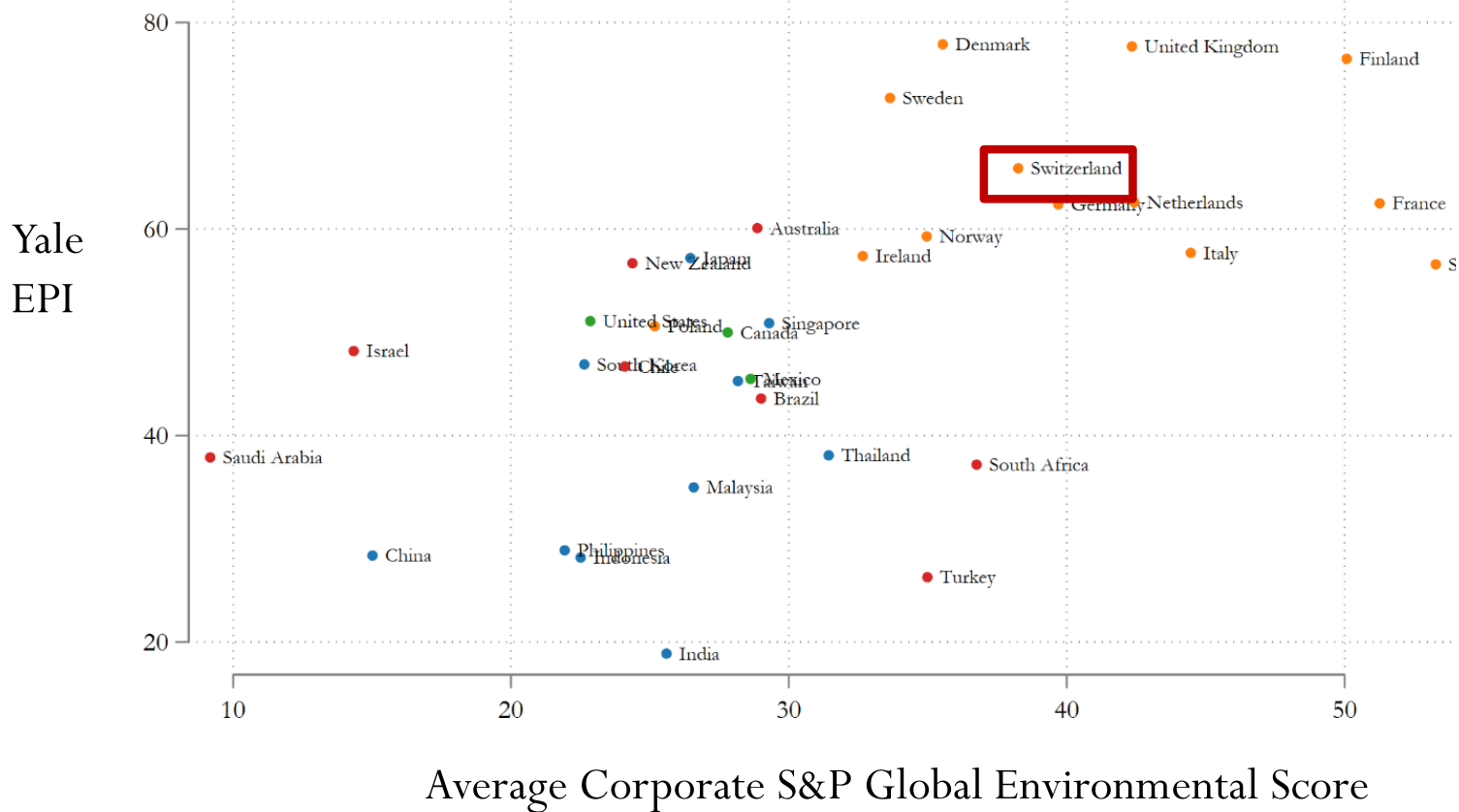
Liang and Renneboog (2017)

Some evidence that social norms may matter on environmental issues



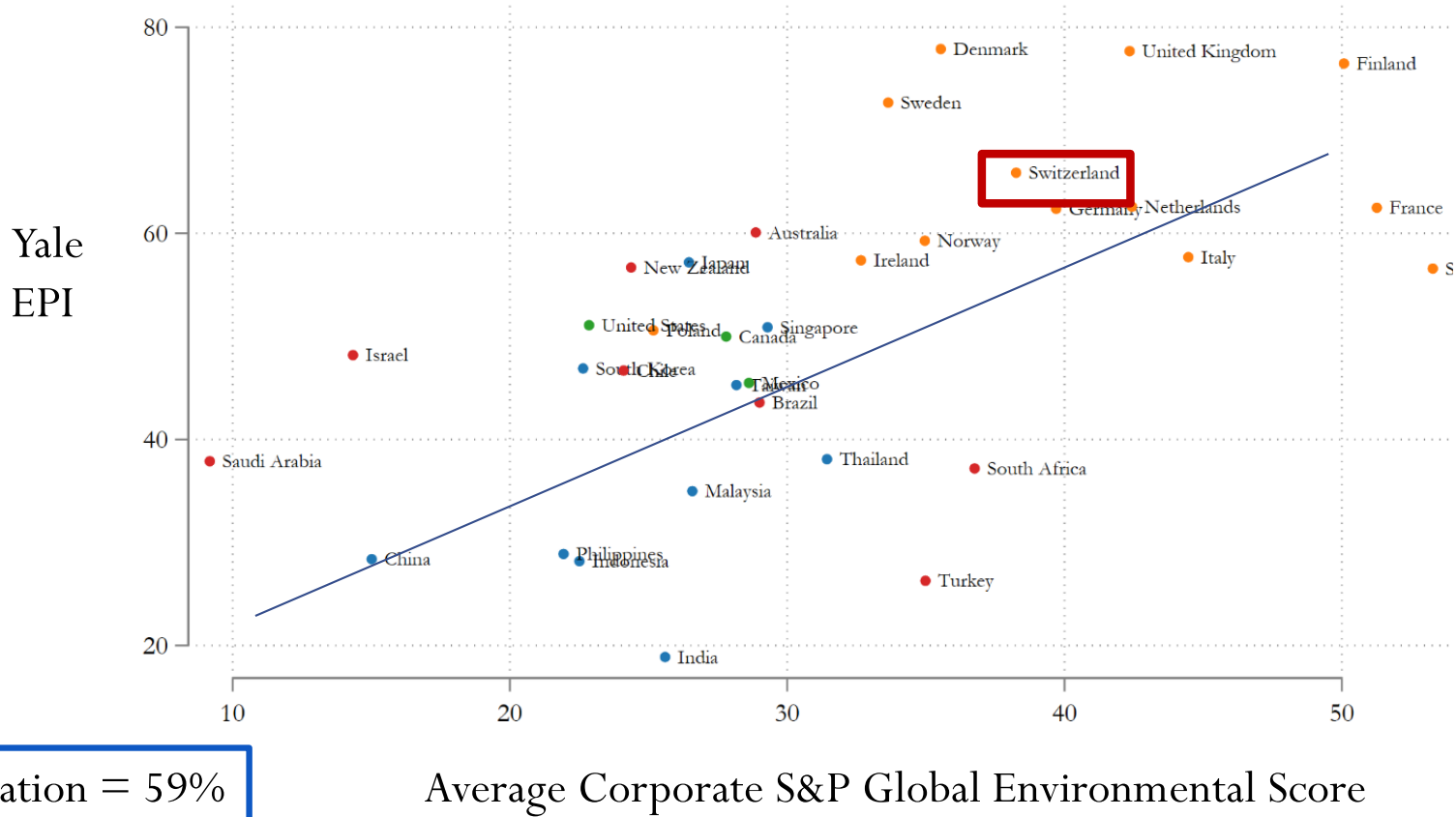
Green stocks across countries using S&P E Scores
Figure 6 from Starks (JF, 2023)

More evidence that social norms may matter on environmental issues



Yale Environmental Performance Index plotted against S&P Global E Score
Figure 7 from Starks (JF, 2023)

More evidence that social norms may matter on environmental issues



Yale Environmental Performance Index plotted against S&P Global E Score
Figure 7 from Starks (JF, 2023)

Evidence from the U.S. shows that politics matter

- **Environmental policy uncertainty** results in a pollution premium for high toxic emission firms. This systematic risk arises from regime changes.

Hsu, Li, and Tsou (2023)

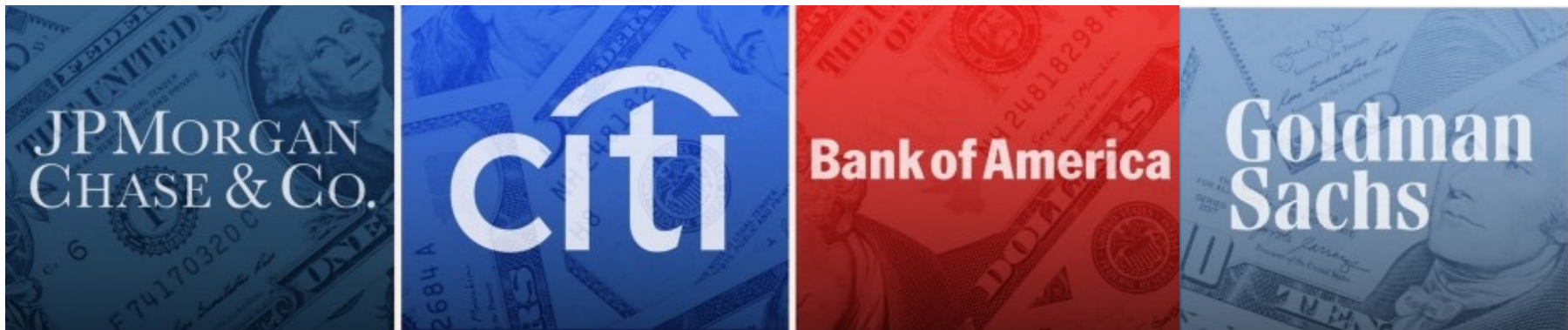
- **Regime changes through presidential elections and appointments** are associated with stock price changes for carbon-intensive firms as well as their counterparts.

Ramelli, Wagner, Zeckhauser, and Ziegler (2021)

And politics can have costly outcomes

- Evidence shows that **when Texas legislation banned** some of the largest municipal bond underwriters from doing business with state and municipal governments, there was **a significant cost on the issuers** of municipal bonds, a cost that is **borne by Texas taxpayers**.

Garrett and Ivanov (2023)



Shareholder activism:

Values and value

Shareholder activism

- Important studies exist on the institutional investor activists who engage firms on E and S
 - Engagement on E and S issues
 - Collaborative engagements on E and S issues
 - Engagement on downside risks

Dimson, Karakas and Li (2015; 2020)

Hoepner, Oikonomou, Sautner, Starks, and Zhou (2024),

Shareholder activists

- Motivations for some shareholder activists arise from a *values* orientation
- Motivations for some shareholder activists arise from a *value* orientation
- **We should expect differences in engagements and results from the engagements and our theories and empirical tests should reflect those differences.**

For intermediated assets, who should control proxy voting?



Legislation being considered in the 2023-2024 U.S. Congress would require investment advisors of passively-managed funds to vote proxies in accordance with the instructions of fund investors—not at the discretion of the adviser.

July 2023 Proxy Voting Choice

**BlackRock joins
State Street and
Vanguard in
further expanding
voting choice**

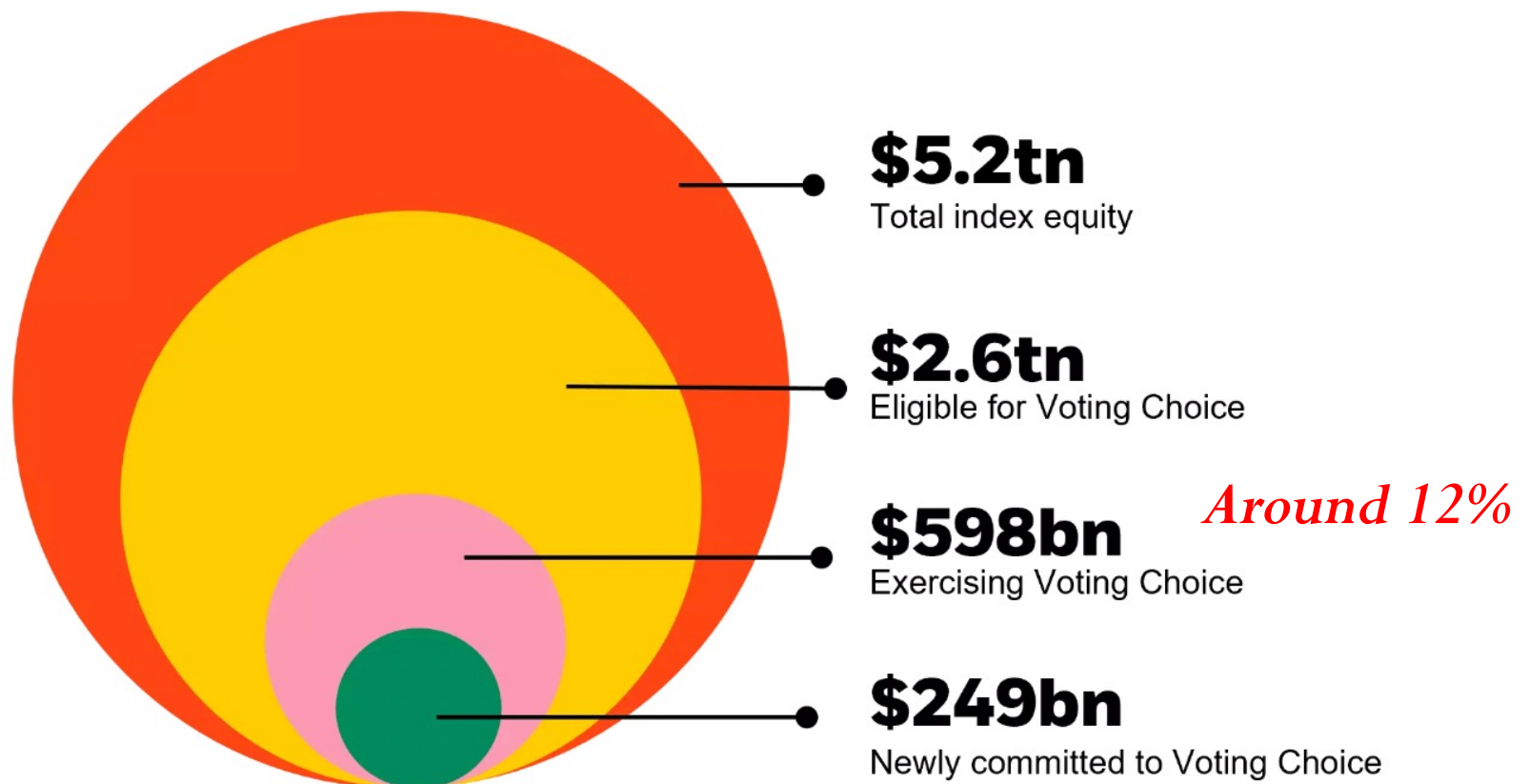
They have also extended this to many of their European funds!

Vanguard's proxy voting choice results (announced a couple of weeks ago)

- Almost all retail clients
- 2% participated in the 2024 proxy voting choice pilot (40,000 investors)
- Choices
 - “Not Voting” Policy: 2.3%
 - Company Board-Aligned Policy: 30.3%
 - Third-party ESG Policy: 24.4%
 - Vanguard-Advised Funds Policy: 43%

Blackrock's proxy voting choice includes institutional and retail clients

As of Q4 2023
*Index Equity clients
participating in Voting Choice
as of December 29*



Value vs. Values in Blackrock's Voting Choice Policies

ISS Policies




- ISS Benchmark Policy
- Sustainability Policy
- Socially Responsible Investment (SRI) Policy
- Catholic Faith-Based Policy
- Public Pension Fund Policy
- Taft-Hartley Policy
- Global Board-Aligned Policy

Glass Lewis Policies

- Glass Lewis Benchmark Policy
- Climate Policy
- ESG Policy
- Catholic Policy
- Public Pension Policy
- Taft-Hartley Policy
- Corporate Governance-Focused Policy

Egan-Jones Policies

- Egan-Jones Wealth-Focused Policy
- Egan-Jones Standard Policy

Value 
Values 
Blend 

Reconsiderations of proxy voting choice

News & Analysis



July 12, 2024

Maine pension fund mulls pulling voting power from BlackRock over resolution misalignment

Comparing the pension fund's own votes to those of Blackrock for 2023, they found very high alignment on management votes, but significant divergence on shareholder proposals.

CIO James Bennett described the findings as “a tale of two cities”.

The pension fund's proxy votes on their own holdings were only the same as Blackrock's for 215 out of 559 votes for the shareholder proposals.

What will happen with shareholder
democracy in proxy voting?

Four potential outcomes of voting choice

- No change
- Increased management opposition
- Increased shareholder proposal opposition
 - Big Three arguably “push ESG agendas” (US Senate, 2022)
- Reliance on proxy advisor recommendations

Examining Vanguard's decentralized voting in 2019



The image shows a screenshot of a CNBC news article header. At the top left is the CNBC logo. To its right is a dark blue navigation bar with white text for 'MARKETS', 'BUSINESS', 'INVESTING', 'TECH', 'POLITICS', 'CNBC TV', 'INVESTING CLUB', and 'PRO'. Below this is the main article title in large, bold, black font: 'Vanguard to surrender some of its corporate voting power to external fund managers'. Underneath the title is the publication information: 'PUBLISHED THU, APR 25 2019•2:20 PM EDT | UPDATED THU, APR 25 2019•2:26 PM EDT'. On the left side, there is a circular profile picture of Thomas Franck and his name with the Twitter handle '@TOMWFRANCK'. On the right side, there is a 'SHARE' button followed by icons for Facebook, X, LinkedIn, and Email.

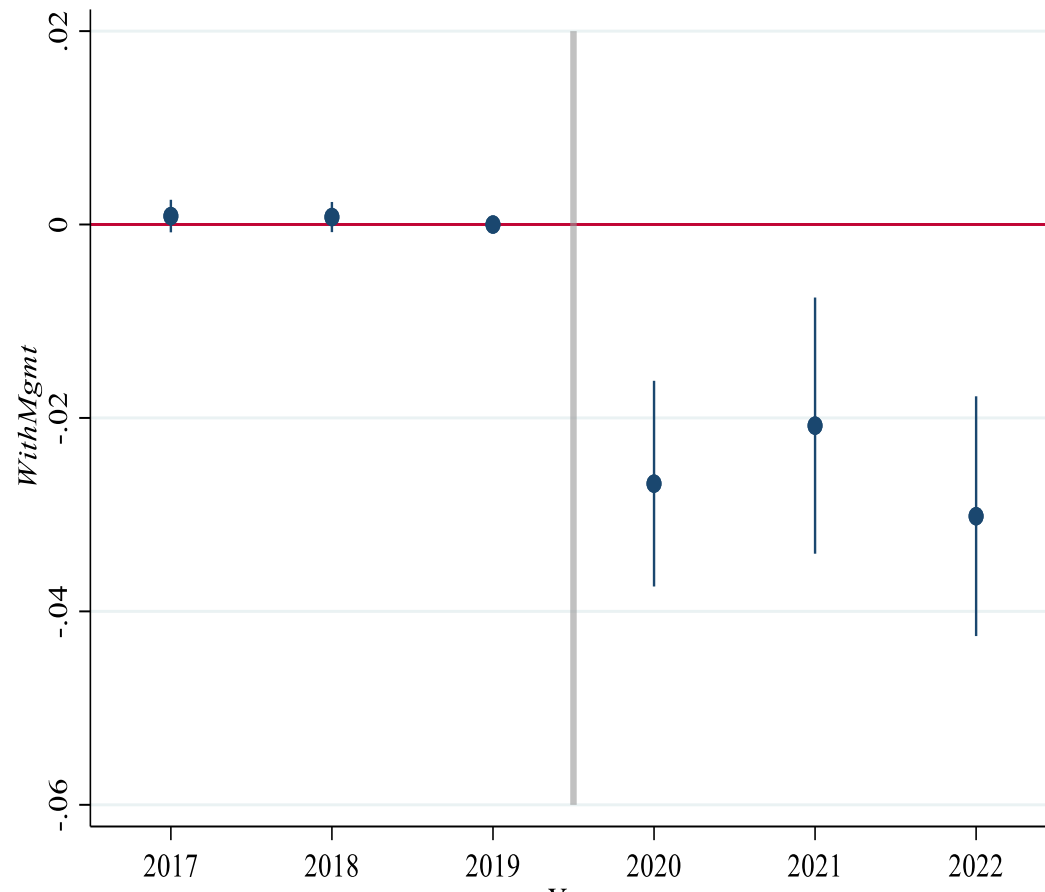
Examining these voting changes should shed light on proxy voting choice outcomes

Decentralizing Proxy Voting Power

Nathan Herrmann, John McInnis, Brian Monsen, and Laura Starks 2024

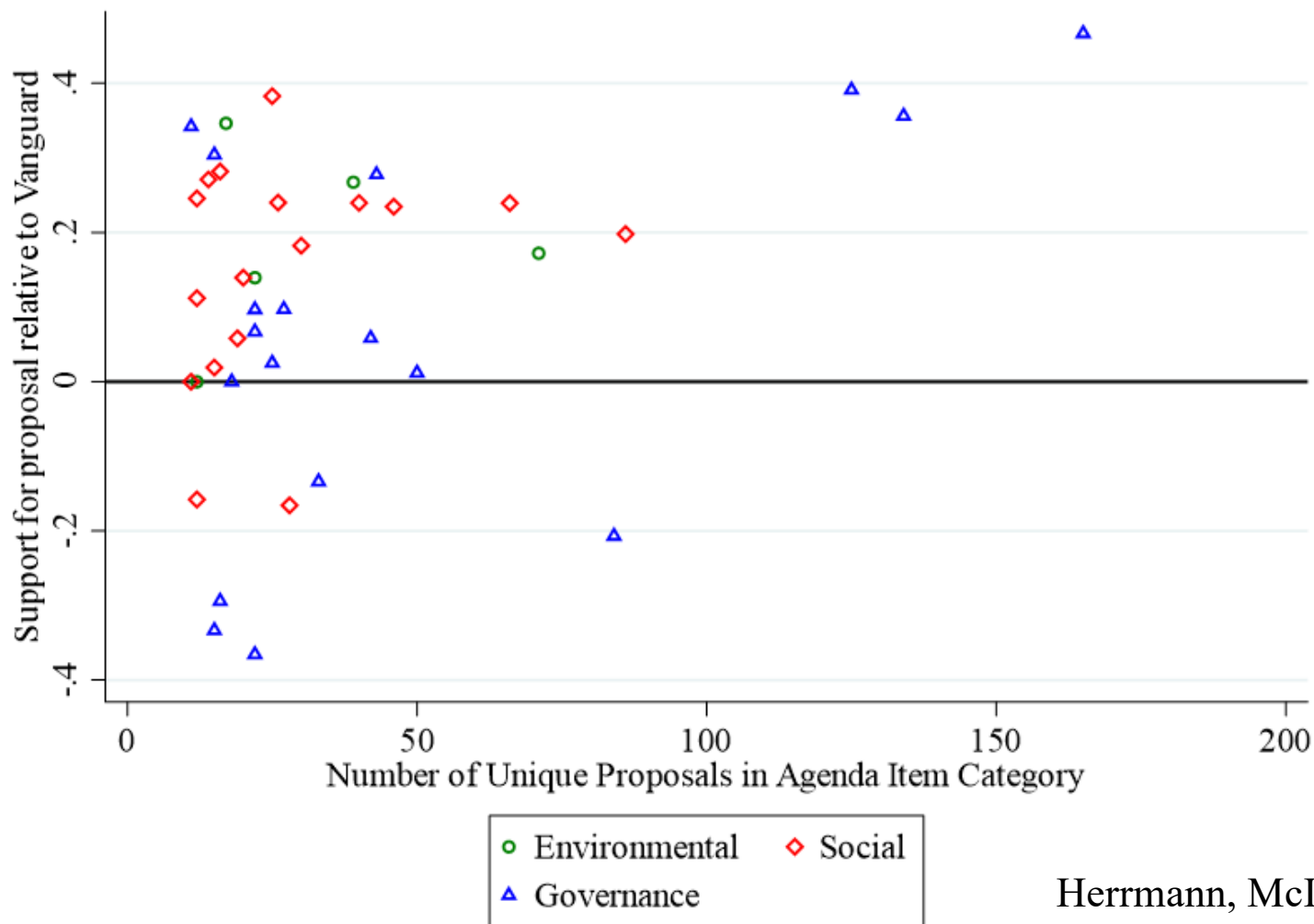
Comparing external fund managers votes after delegation

Voting in opposition to management



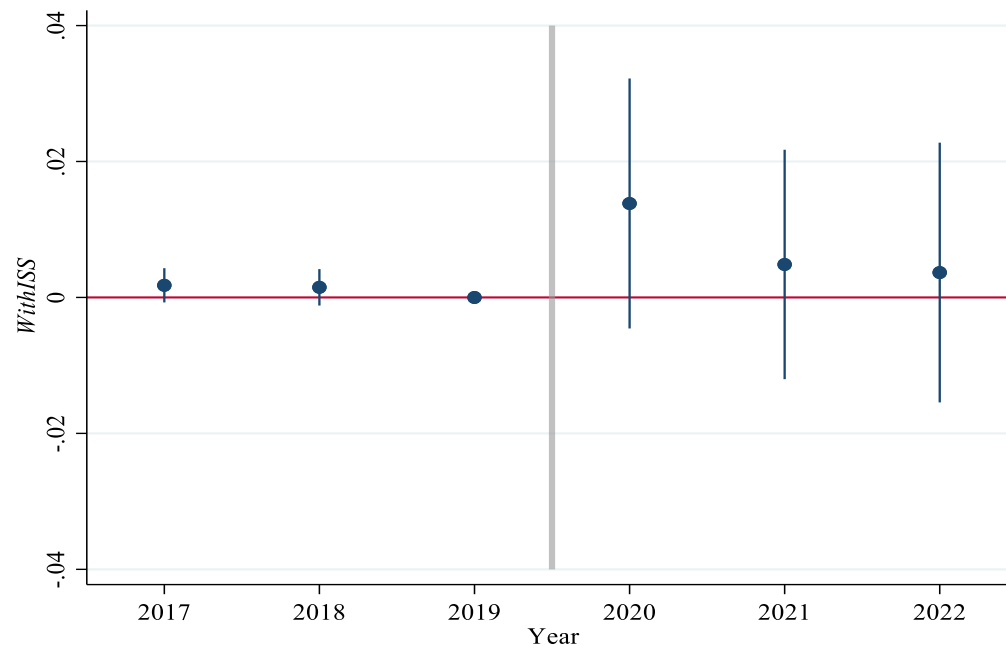
Herrmann, McInnis, Monsen,
and Starks (2024)

Voting on shareholder proposals after voting delegation to external managers



Herrmann, McInnis, Monsen,
and Starks (2024)

Outsourcing to proxy advisory firm after voting delegation to external managers




On average no effect
Why?



Delegated voters with
concentrated holdings
vote with proxy advisor
less often

Herrmann, McInnis, Monsen, and Starks (2024)




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Opposite: increased support
- Reliance on proxy advisor recommendations

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 It depends

Conclusions

- What sustainable finance means depends on the context.
- *Sustainable Finance Values* implies that non-financial factors are important
- But *Sustainable Finance Value* implies that the sustainable activities can be financially material, particularly for long-term investors.
 - Risk management and return opportunities, including engagement
- Considerations on what ESG means for corporate activities and investment decisions depends on which context is important to the managers and investors.