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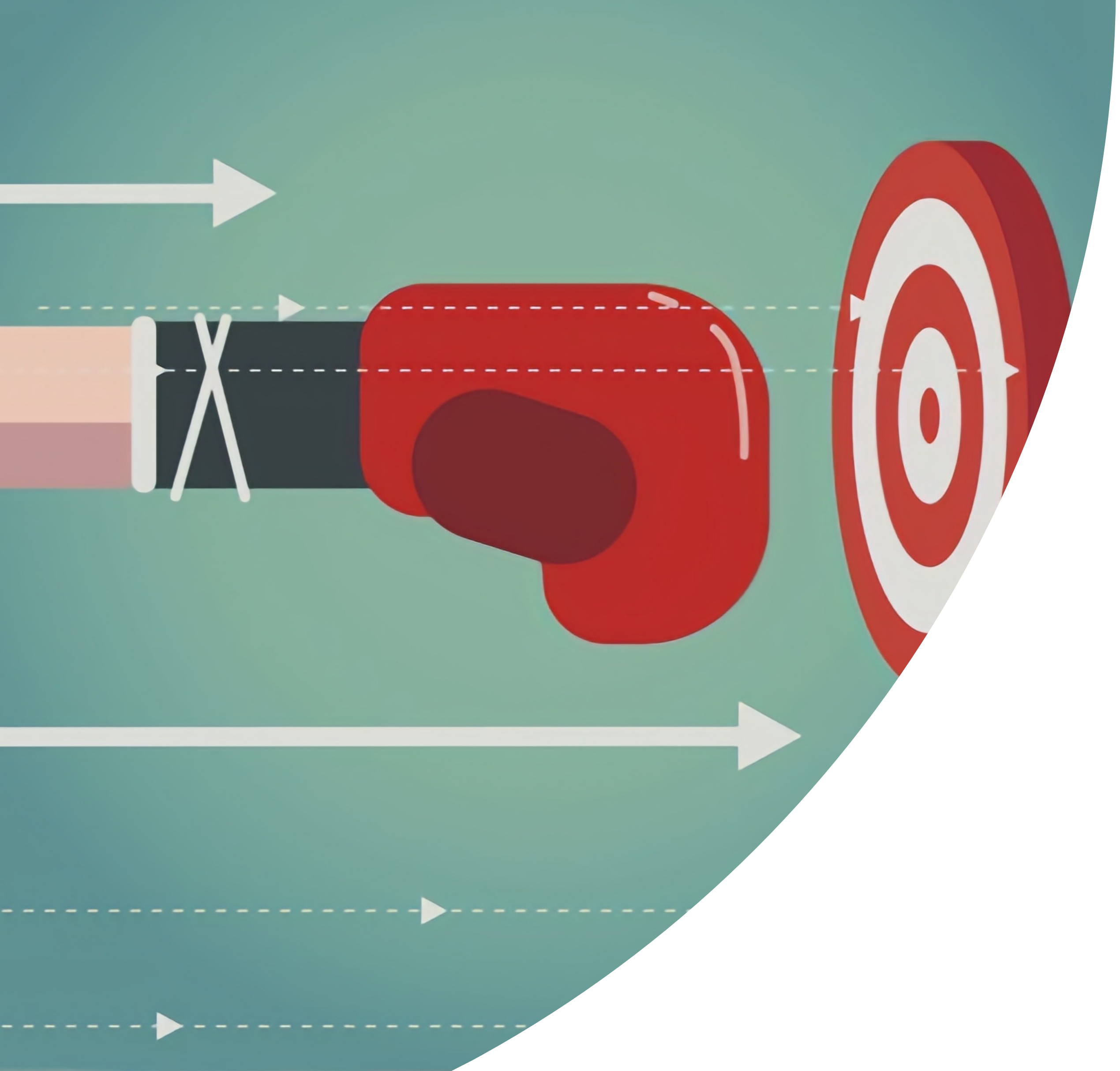

How can investors have impact?

Do inevstors care about impact?

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Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact

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Abstract

This article asks how sustainable investing contributes to societal goals, conducting a literature review on investor impact—that is, the change investors trigger in companies' environmental and social impact. We distinguish three impact mechanisms: shareholder engagement, capital allocation, and indirect impacts, concluding that the impact of shareholder engagement is well supported in the literature, the impact of capital allocation only partially, and indirect impacts lack empirical support. Our results suggest that investors who seek impact should pursue shareholder engagement throughout their portfolio, allocate capital to sustainable companies whose growth is limited by external financing conditions, and screen out companies based on the absence of specific environmental, social, and governance practices that can be adopted at reasonable costs. For rating agencies, we outline steps to develop investor impact metrics. For policy makers, we highlight that sustainable investing helps diffuse good business practices, but is unlikely to drive a deeper transformation without additional policy measures.

Keywords

sustainable investment, impact, causality, Sustainable Development Goals

Introduction

There are growing expectations that sustainable investing (SI)—that is, investing that takes environmental, social, and governance (ESG) information into account—will contribute to the achievement of societal goals. Historically, the Quakers divested to avoid supporting the slave trade, and colleges divested to challenge the South African apartheid regime (Molthan, 2003). Today too, many investors are attracted to SI due to their altruistic motives (Hartzmark & Sussman, 2017; Riedl & Smeets, 2017), expecting that SI will allow them to make a positive impact. Banks and asset managers are catering to these expectations by offering more and more investment products that emphasize sustainability, responsibility, and—increasingly—impact (Global Sustainable Investment Alliance [GSIA], 2018). Policy makers too are discussing SI as a potential mechanism for mitigating climate change (International Panel on Climate Change,

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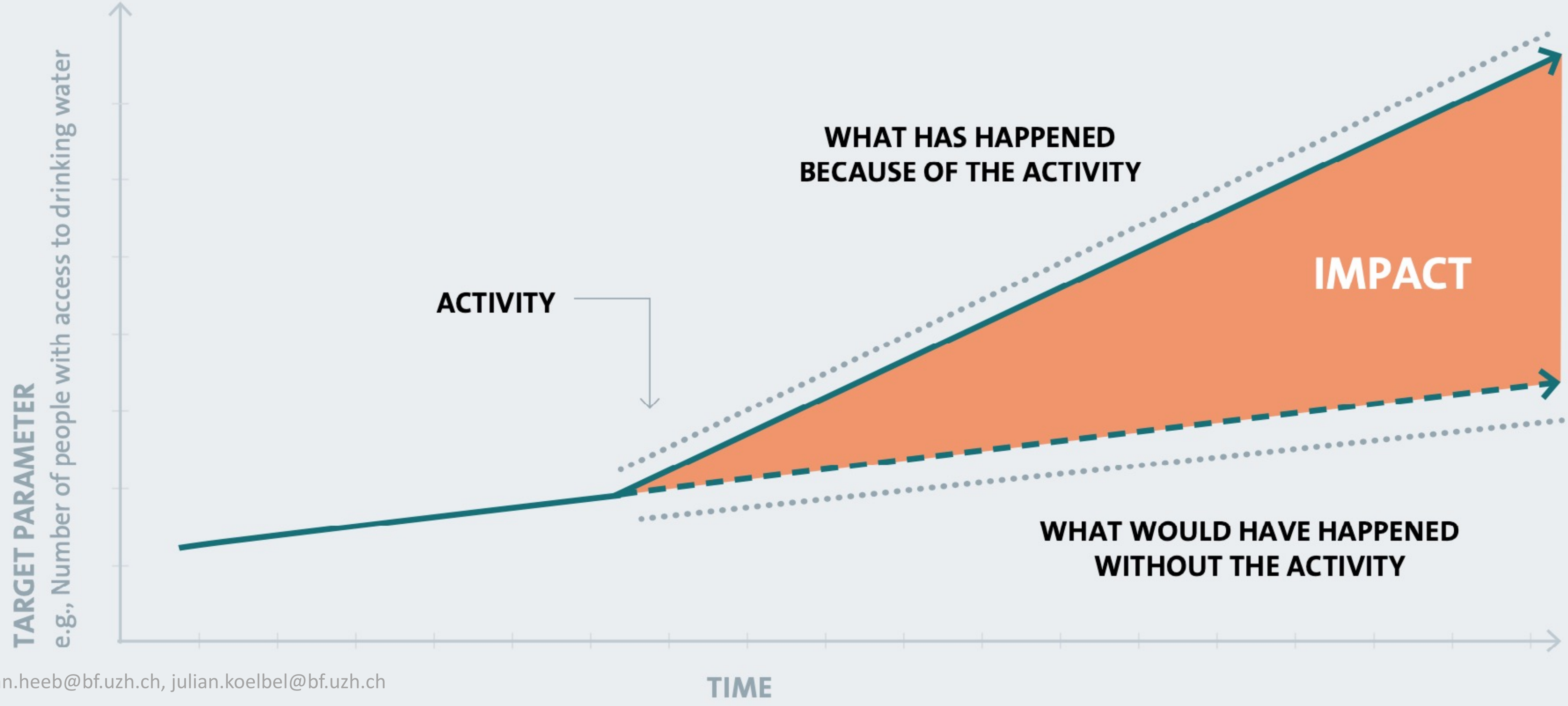
Key Concept #1:
Impact is change in the real world that is caused by your activities



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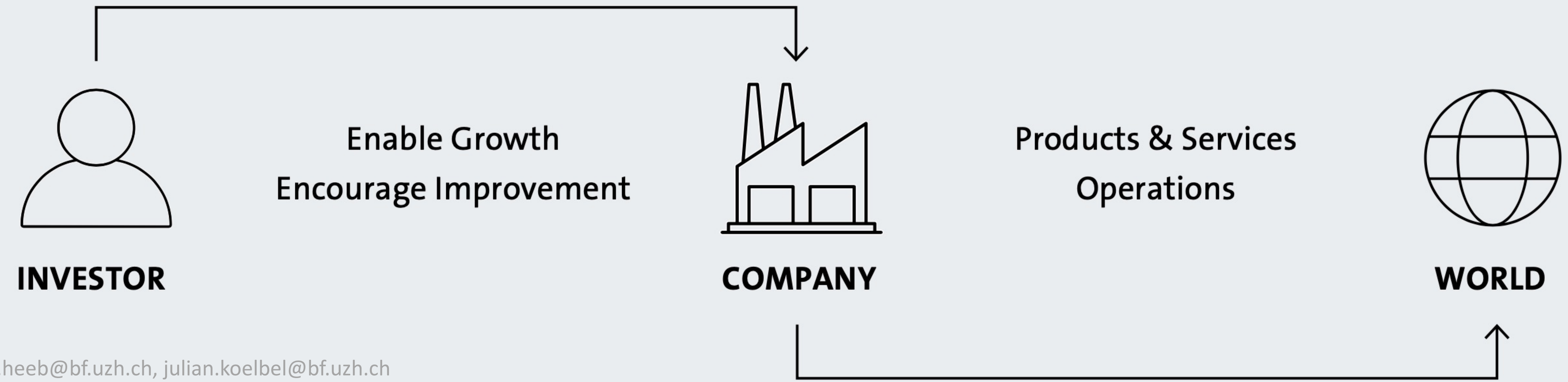
Key Concept #2:
Exposure to impact does not equal having an impact.

INVESTOR IMPACT
Is the change in company impact caused by investment activities

COMPANY IMPACT
Is the change in the world caused by company activities



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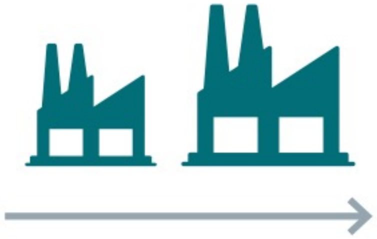
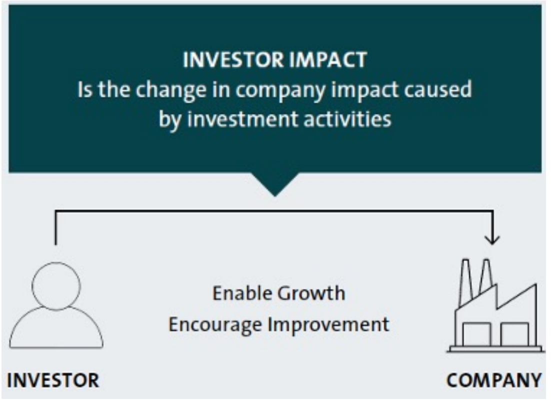
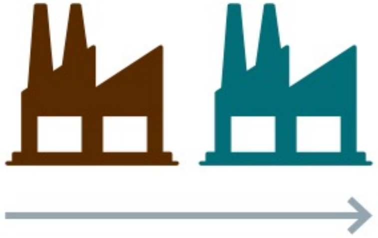
Key Concept #3:
You can *grow* green companies or *improve* brown companies





Enable *Growth:*

- Companies with a positive impact.
- Companies whose growth is limited by external financing conditions.
  - Small and young companies
  - Immature financial markets
  - Companies with intangible assets



Promote *Improvement:*

- E.g., voting, engagement & conduct-based screening
- Companies that have room to improve (also large ones)
- Restricted to incremental change

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Investor Impact Mechanism (based on IMP classification)		Type of Change	Evidence Level	Requirements	Limitations	Typical Asset Classes
Grow new/ undersupplied capital markets		Enabling Growth	**B: Empirical Evidence**	• Investments in companies with net-positive impact • Companies' growth is limited by external financing conditions. This is more likely: – For small and young companies – For companies with mainly intangible assets – In immature financial markets	• Not suited for investments in large, established companies, which have sufficient access to external financing	**Private markets:** • Private equity • Private debt • Venture capital
Provide flexible capital		Enabling Growth	**B: Empirical Evidence**	• Investments in companies with net-positive impact • Companies' growth depends on access to flexible capital	• Not suited for companies that have sufficient access to philanthropic or commercial capital	
Engage actively	**Provide non-financial support**	Enabling Growth	**B: Empirical Evidence**	• Investments in companies with net-positive impact. • Investors with know-how, reputations or networks that help companies grow faster	• Only suited for early-stage investments, where investors can directly influence the company	
	Shareholder engagement	Encouraging Improvement	**B: Empirical Evidence**	• Focus on meaningful improvements that companies can achieve at reasonable cost • Investor with strong influence on a company. Influence increases with: – The number of shares held by investor – The cultural proximity with the company – Size and reputation of the investor	• Limited to incremental improvements; unlikely to transform industries	**Public markets:** • Public equity • Public debt
Signal that impact matters	**Market signals**	Encouraging Improvement	**C: Model-Based Prediction**	• Transparent ESG criteria that companies can meet at reasonable cost • Substantial portion of the market screening out or underweighting firms that don't meet the ESG criteria	• Effect unlikely for industry exclusion • Disagreement on how to measure ESG criteria	
	Non-market signals	Growth or improvement	**D: Narrative**	• High level of public visibility of signals	• Impact is difficult to evaluate as it is indirect and depends on political action or cultural change	

Do Investors Care about Impact?*

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July 15, 2021

Abstract

We assess how investors' willingness-to-pay (WTP) for sustainable investments responds to the impact of those investments, using a framed field experiment. Although investors have a substantial WTP for sustainable investments, they do not pay more for investments with more impact. This also holds for dedicated impact investors. When investors compare several sustainable investments, their WTP increases with impact, but depends strongly on the choice set. Investors experience positive emotions when choosing a sustainable investment, irrespective of the investment's impact. These findings suggest that the WTP for sustainable investments is driven by "warm glow" and not by deliberate evaluations of impact.

Keywords: Responsible investing, impact, externalities, scope neglect, pro-social preferences, behavioral finance

JEL classification: D62, G11, G41, Q56

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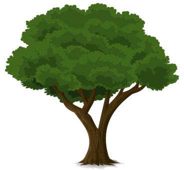
Research Question:

Does it matter for investors' willingness to pay (WTP) <u>how</u> sustainable an investment is?

Impact of Investment:



vs.

Approach: pre-registered framed field experiment

Base Design:

– We measure investors' WTP for an investment with impact, compared to a financially equivalent investment without impact.

– We vary the amount of impact of the investment between subjects.

Independent variable:
Impact (tCO_2 emissions saved with investment)

Dependent variable:
WTP for the impactful investment option

Participants:

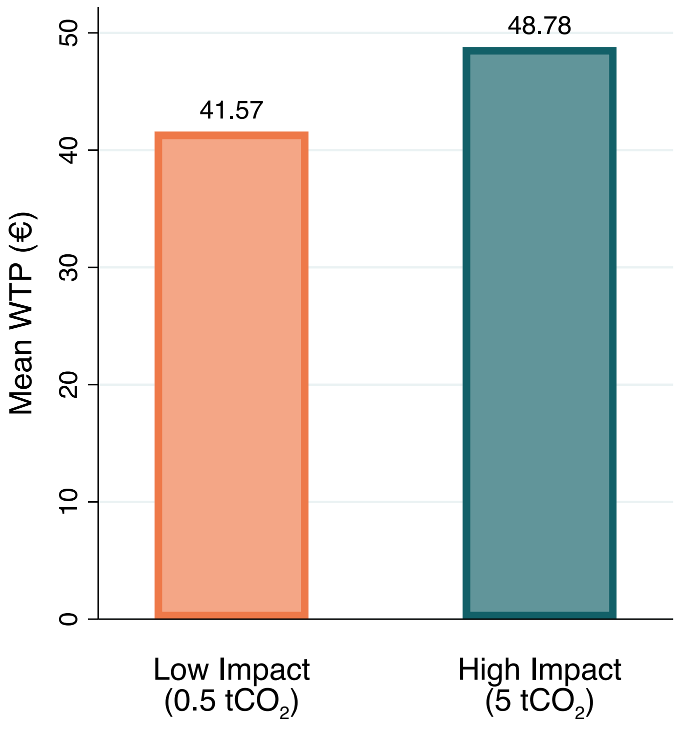
- Panel of 500+ experienced **private investors** (provided by VEB)
- Unique panel of 100+ (U)HNWI **dedicated impact investors**

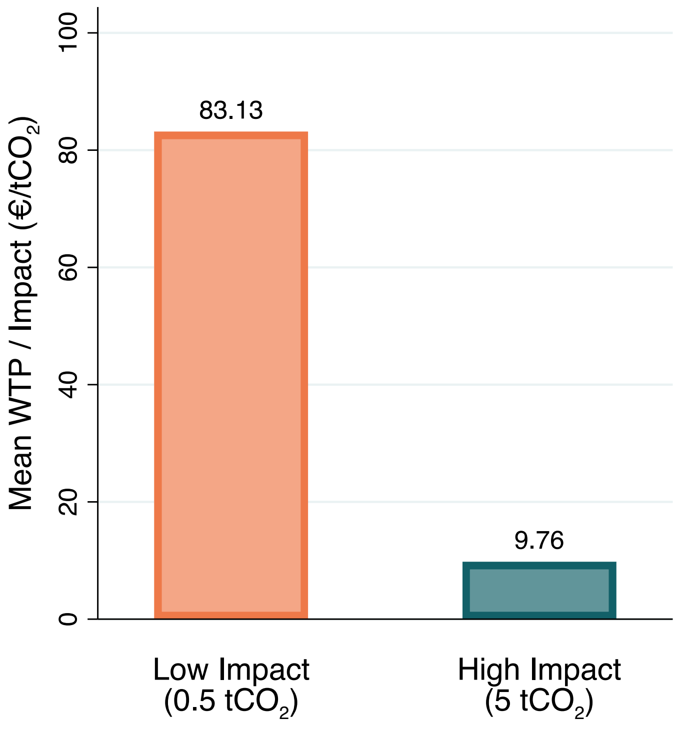
Real consequential decisions:

- €1,000 for each of 10 participants to invest (approx. 60€ expected hourly wage)
- Real impact: We invest in real projects to offset CO_2 according to fund's impact

Do investors value how much impact investments have?

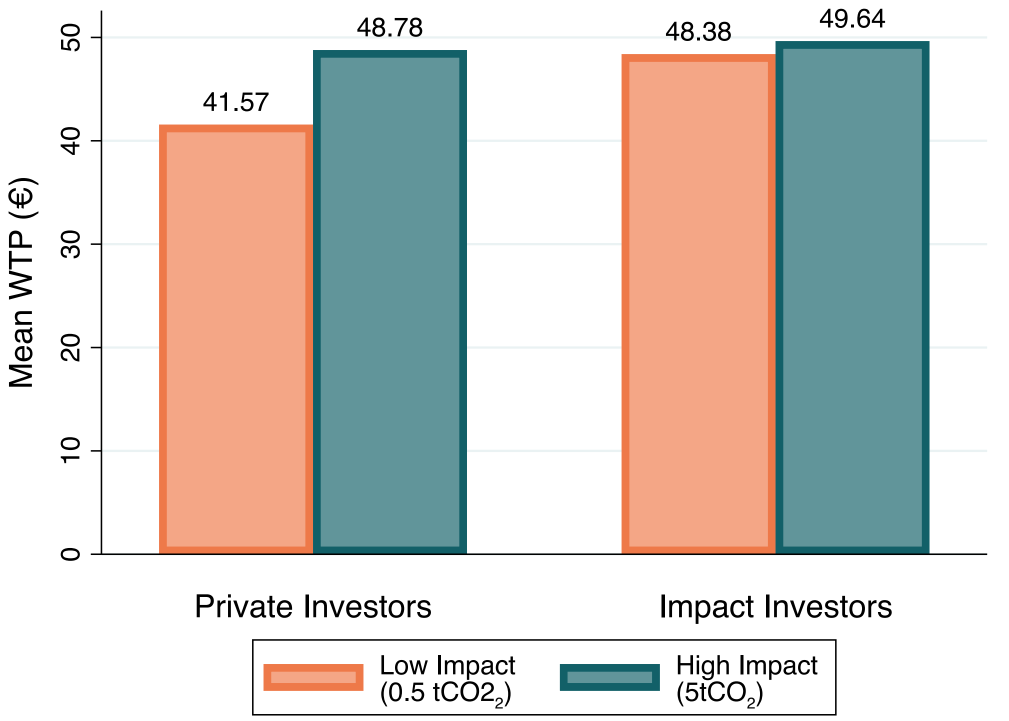
- Investors have a **substantial WTP** for investments with impact. (**$p<0.001$**, Mann-Whitney)
- The **amount of impact** does **not have a significant effect** on their WTP. ($p=0.265$, Mann-Whitney)
- This leads to **inconsistent valuations** per unit of impact between investors. (**$p<0.001$**, Mann-Whitney).





WTP per level of impact

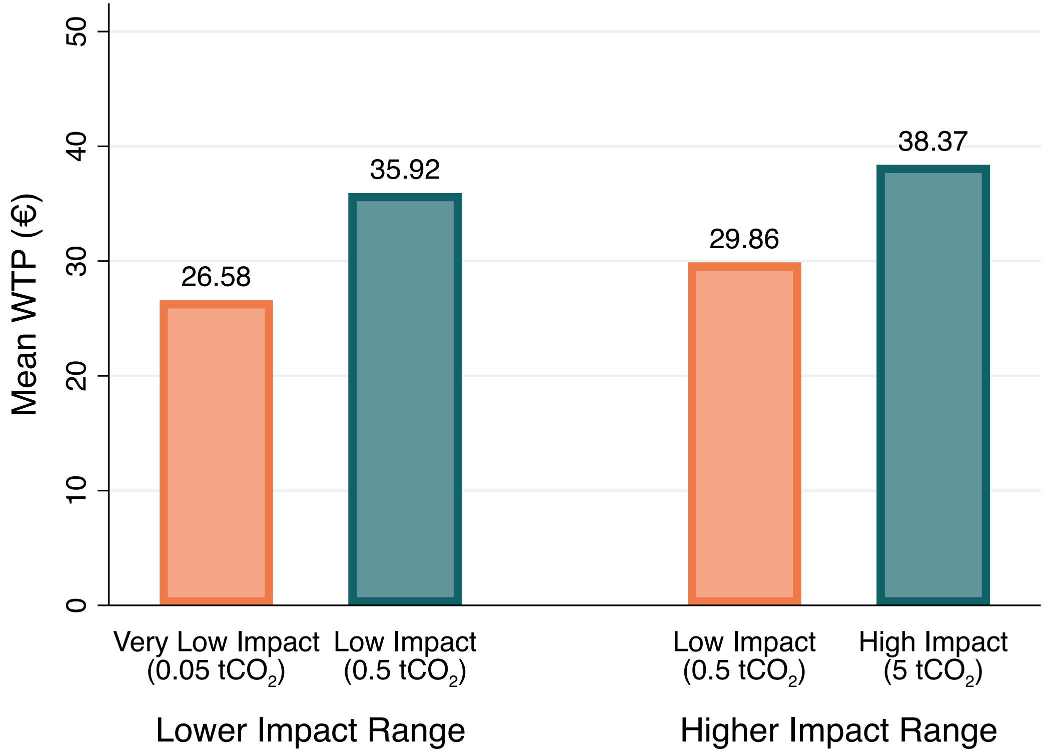
Are investors with a high level of expertise sensitive to impact?



Even dedicated impact investors are not sensitive to the amount of impact.

Does comparability increase sensitivity?

- Increasing **comparability increases sensitivity**…
- … but the **range of options** to compare is crucial.
- Investors seem to value impact relative to other salient options.



Is investors WTP for sustainability driven by warm glow?

Table 6
Positive emotions and investors' WTP for sustainable investments

This table presents the results of an ordinary least squares (OLS) regression with the WTP for the sustainable investment as the dependent variable. Independent variables are the level of self-stated positive emotions investors experience when choosing the sustainable investment and a treatment dummy variable taking the value of 0 for the LowImpact treatment and 1 for the HighImpact treatment. Specifications (1) and (2) are based on observations from our sample of private investors, specifications (3) and (4) are based on the sample of impact investors. Specifications (2) and (4) add controls for investors' preferences and demographics, as described in detail in Table A.3.

	Private Investors		Impact Investors	
	(1) WTP	(2) WTP	(3) WTP	(4) WTP
Positive emotions	5.130***	4.003***	3.566***	3.035***
	(0.672)	(0.751)	(0.778)	(0.877)
Impact treatment	4.586	3.023	4.585	5.877
	(4.939)	(4.833)	(5.612)	(5.977)
Preferences	No	Yes	No	Yes
Demographics	No	Yes	No	Yes
Constant	11.03*	-56.32	20.58**	-24.86
	(5.414)	(30.85)	(7.232)	(30.72)
Observations	196	196	118	118
R^2	0.237	0.343	0.155	0.219
F	29.91	6.271	10.52	1.91

Standard errors in parentheses
* $p<0.05$, ** $p<0.01$, *** $p<0.001$

- Investors' WTP is **correlates with the positive emotions** they derive form choosing sustainable investments.
- On average, investors derive a **high level of positive emotions**, independent of impact.
- Compatible with a **warm glow explanation** for investors' WTP for sustainability.

Conclusion

- Investors have a **substantial WTP** for sustainable investments.
- WTP does **not respond to the absolute level of impact**.
- WTP responds with comparability but is **strongly affected by the choice set.**
- Our observations are most compatible with a **warm glow explanation** of investors' choices.

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Thanks a lot!

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Our Paper: