# 2021 MOSKOWITZ PRIZE RESEARCH BRIEF

## Corporate ESG Profiles and Investor Horizons

By Laura Starks, Parth Venkat, and Qifei Zhu

**Long-term investors put more money into ESG-focused firms and are more patient with these companies even when they have poor returns or earnings shortfalls.**

### ABOUT THE PRIZE

The Moskowitz Prize recognizes empirical research with the potential to inform responsible business and investing practices in the real world.

### SUMMARY OF FINDINGS

Despite increased scrutiny of corporations' Environmental, Social, and Governance (ESG) performance, little has been formally established about what type of investors tend to be attracted to firms with better performance on ESG metrics. **Of special interest is whether investors with longer investment horizons gravitate toward high-ESG firms.**

The authors examine institutional investors' portfolio holdings, including those of pension funds, mutual funds, and others, to understand what types of investors hold shares of firms with better or worse performance on ESG metrics. They also study changes in portfolio holdings over time, to assess how ESG metrics affect investors' patience in the face of poor returns, and to evaluate whether firms newly recognized for ESG efforts attract different types of investors.

**The study finds that:**

- Portfolios of long-term investors have a greater proportion of high-ESG-firm stocks than those of shorter-term investors—an average ESG score of 0.91 versus 0.42
- Long-term investors are less likely to sell a high-ESG firm than a low-ESG firm after a single quarter of poor returns or earnings shortfalls
- Firms newly recognized for ESG initiatives (through inclusion in the FTSE4Good USA Index) see increased holdings by long-term investors—and more patience from them as well.

### PRACTICAL IMPLICATIONS

The research findings have important practical implications for investors and managers:

- Corporate leaders can be more confident in pursuing ESG initiatives, recognizing this is likely to attract longer-term investors, which can drive lower volatility
- If long-term investors continue to reward firms that make ESG-related investments, there may plausibly be incentives for firms to increase investments with positive societal externalities
- Pressure from short term investors may curtail ESG projects, with possible negative financial and societal impacts in the long term
- Long-term investors may be 'matching' with firms with similar time horizons and capturing value created by ESG policies with slow payoffs

### METHODOLOGY AND DATA

- **Methodology**: Analysis of investor portfolio holdings for proportion of high- and low-ESG stocks based on investor time horizons; difference-in-differences analysis to understand investment patterns related to both newly recognized high-ESG firms and firms facing reduced ESG-performance expectations
- **Data**: Portfolio holdings as reported in Thomson/Refinitiv and other databases; ESG level measured by firms' MSCI and Sustainalytics ESG scores, and inclusion in or removal from the FTSE4Good US Index

### QUESTIONS FOR FUTURE RESEARCH

| Do the investments that long-term investors make in high-ESG firms generate attractive risk adjusted returns compared to other holdings? | As ESG metrics are increasingly incorporated into investment decisions, how do we continue to improve measures of E, S, and G and effectively evaluate societal impact? | How are ESG policies affected by the pressure placed on corporations by the priorities of short-term investors? |
|---|---|---|