

‘The Engagement Channel’ Session

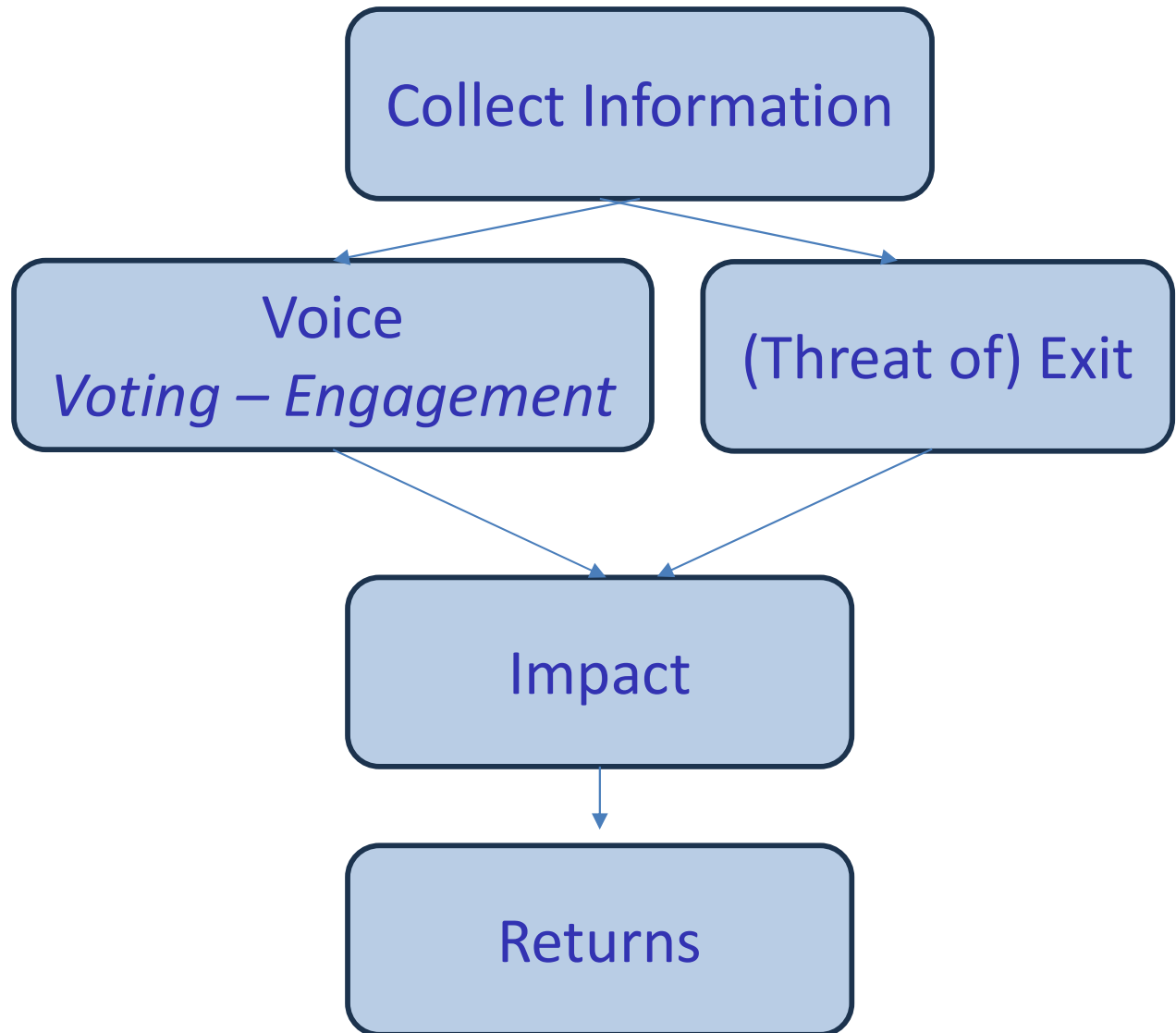
Oliver Hart Conference

Michelle Lowry, Drexel University

Asset owners' (potential) engagement on ESG

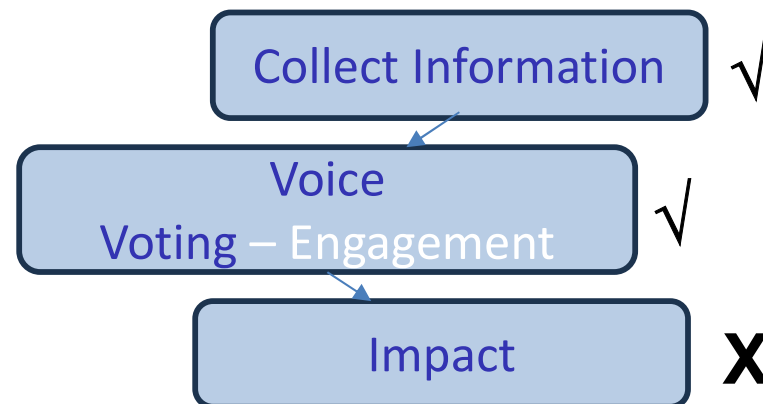
Big-picture questions

1. Do MFs view ES issues as value-relevant
2. If so, can MFs impact firms ES policies?

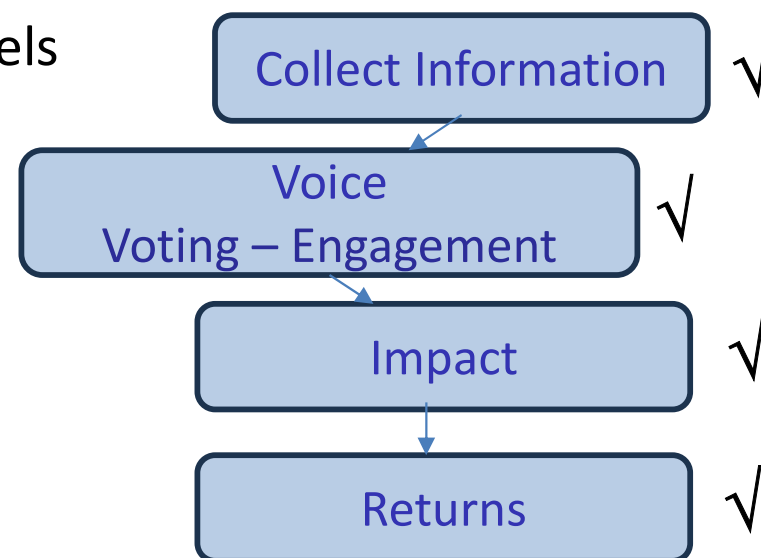


Outline

- Shareholder proposals on ES issues
 - They nearly always fail – no impact
 - But, MFs votes are informative
 - *He, Kahraman and Lowry (2023)*



- A deeper dive: identify ESG funds' with high incentives to engage
 - Potentially engage through multiple channels
 - Engagement is effective
 - Improvements in firms' ES policies
 - Higher returns
 - *Lowry, Wang, Wei (2025)*



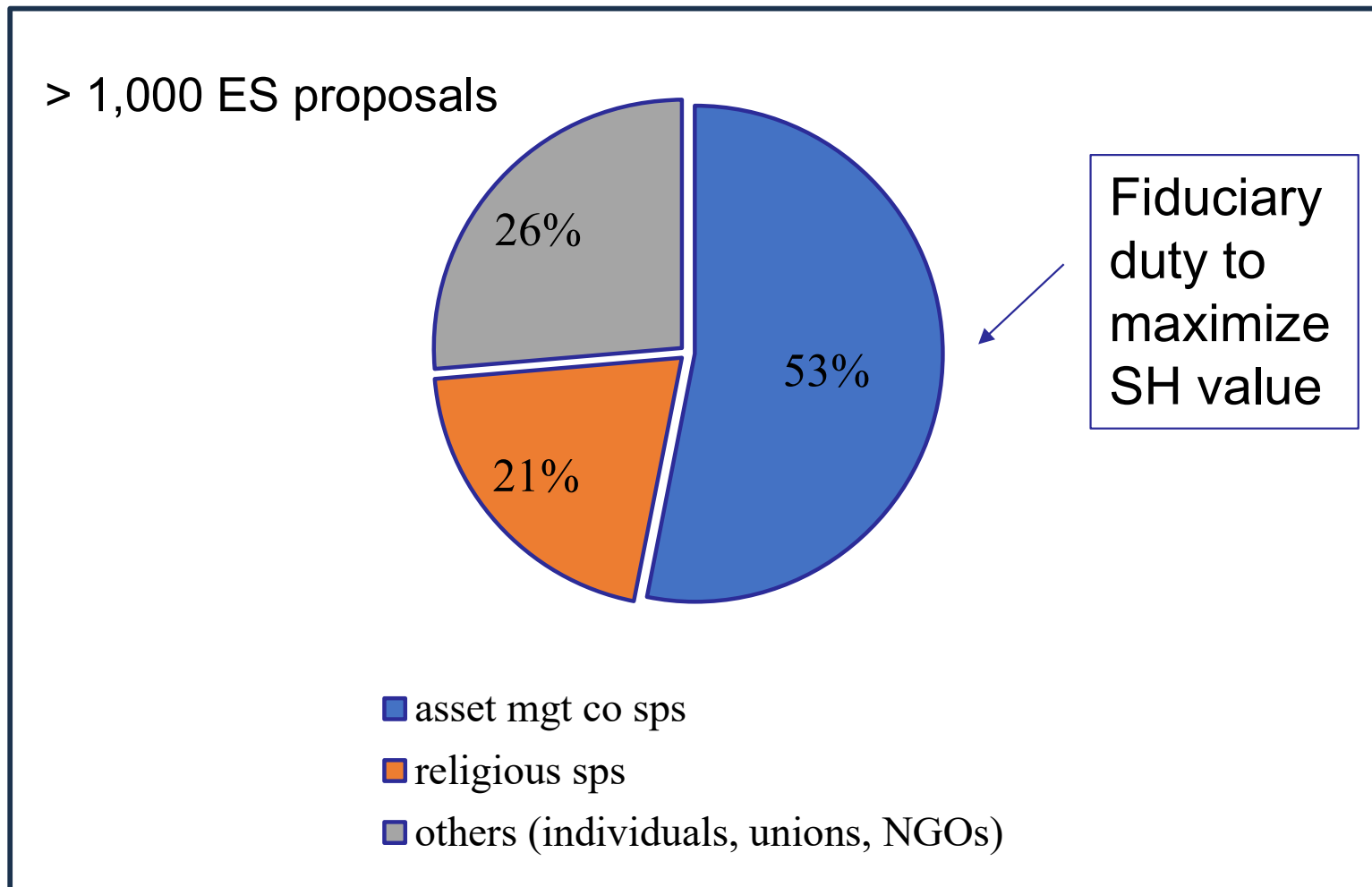
ES Risks and Shareholder Voice

Ellen He, Bige Kahraman, Michelle Lowry
(RFS 2023)

Part 1: Shareholder proposals on ES issues

Are these proposals motivated by shareholder value?

25% of all shareholder proposals focus on ES issues
And majority are sponsored by Asset Management Companies

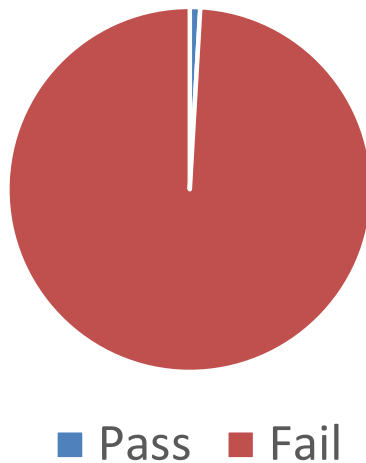


Part 1: Shareholder proposals on ES issues

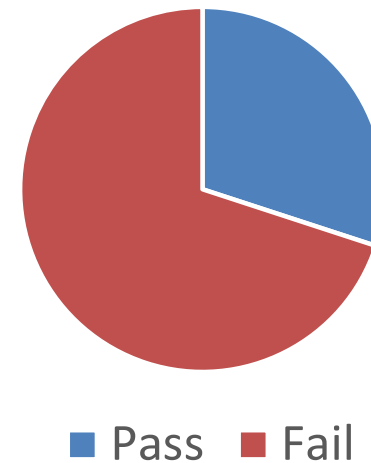
Are these proposals motivated by shareholder value?

However, virtually no ES proposals pass

ES Shareholder Proposals

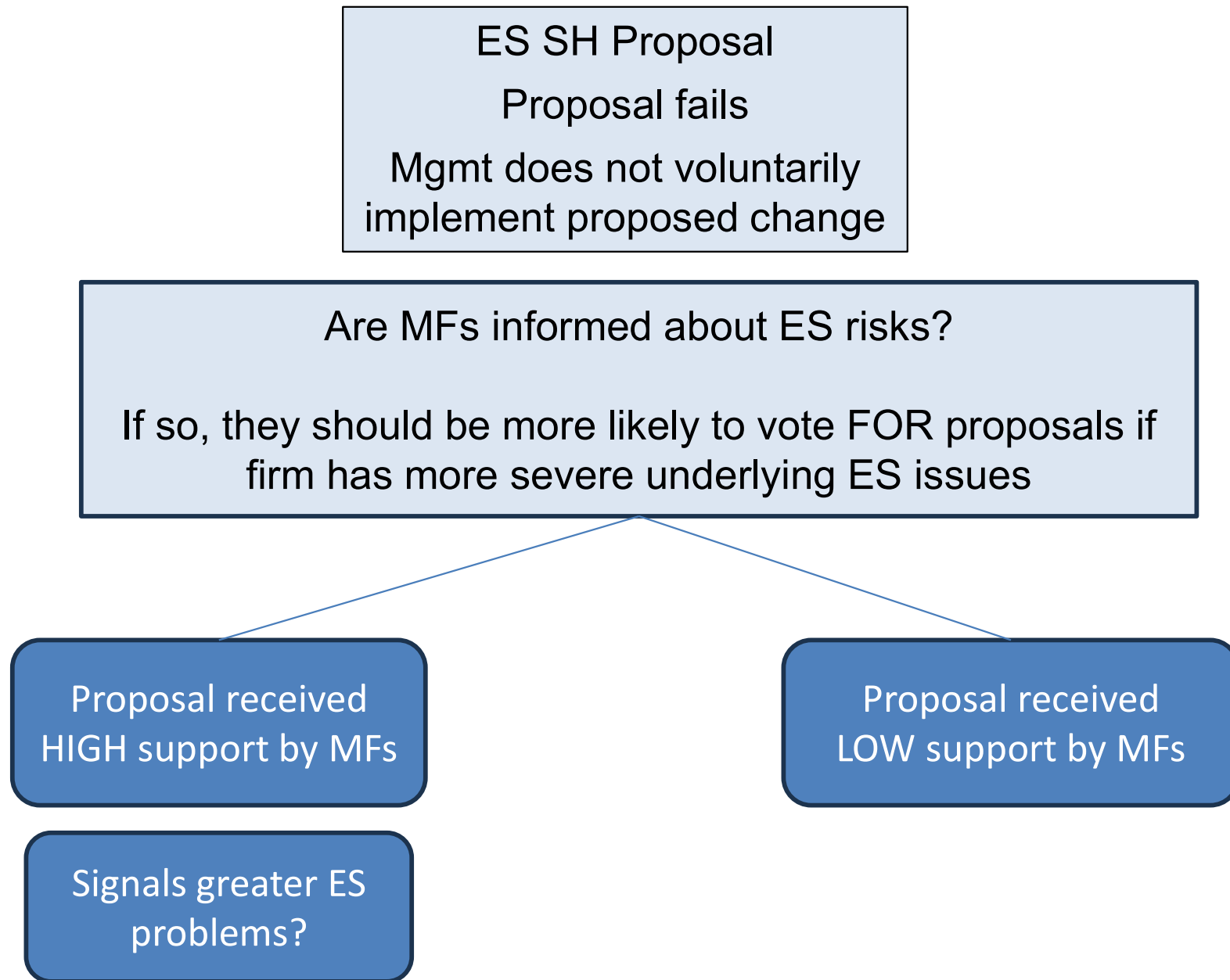


Non-ES Shareholder Proposals



No evidence that mgmt. 'voluntarily' implements proposed changes on failed proposals

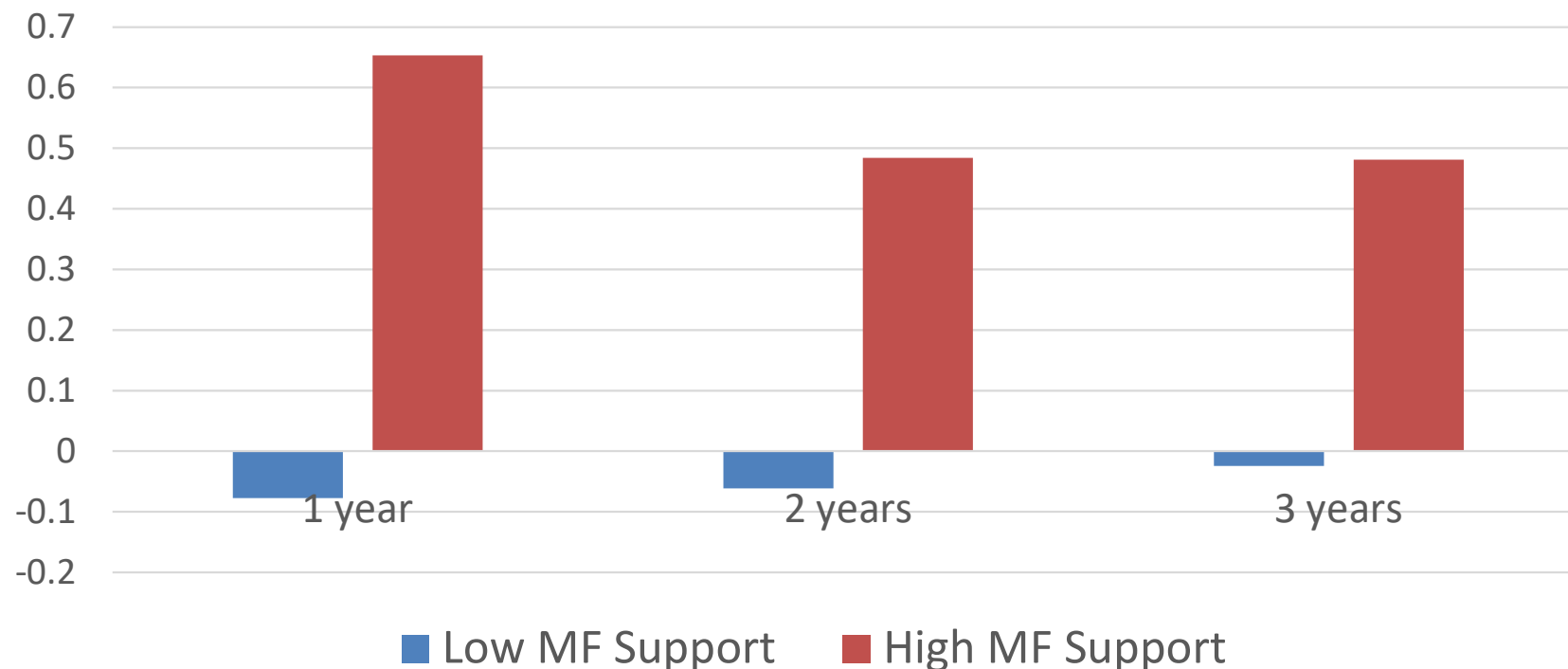
Mutual fund votes on ES shareholder proposals



Part 1: Shareholder proposals on ES issues

BUT ... MFs vote in an informed manner

Firm ES Incidents over years following ES Shareholder proposal



Moreover, firm alphas around these ES incidents are significantly negative

Among (failed) shareholder proposals related to ES issues

Note: No evidence that mgmt. voluntarily implements proposal reforms

- Higher MF support predicts a higher # of negative ES incidents in future
- Higher MF support = signal of greater problems at the firm

Takeaway

- Shareholder proposals on ES issues are
 - Common & Motivated by SH value
- Many MFs devote resources to researching these issues
 - Higher support on (failed) proposals predicts more value-decreasing ES incidents in future
- But proposals nearly always fail
 - Why: Due (partly) to agency issues among some MFs
Investor myopia, fund friendliness toward mgmt
 - Result: Firm mgrs don't implement suggested changes
- Bottom line: SH proposals on ES issues have no impact

How else / Who else might have impact?

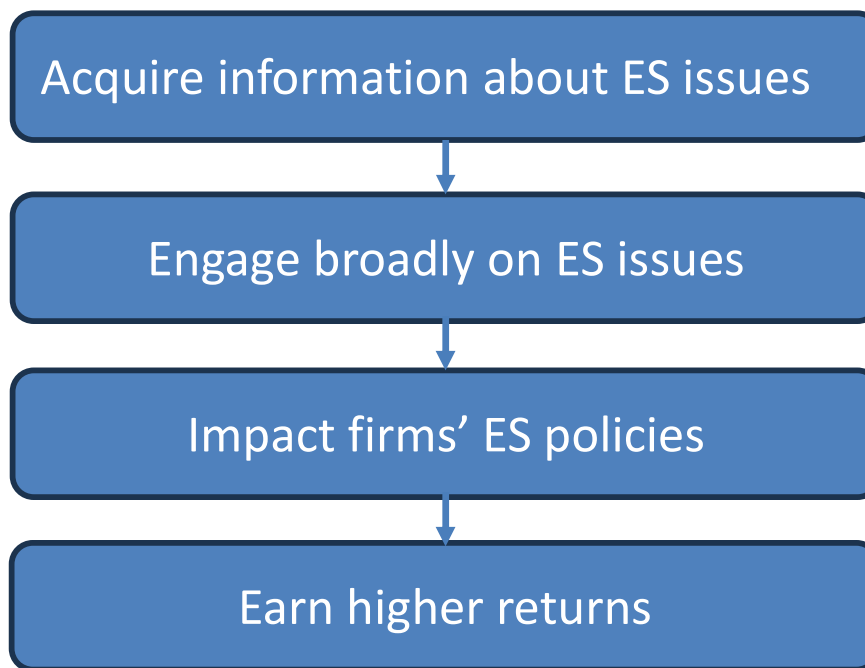
- **HOW** to impact firms' ES policies?
 - Can impact be achieved through channels other than SH proposals?
- **WHO** should be most likely to impact firms' ES policies?
 - Some MFs might have higher incentives to engage than others
- Consider these questions in a subsequent paper

Are All Funds Equal? Only some are committed

Michelle Lowry, Pingle Wang, Kelsey Wei
(RFS, forthcoming)

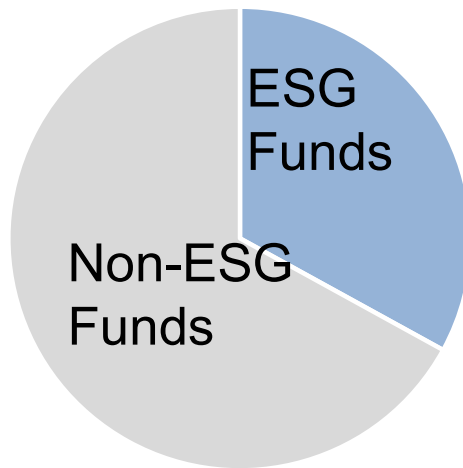
Motivation: Value-driven engagement hypothesis

- Main economic conjecture
 - ESG fund managers view ESG policies as a value driver
 - But all funds are not equal
- Empirical predictions: Funds with HIGHER incentives to engage will



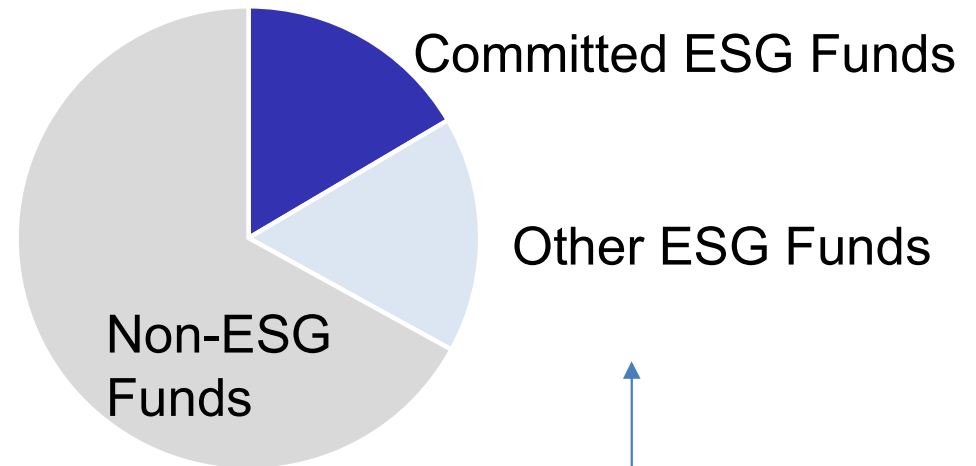
Empirical setup: Categorizing mutual funds

Step 1: Classify MFs based on asset-weighted ESG scores



Step 2: Classify ESG funds into:

- Committed: High incentives to engage
- Other: Low incentives to engage

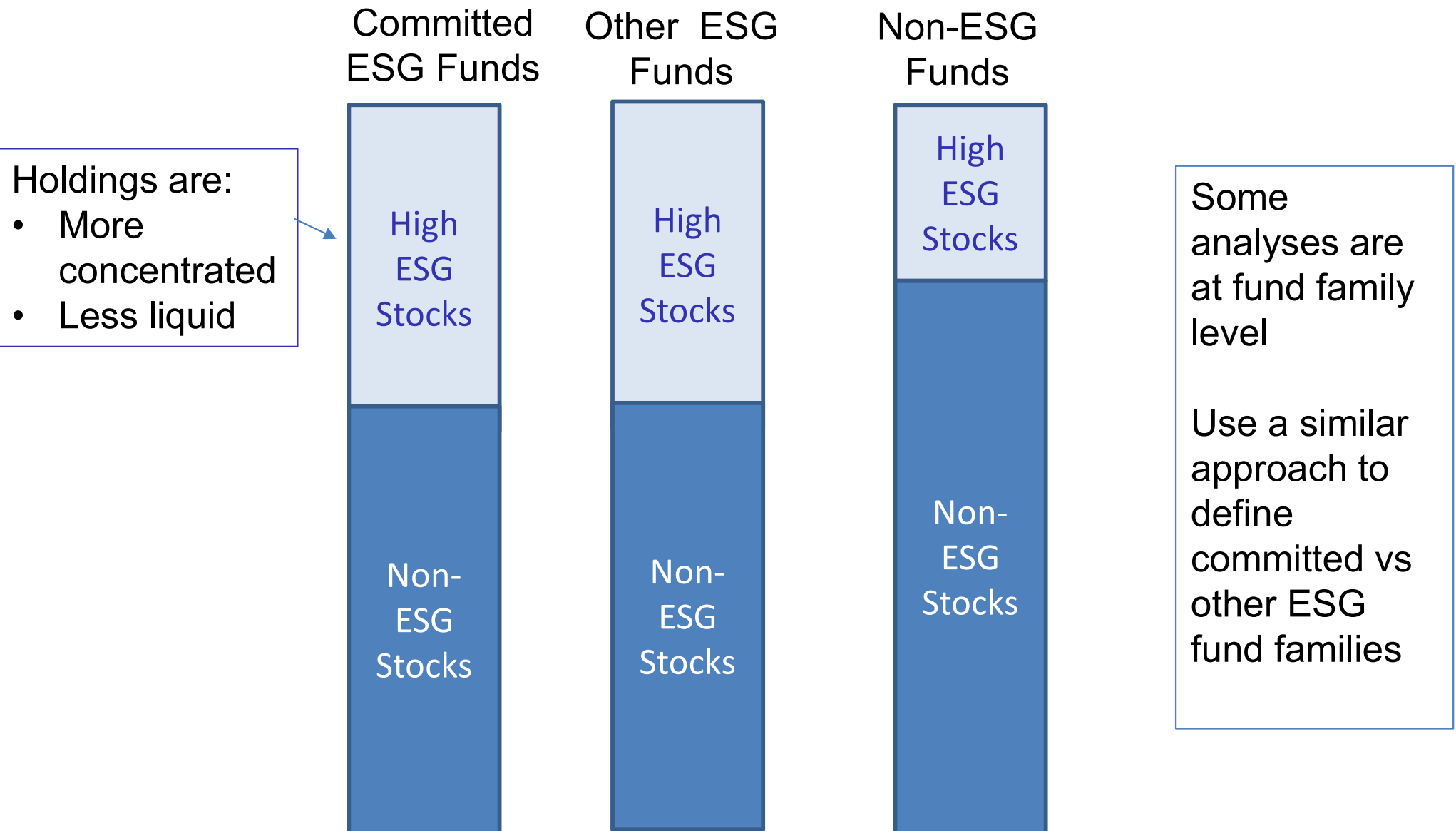


Lewellen and Lewellen, 2022 (LL) Incentive to engage proxy
Captures extent to which increase in firm value -> higher mgmt. fees, through

- Increases in fund value
- Increases in fund flows

Committed funds = ESG funds with above-median incentive-to-engage

Empirical setup: Composition of each type of MF



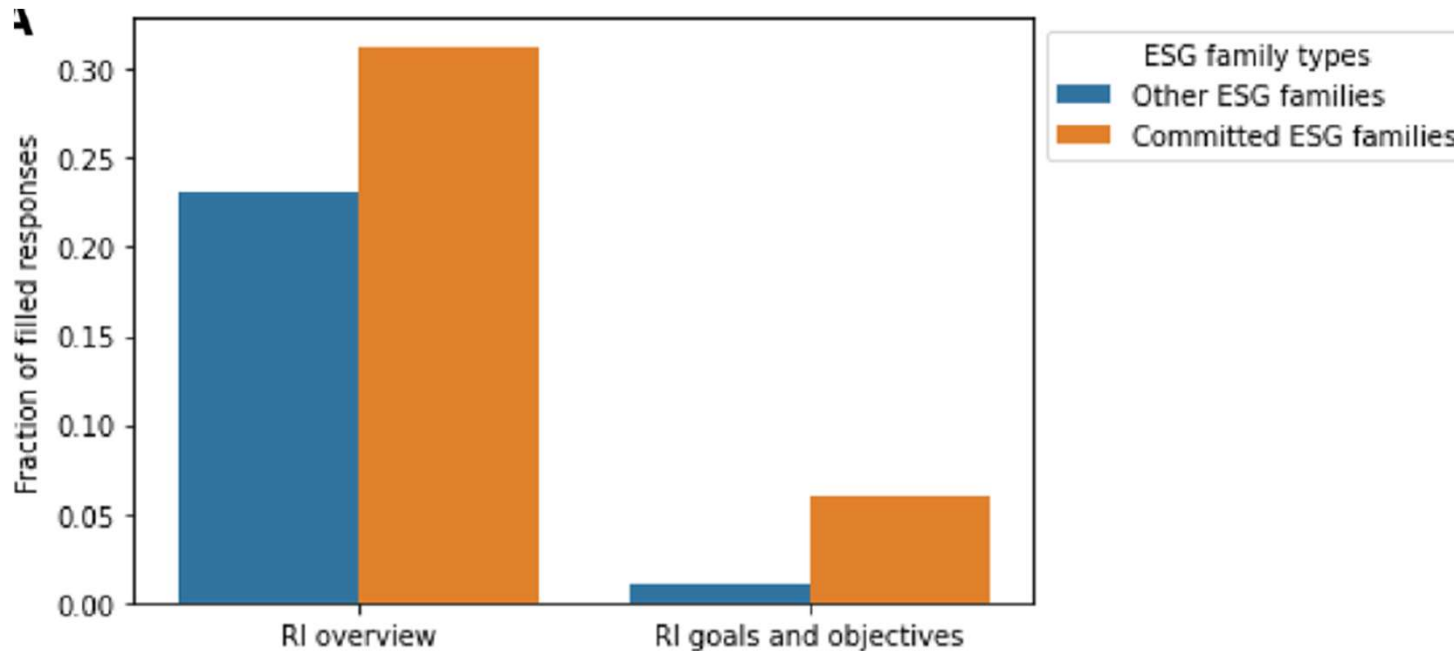
Validation tests

1. Morningstar ESG Commitment Level Measure introduced 2020
 - Based on investment process and active engagement on ESG issues

Morningstar: Leader or Advanced
2 US companies
Both = Committed ESG Fund

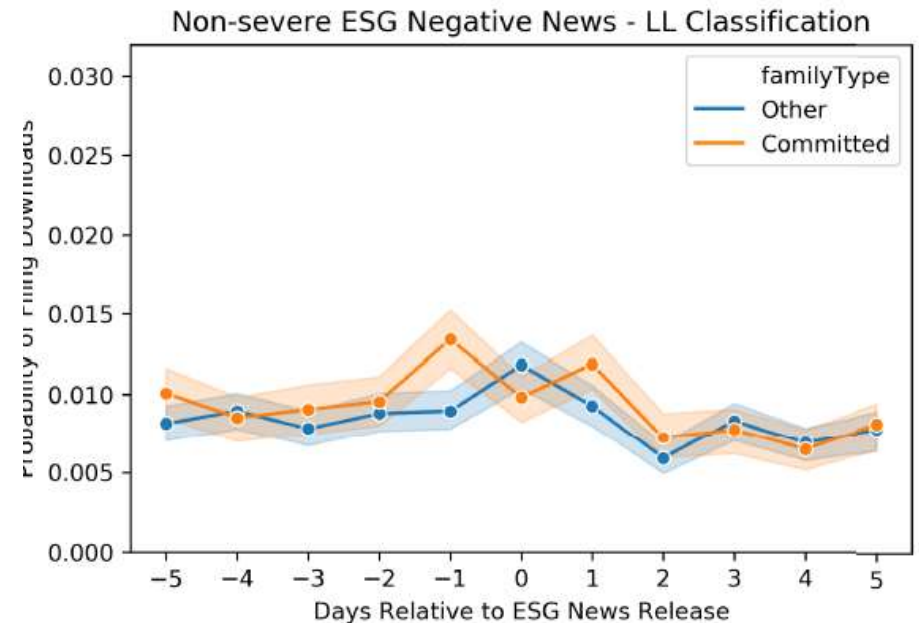
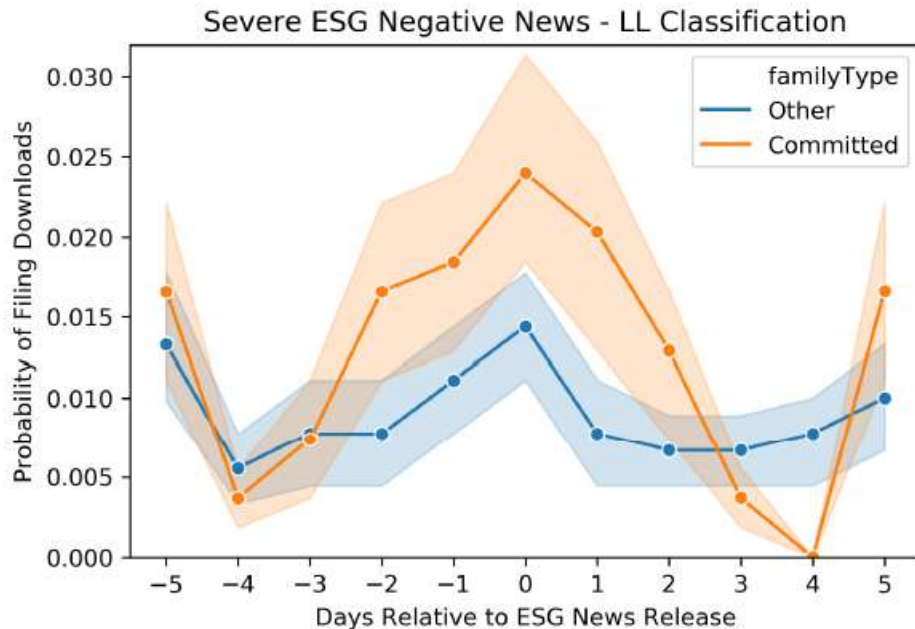
Morningstar: Basic or Low
12 US companies
10 / 12 = Other ESG Fund

2. UNPRI responses on engagement-related questionnaire




Test #1: Information Acquisition

- Predict: committed funds' incentives to engage -> more research
 - If committed funds view ES as a value driver,
 - Then this research should include ES issues
- Analysis: Examine MF views of firm filings (on EDGAR) around ES incidents



Test #2: Investment Strategy

- Predict: Committed ESG funds are less likely to sell after ESG incidents
 - If engagement can -> ESG improvements
 - IF ESG improvements = value driver

Committed ESG Funds less likely to sell
- Analysis:
- $NetTrade_{qtr\ t} = \beta_1 Severe\ ESG\ Neg've\ News_t + \beta_2 Other\ ESG\ Neg've\ News_t + Severe\ Non-ESG\ Neg've\ News + \dots$
 - Estimate among **Other ESG funds**: β_1 predicted Negative
 - Estimate among **Committed ESG funds**: β_1 predicted zero

Test #2: Investment Strategy

Panel A: Fund-security level regressions

	Dept Var = NetTrade	
	ESG Funds	
	Committed (1)	Other (2)
Severe ESG Negative News	0.002 (0.13)	-0.013** (-2.22)
Non-severe ESG Negative News	0.013 (0.63)	0.003 (0.77)
Severe Non-ESG Negative News	0.018 (1.30)	-0.008 (-1.29)
Non-severe Non-ESG News	-0.015 (-0.87)	0.007 (1.45)
Severe ESG - Severe Non-ESG	-0.016	-0.005
FE	Fund-Time	Fund-Time
Controls	Y	Y
N	118535	368318
Adjusted R-squared	0.090	0.033

Takeaways:

- 'Other ESG' funds sell following negative ESG events (col 2)
- Committed funds (col 1)
 - Do not sell after neg've ESG events
 - High incentives to engage -> LT Invst strategy
 - This LT strategy extends to ESG issues

Test #3: Engagement

- Prediction: Committed ESG funds more likely to engage with firms
- Analysis 1: Participation in Q&A section of conference calls
- Analysis 2: Propensity to independently vote
 - i.e., not indiscriminately follow ISS recommendations on all issues
- Analysis 3: Propensity to NOT vote in a one-size-fits-all manner
 - i.e., not vote in the same direction across all proposals of a certain type

Test #3a: Engagement – *conference call participation*

Dept Var = Fund Family asked ES Question(s)

	(1) E&S Question	(2) E&S Question
Committed ESG Family	0.025** (2.16)	0.035* (1.91)
ESG Fund Holding	0.026* (1.86)	0.047* (1.86)
Disp	0.011 (0.31)	0.011 (0.31)
Abs Ret	0.001 (0.03)	0.001 (0.03)
Firm Size	-0.018 (-1.37)	-0.018 (-1.37)
Book-to-market	0.032 (0.62)	0.032 (0.62)
SUE	-0.347** (-2.45)	-0.347** (-2.45)
N	3846	978

Takeaway: Committed funds more actively participate in conference calls, asking questions about ES issues

Q&A section of earnings conf. calls
Textual analysis to identify ES issues
Sautners, Van Lent, Vilkov and Zhang (2022), Chava, Du and Malakar (2021), Li et al (2021)

Classify buy-side analysts into

- From committed ESG fund families
- From other ESG fund families

Sample

- Col 1: family-firm pairs in which fund family asked 1+ question about firm in past year
- Col 2: conf calls in which analysts from both committed and other ESG families asked 1+ questions

Test #3b: Engagement, propensity to independently vote

Dept Variable = $1_{\text{fund vote against ISS}}$

	E&S Proposals
Committed ESG Fund	0.059*** (2.75)
Fund Expense Ratio	-0.631 (-0.17)
Fund Turnover Ratio	0.007 (0.59)
Log(TNA)	0.006 (0.93)
Fund Ownership of Firm	0.049*** (2.68)
Firm Weight of Fund	-0.736** (-1.99)
N	8202
Adjusted R-squared	0.185

Dept Var = 1 if Fund vote \neq ISS Rec

Sample = ESG Funds' votes on portfolio firms' :

- Env. and Social Proposals

Firm Controls

Agendaltem, Industry, Year FE

Takeaway:

Committed ESG funds are sig'ly more likely to devote resources to voting

- Vs other ESG funds
- More likely to independently vote – come to a different conclusion than ISS more often

Test #3c: Engagement, vote in one-size-fits all manner

$$\text{Dept Var} = \left| \frac{\# \text{Vote For} - \# \text{Vote Against}}{\# \text{Proposals}} \right|$$

E&S Proposals

Committed ESG Fund	-0.032*** (-2.60)
--------------------	----------------------

Expense Ratio	6.595*** (3.21)
---------------	--------------------

Turnover Ratio	-0.005 (-0.68)
----------------	-------------------

Log(TNA)	0.025*** (7.91)
----------	--------------------

Sample	ESG Funds
N	3450
Adjusted R-squared	0.020

Dep't variable measured over

- Each fund × agenda item × year
- Across proposals over yrs t+1, t+5
- =1 if always vote in same direction
- =0 if equally likely to vote for vs against

Takeaway:

Committed ESG funds devote resources to voting

- Vs other ESG funds
- Less likely to follow one-size-fits-all strategies

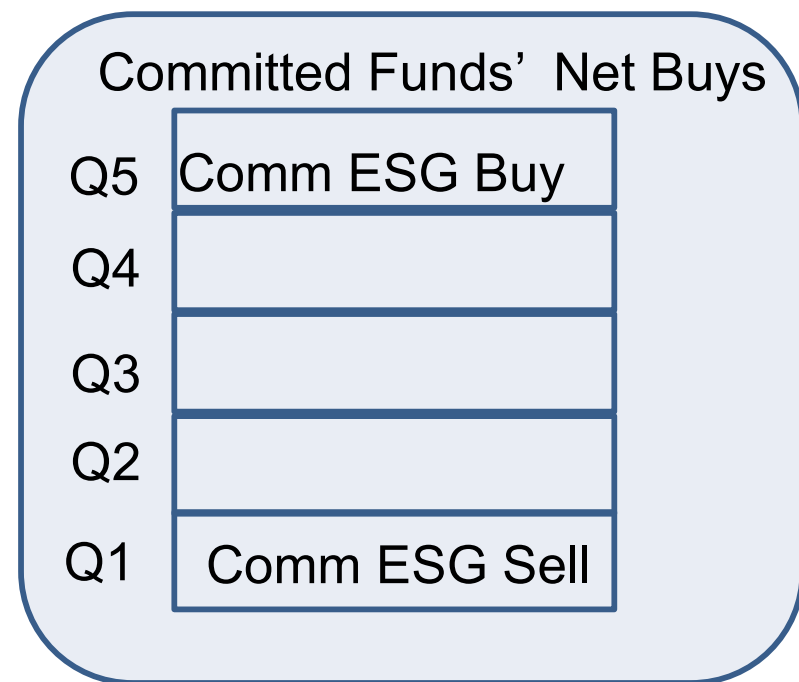
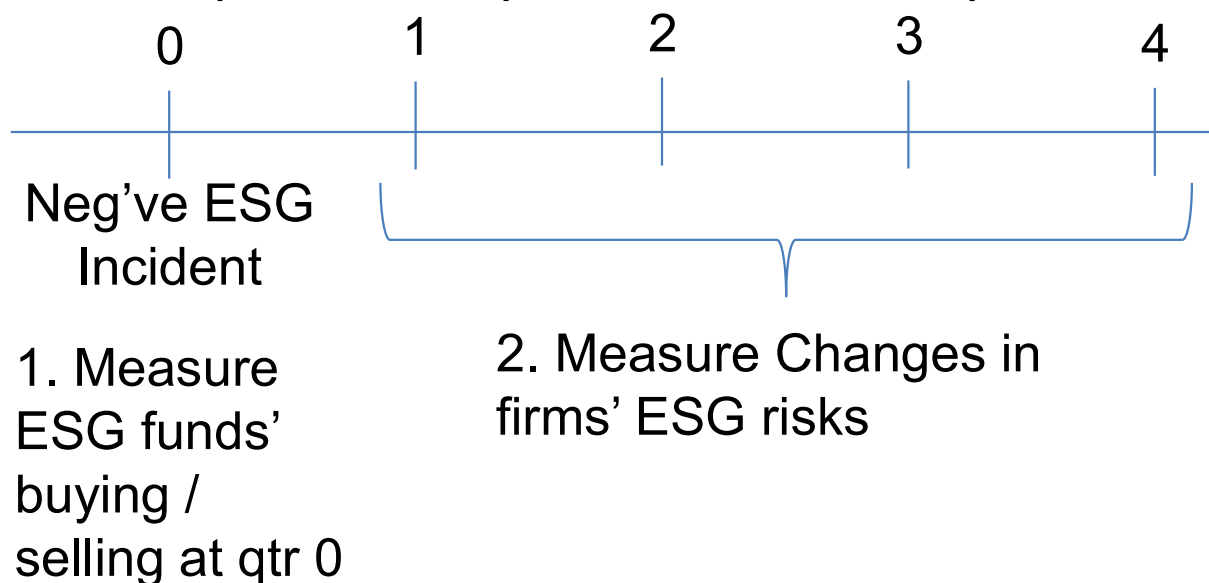
Test #4a: Impact on Portfolio Firms' ESG Performance

- Why does all this matter???
 - Committed' funds info acquisition + Long-term invt policies + Engagement
- Answer:
 - Committed funds should have greater impact
 - Affect portfolio firms' environmental policies
- Two measures of impact
 - Overall risk index of ESG-related risks (RepRisk Index)
 - More micro-level measure of risks (Trucost emissions)
- Several approaches
 - OLS, with heterogeneity analysis to focus on engagement channel
 - Difference-in-Difference analysis to account for endogeneity

Test #4a: Impact on Portfolio Firms' ESG Performance

- Predict: Committed funds will have greater **impact**, due to their
 - Greater info acquisition + Longer-term invt policies + Engagement

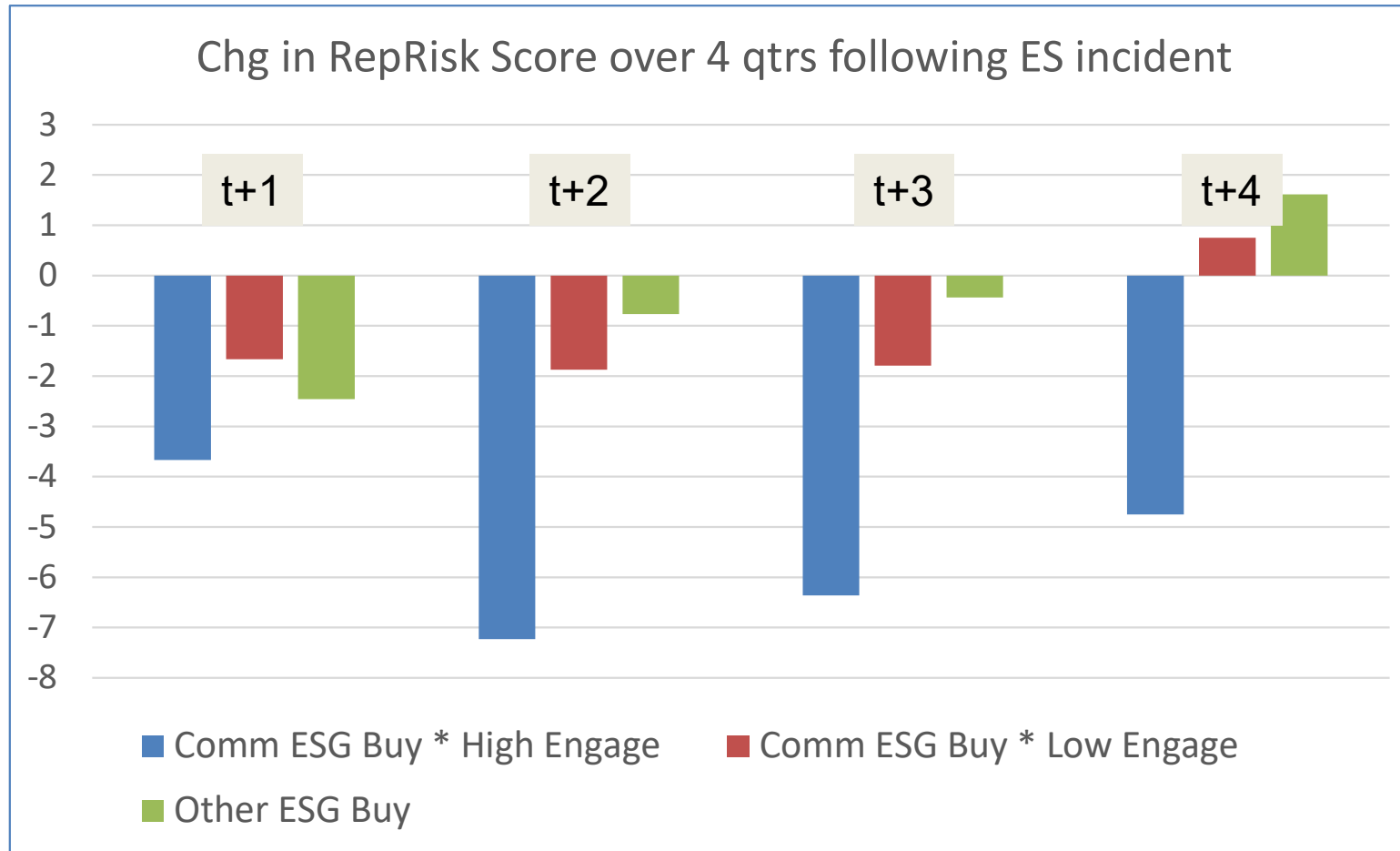
- Empirical analysis #1 = OLS Analysis



$$\Delta \text{Firm Risk} = \overset{\text{Neg've}}{\beta_1} \text{Comm ESG Buy} * \text{High Engagement} + \overset{\text{Zero}}{\beta_2} \text{Comm ESG Buy} * \text{Low Engagement} + \overset{\text{Zero}}{\beta_3} \text{Other ESG Buy} + \beta_4 \text{Committed ESG Sell} + \dots$$

Test #4a: Impact on portfolio firms – OLS

$$\Delta \text{Firm Risk} = \beta_1 \text{Comm ESG Buy} * \text{High Engage} + \beta_2 \text{Comm ESG Buy} * \text{Low Engage} + \beta_3 \text{Other ESG Buy} + \dots$$



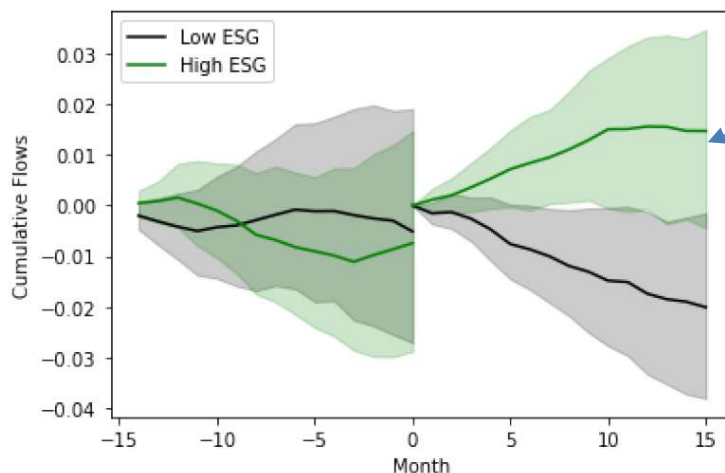
Takeaway: Following a firm ESG incident, firm risk tends to decrease more if:

- Committed funds intensely bought firm
- These funds have history of engaging (devoting resources to independently vote)

Test #4b: Impact on portfolio firms – *dif-in-dif*

- Predict: Committed ESG funds **CAUSED** improvements in firms' ESG
- Emp Analysis #2: dif-in-dif analysis to isolate causality
 - POST = 1 following large exogenous inflow into ESG funds
 - TREATMENT = 1 for firms with high ownership by committed funds
 - Premise: Dollar inflows-> MFs increase amount invested in portfolio firms
Higher ownership -> higher net benefits of engagement
- Exogenous event = Intro. of Morningstar Sustainability Ratings in 2016

Hartzmark
and
Sussman
(2019)



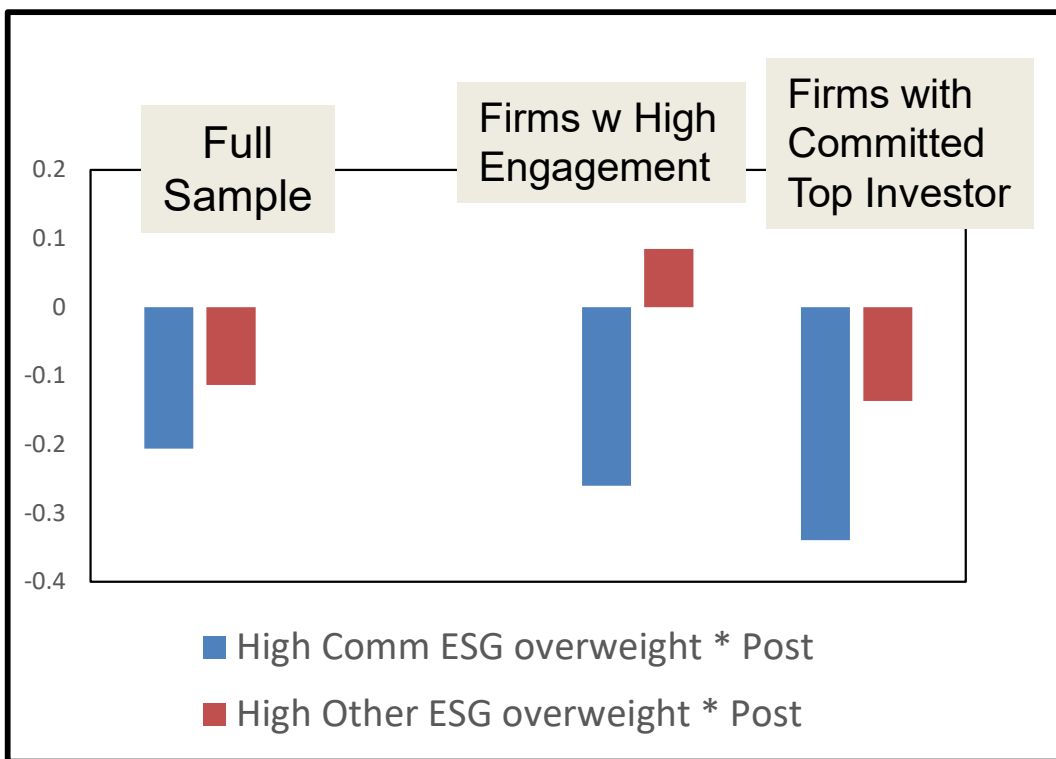
Large ↑ in flows into High ESG Funds

Mth 0:= Rating Introduction

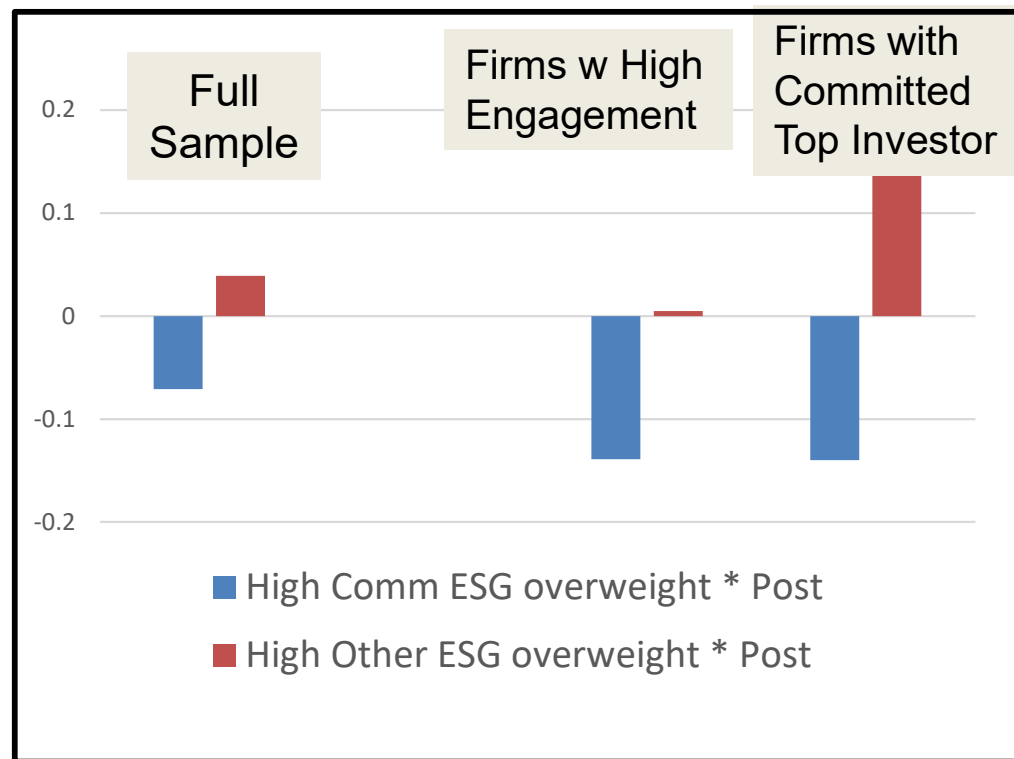
Test #4b: Impact on portfolio firms – *dif-in-dif*

$$Outcome_{i,t} = \beta_1 \text{High Committed ESG}_{i,t} \times \text{Post}_{i,t} + \beta_2 \text{High Other ESG}_{i,t} \times \text{Post}_{i,t} + X_{i,t} + e_{i,t}$$

Δ RepRisk Index after Exogenous Inflow



Δ Emissions after Exogenous Inflow



Takeaway: following a firm ESG incident

- Firms with greatest inv't by committed funds experienced decreases in ESG risks
- This approach shuts down selection channel
- Conclusion: engagement causes observed impacts

Test #5: Do committed funds do well by doing good?

- Results to this point suggest that committed funds
 - View ESG as a value driver
 - Prioritize Information acquisition on ESG
 - Have long-term investment strategy with respect to negative ESG events
 - Engage on ESG issues
 - Positive impact on firms' ESG profiles
- If committed funds are correct in viewing ESG as a value driver,
 - They should earn higher returns as a result of these activities

Test #5: Do committed funds do well by doing good?

Dept Var = DGTW Characteristic adjusted AR's

A. DGTW characteristics-adjusted abnormal returns of fund portfolios

	All stocks (1)	Long holding- period stocks (2)	Short holding- period stocks (3)	High engagement stocks (4)	Low engagement stocks (5)
Committed ESG fund	0.084 (0.74)	1.002*** (4.89)	0.010 (0.07)	0.677*** (3.25)	-0.092 (-0.85)
Fund controls	Y	Y	Y	Y	Y
Time FE	Y	Y	Y	Y	Y
N	9,866	8,951	9,831	8,998	8,934
Adjusted R-squared	.042	.021	.043	.028	.023

B. Performance effects of engagement and ESG improvement

	High engagement with RRI improvement (1)	High engagement without RRI improvement (2)	High engagement with Trucost improvement (3)	High engagement without Trucost improvement (4)
Committed ESG fund	1.546*** (3.66)	0.778** (2.17)	1.712*** (3.74)	0.834** (2.36)
Fund controls	Y	Y	Y	Y
Time FE	Y	Y	Y	Y
N	8,334	8,274	7,019	7,174
Adjusted R-squared	.056	.048	.059	.042

Conclusion

- Research question: Do ESG funds actually affect firm policies?
 - Hypothesis: It depends on funds' incentives to engage
 - Committed funds = Funds w higher incentives to engage on ESG firms
- Committed funds have different investment strategies
 - More likely to research firm around neg've ESG events
 - Less likely to sell around neg've ESG events
- Committed funds engage with firms on ESG issues
 - Voting + Participation in conference calls
- Committed funds influence firms' ESG policies
 - Exogenous increase in committed funds' holdings -> ES improvements
- Committed funds earn higher returns on their ESG portfolio invts
 - Compared to other ESG funds