

Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows

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1 Research questions

Do investors consider sustainability as a positive attribute of firms? How does sustainability affect market?

2 Why are the research questions interesting?

- As more and more companies invest resources in sustainable and socially responsible projects;
 - Understanding whether investors value these investments has become particularly important;
 - Different investors may have different perspectives on sustainability.
- Analyzing investor behavior and market reactions matters for understanding the importance of sustainability.

3 What is the paper's contribution?

(1) Literature on Investor Valuation of Nonfinancial Aspects of Stocks

Previous: Examined how subsets of investors value specific characteristics of securities("sin" stocks).

This: Examining a quasi-exogenous shock affecting a larger part of the market;

- Using a more direct measure of demand to evaluate how investors collectively value the characteristic of interest.

(2) Literature on Social Responsibility Mandates in Investment Products

Previous: Focused on rapidly growing set of investment products with explicit social responsibility mandates.

This: Examining preferences for sustainability among all U.S. mutual fund investors, not just certain investors.

(3) Literature on Emotion in Investment Decisions

Previous: Feelings associated with a given stimulus replace reasoned analysis in guiding judgments/decisions.

This: Association of higher funds with higher returns/lower risk due to influence of emotions on invest-decisions.

4 What hypotheses are tested in the paper?

H1: Investors value sustainability and consider it in their investment decisions.

H2: Investors believe that a high sustainability rating indicates better performance for the fund in the future.

a) Do these hypotheses follow from and answer the research questions?

- Both of these hypotheses are crucial hypotheses based on the research question in the paper.

Do these hypotheses follow from theory or are they otherwise adequately developed?

- Analyzing impact of Morningstar's sustainability rating on fund liquidity. If investors truly value sustainability, high rated funds attract more capital inflows, while low rated funds face capital outflows.
- Investors' expected returns and risk assessments for high rated funds will be higher than those otherwise.

5 Sample: comment on the appropriateness of sample selection procedures.

Sample covers all open-end funds in the U.S., ensuring universality and comprehensiveness of research results.

6 Dependent and independent variables: comment on the appropriateness.

Potential impact of multi-factors on fund flows, controlling for confounding variables during analysis matters.

7 Regression model specification: comment on the appropriateness.

Model takes into account dynamic nature of fund liquidity and can capture real-time market reactions by analyzing changes in liquidity before and after rating releases.

8 What difficulties arise in drawing inferences from the empirical work?

Changes in policies and regulations may affect the attractiveness of sustainable investments, thereby impacting the stability and predictive power of empirical results.

9 Describe at least one publishable and feasible extension of this research.

- 1). Is there a significant correlation between sustainability rating and the long-term returns and risks of the fund?
- 2). Can sustainability rating be used as an effective indicator to predict the future performance of funds?
- 3). The current research mainly focuses on the short-term impact of sustainability ratings on fund liquidity;
 - Investors are more concerned about how these ratings affect long-term performance of fund.
 - Exploring this relationship is crucial for understanding long-term value of sustainable investment.