# PhD Second Year Paper – Research Proposal

### Research Questions

What is the role of firms’ Environmental, Social and Governance (ESG) characteristics in explaining the portfolio holdings of large institutional investors?

How has demand for such characteristics changed over time and across investors?

What are the effects on equity valuations of a change in investors’ demand?

### Motivation

The ESG acronym has become increasingly popular in the financial industry and media. In particular, large asset managers advocate for a “fundamental reshaping of finance”, and foresee “a significant reallocation of capital”[[1]](#footnote-1). In point of fact, there exists no consensus on the effects of a widespread incorporation of ESG considerations in investment decisions.

Most of the academic literature has focused on the impact of ESG on excess returns and cost of capital, finding mixed evidence. Few studies have delved into whether there has truly been a shift in investors’ demand, and its implications for asset prices. This is the objective of my work.

### Main Related Literature

* Data and Methodology  
  Koijen and Yogo (2019) and Koijen, Richmond and Yogo (2020).
* Theory on ESG asset pricing:  
  Pastor, Stambaugh and Taylor (2020), Pedersen Fitzgibbons and Pomorski (2019).
* Empirical work on ESG and stock returns:  
  Hong and Kacperczyk (2009), Edmans (2011), Kruger (2011), Lins Servaes and Tamayo (2017).

### Data

* SEC 13F Institutional Investors quarterly holdings data. These data cover holdings of institutions with at least $100 million AUM, are limited to equities, and exclude short positions.
* Firm-level ESG scores by Thomson Reuters, accessible through *Datastream* (or other available if any).
* *Compustat* and *CRSP* firm-level data.
* *Morningstar* sustainability ratings for mutual funds, if available.

### Roadmap and Methodology

The first part of the work will be to gather, clean and merge the data on holdings and firm-level characteristics.

Then, I will present descriptive evidence on holdings. I want to study whether and how the appetite for “good” stocks has changed over time across investors. Stocks will be defined as “good” based on ESG scores or on categories identified in the literature (e.g. fossil fuel and “sin stocks” as tobacco and gambling).

Finally, I will estimate a demand system à la Kojen and Yogo (2019). This will provide demand curves for different types of investors, to study how the sensitivity to ESG changed over time. In addition, the methodology will allow me to estimate the implications of a demand shift to ESG for equity valuations and returns.

## References

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1. BlackRock CEO Larry Fink 2020 [letter](https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter) to CEO’s. [↑](#footnote-ref-1)