EMPIRICAL RESEARCH ON ESG FACTORS AND ENGAGED OWNERSHIP

A Bibliography

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Summary

This concise collection of research identifies empirical studies connecting improved firm performance and risk mitigation with three general categories: shareholder-friendly corporate governance, sustainability performance material to investors and engaged ownership. These studies generally align with CII’s policy perspective and advocacy work. Member organizations may wish to consider these and other studies to support their unique investment and stewardship strategies.

I. Shareholder-friendly corporate governance

1. Companies generally with owner-friendly governance practices outperformed companies with less owner-friendly governance.


2. Firms with owner-friendly governance were shown to be relatively more profitable, more valuable and pay out more cash to their shareholders.


3. Companies that engage in fraudulent financial reporting were found to have weak corporate governance practices relative to other companies.


4. Aggressive financial reporting was more likely to be found at companies with weak corporate governance structures.

5. Stakeholder governance, defined as a model that encourages and relies on corporate leaders to serve the interests of stakeholders and not only shareholders, was shown to increase the insulation of corporate leaders from shareholders, reduce accountability and hurt economic performance.


6. More outside directors and higher institutional ownership was found to be associated with lower bond yields and higher corporate bond ratings.


7. Target companies with majority-independent boards were found to obtain higher initial premiums and higher revised premiums than those without majority-independent boards.


8. High audit committee quality was shown to have incremental value in driving better financial reporting, internal controls and firm value.


9. The adoption of majority voting was associated with positive abnormal returns and an increase in boards implementing majority-supported resolutions.

More recent non-public version (Review of Accounting Studies, Vol. 20, p. 1-41) at:
10. Competition between management and dissidents over shareholder votes was shown to create management incentives for better performance, more timely disclosure and more engagement with institutional investors.


11. The impact that corporate governance has on firm value was found to depend on the context of broad market conditions as well as firm-specific factors.


12. According to a literature review of empirical research, shareholder voting on corporate control was shown to tend towards maximizing company value.


13. In an international study, the adoption of improvements in corporate governance beyond legal requirements or prevailing market practices was positively associated with firm value.


14. Board reforms involving increased board and audit committee independence were found to increase firm value, with comply-or-explain reforms resulting in a greater increase than rule-based reforms, according to a study of 41 countries.

15. Special purpose acquisition company (SPAC) mergers, which often have less disclosure and more conflicts of interest than IPOs, were shown to result in steep decreases in cash per share post-merger with SPAC shareholders who held shares at the time of the merger bearing the costs.


16. A strong positive association was found between the authors’ board governance index and firm operating performance, including total shareholder return, according to a study in the UK.


17. Owner-friendly governance practices have a positive and significant impact on returns, among a study sample of European industrial companies.

Entrenchment devices (including dual-class stock)

18. Companies with significant anti-takeover provisions (classified board structures, supermajority vote requirements, poison pills, golden parachutes, etc.) had lower firm value than those that did not.


19. The claim that the trend toward annual director elections is value-destructive was shown to be spurious.


20. To the extent that insiders’ voting rights exceed their equity stake (i.e. “cash flow rights”) due to dual-class structures, firms were shown to underperform.


21. Any valuation premiums that multi-class firms had over single-class firms at IPO were found to dissipate over time and turn into discounts six to nine years after the IPO.


22. Financially constrained companies with multi-class stock may be more innovative in the early years, but these benefits were shown to disappear within 10 years after the IPO.

23. The benefits of multi-class structures were shown to be expected to decline, and the costs to rise, over time.


24. In a study of voting rights over 45 years, multi-class structures were shown to become increasingly value destroying by 11 years after IPO.


25. After managers were insulated by the adoption of an antitakeover law, they were found to reduce risk taking and pursue actions that destroy value.


26. When public pension fund ownership is high, a portfolio that buys firms with high takeover vulnerability and shorts firms with the lowest vulnerability generates abnormal positive returns.

Executive Compensation

27. Executive compensation was found to be not only higher, but also less sensitive to performance, at companies where corporate governance was weaker.


28. Say on pay was shown to lead to increases in companies’ market value and improvements in long-term profitability.


29. Companies with more owner-friendly corporate governance were associated with less “pay for luck” and less CEO capture of the pay setting process.


30. Clawback provisions enabling the recoupment of erroneously awarded CEO compensation resulted in increased accounting quality and lower audit risk.


31. Interlocking directorships were found to be associated with certain fraudulent activity in variable compensation, specifically option backdating.


32. Executive pay was shown to be higher at companies that have significant anti-takeover provisions.


33. Long-term pay orientation was associated with an increase in firm value and firm investment in long-term strategies.


34. A ten-year study of S&P 500 companies looking at total shareholder return over three-year periods found companies with performance share plans underperformed, relative to peers granting straight restricted stock or options.


35. A ten-year study of 423 large U.S. companies found about three-fifths had poor alignment between cumulative long-term shareholder return and realized executive pay.

II. Sustainability performance material to investors

**Human Capital Management**

1. Over a period of more than 30 years, firms with human capital management strategies that result in higher levels of employee satisfaction were shown to have higher long-term shareholder returns than their peers.


2. Board diversity, defined broadly to incorporate six demographic and experiential considerations (gender, age, ethnicity, educational background, financial expertise and breadth of board experience) was found to lead to higher asset valuation multiples. Using this same definition, diverse boards were also shown to reduce stock return volatility, invest in more research and development and have more efficient innovation processes.


3. The presence of women on a company’s board was found to have a positive effect on company performance.


4. A more diverse leadership team, in terms of gender and racial diversity, was found to have a significant positive effect on financial performance, as measured by EBIT, with companies in the top quartile of racial/ethnic diversity being 33 percent more likely to have financial returns above their national industry median.

**Sustainability factors, including climate change risk**

5. Firms with favorable ratings on sustainability issues that are material to their industry were shown to significantly outperform firms with poor ratings on these issues.¹


6. Companies that voluntarily adopted environmental and social policies many years ago significantly outperformed firms that adopted almost no such policies, both in terms of stock market and accounting performance.


7. Better ESG performance on material issues was linked to a lower incidence of material credit events and lower credit risk.


8. Commercial banks that had higher scores on financially material ESG factors outperformed banks that had low scores on the same issues, marked by higher average risk-adjusted returns.


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¹ A study asserts this study used idiosyncratic assumptions that caused an accidental over-representation of certain sectors in the study’s portfolio. While the original estimates could be recreated, little evidence of an association was found with more commonly-used assumptions, the working paper found. See Berchicci, L.,...,
9. ESG scores incorporating materiality were shown to be better predictors of investment return than traditional ESG scores.


10. Classifying stocks in the Russell 1000 into industries using sustainability factors was shown to have advantages over using traditional industry classifications.


11. ESG information was shown to affect company valuation and performance through the company’s systematic risk profile (lower costs of capital and higher valuations) and its idiosyncratic risk profile (higher profitability and lower exposures to tail risk).


12. Corporate bonds for companies with higher ESG ratings had improved risk characteristics and showed better risk-adjusted returns than bonds for companies with lower ESG ratings.


13. According to a literature review, firms with higher ESG ratings tended to have lower costs of capital and higher credit ratings than firms with lower ESG ratings.

Henriksson, R., Livnat, J., Pfeifer, P., Stumpp, M., Zeng, G. 2018. ESG Literature Review. QMA (Quantitative Management Associates LLC) and Stern School of Business Administration, New York University. 
14. In a literature review of more than 2,000 studies, a majority of studies found a positive relationship between ESG and corporate financial performance, and about 90\% of the studies found a non-negative relationship.


15. A literature review of over 1,000 peer reviewed studies on ESG factors found robust evidence that corporate investment in sustainability leads to better financial performance, but that on average ESG investing returns were indistinguishable from conventional investing returns. The paper concluded that ESG engagement seemed to perform better as a strategy than divestment, that ESG integration tends to provide downside risk protection and that decarbonization strategies can potentially capture a climate risk premium.


16. A literature review of 39 studies found 80\% of the studies documented a positive relationship between ESG factors and stock prices.


17. Certain ESG investment constraints, notably including diversity and governance criteria, were shown to enhance portfolio returns, while others did not enhance returns but added no costs to investors.


18. Research from 2004 to 2018 showed that sustainable funds had lower downside risk than traditional funds and there were no financial trade-offs in the returns of sustainable funds compared to traditional funds.


19. In a study of over 450 global companies over a ten-year period, companies exposed to more climate change risk were associated with higher corporate default risk.


20. ESG performance was shown to be positively associated with return on assets. Of E, S and G, governance performance had the strongest impact on financial performance, based on evidence from Germany.

III. Engaged shareownership

1. Passive mutual funds were shown to influence firms’ governance choices, resulting in more independent directors, removal of takeover defenses and more equal voting rights. Passive ownership was associated with improvements in firms’ longer-term performance.


2. Investor-company engagement was found to be most effective in lowering downside risk when addressing governance or strategy topics and when changes in firms’ environmental policies were coupled with governance improvements.


3. Institutional investors should not be painted with a broad brush. When firms had “dedicated” institutional investor ownership (characterized by lower portfolio turnover and higher portfolio concentration), there was found to be less tail risk, less volatility in realized returns, better accrual quality and higher payout ratios than those firms with more “transient” institutional ownership.


4. Shareholder adoption of governance-related shareholder proposals was found to trigger positive short-term returns as well as long-term performance improvements.


5. Successful engagements on ESG concerns, marked by achievement of a milestone, were followed by positive abnormal returns, as well as improvements in operating performance, profitability, efficiency, shareholding and governance.


6. Better engagement and transparency around corporate social responsibility activity were found to be important factors in reducing capital restraints.


7. Targets of ESG activism were shown to have higher market share, stock returns and liquidity than non-engaged peer companies. Targets that sufficiently adjusted policies in response to the engagement generated higher returns than those that did not.


8. ESG engagement was shown to be more effective than divestment given that divestment was not found to have a big impact on firm decisions.


9. Targets of green hedge fund activists that reduced chemical emissions were shown to experience higher stock returns after the activism.


10. Once company- and firm-specific factors important to investors were taken into consideration, the impact of vote recommendations by the world’s largest proxy advisor was reduced greatly.

11. Larger mutual fund families were found to exercise their voting rights in ways completely independent from proxy advisor recommendations.


12. According to a literature review, the conventional wisdom about active managers’ ability to create value for investors has been too negative.


13. Engagement on governance issues between underperforming portfolio companies and CalPERS resulted in significant cumulative excess returns over a five-year period from the time of initial engagement.


14. Activism by CalPERS targeting increases in shareholder rights was estimated to have generated about $3.1 billion between 1992 and 2005.