INVESTLOGIC
Your Investment Connection

The conditions of performance

A strategy of socially responsible investment over performs when she aims at not responsible firms and transforms them

Professor of finance at the university Toulouse 1, Sebastian Pouget presented in Geneva Summit on Sustainable Finance he details conditions in which a socially responsible investor can achieve higher financial performance.

Does an investment in a firm respecting lasting principles clear a better performance than an investment in a "dirty" firm?

It is necessary to differentiate profitability of the firm and performance for the investor. On the first point, he is shown that a "respectful" firm is often more beneficial. But so that an investor clears more benefit with a socially responsible strategy, he must benefit from competitive advantages in comparison with the traditional investors.

As what?

For example, if everybody knows that the "green" firms are more profitable, the traditional investors will also invest in these titles and they will get the same outputs as the "responsible" investors. Also, different investors – SRI funds or hedge funds - are possible to perform researches to identify the socially responsible firms and therefore to get the same outputs. But socially responsible investments can overperform traditional investments, for three reasons.

Which?

It is possible to think that funds SRI have competences of extra-financial analysis allowing to assess well the profitability of the "green" firms. And therefore to choose firms better. Second reason: they have with a capacity of stronger anticipation than the traditional investors, due to their specialisation in all what is linked to durability (new norms for example). They can therefore take positions earlier on the market. Finally, the third reason can come down under the appellation «strategy of the washing machine».

That is to say?

We argue in a December paper 2012 Sebastien Pouget :Asset Prices and Corporate Behavior with Socially Responsible Investors . In summary: an investor who takes a position in a "dirty" firm, and therefore not considered by the market, benefits from a positive valuatgion. Then, if he has a capacity of relative influence and a long-term vision, this investor will be able to influence the firm, so that it improves the firm's behavior. He will "clean" it in a way. What will make the company even more attractive for the market, hence the firm will be able to be sold at a higher price. Some investment funds already use this approach, and in a very beneficial way.

What level of participation would need such investor to be able to influence in this point the strategy of a firm?

They know that on the whole, 10 % in 20 % assets are responsibly managed. It would be possible to think that by keeping 10 % firms, no influence is possible. And it is not completely true: the socially responsible investors concentrate on some firms, they exercise therefore the upper influence in this average of 10 %.

Does the nature of activity have an influence on the performance of a responsible investment?

This strategy of the washing machine is more efficient when progress to be made touches consensual topics, as CO_2's programs or slave labour, which are widely accepted and that will provoke the membership of all the investors. We performed a calculation which shows that from a 15-20 % participation, socially responsible investors can influence a firm so that it becomes more respectful of environment.

What about exclusions practiced by some investors ISR?

Exclusions make more difficult the overperformance adjusted to risk, with problems of diversification for example. An approach " best in class " can exercise a more marked influence, by using the traditional levers of capitalism. The shareholders have the means to influence the evolution of a firm. An exclusion is only augmenting the cost of the capital for a firm. But both approaches can be supplementary.

Did your researches allow you to set up a positive screening?

They allow rather to identify the good targets to make a commitment. A crucial point is linked to the necessity to compensate extra-financial problems and cost linked to policies allowing to regulate them. Firms showing the lowest costs will be to aim in first, because impacts will be lesser on economic performance.