Institutional investors' behind-the-scene monitoring and ESG disclosure

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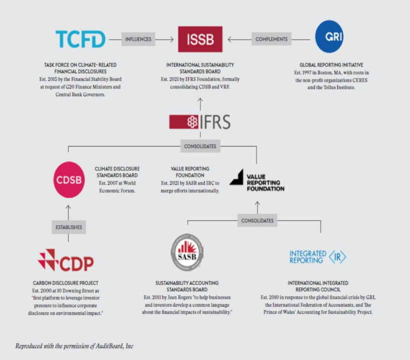
Motivation



(a) International regulations on ESG disclosure

Source: Harvard Law School Forum

Table II. Correlations between ESG ratings

Correlations between ESG ratings at the aggregate rating level (ESG) and at the level of the environmental dimension (E), the social dimension (S), and the governance dimension (G) using the common sample. The results are similar using pairwise common samples based on the full sample. SA, SP, MO, RE, KL, and MS are short for Sustainalytics, S&P Global, Moody's ESG, Refinitiv, KLD, and MSCI, respectively.

	KL SA	KL MO	KL SP	KL RE	KL MS	SA MO	SA SP	SA RE	SA MS	MO SP	MO RE	MO MS	SP RE	SP MS	RE MS	Average
ESG	0.53	0.49	0.44	0.42	0.53	0.71	0.67	0.67	0.46	0.7	0.69	0.42	0.62	0.38	0.38	0.54
E	0.59	0.55	0.54	0.54	0.37	0.68	0.66	0.64	0.37	0.73	0.66	0.35	0.7	0.29	0.23	0.53
S	0.31	0.33	0.21	0.22	0.41	0.58	0.55	0.55	0.27	0.68	0.66	0.28	0.65	0.26	0.27	0.42
G	0.02	0.01	-0.01	-0.05	0.16	0.54	0.51	0.49	0.16	0.76	0.76	0.14	0.79	0.11	0.07	0.30

Source: Berg, Kolbel and Rigobon (2022)

	Huazheng	Syntao	Bloomberg	SP
Huazheng	1			
Syntao	0.275***	1		
Bloomberg	0.243***	0.412***	1	
SP	-0.013	0.175***	0.274***	1

Source: Own calculation

(b) Insufficiency of ESG information

Motivation

Characteristics of ESG information

- Nature of non-financial information;lack of standardized format of reporting (Elzahar et al., 2015; Baldini et al., 2018; Amel-Zadeh and Serafeim, 2018; Christensen et al., 2021)
- Considerable costs of disclosure (Graham et al., 2005; Chapman and Green, 2017; Abramavo et al., 2020)
- Largely left to managers' discretion (Baldini et al., 2018; Tsang et al., 2022)

Call for external pressure on managerial decisions

- Institutional investors: perceived as a powerful market force to affect managerial decisions given their potential active monitoring role that includes **"exit"** if their **"voice"** is not heeded.

Relevant literature

- Monitoring role of institutional investors in **inducing financial information disclosure** (Bushee and Noe, 2000; Healy and Pelapu, 2001; Beyer et al., 2010; Boone and White, 2015; Bird and Karolyi, 2016; Dou et al., 2018; Abramova et al., 2020)

Relevant literature

Monitoring role of institutional investors in **inducing ESG information**

- **Flammer et al. (2021):** more shareholders' environment-related proposals $\rightarrow$ greater disclosure of climate risk.
- **Pawliczek et al. (2021):** BlackRock Dear CEO letter $\rightarrow$ greater disclosure of environmental factors
- **Ilhan et al. (2023):** higher institutional ownership $\rightarrow$ greater disclosure of climate risks
- **Cohen et al. (2023):** ownership of CDP signatories $\rightarrow$ higher probability of disclosing climate-related information to the CDP.

Research gap: Do institutional investors perform monitoring role in promoting ESG disclosure behind the scene?

- Importance of behind-the-scene monitoring of institutional investors through private engagement with management (Dimson et al., 2015; McCahery et al., 2016; Corum and Levit, 2019; Edmans et al., 2019; Levit, 2019)

Relevant literature

Unique setting in China: Shenzhen Stock Exchange requires to disclose investor relationship activities, including site visits since 2009.

Corporate site visits is one crucial channel through which institutional investors acquire information and perform monitoring:

- Jiang and Yuan (2018): corporate visits $\rightarrow$ greater corporate innovation
- Cao et al. (2022): corporate visits $\rightarrow$ increases in corporate dividend payout

Research question

Do firms respond to institutional investors' demands for ESG information conveyed during ESG-related visits by greater ESG disclosure?

Summary of findings

Baseline results: The firms that host ESG-related visits experience greater improvement in ESG disclosure following these visits in comparison with the comparable firms that never host ESG-related visits.

- No such effect is found for non-ESG-related corporate visits.

Effect heterogeneity:

- Strengthens with institutional investors' demand for ESG information.
- Weakens with firms' proprietary costs.

Mechanism analysis: Visiting mutual funds exhibit stronger preferences to firms performing well in ESG disclosure in comparison with the funds that did not conduct ESG-related visits before trading.

- Institutional investors may *ex ante* discipline managerial behaviors by performing credible exit threats *ex post*.

Impact on ESG rating divergence: Greater ESG disclosure is associated with reduction in ESG rating divergence.

Contribution

The first study to provide direct large-scale evidence that institutional investors' **behind-the-scene** monitoring activities elicit greater ESG disclosure.

Adds to the growing body of literature on ESG disclosure:

- Negative relationship between ESG disclosure and ESG rating divergence, consistent with conventional wisdom (e.g., Lang and Lundholm, 1996; Morgan, 2002; Hope, 2003)

Adds to the understanding of the monitoring role of institutional investors:

- Supportive evidence for institutional investors' governance through communications (Adams and Ferreira, 2007; McCahery et al., 2016; Levit, 2019) and threats of exit (Firth et al., 2016; Levit, 2019; Cao et al., 2022)

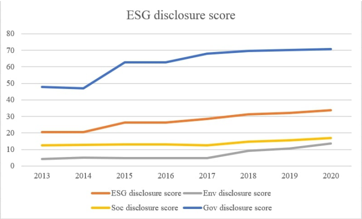
Data collection

Sample period: 2013-2020

- **Firm sample:** 698 public firms listed on Shenzhen Stock Exchange with ESG disclosure data

- **Corporate visit data:** CSMAR
  Visit-level information: name of visiting institutions, visit dates, meeting minutes.

- **ESG disclosure data:** Bloomberg
  Annual disclosure score, with E-/S-/G-pillar score.



Data

Define ESG-related corporate visits

- if the visiting institutions pose at least one question containing ESG-issue keywords during a visit.

Disclosure of investor relationship records of Ping An Bank Co., Ltd..

Type of investor relationship activities	☑ Visit by special entities □ Analysts meeting □ Media interview □ Performance announcement meeting □ News release □ Roadshow □ Site tour □ Other (please describe it here)
Participants	All Pensions Group (APG)
Time	March 19th 2020.
Location	Shenzhen
Insider attendees	Xuguang Lv, and board office, Ping An Bank Co., Ltd.
Content	… **Question**: What social responsibilities does Ping An Bank undertake during the epidemic? **Answer**: During the outbreak of the novel coronavirus pneumonia in 2020, the Bank actively undertook its social responsibility in various ways and urgently carried out a series of public welfare activities as an active support for containing the spreading of the epidemic. (1) A first donation of RMB 30 million to Hubei Charity Federation was made in support of the anti-epidemic action and for the procurement of anti-epidemic supplies, insurances for volunteers, protective tools, supplements for community public health utilities, and so on. In addition, policies were specially made to give relief to affected customers such as medical workers engaged in the anti-epidemic action, customers infected with the novel coronavirus pneumonia, and customers in Hubei who were unable to make repayments as a result of the prevention and control measures. Those customers were allowed to make repayments later or pay less interest without leaving any bad credit records. …(3) Data-based loans assisted small- and medium-sized pharmacies in online financing. For medium-, small- or even mini-sized pharmacies, we provided industry-wide integrated and comprehensive online financial service plans. The data-based financing services specific for pharmacies are upgraded all around with "industry-specific data + online operations + intelligent risk control" to meet the needs of pharmacy customers, strengthen the online services for enterprises in the pharmaceutical industry, improve the convenient service level and support the real economy. …
Attachments (If any)	Slides for annual performance of 2019
Date	March 19, 2020.

ESG-issue keywords

Environmental, social and governance issue keywords.

Environment	Social	Governance
Beautiful China	child labour	assessment mechanism
carbon neutrality	collective bargaining	auditing committee
carbon reduction	community	auditing independence
contamination	discrimination	average pay
emission	donation	board
energy	employee turnover	bribery
energy conservation	employee welfare	business ethics
environment	enterprise foundation	corporate governance
environmental protection	equal pay for equal work	corruption
exhaust gas	fair trade	decentralization
green	female worker	diversity
greenhouse gas	forced labour	employee stock ownership
low carbon	freedom of association	incentives
peak carbon dioxide	human rights	independence
recycling	lost in accidents	independent audit
solid waste	non-regular employee	independent nomination
sustainable development	occupational fatality	information disclosure
utilization ratio	occupational health	internal governance
waste residue	occupational safety	management team reorganization
wastewater	professional training	managerial ownership
water conservation	public benefits	managerial power
water recycling	responsible	organization structure
	social responsibility	ownership structure
	supply chain management	remuneration
	supply chain supervision	salary gap
	vocational training	sustainability
	work-related injury	tax payment
		thematic committee
		unqualified opinion

Notes: Phrases that contain 'environment' but deliver other meanings are excluded from the list of keywords, e.g. economic environment, policy environment, market environment, competition environment, financing environment, development environment, new environment, regulation environment, domestic/international/foreign environment, operational environment, and information environment etc.

Data

Year	#sample firms	#firms with ESG-related visits	#firms with non-ESG-related visits
2013	412	161	154
2014	429	187	137
2015	581	211	222
2016	579	211	236
2017	494	187	184
2018	520	179	196
2019	573	164	200
2020	573	138	185
Total	698	515	546

Identification strategy

- Staggered Difference-in-Differences estimation after nearest-neighbor matching (NNM)
  Treatment: firms that host ESG-related visits
  Control: firms that never host ESG-related visits and share similar characteristics

- Model specification

$$
\begin{aligned}
ESGD_{i,t+1} &= \alpha + \beta Treat_{ESGi} \times Post_{ESGi,t} + \gamma FirmControls_{i,t} \\
&+ \delta_i + \mu_t + \epsilon_{i,t}
\end{aligned} \tag{1}
$$

For comparison:

$$
\begin{aligned}
ESGD_{i,t+1} &= \alpha + \beta Treat_{NESGi} \times Post_{NESGi,t} + \gamma FirmControls_{i,t} \\
&+ \delta_i + \mu_t + \epsilon_{i,t}
\end{aligned} \tag{2}
$$

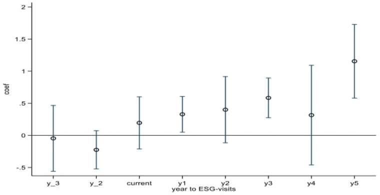
Baseline results

Table: Impact of corporate visits on ESG disclosure

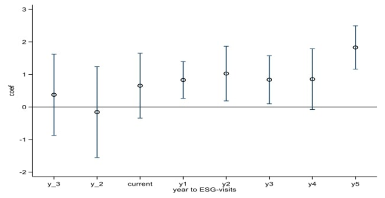
	Panel A. ESG-related		Panel B. Non-ESG-related	
	(i)	(ii)	(i)	(ii)
$Treat_{ESG} \times Post_{ESG}$	0.271**	0.713**		
	(0.043)	(0.033)		
$Treat_{NESG} \times Post_{NESG}$			0.100	-0.104
			(0.423)	(0.574)
Control	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
R2 Within	0.605	0.593	0.575	0.604
#treat firms	339	178	323	153
#control firms	92	65	84	55
Obs.	2,534	1,440	2,343	1,236

Dynamic treatment effects

Figure: Dynamic treatment effect



(a) Baseline results Panel A (i)



(b) Baseline results Panel A (ii)

Effect heterogeneity

Effect strengthens with demand for ESG information

- Firms that receive more ESG-related visits;
- Firms that receive more ESG-related questions;
- Firms that host ESG-related visits and are located far away from the visiting institutional investors;
- Firms that host ESG-related visits and are visited by UNPRI signatories;
- Firms that receive environmental-related questions.

Effect weakens with firm proprietary cost

Table: Mechanism: mutual fund trading

	(i) ΔShare	(ii) ΔShare	(iii) ΔShare	(iv) ΔShare
ESGD	0.011***	0.011***	0.012***	0.012***
	(0.000)	(0.000)	(0.001)	(0.001)
ESGvisit	0.251***	0.115*		
	(0.000)	(0.087)		
ESGvisit × ESGD		0.004**		
		(0.028)		
NESGvisit			0.189***	0.128
			(0.000)	(0.219)
NESGvisit × ESGD				0.002
				(0.419)
Controls	Yes	Yes	Yes	Yes
Fund-firm pair FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
R2 Within	0.057	0.057	0.057	0.057
Obs.	293,902	293,902	306,982	306,982

Impact on ESG rating divergence

Table: Effect of ESG disclosure on ESG rating divergence

	(i) HZ_syn	(ii) HZ_Blbg	(iii) HZ_SP	(iv) Blbg_syn	(v) SP_syn	(vi) SP_Blbg
Panel A: ESG rating divergence in next year						
ESGD	-0.500***	-0.083	0.084	-0.749***	0.032	-0.042
	(0.000)	(0.410)	(0.574)	(0.000)	(0.769)	(0.755)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
R2 Within	0.026	0.016	0.027	0.047	0.025	0.103
Obs.	1,443	836	1,307	647	869	651
Panel B: ESG rating divergence in two years						
ESGD	-0.509***	-0.165	-0.155	-0.720***	-0.413*	-0.327***
	(0.000)	(0.204)	(0.136)	(0.000)	(0.052)	(0.000)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
R2 Within	0.029	0.032	0.038	0.044	0.022	0.097
Obs.	1,413	786	1,184	639	849	617

Conclusion

- Institutional investors make real efforts behind the scene, e.g. conducting costly corporate visits and communicating with corporates regarding ESG issues, to promote corporates' ESG disclosure practices.
- The pressures and demands from market participants, particularly from institutional investors, could be an effective stimulator of ESG disclosure.

Thank you!