The Social Responsibility Boom

Socially Responsible Funds Fuel Growth but Competition for Assets is Heating Up

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Highlights

It's no secret that socially responsible investing is on the rise, but in the past several years, it's risen from novelty fund characteristic to ubiquitous deployment across the strategy spectrum. While some investors question the validity of mixing morality with investment outcomes, it's clear that the boom in socially responsible investing is full-steam-ahead. We analyze a global universe of open-end fund and ETF products to determine the extent of investors preference for socially responsible funds, asset managers' pricing of such funds, and the performance trade-offs (or lack thereof) of investing in such funds. Our key findings include:

- Investors prefer socially responsible funds always and everywhere. The preference is robust across all category groups and domicile countries, and shows little variance.

- All else equal, asset managers are charging less for socially responsible funds than their non-socially responsible peers – a recent occurrence despite a history of charging a premium for social responsibility.

- Not all asset managers have embraced socially responsible investing, but some who have are experiencing significant growth tailwinds as a result.

- Investors who choose socially responsible funds sacrifice nothing in performance relative to their non-socially responsible peers.

The Insatiable Appetite for Social Responsibility

As asset managers face stiffer competition, crowded categories, and declining pricing power, fund characterstics that differentiate their product lineup and pique investor interest are highly sought after. In that vein, social responsibility has become a very appealing fund characterstic to layer on to existing investment strategies to invigorate AUM growth without sacrificing fees.

Thus far, despite asset managers' best efforts to provide a socially responsible fund for every conceivable portfolio niche, investors show no signs of social responsibility fatigue. Since the year 2000, more than 12,000 socially responsible investment products have been launched globally, with more than 2,260 of those in 2018 alone.

Before delving further into these trends, it's important to define the term "socially responsible". For the purposes of this paper, we distinguish socially responsible funds as distinct (but certainly an overlapping set) from environmental, social, governance (ESG) funds. Socially responsible funds, for our purposes, are any funds which apply a moral filtering criterion in their security selection process. We make no judgment about the validity, accuracy, or morality of these filters.

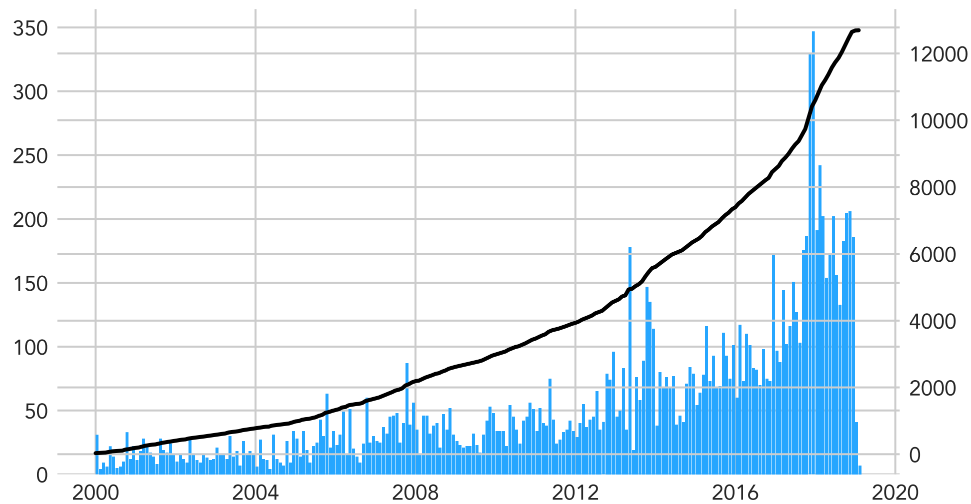

Figure 1: Monthly and cumulative launches of socially responsible investment products

Global assets in socially responsible funds have grown at a CAGR of 11% since the year 2000 reaching more than $1.2 trillion by the end of 2018. However, as we'll see later, this growth has not been evenly distributed across all asset classes or countries.

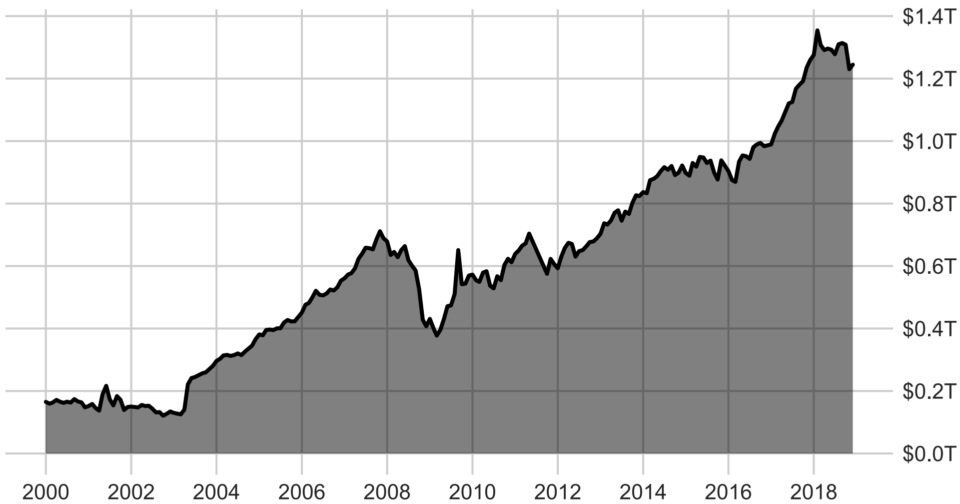

Figure 2: Total Global Assets in Socially Responsible Funds

In fact, the growth of socially responsible funds has outpaced total asset growth by 7 percentage points over the last 3 years. Accordingly, the market share of socially responsible funds has increased nearly 1.5 percentage points over that time frame. This trend is even more pronounced when using fees instead of assets.

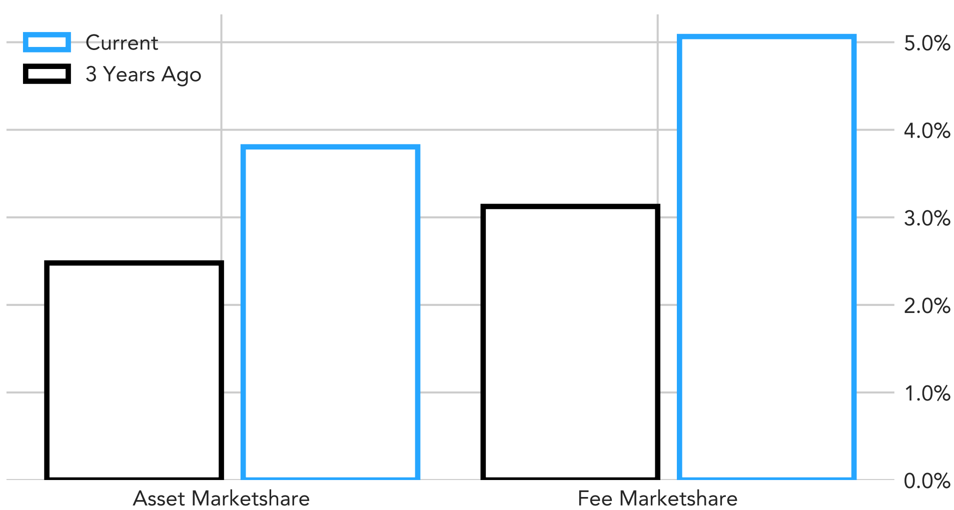

Figure 3: Socially responsible global market share based on assets and fees

What we know is that investor preferences for socially responsibility seem to be strengthening. Differences in social responsibility explained the movement of $46 billion in assets in 2018, up from $32 billion in 2015.

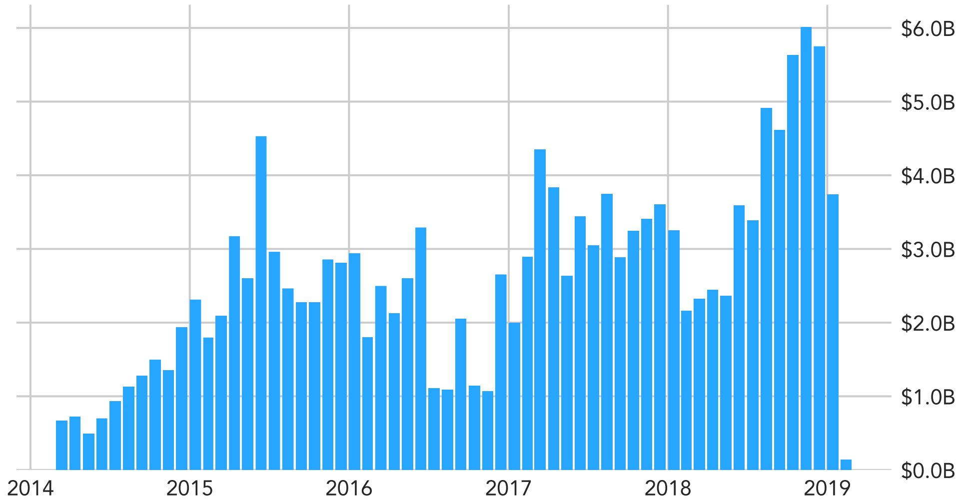

Figure 4: Dollars moved attributable to social responsibility

It's clear that the increasing importance of social responsibility is an ongoing trend. While investors may de-emphasize such concerns in bear markets as they prioritize investment performance, we see no fundamental reason for the long-term trend towards socially responsible investing to slow.

Social Responsibility Preference is Ubiquitous and Robust

On average, investors prefer socially responsible funds to the extent that they grow organically 3.6 percentage points faster than their non-socially responsible category peers each year. But this tells us nothing of whether that preference is conditional on the type of fund in question.

While the strength of the preference does vary minimally across categories, we find that the preference is always positive (i.e. nowhere are non-socially responsible funds preferred).

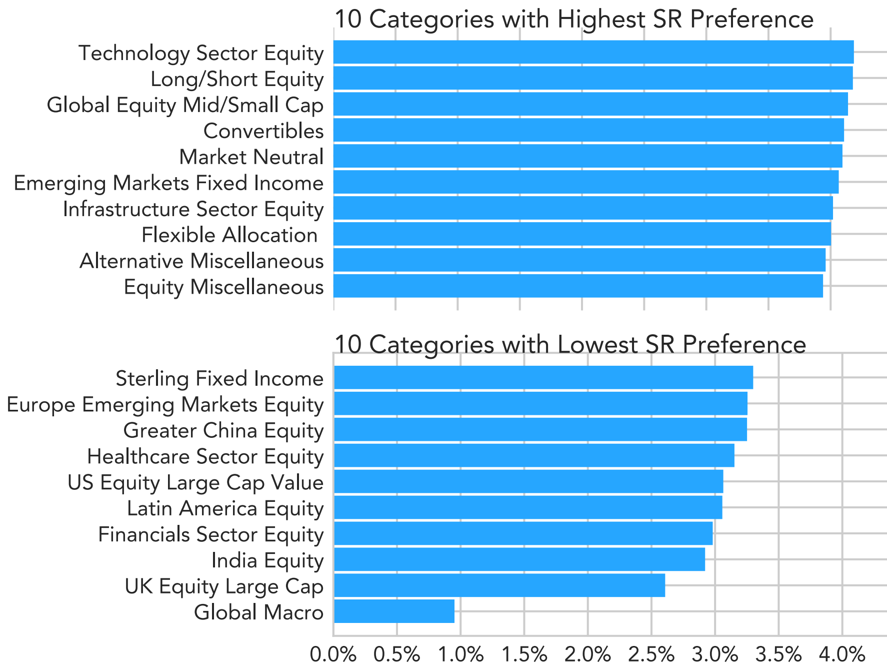

Figure 5: Top and bottom 10 global categories by social responsibility preference

Likewise, a positive social responsibility preference is ubiquitous across all countries with a meaningful number of socially responsible options. Interestingly though, across categories, and across countries there is a negative correlation between the market share of socially responsible funds and the preference, indicating that socially conscious investors reward socially responsible funds launched into less saturated markets.

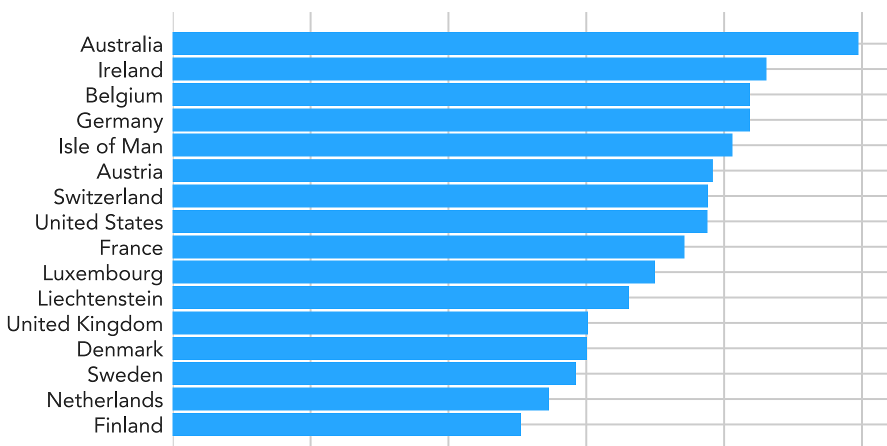

Figure 6: Social responsibility preference across domicile countries with more than $10mil USD in socially responsible assets

The Social Responsibility Fee Premium is Gone

Nearly 80% of global fund categories now have at least one socially responsible fund, and socially conscious investors now have the expectation that they will have options for investing in most areas of the market.

Simultaneously, many categories have become increasingly packed with socially responsible options. For example, the Global Equity Large Cap category has gone from 246 socially responsible funds in 2014 to 451 today.

Consequently, social responsibility is not such a differentiating factor anymore, and the pricing power associated with it has declined.

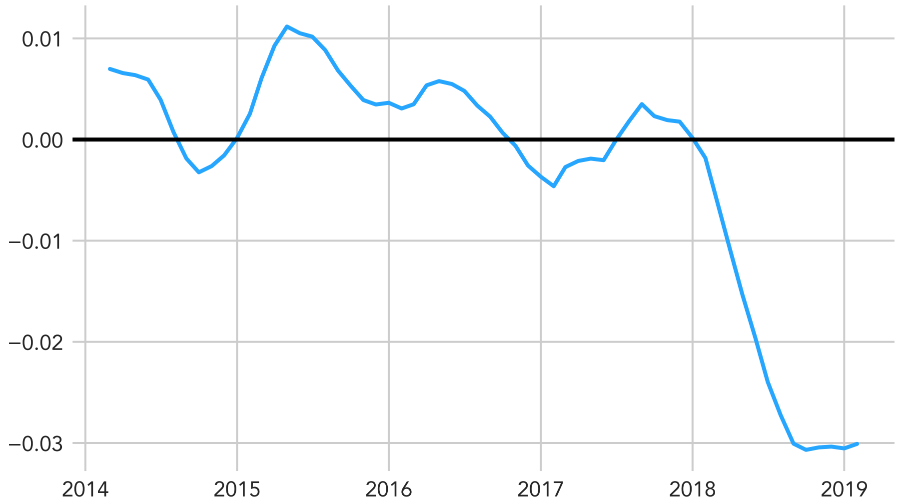

Figure 7: Price premia in percentage points associated with social responsibility

Whereas socially responsible funds enjoyed higher-than-average prices through mid-2016, asset managers are now pricing them about 3 basis points lower than their non-socially responsible peers. This precipitous decline happened mostly in 2018, the year which saw the launch of 2,260 socially responsible investment products.

Given that there's no end in sight to new socially responsible product launches, we expect price competition to continue to heat up among socially responsible investment offerings.

Concentrated Adoption of Social Responsibility

Not all asset managers have embraced social responsibility, while others have built their entire business around it. Calvert Investments, for example, is 100% comprised of socially responsible funds, and they've capitalized on it well - organically growing by more than 3 percentage points faster than they would have had their same product line-up been non-socially responsible.

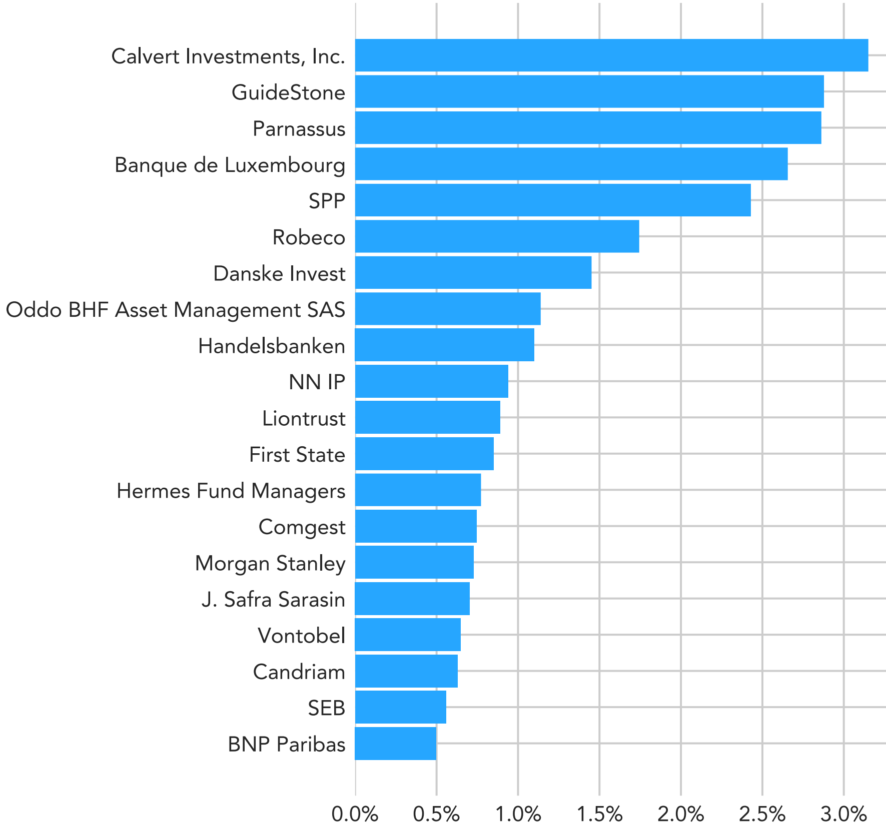

Figure 8: Top 20 asset managers by organic growth rates attributable to socially responsibility

Of the 20 firms listed above, BNP Paribas benefits the least in terms of organic growth, and has the lowest percent of socially responsible assets at 17%. There is a very tight correlation between percent of socially responsible assets and the amount a firm benefits from their social responsibility, indicating that firms that heavily pursue socially responsible investing are also successful at marketing themselves accordingly.

There is No Performance Tradeoff for Social Responsibility

A common criticism of socially responsible investing is that by adding a non-performance- or risk-related screening criterion to an investment strategy, its opportunity set is restricted and investment performance is impacted negatively at the margin.

This theory should be correct, under the assumption that socially responsible security identification is completely uncorrelated to risk and return. However, some studies have indicated that companies with a focus on sustainable practices may have better risk return profiles, and therefore socially responsible strategies, and ESG strategies may result in superior investment performance.

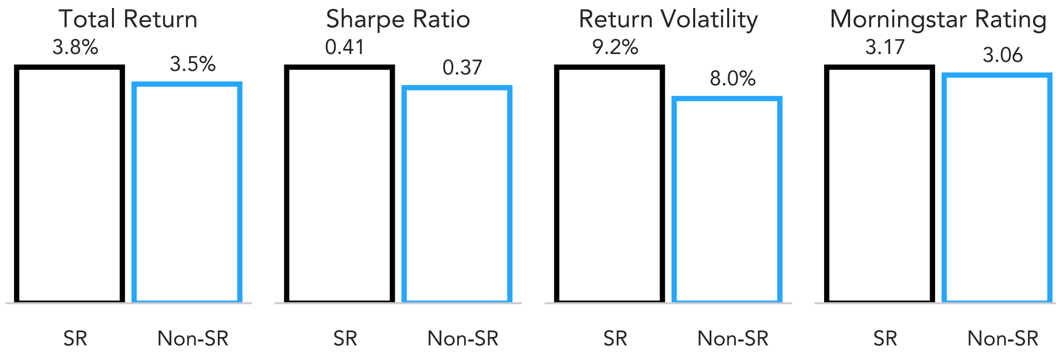

Figure 9: Various performance metrics for socially-responsible funds vs. their non-socially responsible category peers

Regardless, we find that over the past 5 years, there has been no penalty to being invested in socially responsible funds. On the contrary, socially responsible investors would have slightly outperformed their non-socially responsible peers, albeit not by an economically significant amount.

Conclusion

Socially responsible investing has attracted a large and growing portion of assets from investors. Asset managers, seeing opportunity to simultaneously attract assets and launch differentiated products have understandably increased supply of socially responsible funds to meet investor demand. This was made even easier due to the ease of implementing social responsibility screens in existing investment strategies.

However, we seem to have reached an inflection point in supply, where socially responsible products cover enough investment strategies that the differentiation benefit, and therefore the pricing power associated with social responsibility is on the decline. Asset managers entering the social responsibility game today may still generate strong asset growth as a result, but should not expect to be able to charge a premium price for such a service.

Given that fears of investment performance shortfalls due to social responsibility screens seem overblown, and societal concern about environmental, health, and welfare issues seems on the rise, we expect social responsible investing to continue to be a staple feature across the investment product landscape.

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