DeGroote
SCHOOL OF BUSINESS
EDUCATION WITH PURPOSE

McMaster University

BRIGHTER WORLD

Research Summary

This report presents a research update on understanding how and when advisors adopt responsible investing-related or other pro-social financial advice at the retail level. The research team has interviewed approximately 20 advisors, in addition to 10 investors, and collected years of responsible investing-related news to begin to understand the motivations and challenges advisors (investors) face in providing (receiving) financial advice regarding responsible investments (RI).

Since we began conceptualizing this study in 2018, the world of RI has grown dramatically with more money flowing into RI funds. The recent coronavirus pandemic may further strengthen the case for RI with Bloomberg reporting that ESG funds have done a good job of weathering the recent plunge in the stock market.

Below we offer a brief update on our progress to date including some key findings, as well as how we are looking to continue this research.

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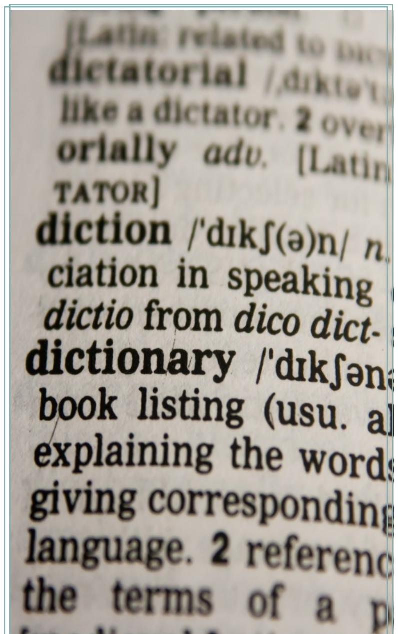


Key Findings

LACK OF A SHARED LEXICON

One of the really interesting findings from our interviews is a surprising lack of a shared lexicon as to what constitutes RI. Most investors, understandably, and many financial advisors, surprisingly, have a rudimentary knowledge of the many RI investment options and mistakenly equate “doing good” with “lower expected returns”. This lack of a lexicon, in our opinion, hampers the ability of advisors and investors to communicate effectively.

We found a surprising lack of shared lexicon as to what constitutes responsible investing

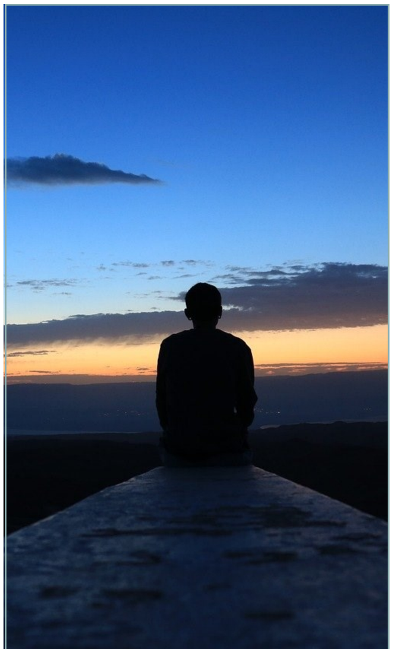
RESEARCH TEAM

Brent McKnight is an Associate Professor of Strategic Management at the DeGroote School of Business, McMaster University. Dr. McKnight studies how firms and organizations address complex societal problems. Currently this interest has led to him to undertake research in the areas of responsible investing at the retail advisory.

Kevin Veenstra is an Assistant Professor of Accounting at the DeGroote School of Business, McMaster University. Dr. Veenstra studies the influence of social norms and personality traits on an assortment of phenomenon, including career trajectories and corporate financial performance. His interest is driven by his fascination with how individual and group characteristics influence decision making and related outcomes.

Benson Honig is the Teresa Cascioli Chair in Entrepreneurial Leadership, DeGroote School of Business, McMaster University. Research interests include business planning, nascent entrepreneurship, transnational entrepreneurship, ethics in scholarship, immigration and social entrepreneurship, social capital, and entrepreneurship in transition environments. He has published in leading academic journals (over 100 peer reviewed articles) and serves on ten editorial boards.

Anjali Chawla is a PhD Student of Organizational theory at the DeGroote School of Business, McMaster University. Her research interests include sustainability and social entrepreneurship.



VARIATION IN ADVISOR MOTIVATIONS

We find that financial advisors vary substantially in their motivations to engage in RI. Some advisors are pursuing RI because they recognize it is an increasing trend among clients. For these advisors, RI is about getting ahead of the competition.

For others, RI is a personal passion emanating from their upbringing and past experiences. For instance, advisors describe past careers defending human rights, an education in biology or science, and pro-environmental or pro-social pursuits. These advisors comment on the importance of possessing a strong connection to RI. For example – one advisor mentioned that it is important for him to “connect his values and his background with his work” whereas another mentions that she “only carries on because she has such a strong personal interest”.

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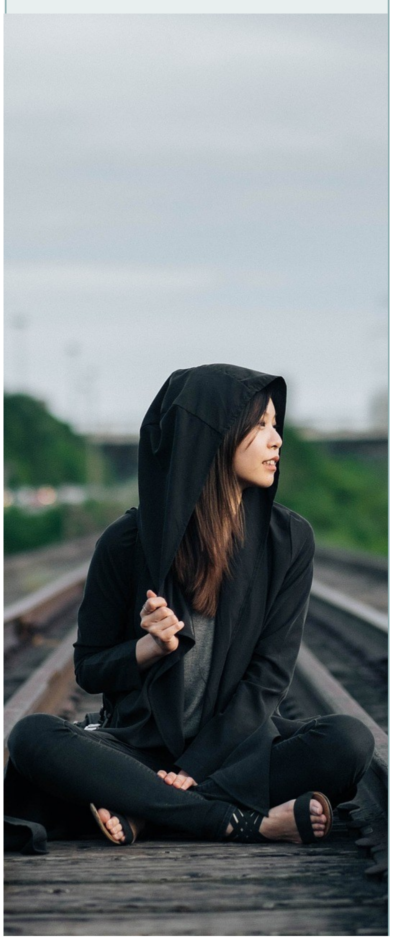


OUT OF THEIR COMFORT ZONE

Advisors keep recounting that a move towards RI puts them outside their comfort zone. The deluge of new products, with various ESG protocols and mandates, push some advisors to want to come “back to the funds [they] know”. The advisors who appear the most committed to RI spend more time researching the various products.

Others are uncomfortable with the subjective nature, and sometimes conflicting environmental, social and governance (ESG) assessments of a firm by various ESG rating service providers. In addition, ESG research is less readily available than financial performance data and often needs to be purchased by the advisor at a substantial cost.

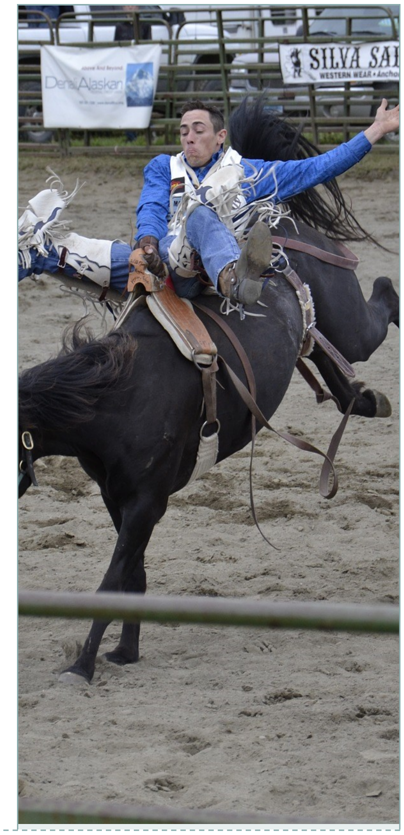
Many advisors also connect the adoption of RI with more practical concerns such as the need for legitimacy in the eyes of their customers i.e. the confidence of comparable returns.

Overall, we find a strong connection between internal motivation and the ability for advisors to overcome the challenges of product and research availability. Highly motivated advisors push through the challenges associated with adopting a RI approach.

RISK MANAGEMENT VS VALUES-BASED RELATIONSHIP DEVELOPMENT

We found that many RI advisors take the requisite time to have values-based conversations with their clients. For some advisors, this occurs during the onboarding process as a means to get to know the client. Others engage clients through social media or casual conversations to understand the kind of issues they care about. Through these interactions, advisors are able to integrate the client's principles and values with the client's investments. This is a daunting task for some advisors; the idea of highly customized portfolios based on a client's values raises challenges of effectively managing such a range of portfolios. At least one advisory practice manages these risks by offering a range of portfolios that address different categories of values.

For other advisors, RI is more about using ESG factors to mitigate risk. In such situations, investors may not even know that they are practicing RI.

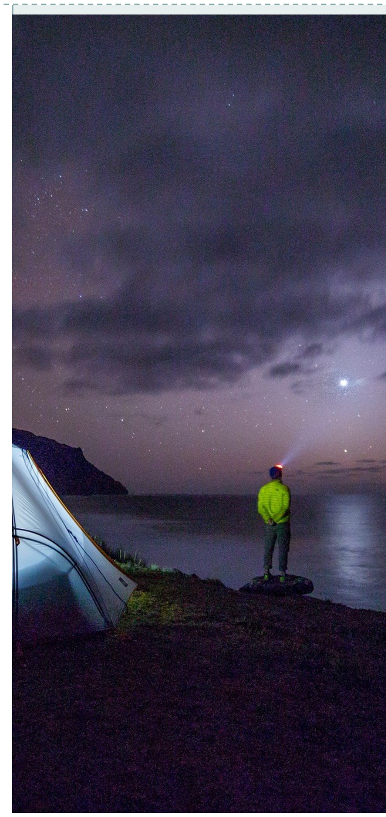


"We found that many RI advisors take the requisite time to have values-based conversations with their clients."

DIVIDE ON HOW CUSTOMERS ARE VIEWED

Some advisors advertise themselves as RI specialists committed to RI. Others are concerned to do so, for risk of losing clients that are not interested in RI. This difference in approach is connected to whether advisors view their customers as interested in RI, a view which varies markedly across advisors.

There is also a large divide between advisors with RI as part of their mission statement and those who are seeking to make a change with an established client base. The former advisor type is more likely to advertise their RI practices and seek customers with a specific interest in RI. Understandably, those advisors with an established client base are more wary about how they discuss RI options with their clients.



DEGROOTE SCHOOL OF BUSINESS

DeGroote is the business school at McMaster University in Hamilton Ontario. We operate out of two campuses—one in Hamilton at the Central McMaster campus and the other is the Ron Joyce centre in Burlington

DeGroote believes in delivering education with purpose. We actively foster interdisciplinary thinking and evidence-based management to transform business and society.

FURTHER RESEARCH

Our research team is buoyed by the preliminary findings. We continue to develop the research along two lines.

The first research stream focuses on understanding how the lexicon for RI has developed over the decades. We will study the development of the responsible investing lexicon in the financial industry over time and as compared to media portrayal. To this end, we will engage community members who are tightly connected to RI such as "early mover" financial firms and financial intermediaries that have a history of assessing ESG indicators. We expect interesting findings, highlighting gaps between how different groups talk about RI and related convergence/divergence over time. We hope to identify some of the reasons why investors and advisors do not seem to discuss RI as much as they might.

Our second research stream continues our work to date, understanding how advisors resolve some of the challenges associated with engaging in RI. We will focus on how an advisor identifies with RI, as the "key" to the process by which they address the challenges of customer engagement, product availability, and others. To this end, we will explore the relationship between advisor personality traits i.e. ego, and RI adoption.

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CONNECT WITH US

In this research endeavour we are seeking to continue to further our understanding of responsible investing among retail advisors and investors. As such, we want to hear from you about anything described here or about your perspective and experiences with responsible investing.

Contact Brent McKnight at bmcknight@mcmaster.ca to get in touch!