CHAPTER 5

"Ready or Not, Here I Come, You Can't Hide." Are Italian Institutional Investors Ready for Responsible Investments?

Duccio Martelli and Luca Testoni

Abstract Despite the number of studies showing the potential advantages of responsible investing, and the growing number of international investors interested in this type of assets, at the domestic level it is not clear yet whether Italian investors are ready for this switch. Thanks to the use of a proprietary database, collecting data about institutional investors, and two partnerships (with the Italian Association of Pension Funds—Assofondipensione, and the Italian Family Officers Association—AIFO), it has been possible to conduct a preliminary survey among major Italian institutional investors, potentially interested in responsible assets.

Keywords Responsible finance · Italian institutional investors · Survey

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The results of the pilot study seem to point out a change in their attitude: A large portion of respondents declares themselves to be ready to invest either in sustainable and responsible assets or in companies running responsible businesses. However, the results of this pilot inquiry show a delay by domestic players in investing in these assets, compared to foreign investors, who appear to be more familiar with them. The survey, therefore, confirms the growing interest and awareness regarding responsible finance among domestic players; in fact, sustainable and responsible investments (SRIs) currently represent a tendency among institutional investors toward the future way of investing.

SRIs can be defined as type of assets designed to generate social and environmental benefits alongside financial returns. In the past, this type of investments were closely associated with philanthropy; however, recent studies (among others, Eccles et al. 2012) have shown that they may provide favorable returns in addition to volatility reduction. A growing evidence states that responsible investing can produce financial returns comparable to those of alternative traditional investment strategies, as well as being particularly favorable over a long time period. This is especially beneficial for institutional investors, who often employ long investment horizons and long-term investment objectives. That is why institutional investors (such as pension funds, foundations and family offices) are considered key players in creating and developing an international responsible market. At the same time, it could be hard for such players to move towards these new types of investments, mainly because of cultural and behavioral issues.

Despite the number of studies showing the potential advantages of responsible investing, and the growing number of international investors interested in this type of assets, at the domestic level it is not clear yet whether, Italian investors are ready for this switch. Thanks to the use of a proprietary database, collecting data about institutional investors, and two partnerships (with the Italian Association of Pension Funds—Assofondipensione, and the Italian Family Officers Association—AIFO), it has been possible to conduct a preliminary survey among major Italian institutional investors, potentially interested in responsible assets.

The results of the pilot study seem to point out a change in their attitude: almost the entire sample of respondents has move beyond the concept of responsible investments as a synonym of philanthropy, also showing a wider awareness of responsible finance in general. Moreover, a large portion of respondents declares themselves to be ready to invest either in sustainable and responsible assets or in companies running responsible businesses. However, the results of this pilot inquiry show a delay by domestic players in investing in these assets, compared to foreign investors, who appear to be more familiar with them. The survey therefore confirms the growing interest and awareness regarding responsible finance among domestic players; in fact, SRIs currently represent a tendency among institutional investors towards the future way of investing.

1 Introduction

Over the last decade, responsible finance has become an increasingly discussed topic among institutional investors, who aim to combine social or environmental goals with financial returns (Eccles et al. 2012).

The survey presented in this paper is part of this strand of research, aiming to investigate the beliefs of investors in the Italian market toward responsible finance, and the operational issues financial institutions have in putting in practice sustainable and responsible principles. In particular, the survey is targeted to pension funds and family offices, as these are the institutional investors which are more likely to foster responsible investments in the near future, also considering that insurance companies and foundations are already among the major players in the market. Unlike other surveys conducted in the Italian market, the present study shows that participants are more aware of the meaning of responsible finance, although investors still face practical issues in identifying the right approach to invest in these assets.

The study is divided as follows. Section 2 summarizes the literature review regarding the perceptions investors have toward responsible finance, while Sects. 3 and 4, respectively, describe the methodology and the preliminary results of the analysis. Finally, the concluding section highlights the main evidence that emerges and underlines both the limits of the study and some suggestions to promote SRIs in Italy.

2 Literature Review

In recent years, responsible finance has played a key role, especially for institutional investors and high-net-worth individuals. According to Eurosif, “Sustainable and Responsible Investment (‘SRI’) is a long-term oriented investment approach, which integrates environmental, social and governance (ESG) factors in the research, analysis and selection process of securities within an investment portfolio. It combines fundamental analysis and engagement with an evaluation of ESG factors in order to better capture long term returns for investors and to benefit society by influencing the behaviour of companies.”[1] From what emerges from the 2016 European SRI Study (Eurosif 2016), in recent years institutional players have always increased their investments in sustainable and responsible assets. In particular, at the European level, responsible investments amounted to about 11,000 billion euros at the end of 2015. Among a few big players, insurance companies continue to play a central role, despite pension funds having increased their market presence over the last two years, although their assets are still limited. As for retail investors, high-net-worth individuals are showing an increasing awareness of responsible investments and have started demanding responsible assets, after a few asset managers decided to launch SRI products.

However, despite the growing body of literature suggesting that investor interest in SRIs is growing rapidly, some issues appear to limit the potential of the market. One of the main issues is represented by the skepticism some institutional investors still have toward the financial performance of responsible assets, despite several studies find that there is no difference in terms of return between responsible and traditional assets. The perceived lower returns of responsible investments are seen as an important obstacle to the real development of the market: About 30% of fund managers experience the “return issue” as an obstacle to implementing SRI strategies (Escrig-Olmedo et al. 2013).

Another issue in the development of a responsible market is that fund managers tend to focus mainly on short-term returns. According to several studies (among others Rappaport 2005), when investors have a strong focus on the short term, they are more willing to emphasize short-term information (e.g. market momentum) and to underweight

[1] Eurosif. European SRI Study 2016. Brussels: 2016, p. 9.

information relevant to the evaluation of an investment in the long run, such as social and environmental impacts (Guyatt 2006; Juravle and Lewis 2008).

Furthermore, reputational issues can be detrimental to the growth of a responsible market. When institutional investors are afraid of reporting lower performances compared to their peers, they are more willing to show a herding behavior (i.e., a tendency to follow others). This behavior reduces the need to justify the choices made to their clients and internally, since most other investors in the market behave in a similar fashion. Since responsible investments still represent a niche in the asset allocation of institutional investors, the fear of reputational damage does not represent an incentive to invest in sustainable and responsible assets (Guyatt 2006).

To further develop this strand of research, the present study aims to investigate the perceived drivers of SRIs among pension funds and family offices in the Italian market. Understanding their beliefs and the issues they face while implementing responsible strategies is, in fact, crucial for the development of a responsible market in Italy.

3 Methodology

The study aims to understand the awareness Italian pension funds and family offices of responsible investments, as these investors could in the near future foster the growth of these assets in the Italian market. The study is based on an online self-administered pilot survey promoted by ETicaNews in Spring 2017, in collaboration with the Italian Association of Pension Funds (Assofondipensione) and the AIFO. A self-administered survey is a quantitative research method, which does not require the use of an interviewer in submitting the questions. Respondents receive the questionnaire by e-mail and select their responses themselves. While a self-administered survey allows the interviewer to contact a large number of potential respondents within a short period of time, one of the disadvantages of this methodology is the relatively low response rate (among others Bourque and Fielder 2002).

The survey, involving 142 Italian pension funds and family offices, with a response rate of 20.42%, is structured in 10 close-ended questions, 5 of which are dichotomous (yes/no questions) while the other 5 are multiple-choice questions. The number of questions has been

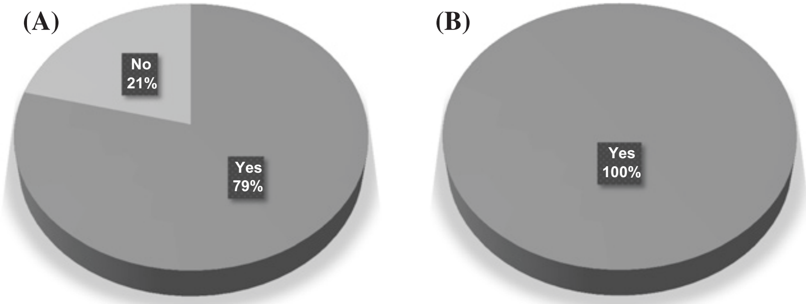


Fig. 1 **Panel A** Level of awareness of family offices. **Panel B** Level of awareness of pension funds (*Source* Authors' elaboration)

deliberately kept low, as this is a pilot survey. The questions mainly focus on two areas of interest: on the one hand, the perception of investors regarding responsible finance, and on the other, whether investors have implemented responsible strategies in their portfolios (or are likely to in the near future). Although the questionnaire is short and the number of respondents is limited, to our knowledge the study represents one of the first attempts in Italy to directly investigate the interest of institutional investors toward responsible assets.

4 Preliminary Results

Analyzing the answers given by the institutional investors surveyed, Italian pension funds and family offices show a general interest in SRIs. When asked if they or some of their clients had started to consider investing in responsible assets, the level of awareness is very satisfactory: 79% of respondents affirm they have started thinking about these alternatives, and this percentage reaches 100%, if we filter only the answers given by pension funds (Fig. 1).

The different sensitivity toward responsible investments probably denotes some reservations among high-net-worth individuals toward sustainable and responsible assets, which are still perceived as a form of charity. Family offices have instead definitively abandoned the philanthropic aspect generally associated with responsible assets, seeing these types of investments as alternatives like any other (Fig. 2).

Fig. 2 Perception of responsible investing: investment strategy vs philanthropy (*Source* Authors' elaboration)

Given the managers' awareness of the role of responsible finance, they have been specifically asked whether the family offices they work for have planned or are planning to make responsible investments in the near future. The answers given are quite surprising, as only half the professional investors surveyed are actively engaged in these forms of investments, or will be shortly; 48% of respondents still seem not to perceive correctly, or not to believe, in the real benefits that these alternative investments can generate from both a social and a financial points of view (Fig. 3).

Among managers who believe in the opportunities offered by responsible assets, around 40% consider these alternative ways of investing to be a good model for supporting local communities; others see in responsible finance a system for funding deserving initiatives or a high-yield asset class, with both financial and social returns (Fig. 4).

The same family office managers, interested in responsible investments, also appear to be more likely to invest directly in companies adopting sustainable strategies, such as greater respect for the environment or other social aspects, and focusing on the quality of their governance. About six out of ten investors believe that these companies will outperform their competitors, mainly thanks to a correct integration of all ESG factors. Companies, which follow only one of these three principles, are by contrast only seen as an interesting investment by a third of the interviewees, while the attractiveness of companies which only follow corporate social responsibility principles has dropped dramatically over the years (Fig. 5).

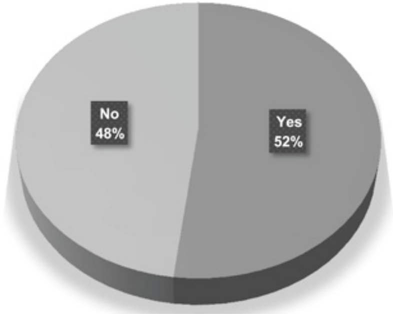


Fig. 3 Willingness to make responsible investments (*Source* Authors' elaboration)

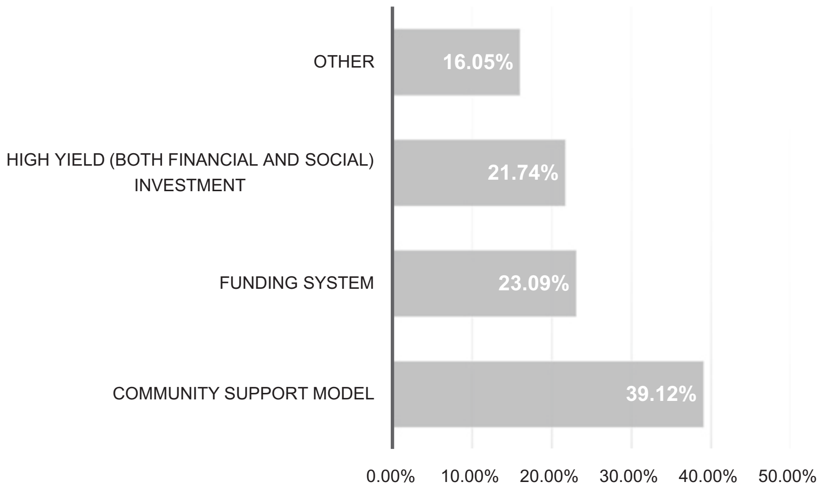


Fig. 4 Aims of responsible investments (*Source* Authors' elaboration)

Pension funds also seem to prefer companies that integrate ESG principles as a whole, as compared to companies which have either high standards of governance, or respect for the environment, or social aspects. In these cases, however, response rates show that preferences for these types of investments are higher, compared to the answers given by family offices: More than 40% of pension funds are willing to invest in environment-oriented or social-oriented companies, while only under

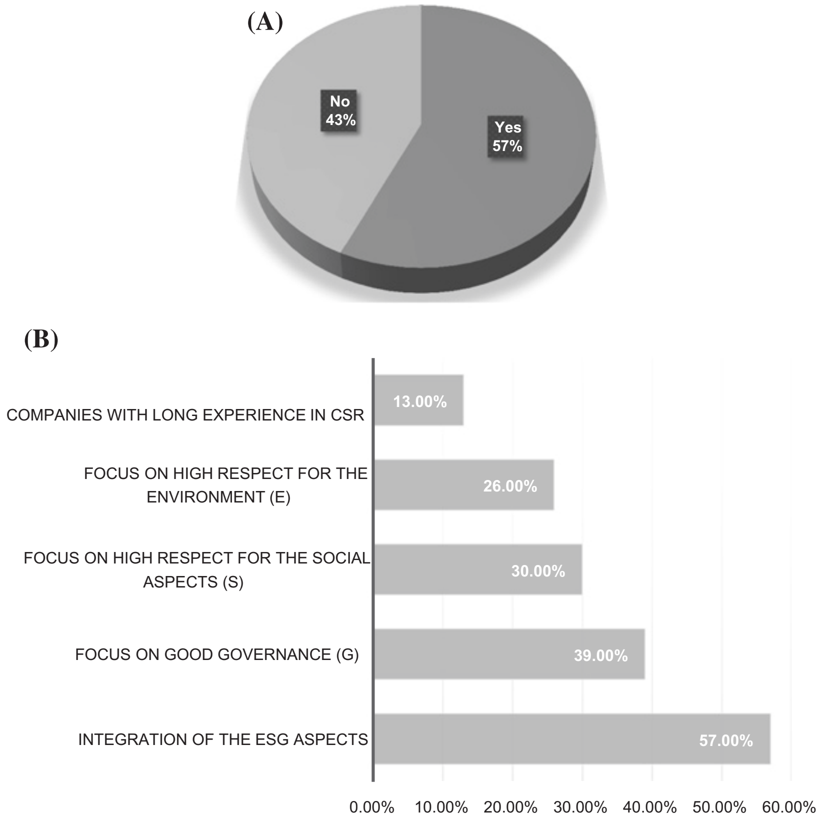


Fig. 5 **Panel A** Investments in responsible companies: family offices' view. Attractiveness of responsible companies. **Panel B** Investments in responsible companies: family offices' view. Characteristics of companies selected (*Source* Authors' elaboration)

a third of them would choose companies focusing exclusively on governance. The data regarding pension funds willing to choose companies which fully integrate ESG principles might appear to be quite surprising at first (Fig. 6). This percentage (100%), however, is not entirely unexpected, as a strong inclination toward responsible investments has already been observed in Fig. 1—Panel B.

While previous tables highlight the fact that Italian pension funds and family offices are theoretically interested in investing in responsible

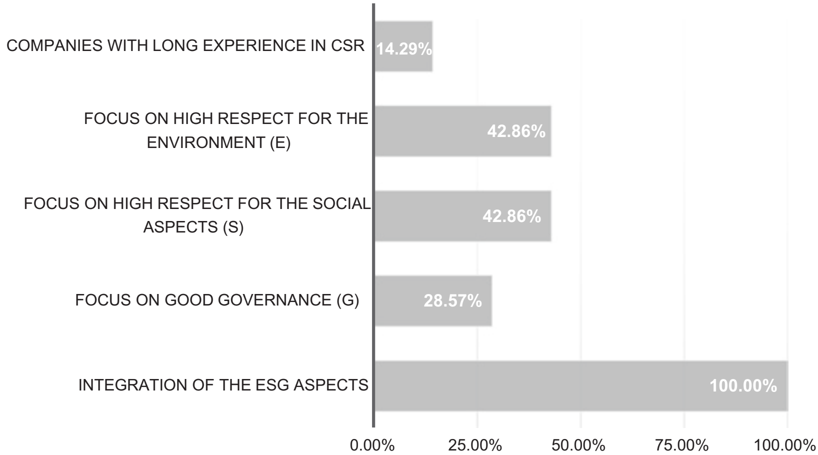


Fig. 6 Investments in responsible companies: pension funds' view. Characteristics of companies selected (*Source* Authors' elaboration)

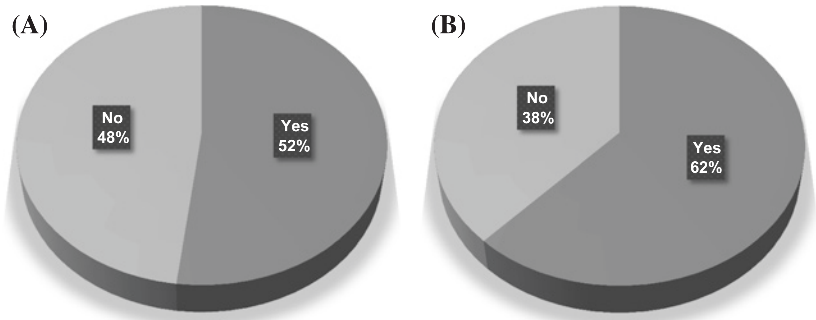
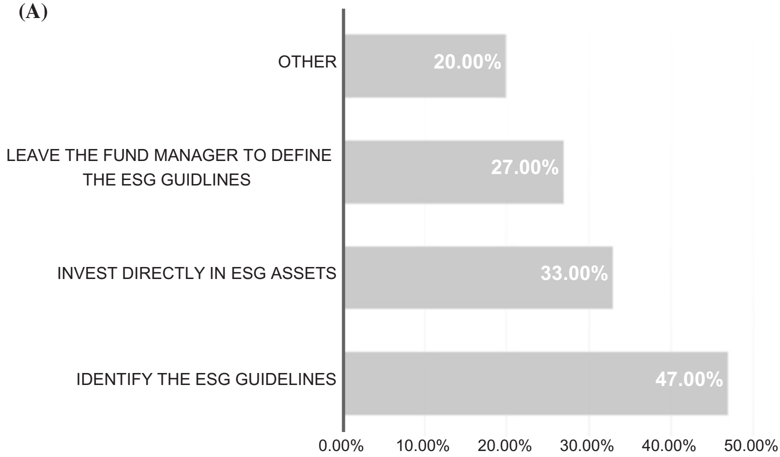


Fig. 7 **Panel A** How many family offices apply ESG filters in the investment process. **Panel B** How many pension funds apply ESG filters in the investment process (*Source* Authors' elaboration)

assets, in practice only a small percentage integrate ESG aspects in the investment process. The percentages are similar both for family offices and pension funds, although the latter are more active in using responsible selection strategies (52% of family offices against 62% of pension funds) (Fig. 7).

(A)



(B)

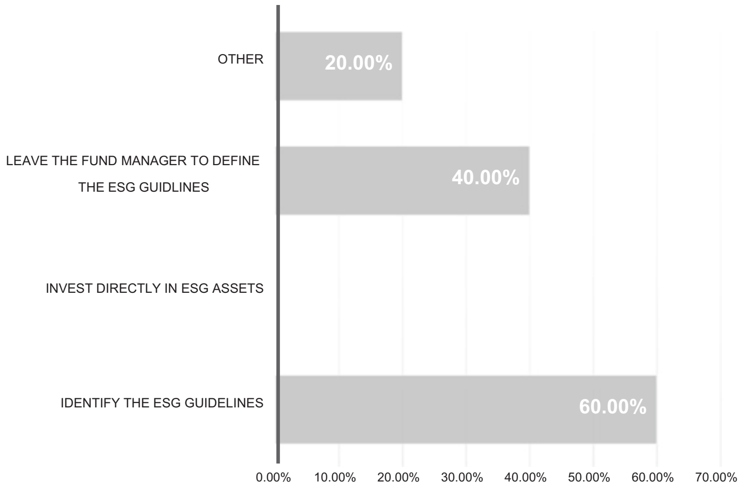


Fig. 8 **Panel A** Responsible investment strategies: family offices. **Panel B** Responsible investment strategies: pension funds (*Source* Authors' elaboration)

In particular, among family offices, which integrate responsible filters in their investment processes, about half define the guidelines that fund managers have to follow, while another 30% prefer either to invest directly in responsible companies or leave fund managers free to define the guidelines to follow. These behaviors are completely different if we analyze pension funds: Indeed, they mainly tend to define the guidelines themselves, or allow the manager choose the strategy to adopt (Fig. 8).

5 Conclusions

The pilot survey presented above shows interesting preliminary results regarding the level of interest institutional investors have in responsible investments. In particular, many players are aware of the importance of the issue of sustainability while choosing the right investments, although they are not completely sure of the real added value (in terms of achieving a better risk-return trade-off) that responsible investments can effectively give portfolios. These beliefs still survive, although the similarities between responsible investing and philanthropy have disappeared. In practice, players adopt a number of practical approaches while selecting responsible assets: Sometimes it is the institutional investor who decides the strategy to follow (as in the case of pension funds), while in other cases this choice is delegated to fund managers (as in the case of family offices). This lack of homogeneity seems to demonstrate an operational issue that asset managers have to face when practically choosing responsible assets to add to their portfolios. There is, therefore, a very strong demand for qualified training and events on these topics, which can help investors to correctly evaluate the risk-return profile of such assets. It does not matter, therefore, whether Italian institutional investors are actually ready to invest effectively in responsible assets; these alternatives, which only a few years ago were considered very specific investments reserved for certain types of clients, are nowadays widely appreciated among both institutional and retail investors.

Following studies which focus on other European countries (such as the analysis proposed by Escrig-Olmedo et al. 2013 for the development of the responsible retail investment market in Spain), it is possible to suggest some guidelines to increase awareness among institutional investors of responsible finance in the near future. The main aims of these suggestions are, on the one hand, to finally overcome the prejudice of their hypothetically low level of profitability, and on the other, to highlight the benefits these assets give when added to institutional and retail portfolios. In order to achieve these aims, more in-depth studies are needed, focusing on both the risk-return trade-off of well-diversified portfolios, including responsible assets, and the potential demand for these instruments from wealthy and retail investors. This second field of studies will allow institutions to offer products which are more in line with the real needs of the market. Moreover, institutional investors should raise the awareness of final investors, through the promotion of events and the distribution of brochures, which show the characteristics of responsible alternatives, in order to capture the unexpressed demand. Finally, governments should also promote these forms of investment (also using tax incentives), given the positive impacts the companies and projects financed have on local communities and the environment.

Although the pilot survey has highlighted interesting preliminary results, which need to be confirmed in future studies, the above analysis shows certain limitations. Further development of this strand of research should follow these lines of enquiry: (i) increase the number of respondents, including not only pension funds and family offices, but also other financial institutions (e.g., foundations) and retail investors as well; (ii) survey respondents on one specific topic at a time, focusing for instance on the reasons why investors are (or are not) willing to invest in responsible assets; and (iii) finally, employ alternative strategies (such as nudging to overcome potential behavioral issues) to make institutional and retail investors more aware of SRIs.

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