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Cash flow timing skills of socially responsible mutual fund investors

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ABSTRACT

This paper studies, for the first time, the cash flow timing skills of socially responsible (SR) mutual fund investors. Our findings show that SR investors neither worsen nor improve their returns according to their cash flow timing decisions, although they show good timing for net purchase and perverse timing for net withdrawal decisions. When controlling for fund characteristics, investors in larger, institutional, with longer mean manager tenure, lower expense ratio, no load, lower mean turnover ratio and a fee level below the average funds, show better timing results; in other words, sophisticated and better informed investors make better cash flow timing decisions. Controlling for SR strategy, green fund investors (our proxy for profit-seeking investors) had the worst results (similar to those obtained for conventional investors in the prior literature), and religious fund investors (our proxy for the values-driven profile) had results that were most different from conventional investors.

1. Introduction

The socially responsible (SR) mutual fund industry has experienced huge growth in recent years. According to the US SIF,[1] the value of assets under the management of SR mutual funds in the United States rose from $641 billion to $1.93 trillion between 2012 and 2014. Given these figures, academic interest in the analysis of this segment of the collective investment industry is understandable.

Many of the papers that analyse SR mutual funds have focused on the management perspective. The first articles on this topic analysed the financial performance achieved by this type of portfolio (Luther, Matatko, and Corner (1992) or Cummings (2000)). Some of these first articles made comparative analyses of conventional mutual funds (see Mallin, Saadouni, and Briston (1995), Gregory, Matatko, and Luther (1997), Bello (2005), Bauer, Koedijk, and Otten (2005) or Bauer, Otten, and Tourani (2006); Bauer, Derwall, and Otten (2007), among others).

More recent articles have studied the financial performance of SR mutual funds controlling for the type of SR mutual fund strategy (see Renneboog, Ter Horst, and Zhang (2008a), Nofsinger and Varma (2014) or Capelle-Blancard and Monjon (2014), among others) or for the skills of SR mutual fund managers (stock-picking, market timing and/or style timing). The skills of mutual fund managers could be an important source of good financial performance for investors. Stock-picking is the ability to choose stocks that outperform other securities with a similar level of non-diversifiable risk. Market timing supposes to change exposure to the market at the right moment. A good manager will maintain a higher beta in bull markets and a lower beta in bear markets. A good manager could also improve their performance by anticipating which investment style will behave better, and by raising the exposure of their portfolio to this style (style timing). These managerial skills have been broadly analysed for conventional mutual fund managers, but we can also find articles dealing with this question for SR mutual fund managers (see Schröeder (2004), Kreander, Gray, Power, and Sinclair (2005), Gregory and Whittaker (2007), Ferruz, Muñoz, and Vargas (2012), Muñoz, Vargas, and Marco (2014), Muñoz, Vargas, and Vicente (2014), Muñoz, Vicente, and Ferruz (2015) or Leite and Cortez (2015), among others)[2,3].

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[1] US SIF, the Forum for Sustainable and Responsible Investment, is the US membership association for professionals, firms, institutions and organisations engaged in sustainable, responsible, and impactful investing. The US SIF website is http://www.ussif.org/sribasics.

[2] Chegut, Schenk, and Scholtens (2011) carry out an exhaustive literature review of the SR mutual fund financial performance literature.

[3] The relationship between financial and non-financial performance (see Derwall, Guenster, Bauer, and Koedijk (2005), Kempf and Osthoff (2007), Statman and Glushkov (2009) or Manescu (2011), among others), the motivations of SR mutual fund investors (see McLachlan and Gardner (2004), Beal, Goyen, and Philips (2005), Nilsson (2009) or Derwall et al. (2011), among others) or SR mutual funds and criteria decision analyses (see Ballestero, Bravo, Pérez-Gladish, Arenas-Parra, and Pla-Santamaria (2012), Bilbao-Terol, Arenas-Parra, Cañal-Fernández, and Bilbao-Terol (2013), Pérez-Gladish, Méndez-Rodríguez, M'Zali, and Lang (2013), Utz, Wimmer, Hirschberger, and Steuer (2014) or Petrillo, De Felice, García-Melón, and Pérez-Gladish (2016), among others) are other topics for which works can be found in the SR literature.

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Mutual fund investors can achieve good financial result if they are able to make good investment decisions. The investment decisions of conventional mutual fund investors have been broadly analysed. A large number of papers analyse how past financial return affects investor decisions about fund flow allocation (Sirri and Tufano (1998) is one of the most representative works in this field), regarding the skill of investors to select funds that will outperform in the future (smart-money effect or selection skills) (Zheng (1999) is a good example) and/or regarding the ability of investors to properly time their purchase and redemption fund share decisions (Friesen and Sapp (2007) is one of the most relevant works for this topic). There are fewer articles dealing with these matters as regards SR mutual fund investors, however. There are several articles involving the relationship between past financial performance and fund flow allocation decisions, but, we have only found two articles studying the smart money effect, and we did not find any article studying the cash flow timing skills of SR mutual fund investors. The analysis of these questions for SR mutual fund investors is interesting due to the special characteristics of this kind of investor (they take into account both financial attributes and other non-financial issues such as environmental, religious or governance when making their investment decisions).

In this article we analyse for first time, as far as we know, the cash flow timing skills of SR mutual fund investors, covering this gap in the literature. In the next section, we explain why the analysis of this issue is relevant for SR fund investors, showing the most relevant works for the topics dealt with in this article and posing the research questions that we want to answer with this research.

The rest of article is structured as follows: in the third section, we explain the methodology employed to carry out the analyses; Section Four describes the data used in the study; the fifth section is devoted to presenting and discussing the main results of the paper; and finally, the sixth section draws the main conclusions.

2. Literature review

2.1. Investment decisions of SR mutual fund investors

When considering the investment decisions of fund investors, the question most widely analysed for SR investors has been their reaction to past returns, that is, the relationship between fund flows and financial performance. In the case of conventional mutual fund investors, this relationship is asymmetric, that is the mutual funds with the best financial performance in the past attract higher inflows in subsequent periods, but the worst performing mutual funds do not suffer proportional outflows (Sirri & Tufano, 1998).

For SR mutual fund investors this relationship is different. Bollen (2007) finds that the volatility of SR mutual fund flows was lower than that of conventional mutual funds in the period 1991–2002. This author shows how SR investors are less influenced by past negative returns than conventional mutual fund investors when making their investment decisions. Benson and Humphrey (2008) find that SR fund flows are less sensitive to returns than conventional flows, thus showing that SR investors have difficulty finding an alternative SR fund that meets their non-financial concerns. Renneboog et al. (2008b: p.1739) highlights two results from the US SIF (2001 and, 2003 report that suggest different fund flow behaviour for SR investors:

i) "*During the stock market downturn over the first 9 months of 2001, there was a 94% drop in the money inflows into all the US mutual funds, whereas the fall in the net investments in socially screened funds amounted to merely 54%.*
ii) *Typically, a social investor's assets are 'stickier' than those of investors concerned only with financial performance. That is, social investors have been less likely to move investments from one fund to another and more inclined to stay with funds than conventional investors*".

Renneboog, Ter Horst, and Zhang (2011) studied the SR fund flows for a broad international sample of SR mutual funds, and controlled for the different kinds of SR investment strategy implemented. The findings of this study are very interesting. They show that SR money flows are minimally related to past fund returns, but, at the same time, that the kind of SR investment strategy that is implemented plays an important role in this relationship. From this, we can conclude that SR fund flows are less sensitive to past negative returns than conventional fund flows, and that this is especially true for SR funds implementing negative or sin/ethical screens. Social attributes also weaken the relationship between inflows and positive past returns. The opposite is found for environmental criteria: the relationship between past positive returns and inflows for funds with environmental criteria is stronger than for conventional funds.

Peifer (2011) studied the stability[4] of religious mutual fund investors and compared it with the stability of other kinds of investors (other SR mutual fund investors and conventional fund investors). The author found that religious mutual fund investors are the most stable; that is, past financial return has little impact on their fund flow decisions. Religious mutual funds usually implement negative or exclusionary screens as their SR strategy. In this way, the results obtained by Peifer (2011) are consistent with those reached by Renneboog et al. (2011).

The relevance of the SR strategy implemented in the analysis of SR investor investment decisions means that the literature divides the SR movement into segments. A salient article is that of Derwall, Koedijk, and Ter Horst (2011), who split SR investors into two segments, values-driven and profit-seeking investors. Investors for whom social and personal values are the main reasons for investment decisions comprise the first group, and they are willing to sacrifice financial performance in exchange for utility from non-financial attributes. Investors for whom the main aim of implementing SR criteria when making investment decisions is the achievement of a good financial result, comprise the second group (profit-seeking).

Derwall et al. (2011) sort SR investors into these two groups according to the SR strategy implemented by the fund in which they invest. These authors argue that values-driven investors put their money in SR mutual funds that implement negative or exclusionary screens, that is, funds that exclude, from their eligible stock universe, stock issued by companies in certain sectors that are considered morally reprehensible (some examples are the tobacco, alcohol and gambling sectors). These sectors are termed 'sin sectors' in the literature, and religious mutual funds, for example, usually implement this type of strategy (see, for example, Appendix 1 in Ferruz et al. (2012)). SR mutual funds implementing positive screens would represent profit-seeking investors. A positive screen strategy selects stocks with good records on environmental, social and/or governance issues. Derwall et al. (2011) justify their reasoning on the basis of the prior literature about the relationship between past returns and fund flows.

Muñoz, Vargas, and Vicente (2014) developed work that controlled the results for the two SR investor segments described above. They analysed whether the decisions made by investors in profit-seeking and values-driven funds have an impact on the timing ability of socially responsible mutual fund managers. The findings indicate that controlling for fund flows has only a weak effect for the positive screening sample. Controlling for fund flows slightly improves the market timing coefficients for these funds.

In short, this review of the literature about the relationship between fund flow and financial performance for SR investors suggests two main conclusions:

i) The relationship between fund flow and financial performance differs between SR and conventional mutual fund investors.

[4] The author defines stability as the extent to which investors hold onto their fund shares regardless of the performance in terms of past returns.