

EMBRACING ESG IN TIMES OF COVID-19: A MARATHON NOT A SPRINT

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Abstract

Resilience is at the forefront in companies. Insurance through ESG investment is the focus of much research, yet it has thus far been dominated by a somewhat static approach. We embrace a longitudinal approach by accounting for two aspects of a firm's ESG engagement: its degree of regularity over time (ESG consistency), and the extent to which each firm reallocates its ESG engagement across pillars (ESG adaptability). We examine how these characteristics affect firm resilience during the COVID-19 shock: stability (the maximum economic loss suffered following the shock), and flexibility (time to recovery). Using a sample of U.S. listed firms, our evidence suggests that ESG consistency and ESG adaptability improve resilience stability, but that they have no significant impact on the flexibility dimension. We further find that such dynamic aspects of ESG become more important vis-à-vis strengthening the resilience of poorer ESG-engaged companies.

Keywords: firm resilience; ESG; corporate social responsibility; COVID-19 shock.

Research proposal

The global-scale disruption triggered by the coronavirus has raised company awareness about their exposure to a fast-moving and unpredictable environment. There has been an upsurge of interest in exploring which corporate characteristics make firms more “immune” (Ding et al., 2021). Many studies have pointed to ESG (environmental, social and governance) engagement as a powerful strategy to build firm resilience. One stream of works has tested the insurance role of ESG investment in the most recent crisis shocks such as the financial crisis (Lins et al., 2017; Flammer & Ioannou, 2021; Sajko et al., 2021) and the COVID-19 (Albuquerque et al., 2020; Broadstock et al., 2021; Ding et al., 2021).

Nonetheless, one major drawback of earlier research lies in its primary focus on the level of ESG engagement, largely downplaying the multidimensional nature of ESG and how each firm allocates its ESG efforts over time. Altogether, this neglects the diversity of ESG patterns observed across companies (Cuypers, Koh & Wang, 2016) and restricts a better understanding of how firms should successfully implement ESG. The primary force that endows ESG engagement with its insurance benefits lies in the accrual of moral capital and trust across a firm’s stakeholders, which pay off during negative shocks (Godfrey, 2005; Godfrey, Merrill & Hansen, 2009; Lins et al., 2017; Shiu & Yang, 2017; Jia, Gao & Julian, 2020; Flammer & Ioannou, 2021). Consistent with this idea, existing evidence suggests that companies are likely to increase their ESG disclosure following adverse events (Huang et al., 2022). Our study addresses this research void by shifting the focus from how much ESG-scoring a firm displays at a particular point of time (a static approach) to which temporal ESG pattern each firm develops over time (a longitudinal approach). In so doing, we answer calls for further research on this strategy’s temporality (Tang, Hull & Rothenberg, 2012; Bansal, Jiang & Jung, 2015; Uyar, Kuzey & Karaman, 2022). Given the long-term orientation of ESG actions, a dynamic viewpoint can help to elucidate the underlying mechanisms which shape firm resilience.

Specifically, we explore two dimensions of a firm’s ESG engagement over time: temporal ESG consistency –capturing the extent to which each firm engages in ESG in a systematic and regular manner over time (Tang et al., 2012); and ESG adaptability –which refers to the degree to which each firm reallocates its ESG engagement across pillars to align with its environment’s demands. As far as the first dimension is concerned, we expect stronger temporal ESG consistency to favour more highly perceived sincerity of such ESG efforts by stakeholders. This might in turn strengthen their attachment to the firm and stimulate their support under adversity, contributing to mitigate market losses. Besides, we expect a more favourable appraisal of ESG genuineness due to stronger temporal consistency to increase stakeholder willingness to embrace and to become involved in adaptations within the firm to prompt its survival (the flexibility dimension). Concerning ESG adaptability, we argue that firms who make a major effort to achieve a better and more timely alignment of their ESG practices in line with their stakeholder demands will be more likely to receive stronger support from their stakeholders when faced with an adverse shock (Fombrun et al., 2000; Su & Tsang, 2015; Lins et al., 2017). Consequently, such firms are likely to suffer weaker economic losses. Additionally, recent research underscores the importance of congruence between socially responsible activities and the demands of a firm’s stakeholder environment (Bae et al., 2021) because this enhances the credibility of a firm’s ESG efforts. We contend that a firm’s reallocation of its ESG efforts to align them to the changeable needs that emerge from the environment might stimulate trustworthiness from its stakeholders, which is found to spark stakeholder

trust and cooperation during crisis periods (Fombrun et al., 2000; Lins et al., 2017). As a result we expect that this greater ESG adaptability will ensure that the firm satisfies its stakeholders' demands successfully in response to the circumstances at each point in time, thereby improving firm resilience at the flexibility dimension.

To the best of our knowledge, no prior research has yet addressed the link between ESG engagement and firm resilience using such a longitudinal and contingent perspective. Our investigation sheds light on what impact these two ESG dimensions have on a firm's resilience. We offer empirical evidence during the COVID-19 pandemic to exploit this shock as a natural experiment. The manner in which each firm manages its ESG engagement over time is by no means a trivial issue since the insurance benefits of ESG depend to a large degree on social reputation and stakeholder trust-building (Cuypers et al., 2016; Lins et al., 2017; Uyar et al., 2022). This in turn calls for a multidimensional analysis of ESG engagement –to which this study aims to contribute– in order to appraise the heterogeneity apparent in how companies engage in this strategy (Cuypers et al., 2016; Uyar et al., 2022). The more genuine and authentic a firm's ESG strategy, the stronger and longer-lasting the bonds it helps to forge between firm and stakeholder (He & Harris, 2020). The literature emphasizes that ESG credibility is essential for this strategy to work in practice (McShane & Cunningham, 2012; Albuquerque et al., 2020).

The starting point of our study reproduces recent works on the COVID-19 shock (Albuquerque et al., 2020; Fahlenbrach, Rageth & Stulz, 2021) by considering all listed U.S. companies with available financial data at the end of the 2019 fiscal year. We gather data on U.S. firms from Eikon, which is our main source of data. We retrieve 2019 fiscal year-end data for financial variables from Worldscope. We obtain daily closing stock market prices from Thomson Datastream for the period January 2020 to March 2022. We also collect yearly ESG scores for the period 2011-2019 from Refinitiv. The World Health Organization (WHO) officially announced the outbreak of a Public Health Emergency of International Concern on 30 January 2020. We consider such a date as the event date of the COVID-19 shock in our empirical analyses. We find that ESG consistency and ESG adaptability improve the stability dimension of firm resilience. ESG consistency is seen to play a more prominent role than ESG adaptability. In contrast, they have no significant effect on the flexibility dimension of resilience. This leaves room to identify other potential factors which may help firms to shorten the recovery time from the shock. Additionally, our evidence reveals that these two dynamic aspects of an ESG strategy (ESG consistency and ESG adaptability) become more important in firms with poorer ESG engagement, for whom conveying the sincerity of their ESG actions proves to be more important. We offer a battery of robustness analyses which give further insights into the evidence obtained.

This paper makes several contributions. First, we add to the measurement of a firm's ESG strategy by proposing longitudinal measures to gain a better understanding of each firm's track record in ESG. This also advances a multidimensional view of ESG in order to appraise the heterogeneity of ESG strategies and, therefore, be better positioned to determine their degree of sincerity (He & Harris, 2020). Second, we contribute to the literature on firm resilience. The two-fold breakdown of resilience based on the stability and the flexibility dimensions delves into the underlying mechanisms of the insurance advantage of ESG and promotes a closer examination of how ESG shapes resilience at different levels. We complement prior research –which primarily focused on the value impact of ESG– by shifting to another perspective which gains primacy during adverse

times: value preservation and firm survival. Identifying resilience-enhancing strategies—which may not necessarily be the most-value creating ones in all cases—proves crucial vis-à-vis protecting the interests of all stakeholders and of reinforcing their attachment to the firm during adversity.

From a practical standpoint, this research is also valuable for managers and policymakers. We illustrate the benefits of enhancing the transparency and reporting standards of ESG practices. Conveying this complementary non-financial information of companies can promote the design and implementation of more efficient policies to strengthen firm resilience. Additionally, policymakers should do as much as they can to provide companies with standard regulations for ESG reporting at the international level in order to foster its comparability and interpretation, not only within firms from the same sector, but also across sectors and countries. Once a high-quality package of international reporting standards has been developed, it will be equally important to preserve their consistency over time.

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