How ESG Reduces Risk: The Role of Consumers and Institutional Investors

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Abstract:
Industry insights and business reports suggest that firms primarily use environmental, social, and governance (ESG) factors as a crucial risk management practice. However, no empirical evidence has yet linked ESG factors to firm risk through different stakeholders. Drawing on stakeholder management theory, the authors develop and test a conceptual framework, which posits that (1) two primary stakeholders of firms (consumers and institutional investors) have a mediating role in the association between ESG and firm idiosyncratic risk; (2) the effect varies for each of the E, S, and G factors; and (3) competitive intensity moderates these effects. Using quarterly data from 416 firms from 2012 to 2020, the authors find that consumers and investors indeed play a mediating role in the effects of ESG on risk. While consumers respond positively to the E factor and negatively to the G factor, institutional investors respond negatively to E and S factors and positively to the G factor. Competitive intensity strengthens the effect of the S factor on consumers and the effect of the E factor on investors but weakens the effect of the G factor on both.