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Green and social policies help businesses weather COVID-19 crash

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Businesses with strong environmental and social credentials are more resilient in times of economic crisis, according to research into the COVID-19 stock market crash.

Chendi Zhang, a professor of finance at the University of Exeter

Business School, and his co-authors measured the performance of US stocks in the first quarter of 2020, in which the financial market saw its fastest ever collapse due to the coronavirus pandemic.

They found that in the three weeks between the start of the stock market decline and the US government's 18 March bail-out package, firms with high ESG (environmental, social and governmental) ratings outperformed those with low ESG ratings by 7.2 percent.

"These policies act like a risk management policy," said Professor Zhang. "The COVID crisis has affected financial markets everywhere, but we found that firms with green policies or that take social responsibility seriously are less affected by the crisis."

ESG ratings take into account factors such as a firm's carbon emissions or the sustainability of a product or service, as well as social issues such as diversity and inclusion in the workforce, human rights and product responsibility.

Examples of ESG policies include Microsoft's pledge to become "carbon negative" by 2030, or Google's commitment to promote social change at its supplier sites.

"Our findings are not associated with any particular industry, but encompass most industries," said Professor Zhang.

Companies with large cash balances tend to be best equipped to weather economic shock, but the results show that environmental and social policies are as valuable in creating resilience as cash, which Professor Zhang described as "extraordinary."

The research also found companies that paired high environmental and social commitments with strong advertising fared even better, a sign that spending on social responsibility pays off—especially if consumers know about it.

To explain the findings, Professor Zhang said firms with credible ESG policies tend to attract more loyal customers and so face less need to compete on price. "For firms and investors, sustainability is an investment in a product differentiation strategy," Professor Zhang said.

"If you are just trying to compete to sell the cheapest product your profits can be more sensitive.

"When you go to the supermarket and buy organic food, this demand is more stable but if you just try to compete to sell the cheapest product your profits can be more sensitive to economic cycles that increase the risk for firms and reduce firm value."

The researchers argue the impact of the COVID-19 pandemic on stocks has given them the clearest indication yet of the impact of environmental and social policies on financial performance.

"The crisis has affected everyone, there's no hiding from it," said Professor Zhang. "It's a shock from outside the economic system, from the outset it originated from a public health crisis, and this helped us have a cleaner set up to study the effect of environmental and social policies on stock prices."

The research paper, entitled Resiliency of environmental and social stocks: an analysis of the exogenous COVID-19 market crash was published in the CEPR's COVID Economics paper series (issue 11).

More information: Rui A. Albuquerque et al. Love in the Time of COVID-19: The Resiliency of Environmental and Social Stocks, *SSRN Electronic Journal* (2020). DOI: 10.2139/ssrn.3583611

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