e-axes FORUM

Digest

The reaction of customers to corporate ESG performance

March 2024

Environmental, social, and governance (ESG) issues are a topic of growing focus in the business world and academia alike. In particular, a lively debate is emerging about the role of corporations in adopting more sustainable ESG policies. It is almost an article of faith that external pressures from various stakeholders can be applied to improve corporate ESG performance. These channels include divestment and engagement activities by shareholders, regulations and taxes imposed by governments, and the pressure from customers and employees. While there is growing evidence of the impacts of regulatory actions and investors on firms' ESG practices, there is only scant systematic evidence on whether consumers are a possible group of influence. Several recent papers have attempted to examine whether customers care about firms' ESG reputation, and in turn, how their reactions impact firms' financial and ESG performance.

Curated by:

Frank Weikai Li (Singapore Management University)

Consumers' Reaction to Corporate ESG Performance

In a recent working paper, **Duan, Li, and Michaely** (2023), investigate end-consumers' attitudes toward firms' ESG performance. They use granular foot-traffic data at the store level to capture consumer behaviour and ESG incidents to capture negative shocks to firms' ESG reputation. They find consumers significantly reduce visits to firms' commerce locations following the occurrence of negative ESG news. The reduction in consumer foot traffic lasts for several months and has material impacts on firm sales and profits. Importantly, they show consumers' attitude toward ESG has a real impact: firms under the threat of losing consumers subsequently improve their ESG performance. Using abnormally hot temperature as a shock to consumer awareness of sustainability issues, they show the effect of

ESG incidents is plausibly causal and unlikely driven by omitted firm characteristics. Their findings suggest that end-consumers are an important group of stakeholders that can potentially improve corporate ESG practices.

Do Consumers Care About ESG?

Meier et al. (2023), show that environmental and social (E&S) ratings positively relate to local sales, especially in counties with more Democratic-leaning and higher-income households. They use granular barcode-level sales data from retail stores to capture consumer demand. They further document a spillover effect in the sense that E&S ratings of a firm's product market rivals negatively affect a firm's sales. To address endogeneity concerns, they show that sales in counties close to the major natural and environmental disasters become more sensitive to E&S ratings.

ESG Shocks in Global Supply Chains

In a new working paper, While the above two papers focus on end-consumers' behaviours, **Bisetti, She and Zaldokas**(2023) look at how corporate customers react to ESG incidents of suppliers in global trade. They show that U.S. firms cut imports by 29.9% when their international suppliers experience E&S incidents. These trade cuts are larger for publicly listed U.S. importers facing high E&S investor pressure and lead to cross-country supplier reallocation. Larger trade cuts around the incident result in higher supplier E&S performance in subsequent years, and in the eventual resumption of trade. Their results highlight the role of customers' exit in ensuring suppliers' E&S compliance along global supply chains.

ESG News, Future Cash Flows and Firm Value

Finally, **Derrien et al.** (2021), investigate the expected consequences of negative ESG news on firms' future profits, where they use analyst forecast to proxy for expected future profits. They find analysts significantly downgrade their forecasts at short and longer horizons after learning about ESG incidents. Consistent with the above papers, they find the negative revisions of earnings forecasts following ESG incidents reflect expectations of lower future sales (rather than higher future costs). Quantitatively, they show forecast revisions can explain most of the negative impacts of ESG news on firm value.

e-axes
FORUM

The E-axes Forum is an independent nonprofit, nonpartisan research organization on macroeconomic policies and sustainability. The Forum is dedicated to aggregating knowledge from around the globe with the aim to catalyze the engagement of economists and decision makers who are working on policies towards achieving a sustainable economy.

www.e-axes.org
228 Park Ave S., PMB 35845, New York, NY 10003