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ESG AND IDIOSYNCRATIC RISK: THE INFLUENCE OF EXTRA-FINANCIAL RATINGS ON CORPORATE MARKET RISK

Abstract:

The main objective of this study is to shed light on the ambiguous relationship of ESG Performance scores on idiosyncratic risk. While most studies focus on performance layers of Corporate Financial Performance, this study examines the portfolio risk in the ESG context. The sample comprises a dataset of 941 firm-year observations consisting of companies listed on the STOXX® Europe 600 index excluding financials, in the timeframe of 2018-2020. In the previous literature, approaches can be identified for a positive, negative or missing correlation. This study found no significant impact of ESG Performance scores on idiosyncratic risk while analysing overall ESG metrics or the individual E, S and G pillars. According to the literature, this effect may be caused by managerial greenwashing opportunities according to Principal-Agent-Theory or the fact that the market already prices ESG factors and their respective idiosyncratic risk. An IV regression model with one-year lagged ESG metrics has been applied to address endogeneity concerns. Furthermore, the reliability of the results has been tested by using the MSCI World index as a reference index for β calculation. All robustness tests support the initial results.

Keywords:

ESG, Environmental, Social, Governance, Sustainability, Capital Markets, Risk