

Strategic Risk Management and ESG

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Executive Summary

Risk management is an important part of the corporate strategy. A firm's positioning relative to its peers shapes its financial choices, including how much debt it carries and how it hedges against business uncertainties. ESG (Environmental, Social, and Governance) factors have currently become the topic of interest. Investors can interpret a firm's ESG standing as a signal of its business resilience. However, there is little evidence about how these ESG standings influence a firm's hedging and capital structure decisions, or whether the effect is the same across countries.

This study examines how a firm's ESG positioning relative to its peers relates to its corporate hedging level. We ask two main questions: first, how does ESG positioning affect hedging levels or capital structures? Second, does it explore the simultaneous interaction between ESG positioning and hedging levels? We use cross-country/region ESG and financial datasets to compare firms with different regulations, investor preferences, and enforcement regimes. Because ESG positioning and hedging may influence each other simultaneously, we apply several methods, including pooled OLS, fixed-effects regression, and three-stage least squares (3SLS), to assess the sensitivity of the results to model choice.

Our results show a link between ESG positioning and corporate debt levels in the Asia-Pacific region, where stronger environmental positioning is associated with higher debt levels, as shown in fixed-effects regressions. Importantly, this relationship can change once we account for endogeneity with 3SLS, indicating that the result is highly sensitive to the method used. We also find that firms adjusted their strategic risk

management after the Paris Agreement. ESG positioning matters for how firms manage strategic risk and capital structure. The strength of that effect depends on the region and the method used. Future work should refine identification strategies and explore how country endogeneity shapes corporate financial decisions.