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The role of ESG in the decision to stay or leave the market of an invading country: The case of Russia

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ABSTRACT

We study firms' decisions to stay or leave the Russian market amid the invasion of Ukraine. Lower ESG scores increase the likelihood of keeping the Russian operations unchanged. Higher scores lead to less negative stock market reactions following complete exits.

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1. Introduction

Following Russia's invasion of Ukraine on the 24th of February 2022, numerous firms decided to partly or fully exit the Russian market, while others decided to leave their operations unchanged. On the one hand, leaving Russia adversely affects the firms' cash flows to the extent of the scale of their operations and the mode of exit. On the other hand, some of the negative impact on cash flows from leaving can be recouped through a strengthened ESG policy, where a more prominent policy can lead to higher market valuations (Servaes and Tamayo, 2013). Our study explores whether ESG (environmental, social and governance) scores influence a firm's choice to stay or leave the Russian market and the resulting stock market reaction.

The initial analysis explores the impact of previous ESG policies on the decision to stay in the Russian market. Theoretically it is difficult to make ex-ante predictions on how prior ESG and human rights policies affect the decision, where both a reactive and a pro-active approach can prevail. First, Kotchen and Moon

(2012), and Krüger (2015) argue for valuation improvements by offsetting previously lax ESG policies, creating incentives to leave Russia. Second, firms with a high degree of stakeholder orientation are likely to continue to do so (Prakash et al., 2017; Werther and Chandler, 2005), postulating that firms with lower ESG scores fully remain in Russia.

The second part of the analysis covers the stock market reactions to fully exit Russia compared to a partial exit. We are motivated here by the fact that the theoretical link is ambiguous. First, Krüger (2015) argues for an offsetting effect, where firms with low ESG scores disclosing positive ESG news exhibit better stock market reactions. Second, Capelle-Blancard and Petit (2019) instead report that firms with higher ESG scores react better to negative news releases. Hence, the opposing predictions make the Russian invasion an excellent laboratory to study how previous ESG policies affect future decision making and the resulting stock market reactions.

We use data from Yale SOM covering over 500 firms' decisions to leave or remain in Russia. We first report that firms with lower ESG and human rights scores are more likely to leave their Russian operations unchanged. We further find a heterogeneous stock market reaction, firms with higher ESG and human rights scores have better stock market reactions following a complete exit.

First, our study contributes to the understanding on stock market performance and corporate decision-making during times

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Table 1

Variable definitions.

Variable	Definition
CAR	−1 to +1 days CAR around the exit announcement date
War_CAR	−1 to +1 days CAR around the start of the invasion on 24.2.2022
U.S_Intelligence_CAR	−1 to +1 days CAR around Joe Biden's announcement of the U.S. intelligence regarding a prospective Russian invasion
Human_Rights_Score	Score from the Human Rights ESG pillar
ESG_Score	Total ESG score of the firm
Complete_Withdrawal	An indicator variable equals one if the firm completely withdraws its Russian operations, and zero otherwise
Market-to-Book	Market value of assets (total assets-book value of equity+market capitalization) scaled by book value of total assets
Leverage	Total debt scaled by total assets
ROA	EBIT scaled by total assets
ln(Sales)	Natural logarithm of sales
ln(Trading_days_to_decision)	Natural logarithm of days between the announcement of war and exit announcement date.

Table 2

Descriptive statistics.

	N	Mean	Std. Dev.
CAR	278	−1.66%	5.91
War_CAR	299	−1.99%	4.61
U.S_Intelligence_CAR	299	−0.07%	1.59
Human_Rights_Score	299	69.34	27.35
ESG_Score	299	68.44	17.95
Market-to-Book	299	2.88	2.61
Leverage	299	0.30	0.18
ROA	299	0.08	0.08
ln(Sales)	299	16.46	1.54
ln(Trading_days_to_decision)	278	2.02	0.63

This table shows the sample characteristics. All variable definitions are provided in Table 1.

of war. To our knowledge, we are the first to study the stock market impact of exiting an invading country. Contrary to [Schneider and Troeger \(2006\)](#), and [Hudson and Urquhart \(2015, 2022\)](#), who focus on the aggregated stock market reaction, we instead study firm level evidence. Complementary to our study is [Deng et al. \(2022\)](#) who focus on the overall ESG impact on stock prices during the conflict, instead of the remain or leave decision. Second, we add to the vast literature on ESG actions and stock market performance [see, e.g. [Edmans \(2011\)](#); [Flammer \(2013\)](#); [Krüger \(2015\)](#); [Capelle-Blancard and Petit \(2019\)](#)], by showing that higher ESG scores lead to a greater stakeholder orientation and partly mitigate the negative cash-flow impact of leaving an invading country.

2. Data

We use data from Yale SOM (collected on 30.3.2022) on the firms' actions in Russia from the beginning of the war (24.2.2022). The data consists of 500 listed and non-listed companies from around the world. We include all firms that we can match with stock market, accounting and ESG data from Refinitiv Eikon. Our final sample consists of 299 firms.

Our first dependent variable is from Yale SOM's definition of exit mode. They categorize exits from A to F, where A indicates a complete exit, F indicates unchanged operations, and B to D indicate partial exits. We create an indicator taking the value of one if the firm leaves their Russian operations unchanged and zero otherwise. Our second dependent variable is a three-day cumulative abnormal return (CAR) centered around the disclosure of a complete or partial exit from Russia. We calculate the −1 to +1 CAR using the market model with parameter estimates between −252 to −30 days relative to the event using the MSCI world index. Studying the impact of ESG orientation on firm value is normally coupled with two main problems, measurement error and reverse causality. [Krüger \(2015\)](#) argues that by using an event

study methodology, we can better identify the valuation impact of a firm's actions compared to studies that regress ESG scores on Tobin's Q or portfolio returns.

To control for the scope of the Russian operations, we calculate CARs around the war date (War_CAR) and Joe Biden's announcement of the U.S. intelligence regarding a prospective Russian invasion on 19.2.2022 (U.S_Intelligence_CAR). If the stock market efficiently prices in the war effect, we expect firms with greater Russian exposure to have more negative War_CAR and U.S_Intelligence_CAR.

As our main independent variables, we include the firm's total ESG and the human rights score. We are also interested in the interaction between a complete withdrawal (category A according to Yale SOM's classification) and the ESG scores. We include standard controls including ln(Sales), ROA, Leverage, and Market-to-Book. We further include 2-digit industry and country fixed effects due to large cross country and industry heterogeneity in ESG/CSR ([Liang and Renneboog, 2017](#); [Papadimitri et al., 2021](#)). Variables are defined in Table 1.

Table 2 shows the descriptive statistics of our sample. The average sample firm lost 1.66% in market value following their decision to completely or partially leave Russia, while losing 1.99% around 24.2.2022 and 0.07% around Biden's U.S. intelligence presentation. The average Human rights and ESG scores are high (69.34 and 68.44).

3. Results

To test our predictions, we estimate two types of models. First, we analyze how the ESG and human rights policy of a firm affect the likelihood of fully remaining in Russia. Second, we test how the interaction between the firm's ESG policy and a complete withdrawal affect the announcement return.

Our estimations in columns (1) and (2) of Table 3 show that higher human rights and ESG scores negatively affect the decision of a firm to remain in Russia. The economic magnitude is large, as increasing the human rights (ESG) score by one standard deviation decreases the probability of remaining in Russia by 5.5% (5.4%). Interestingly, the ESG based measures are the only ones to have explanatory power on the decision to remain in Russia. In columns (3) and (4), we interact human rights and ESG scores with a complete withdrawal. Our findings show that firms with higher ESG and human rights scores have less negative stock market reactions following a complete exit from the Russian market. Furthermore, the main effect of ESG in column (4) suggests that firms with higher ESG scores only benefit if they decide to completely terminate their Russian operations. In line with our expectations, the War_CAR is positively related to the announcement CAR. This is due to that firms with less exposure

Table 3
Multivariate results.

	(1) Unchanged Operations	(2) Unchanged Operations	(3) CAR (−1,1)	(4) CAR (−1,1)
Human_Rights_Score	−0.002*** (−4.08)		−0.027 (−1.40)	
ESG_Score		−0.003** (−2.70)		−0.073** (−2.34)
Complete_Withdrawal			−1.847 (−1.13)	−3.596 (−1.45)
Complete_Withdrawal * Human_Rights_Score			0.031* (1.96)	
Complete_Withdrawal * ESG_Score				0.057* (1.86)
War_CAR	0.001 (0.28)	0.002 (0.38)	0.162** (2.44)	0.176*** (2.99)
U.S_Intelligence_CAR	−1.625 (−1.56)	−1.595 (−1.27)	−0.058 (−0.16)	−0.056 (−0.16)
Market-to-Book	−0.002 (−0.57)	−0.000 (−0.09)	−0.572** (−2.54)	−0.561** (−2.37)
Leverage	−0.107 (−1.42)	−0.090 (−1.09)	0.123 (0.04)	0.142 (0.04)
ROA	−0.091 (−0.51)	−0.113 (−0.55)	12.488** (2.66)	11.868** (2.26)
ln(Sales)	−0.009 (−0.54)	−0.004 (−0.26)	0.459* (2.09)	0.731** (2.55)
ln(Trading_days_to_decision)			2.030** (2.19)	2.222** (2.74)
Constant	0.413 (1.71)	0.354 (1.34)	−10.577** (−2.86)	−12.176*** (−3.24)
Industry & Country FE	Y	Y	Y	Y
Observations	299	299	276	276
R ²	0.343	0.323	0.267	0.276

This table shows regressions on the decision to leave a firm's Russian operations unchanged in columns (1) and (2) and on the −1/+1 CAR around the announcement to alter the Russian operations. All models use 2-digit industry and country fixed effects with heteroscedasticity robust standard errors clustered on industry and country. All variable definitions are provided in Table 1.

***Denote statistical significance at 1% level.

**Denote statistical significance at 5% level.

*Denote statistical significance at 10% level.

to the Russian market have a less negative CARs after conveying negative cash flow news by disclosing their exit decisions. Among the other control variables ln(Sales), ROA and days between the beginning of the war and announcement positively affect the CAR, while Market-to-Book is negatively related.

4. Conclusions

Using a data subset from Yale SOM covering 299 firms, we study the decision to remain in or leave the Russian market amid the invasion of Ukraine. Our findings reveal that firms with lower ESG and human rights scores are more likely to leave their operations unchanged amid the Russian invasion. Consistent with Capelle-Blancard and Petit (2019), we report that firms with high human rights and ESG scores have a less negative stock market reaction following negative cash flow news.

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