ESG: A Panacea for Market Power?

Philip Bond and Doron Levit
University of Washington

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What happens if firms pledge to treat stakeholders better than market conditions dictate?

Good pay, generous benefits, nice working conditions for workers

Fair prices, high quality, enhanced safety, privacy, environmental sustainability for consumers

Above-market prices for inputs

Market conditions

Labor, product and input markets may all fall short of competitive ideal

Firms exercise market power

Firm choose <u>higher prices</u>/<u>lower wages</u> than competitive ideal

Output <u>lower</u> than competitive ideal

ESG Pledges

Workers expensive to hire/customers unprofitable to serve
→ produce even less
"anti-competitive"

Vs

Benefit of reducing output = higher prices/lower wages
→ After ESG pledge, incentive is gone
→ produce more
"pro-competitive"

Moderate ESG policies are pro-competitive

ESG firm effectively commits to compete harder

Own output and market share ↑, <u>total output</u> ↑

Own profits ↑

Competitor output, market share, profits ↓

Competitor prices ↓/ wages ↑

In equilibrium, prices and wages same at ESG and competitors

Aggressive ESG policies are anti-competitive

ESG firm effectively constrains itself to be a weak competitor

Own output and market share ↓, <u>total output</u> ↓

Own profits ↓

Competitor output, market share, profits ↑

Competitor prices ↑/ wages ↓

ESG firm’s stakeholder benefit, but those at competitors are hurt

Profit-maximizing firm chooses moderate ESG policies

Profit-maximizing policy <u>less aggressive</u> as market competition ↓

(product demand/labor supply more elastic and/or more competitors)

Competition in ESG policies

So far:

A moderate ESG policy gives firm advantage over non-ESG competitors

Firms compete in ESG policies

Can always raise profits by outdoing competitors’ ESG policies

But if competitors’ ESG policies very aggressive…

… even better response is to abandon ESG

Not in paper: Will generate ESG cycles

ESG policies of a purposeful firm

So far: ESG choice by a profit-maximizing firm

But what if firm directly cares about profits + stakeholders?

Firm wants to be big---it focuses on the surplus it is creating

To accomplish this:

Chooses most aggressive ESG policy that is still pro-competitive

ESG firm captures too much market share at competitors’ and society’s expense

Competing purposeful firms

In common with competing profit-maximizing firms…

…want to outdo competitors’ ESG policies

But no incentive to abandon ESG until reach competitive ideal
→ wages rise/prices fall to competitive ideal

Purposeful ESG firm would like to be bigger still

But doesn’t adopt more aggressive ESG because would backfire

What happens if firms pledge to treat stakeholders better than market conditions dictate? (ESG)

Moderate pledges → pro-competitive

Aggressive pledges → anti-competitive
(though help some stakeholders)

Expect to see firms adopt moderate pledges