

THE EFFECT OF CLIMATE RISK ON FIRM CASH HOLDINGS: EVIDENCE FROM THE EURO AREA

AUTHORS

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EXECUTIVE SUMMARY

Using a large panel of mainly unlisted firms from 12 euro area countries, we investigate the impact of climate change exposure on firms' cash holdings. We construct a comprehensive measure of climate risk in the form of drought risk and show that it significantly affects the decisions of firms to hold more cash as a buffer against adverse climate conditions. Our paper provides novel evidence which reveals that drought risk exerts a greater impact on the cash holdings of unlisted firms compared to their listed counterparts. We further introduce different levels of drought severity and demonstrate that unlisted firms hold higher levels of cash reserves as we move towards a scenario of rising climate risk. Our inferences remain unaffected when we employ a battery of tests that address endogeneity concerns. Moreover, our results hold when we consider alternative measures of climate risk and cash as well as different model specifications. Overall, we provide fresh empirical findings which support the precautionary motive hypothesis and have important implications for market participants and policy makers. Our study is also of relevance to the current strategy of the European Union which aims to prevent and mitigate conditions of water shortage under various drought scenarios.



KEYWORDS

- Cash holdings
- Climate risk
- Drought
- Climate change
- Unlisted firms

RESEARCH RELEVANCE

- Risk Preparedness for Firms: We show that unlisted firms, especially small and medium-sized Enterprises (SMEs), increase cash reserves in response to climate risk, highlighting the need for businesses to improve financial resilience under environmental pressures.
- Policy Development Support: Results support EU strategies on drought mitigation, emphasizing the importance of integrating climate risk into financial policy and regulatory planning.
- Investor and Lender Insights: Investors and banks can better assess financial vulnerability and liquidity strategies by considering firms' exposure to climate risk.
- SMEs Financial Support: Findings underline the need for targeted financial tools and climate adaptation support, especially for unlisted and smaller firms.

BIBLIOGRAPHIC INFORMATION

Fernandes, F. D. S., & Papadimitriou, F. I. (2025). The effect of climate risk on firm cash holdings: evidence from the euro area. *The European Journal of Finance*, 31(9), 1168–1196.
<https://doi.org/10.1080/1351847X.2025.2462262>

“Unlisted and smaller firms, being more susceptible to external shocks, maintain larger cash reserves as a safeguard against climate-related risks such as droughts, which carry substantial economic and financial consequences.”

