



Analysis

How do investors respond to Green Company Awards in China?

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ABSTRACT

We find that firms winning Green Company Awards in China from 2008 to 2011 experienced on average insignificant and in some cases significantly negative effects on shareholder value. Various robustness checks suggest that these findings are not driven by the inefficiency of the Chinese stock market or a lack of perceived credibility of the award. In addition, we find important variation in the responses across firms: shareholders of firms in low-pollution industries and firms with primarily private ownership responded more negatively to award announcements. Furthermore, the peers of winning firms showed higher announcement returns than the award winners. Our results suggest that a key benefit of corporate environmentalism in China comes through building stronger relationships with government, and that otherwise the market generally discourages firms from environmental leadership.

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1. Introduction

Many firms in developed countries have decided that integrating sustainability into their business strategy is profitable (Esty and Winston, 2006; Nidumolu et al., 2009). The business benefits of proactive sustainability strategy are less clear in emerging and transition economies, where environmental and social regulations may be lacking or poorly enforced, and demand for greener products may be virtually non-existent (Blackman, 2010; Earnhart et al., 2013).

China is of particular interest since it combines elements of a market-based economy (e.g., in coastal export zones), a developing economy (e.g., in rural regions), and a transition economy (e.g., with the privatization of state-owned enterprises). News reports suggest China gives firms weak incentives to be environmentally and socially friendly. Tainted milk and pet food, toxic toys, suicides among mistreated workers, and an unsafe high-speed rail system have all been widely reported in the media, and give the impression of a country whose single-minded focus on economic growth has come at the expense of social and environmental protection. Nevertheless, China has begun taking measures to increase environmental fees, to increase reliance on renewable energy, and to tolerate environmental protests and non-governmental organizations (Mol and Carter, 2006). Chinese leaders Hu Jintao and Wen Jiabao have

frequently spoken of the need to create a “harmonious society,” emphasizing not just economic growth but also the other dimensions of social welfare. Do these changes mean that profits and welfare have been better aligned, so that it now pays to be green in China?

Even in developed countries, it is difficult to establish empirically whether firms profit from being more socially and environmentally responsible. Indeed, scholars have debated whether better corporate social and environmental performance leads to better corporate financial performance for years with remarkably limited success. After reviewing literally hundreds of academic studies, Margolis and Walsh (2001) conclude that it remains unclear whether being green really pays, or whether financially-successful firms simply have greater latitude to indulge their managers' whims at the expense of shareholders.

One way of cutting through the tangle of causality is to focus on a discrete event that occurs within a narrowly defined window of time, and that is expected to affect shareholder value. Work of this sort starts from the premise that financial markets have powerful incentives to rapidly incorporate all available information that may affect the future returns of listed companies. When news reaches the market, share prices will quickly reflect its effect on expected future returns (MacKinlay, 1997). Such financial “event studies” can identify the impact on profitability of good or bad environmental news.

In this paper, we use the event study methodology to examine how financial markets responded when Chinese firms received awards for their environmental and social performance. Data on industrial and, more importantly, on environmental performance are notoriously

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unreliable in China. However, stock prices are public by necessity and investors have strong incentives to make use of all available formal and informal information to assess whether being green pays in China. Thus, the event study approach can offer insights into the extent to which China's institutional system rewards environmental protection.

The emerging literature on environmental event studies has begun to establish some empirical regularities. First, environmental problems that are likely to generate regulatory penalties or legal liability are punished by capital markets, in both developed and developing countries (Capelle-Blancard and Laguna, 2010; Dasgupta et al., 2001; Karpoff et al., 2005; Klassen and McLaughlin, 1996; Lanoie and Laplante, 1994; Lanoie et al., 1998; Muoghalu et al., 1990). Second, emissions of toxic chemicals, even unregulated ones, by U.S. firms are viewed negatively by investors (Bettenhausen et al., 2010; Hamilton, 1995; Khanna et al., 1998; Konar and Cohen, 2001). Third, negative ratings by third parties reduce stock prices significantly both in the U.S. and in India (Beatty and Shimshack, 2010; Gupta and Golder, 2005; Lyon and Shimshack, 2012). Thus, there appears to be an emerging consensus that stock markets punish bad environmental news.

Whether good environmental news is rewarded by financial markets is much more controversial. Some research finds that corporate participation in environmental management systems (Cañón-de-Francia and Garcés-Ayerbe, 2009; Wang and Yuan, 2004) or voluntary programs like the Carbon Disclosure Project (Kim and Lyon, 2011) or Climate Leaders (Fisher-Vanden and Thorburn, 2011) is not valued by the market, and may even meet a negative response. A neutral response may occur because external parties cannot distinguish "greenwash" (Lyon and Maxwell 2011) from substantive action; a negative response may occur because firms are pressured into taking action, so that what appears "voluntary" is really coerced, and hence should not be expected to be profitable (Fisher-Vanden and Thorburn, 2011; Reid and Toffel, 2009).

Awards granted by credible third parties would appear to be immune from the criticisms that they are simply greenwash on the part of self-promoting firms, or the result of pressure from other stakeholders. However, the limited empirical evidence to date finds mixed results. Some studies find that environmental awards are greeted positively by the capital markets, both in the U.S. (Klassen and McLaughlin, 1996) and in developing countries (Dasgupta et al., 2001). More recent work on U.S. firms (Jacobs et al., 2010) finds insignificant average market reactions to both self-reported corporate environmental efforts and recognition granted by third parties for environmental performance; however, the market reacted negatively to announcements of voluntary emissions reductions and awards from non-governmental sources.

We present what is to our knowledge the first test of how markets respond to environmental awards in China. We find that these awards are not viewed positively by the market. Indeed, privately-owned firms and firms in low-pollution industries suffered significant negative impacts from winning environmental awards. We conduct a number of robustness checks that suggest these results are not due either to inefficiency of the Chinese stock market or to any perceived lack of credibility of the awards. Furthermore, the peers of the winning firms showed positive announcement returns, suggesting that the market viewed award winners as having unduly high costs. Our findings are surprisingly similar to those of Jacobs et al. (2010) given that the U.S. has a much older and presumably more developed and transparent system of environmental governance than does China. Our results suggest that in China, the main incentives for firms to improve their environmental performance are transmitted through state ownership, and that otherwise the market actually discourages firms from greening themselves.

The remainder of the paper is organized as follows. Section 2 provides background information on the Annual China Green Companies Awards. Section 3 presents the data and sample construction. Section 4

describes the empirical strategy. Section 5 reports and discusses the main findings. Section 6 explores heterogeneity in winning firms' treatment by investors. Section 7 estimates the effects of award announcements on peer firms that did not win awards. Section 8 concludes and provides some policy implications.

2. The Annual China Green Companies Awards

The annual China Green Companies Awards were initiated by the China Entrepreneur Club in 2008,¹ and are presented each year at the annual summit of China Green Companies. The annual summit has received much attention from the public. More than one thousand business leaders, political dignitaries, academic authorities, NGO representatives and mainstream journalists, from China and abroad, have attended the summits.² Supporters include the United Nations Global Compact, United Nations Environment Program (UNEP), China Enterprise Confederation and China Enterprise Directors Association. The awards are intended to promote the development of sustainable business practices in China and cross-country cooperation and communication on issues of sustainable business development.

The process of selecting winning companies is methodical and the criteria used are transparent to the public. Two groups of researchers independently rate different aspects of corporate sustainability across the candidate firms. The rating system evaluates five principal aspects of corporate behavior: prospective corporate culture; business advantage; eco-friendly operation; socially responsible practice; and driving force from innovation. After preliminary screening, more detailed investigations of candidate firms are conducted. Meanwhile, socially controversial issues associated with candidate firms are also investigated by the selection team. The selection criteria and process are overseen by a group of well-known non-governmental organizations (NGOs) and dozens of influential academic experts in the fields of economics and corporate social responsibility from all over the world.³ After the final selection, the results of the award are announced during the Annual Summit of China Green Companies, with substantial media coverage.

This award has been regularly issued for four years since 2008. In 2008 and 2009, there were 20 companies receiving the award each year, while in 2010 and 2011 the number of winners was increased to 100. Since we focus on the effect of winning the Green Companies Award on winners' stock values, only firms with shares publicly listed on the Chinese Stock Exchange are included in our sample.

3. Data and Sample Construction

We collected primary data on the identity of the award-winning firms directly from the China Entrepreneur Club website, and supplemented it with data from a variety of other sources. Data on firms' industries were collected from the CSMAR Database; data on firms' ownership structures came from the Resset Database, and data about firms' globalization levels were collected from the annual reports of each individual firm. We collected firms' stock prices and other characteristics from the CSMAR Database and Yahoo Finance.

In total, there were 77 awards granted to firms listed on the Chinese Stock Exchange. As some companies received the award more than

¹ The China Entrepreneur Club was launched in 2006 by 31 of China's most influential economists, such as Weiyang Zhang, the former Dean of Guanhua School of Management in Peking University, and Qiren Zhou, Dean of the National School of Development in Peking University, and businesspeople, such as Chuanzhi Liu, Chairman of Lenovo Group, and Yun Ma, founder of Alibaba Group. The complete list of the founders and other information of the Club and the Green Company Awards can be found at <http://www.daonong.com/English/index.htm>.

² See the following website for more information about the summit: <http://www.daonong.com/green2011/news/2011aboutE.html>.

³ The name list of the involved experts can be found in <http://www.daonong.com/green100/>.

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