Green firms rewarded by financial markets

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When a company improves its environmental performance, it is common to think that the accompanying economic improvements are based on the company's more efficient use of resources. However,

A new study in *Strategic Management Journal* reveals that financial markets reward green firms because those firms are seen as less risky.

Using data on 267 U.S. firms, Mark Sharfman and Chitru S. Fernando of the University of Oklahoma analyzed whether firms that had improved their environmental risk management also experienced a reduction in their total cost of capital, and found evidence supporting their hypothesis.

Financial markets seem to perceive greener firms as safer investments because of a reduced likelihood of litigation, government penalties, and/or catastrophic accidents. The financial markets reward this lower level of risk by charging the firm less for its capital, thus allowing the firm to carry more debt.

In addition, firms benefit when individual investors seek out green firms, and the study shows that greener firms had higher levels of ownership by individual investors. The broader the ownership of a firm's stock, the lower its cost of equity capital.

Greener performance thus has the potential shorter-term and longer-term financial benefits. As the authors note, "firms that make major investments in environmental performance may be providing the markets with an earlier signal about their longer term financial and stock performance."

Source: Wiley