

The Interplay of “E” and “G” in ESG

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Summary

Previous studies debate on whether corporate environmental engagement is a cost to shareholders. It is unclear whether corporate governance mechanism provides a resolution to the potential conflicts of interest between stakeholders and shareholders. I investigate this issue in the context of China, where control rights overwhelming cash flow rights is common and corporate environmental investment data is available. I find that **a firm’s environmental investment increases with its control-ownership wedge**. This impact is more pronounced if a firm suffers from greater environmental pressures. Further analyses demonstrate that dividend cuts increase while the likelihood of initiating dividends and receiving environmental penalties decreases with the magnitude of the control-ownership wedge following environmental investments.

Motivation

Dichotomous incentives for ESG engagement:

- The value-motivation view
- The agency motivation view

The two views are largely **unresolved**:

- An earlier debate on governance and corporate CSR activities (Ferrell et al., 2016; Krueger, 2015)
- A recent discussion on ESG engagement leans towards the value-enhancing view (Welch & Yoon, 2023; Freund et al., 2023).

Research Question

How does corporate governance impact corporate environmental investment decisions?

Measures:

- Environmental engagement - monetary value invested in environmental-related matters.
- Corporate governance - control-ownership wedge.

Main findings:

- A firm’s environmental investments ↑ with its control-ownership wedge.
- This impact is more pronounced for firms that face greater external monitoring pressure.
- Following the environmental investments, dividend cuts ↑ and the likelihood of receiving environmental penalties ↓ for firms with greater control-ownership wedge.

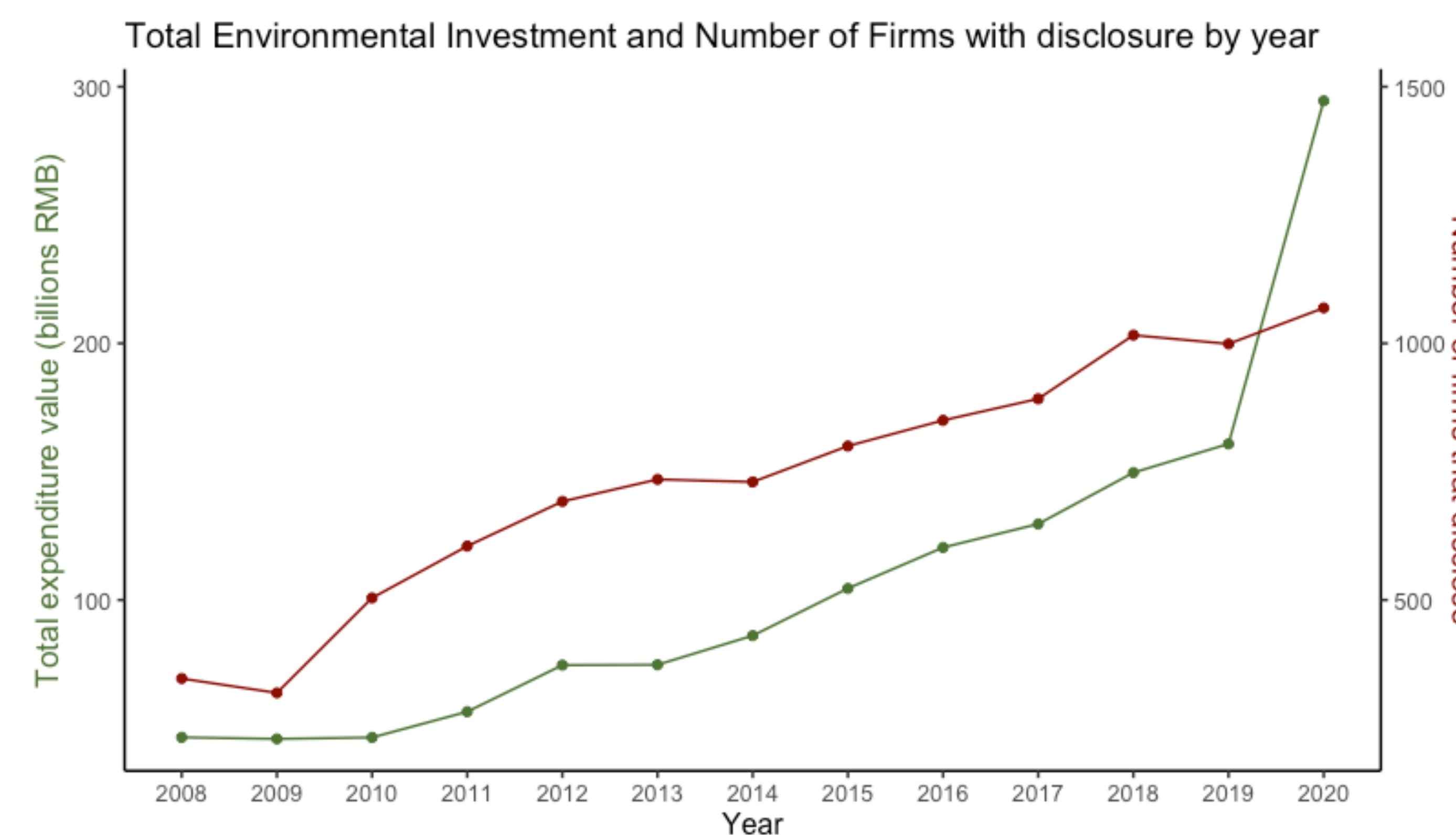
Contributions:

- Responds to the call for more research relating “G” to “ES” (Edmans, 2023).
- Extends the debate on the relationship between governance and CSRs to environmental matters with measures that reduce measurement biases.

Data and Empirical Design

Empirical analyses focuses on Chinese listed firms.

- Environmental investments are voluntarily disclosed in two sections of financial statements.
- Hand-collected.



Baseline Specification

$$EnvInv_{i,t} = \beta_0 + \beta_1 Diverge_{i,t} + \beta_2 Voting\ Rights_{i,t} + Controls + \eta_{i,t} + \gamma_t + \epsilon_{i,t}$$

- Two dependent variables: a binary variable indicating positive environmental investments and the logged total investment value.

IV Estimation

- IV: initial industry-province average control-ownership wedge and voting rights following Lin et al. (2012).

Results

IV second stage

| VARIABLES | (1) Logit EnvInv_Dummy | (2) Tobit EnvInv_In |
|---------------|---------------------------|------------------------|
| Diverge | 1.22*** (2.94) | 16.10*** (2.89) |
| Voting_Rights | 0.25 (1.21) | 3.49 (1.08) |
| Controls | YES | YES |
| Year FE | YES | YES |
| Industry FE | YES | YES |
| N | 22876 | 22919 |

Dividend policies following environmental investments

- Percentage dividend cut and the likelihood of initiating dividends.

| VARIABLES | Firms with Dividends | | Firms without Dividends | |
|----------------------|----------------------|---------------------|-------------------------|-----------------------|
| | (1) Regression | (2) Regression | (3) Logit | (4) Logit |
| EnvInv_Dummy*Diverge | 0.540* (2.01) | | -2.734** (-1.979) | |
| EnvInv_Dummy | -0.060** (-2.495) | | 0.0411*** (-2.99) | |
| EnvInv_In*Diverge | | 0.031* (1.92) | | -0.202*** (-2.595) |
| EnvInv_In | | -0.003* (-1.894) | | 0.029*** (3.188) |
| Diverge | -0.241 (-0.922) | -0.216 (-0.797) | 0.409 (0.374) | 0.568 (0.474) |
| Voting_Rights | -0.13 (-0.626) | -0.128 (-0.619) | 2.789*** (6.996) | 2.764*** (6.995) |
| Year FE | YES | YES | YES | YES |
| Firm FE | YES | YES | YES | YES |
| R2/Pseudo-R2 | 0.194 | 0.194 | 0.2 | 0.246 |
| N | 16398 | 16398 | 3967 | 3967 |

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