WHY DO FIRMS ISSUE GREEN BONDS?

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Abstract:

Green finance links investment to firms' environmental performance. In the past few years, for example, green bonds drove rapidly increasing amounts to firms' climate-friendly projects, and the existing empirical literature suggests that it works: When firms issue green bonds, their stock price rises, and their CO2 emissions decrease subsequently. To explain these facts, much research has looked for a green bonds' yield spread, but investors' concern for the environment does not appear to currently play a significant role. By contrast, we suggest that (1) firms' managers use green bonds to signal the economic efficiency of their green projects to investors, and that (2) they do so because they are concerned about their firm's stock price, unlike the traditional view of corporate social responsibility. Our model predicts a relationship between firms' proportion of green bonds, managerial incentives, and carbon pricing. We test this prediction by exploiting both cross-industry differences in the stock price sensitivity of managers' pay and in share turnover, and cross-country variations in effective carbon prices. Our results not only support the role that our theory ascribes to managerial incentives, but also show that this role positively depends on carbon pricing, whose effect is, therefore, amplified by green bonds.

Slides available at:

https://www.researchgate.net/publication/352064586_Why_Do_Firms_Issue_Green_Bonds