In 2019, the United Nations declared that there is only 11 years left to act before there is irreversible damage from climate change. Even though ESG scores have been around for decades, they have only recently become a popular investing subject. However, there is a downfall from there being no clear scoring equation like there is in the rest of finance, GAAP Accounting for example. Companies like MSCI, Refinitiv, and Bloomberg have emerged as leaders in this space to provide data and weighted scores for each of the Environmental, Social, and Governance spaces, and combining them all into one ESG score for a company. Green bonds on the other hand started in around 2007. This market has grown substantially within the past decade.

Roughly $157 billion worth of bonds labeled as “green” were issued in 2019. Since sustainable investing is a relatively new subject, there is a lack of literature and previous studies done on the topic. However, there have been some studies that have investigated ESG and green bonds’ impact on performance and pricing. For example, Buallay (2017) looks into ESG scores and their impact on performance with a focus on the European banking sector. Buallay defines performance by using the Return on Assets (ROA), Return on Equity (ROE), and Tobin’s Q (TQ). In her study, she finds that ESG is in fact related to positive performance of the banks. Other studies on the green bond market have also looked into the pricing and ownership of green bonds relative to conventional ones. Baker et al. (2018) finds that green bond ownership is very concentrated and investors are paying a premium. This means that investors are giving up returns for better social performances.

Background

After running many regressions, it is determined that there is no significant effect that ESG rating has on financial performance. Most regressions that were run show a lack of relationship, however, there is one that depicts a significantly positive relationship between the Tobin’s Q and Governance Disclosure Score. Other than this, there is evidence of a lack of relationship. This shows that companies can invest in higher rated ESG companies without the risk of lowered returns. As for the effect on Green Bonds, there are not enough active Green Bonds within the United States to make an accurate conclusion. However, there is evidence of a possible negative relationship. My reasoning of this is that lower rated ESG companies are making strides to lowering their impact on the environment.

Similar Studies

Methodology

Perf = β0 + β1ED + β2CSRD + β3CGD + β4ESG + β5MKTCAP + β6D/E + β7CAPEX + Error

RGB = β0 + β1ED + β2CSRD + β3CGD + β4ESG + β5MKTCAP + β6FCF + β7D/F + Error

Performance and pricing. For example, Buchli (2017) looks into ESG scores and their impact on performance with a focus on the European banking sector. Buchli defines performance by using the Return on Assets (ROA), Return on Equity (ROE), and Tobin’s Q (TQ). In her study, she finds that ESG is in fact related to positive performance of the banks. Other studies on the green bond market have also looked into the pricing and ownership of green bonds relative to conventional ones. Baker et al. (2018) finds that green bond ownership is very concentrated and investors are paying a premium. This means that investors are giving up returns for better social performances.

Conclusion

The Effect of ESG Rating on Financial Performance and Green Bond Issuance within the United States

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Figure 9. Global Green Bond Cumulative Issuance & Outstanding (USD billions). Source: Blackrock, Bloomberg, Environmental Finance, Climate Bonds Initiative (CBI), Fanara Male, as of April 1, 2020.