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   RESULTS & DISCUSSION

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AN ANALYSIS OF EFFECTS OF ENVIRONMENTAL PERFORMANCE OF CONSUMER GOODS INDUSTRY AND THE FINANCIAL PERCEPTION OF THE INVESTORS: A COMPARISON OF INDIAN AND US FIRMS

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ABSTRACT

A lot of studies suggest that the environmental performance of firms affect their financial performance. Financial performance could be the operational or market performance of the firm. However, in this paper we have looked through a different perspective where we have analyzed whether how do the investors of a company perceive environmental performance of the company and affect the future prices of the stocks and the earnings. We find that the environmental performance of companies does in fact affect how investors perceive a company's reputation and certainty of its future, and hence affecting the future stability of company's stock prices. By comparing the results of US and India we find that in US investors' perception about the company's future and reputation is affected more due to its environmental performance, as compared to the perception of Indian investors.

KEYWORDS
Environmental performance, financial perception.

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INTRODUCTION

Since the rise industrialization, the question has been raised from time to time whether the industrialization is deteriorating the environment. Top researches have in fact linked industrialization directly to the global warming (nationalgeographic.com). Certain managers of companies believe it their social responsibility to give back to the environment and prevent their companies to affect environment in a negative manner, however some other need a more concrete motivation linking directly to their firm's performance. To get an answer to whether a company's actions which are detrimental to the environment affect its performance in any manner, several researchers have tried to reach an answer, but a consensus could never be reached (Stanwick PA, Stanwick SD. 1998, Wagner M, Schaltegger S. 2004, Wagner M. 2005, McWilliams A, Siegel D. 2001, Fogler HR, Nutt F. 1975, Jensen MC. 2001). Needless to say, a research analyzing such relation for India cannot be found in the published literature. With the help of this paper, we would not only try to analyze whether the environmental performance of consumer goods industry has any relation with the market performance of the company, but we would also compare this relation for Indian and US firms.

LITERATURE REVIEW

A lot of researchers over the decades have tried to answer whether a socially responsible company has a positive effect on its financial performance. The result have been mixed, while some showing a positive relation, some showing neutral relation while few showing even a negative relation. The reasons for this discrepancy are many. First of all, being socially responsible could mean a lot of things. Few researchers considered it to be environmentally responsible (Russo MV, Fouts PA. 1997, Christmann P. 2000, Natalia Semenova and Lars G. Hassel 2008), while few considered it as a much broader concept consisting of economic, social, environmental and governance dimensions (Dong-shang Chang and Li-chin Regina Kuo, 2008, Pratima Bansal (2005), Bert Scholtens and Yangqin Zhou 2008). Also, the financial performance can either be considered as an operational measure, market performance or financial risk measure. Also, different industries are likely to perform differently on environmental aspects due to social and governmental pressures. Due to these variations of measures, different researches have concluded different result. We could not find any research in the published literature which tried to determine the relation between the environmental impacts of a company and their effect on the company's financial position for India. We have considered choosing the Consumer Goods industry for this study because consumer goods industry is considered as a high risk industry (FTSE4Good) which has a very high environmental impact due to its high level of production activities. Such an environmental impact cannot go unnoticed by the investors of the company, and we believe that it's going to affect the way they perceive the reputation and certainty of the company's future, and are likely to panelize it for that in the future. In this section we will discuss few studies which tried to establish a relation between a company's environmental performance and its financial performance.

STUDIES WHICH SHOWS A POSITIVE RELATION BETWEEN A COMPANY'S ENVIRONMENTAL PERFORMANCE AND ITS FINANCIAL PERFORMANCE

Porter and van der Linde (1995) proposed that properly designed environmental standards and practices could induce innovativeness which could lower the overall cost of the product, give a competitive advantage to the firm and improve its value. Stanwick PA, Stanwick SD. 1998 analyzed 24 chemical companies and found that their environmental disclosures and social responsiveness had a positive impact on the firms' financial performance. Russo MV, Fouts PA. 1997 found that "it pays to be green" after analyzing 243 firms where high returns with respect to their environmental performance were seen among high-growth industries. Wagner M, Schaltegger S. 2004 conducted research on the manufacturing sector of Europe and found that for firms with shareholder value-oriented strategies the relationship between environmental performance and different dimensions of economic performance was more positive than for firms without such a strategy. Wagner M. 2005 analyzed the European paper industry and found a U-Shaped relationship between firms' environmental and economic performance. Christmann P. 2000 analyzed 88 chemical firms and established that environmental management is a significant factor to determine a firm's economic success. It was further established that firms can take certain actions which could simultaneously protect the environment and reduce costs. Waddock SA, Graves SB. 1997 proposed that slack resource availability and CSR are positively related. Brammer S, Millington A. 2005 proved that corporate philanthropy has a positive impression on shareholders of a firm. Frooman J. 1997 using a meta-analysis proved that socially irresponsible and illicit behaviors have a negative impact on the company's share's performance. According to Argandoña A. 1998 social performance is an asset to the firm which would give it strategic advantage in terms of lower cost. Orlitzky M, Schmidt FL, Rynes SL. 2003 did meta-analysis of 52 studies and found a strong positive link between CSR and CFP. Orlitzky 2001, using a meta analysis concluded that higher firm's CSP results in the lower financial risk. McGuire et al. (1988) found that a firm's prior performance, assessed by both stock-market returns and accounting-based measures, is more closely related to corporate social responsibility than is subsequent performance. Moskowitz M. 1972 found that firms could benefit from socially responsible actions by increasing employee's productivity and hence lowering the cost. Cornell and Shapiro (1987) suggested that if stakeholders' implicit contracts are not served properly, parties to these contracts concerning social responsibility of the firm may attempt to transform them into (more costly) explicit contracts. Dowell et al. (2000) found that firms adopting stringent environmental measures have much higher market values than firms with poor standards. Konar and Cohen (2001) found that companies with lower environmental risks had higher market values. King and Lenox (2002) found a positive relation between waste prevention and company value. Guenster et al. (2006) found that eco-efficiency have a positive impact on the operating performance and market value of the firm. Preston and O'Bannon (1997) revealed a positive relation between a firm's social and financial performance.

STUDIES WHICH SHOWS A NEUTRAL RELATION BETWEEN A COMPANY'S ENVIRONMENTAL PERFORMANCE AND ITS FINANCIAL PERFORMANCE

McWilliams A, Siegel D. 2001 found a neutral relationship between CSR and financial performance and argued that firms invest in socially responsible activities only to satisfy the demands of the stakeholders. Fogler HR, Nutt F. 1975 found no significant linkage of the measures of environmental and profitability. Alexander, G. J., and R. A. Buchholz. 1978 indicated insignificant relationship between a firm's performance and the degree of social responsibility. Aupperle, K. E..A B. Carroll and 1. Hatfield. 1985 too did not find any correlation between a firm's social performance and profitability.

STUDIES WHICH SHOWS A NEGATIVE RELATION BETWEEN A COMPANY'S ENVIRONMENTAL PERFORMANCE AND ITS FINANCIAL PERFORMANCE

Jensen MC. 2001 proposed that social constraints on firms and socially responsible behavior may conflict with value maximization. According to Ullmann A. 1985 Firms face a trade-off between various aspects of social responsibility and financial performance. According to Williamson OE. 1964 there will be a negative link between social and financial performance when managers pursue their own objectives, which may conflict with shareholder and stakeholder objectives. Palmer K, Oates WE, Portney PR. 1995 argue that the pollution abatement expense required for complying with environmental regulations is a cost and it can never be recovered. Walley N, Whitehead B. 1994 suggested that companies that respond actively to environmental challenges incur extra costs and thus reduce their profits and shareholder value.

IMPORTANT OF THE STUDY

This study is unique because it is the first study done for Indian companies to compare their environmental performance and its impact on the investors' financial perception as reflected by the P/E Ratio. Also, this is the first study to compare such relation between Indian and US. If we are able to establish the relation between company's environmental performance and its investors' financial perception, then the managers can use the evidence to indirectly affect their investors' perception by being environmentally responsible, hence securing a high market earnings in the future.

OBJECTIVES

The objective of this study is to add to the already existing literature on the relationship between firms' environmental and financial performance. Though, our study would add uniqueness to the literature because we have considered investors' financial perception which reflects the financial performance of a company in the future, rather than considering the firms' present or past financial performance.

HYPOTHESES DEVELOPMENT

Based on the literature above, it is clear that even though there is no clear answer to whether a firm's environmental performance would have a positive effect on a firm's financial performance and investor's perception, majority of the studies do make us think that there should be a positive relation between the two for the Consumer Goods industry. Hence, on the basis of the above literature we propose the following hypothesis:

H1: There exists a positive relation between a firm's environmental performance and investors' perception about the reputation and future certainty of the firm as reflected by the firm's P/E ratio.

Also, it is clear from the literature that the environmental performance and the investors' perception may vary from one region to another hence affecting the relationship between firm's environmental performance and its P/E ratio in different regions differently. Hence, we propose the following hypothesis:

H2: The relation between a firm's environmental performance and investors' perception about the reputation and certainty of the firm as reflected by the firm's P/E ratio would vary between US and India.

DATA COLLECTION

Our data was collected for 80 firms from Consumer Goods industry from US and India (41 US firms and 39 Indian firms).

To measure the environmental performance, we used the ratings supplied by the csrhub.com which uses over 291 sources to compile this rating. Sources include Thomson Reuters, Newsweek green rankings, GMI Ratings, MSCI, Vireo, REP Risk ratings, CLIMATECOUNTS.org, CDP ratings, among others. Environmental ratings are a cumulative of ratings on energy and climate change, policy and reporting, and resource management, making it a very comprehensive environmental rating.

The financial perception of the investors is the the perception of investors about the environmental responsiveness of the company which could affect the earnings of the shares of the company in the future. We measure this financial perception using Price-Earning (P/E) ratio. A P/E Ratio is a valuation ratio of a company's current share price compared to its per-share earnings which is calculated as:

$$\frac{\text{Market Value per Share}}{\text{Earnings per Share (EPS)}}$$

A low price-earnings ratio generally means that most investors perceive the company to be facing an uncertain future. In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E (www.investopedia.com).

The information regarding the P/E ratio of the Indian companies was collected from www.indiainfoline.com which keeps a constant and accurate record of financial status of registered Indian companies, and that for the US companies was collected from http://www.nasdaq.com which keeps the financial information of the companies registered with NASDAQ.

METHODOLOGY

We used SPSS V20 for our analysis. Regression and ANOVA models were applied to find out the relationship between both variables (environmental ratings and P/E ratio) of the companies in order to test our hypotheses. Firstly, we ran the regression analysis and ANOVA on the cumulative data of companies from both countries to test our first hypothesis, if whether a positive relation exists between the environmental ratings and P/R ratio of the companies. We log transformed the dependent variable (P/E ratio) because the distribution of log-transformed P/E ratio was found to be closer to normal and the linear regression model works better with normal variables, but few of the P/E ratios were 0, hence we had to add 1 to each score of the P/E ratios to make every value positive as a log-transformation would not run on a 0 value. Then we removed the outliers. To do this we calculated the z values of the transformed variable environment rating first. To qualify as an outlier, we used the criteria where any absolute Z value greater than 3.29 would be considered as an outlier. There was only one outlier in the environment rating variable with a z value of -3.51. To remove the outliers from the analysis we set the range of 0-3.7 as missing values. We repeated the same procedure for the P/E Ratio variable but found no outliers.

RESULTS

The summary of the regression analysis and ANOVA of the cumulative data is as follows:

TABLE 1: MODEL SUMMARY

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.358[a]	.128	.210	156.79315

a. Predictors: Environmental Ratings

TABLE 2: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	140.639	1	140.639	150.978	.006[b]
	Residual	149.358	78	.930		
	Total	289.997	79			

a. Dependent Variable: Log of P/E
b. Predictors: Environmental Ratings

TABLE 3: COEFFICIENTS[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.859	3.109		4.094	0.215
	Environment Ratings	0.663	0.039	0.287	0.248	0.005

a. Dependent Variable: Log of P/E ratio.
The value of R^2 indicates that 12.8 % of the variation in the dependent variable (P/E ratio) is explained by the independent variable (environment ratings). Value of R=0.358 shows that P/E ratio is positively correlated to the dependent variable at a degree of 0.358. The other table is the ANOVA table. This table indicates that the regression model predicts the outcome variable significantly well. Here, p = 0.006, which is less than 0.05, our accepted level of significance, and the value of F statistics is greater than the value of mean square, which indicates that, overall, the model applied can statistically significantly predict the outcome variable. Third table named "Coefficients" provides us with information on the predictor variable, environment ratings. It is clear that environment rating significantly predict P/E Ratios at a degree of 28.7%. These results prove our first hypothesis that there exists a positive relation between a firm's environmental performance and investors' perception about the reputation and future certainty of the firm as reflected by the firm's P/E ratio.
To test our second hypothesis we look at the ANOVA results from both US and India. The results are summarized as follows:

RESULTS FOR INDIAN CONSUMER GOODS COMPANIES

TABLE 4: MODEL SUMMARY

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.259[a]	0.067	0.207	156.7932

a. Predictors: (Constant), Environmental Ratings

TABLE 5: ANOVA[a]

Model		Sum of Squares	df	Mean Square
1	Regression	47.412	1	47.412
	Residual	49.077	37	1209.272
	Total	96.489	38	

a. Dependent Variable: Log of P/E
b. Predictors: (Constant), Environmental Ratings

TABLE 6: COEFFICIENTS[a]

Model		Unstandardized Coefficients
		B
1	(Constant)	4.923
	Environment	0.14

a. Dependent Variable: Log of P/E Ratio

Results for US Consumer Goods companies:

TABLE 7: MODEL SUMMARY

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.427[a]	0.182	0.41	156.7932

a. Predictors: Environmental Ratings

TABLE 8: ANOVAa

Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	64.760	1	64.760	92.906
	Residual	22112.879	39	566.997	
	Total	23760.480	40		

a. Dependent Variable: Log of P/E
b. Predictors: (Constant), Environmental Ratings

TABLE 9

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.088	2.292		5.474	.655
	Environment	.229	.028	.364	8.088	.000

a. Dependent Variable: Log of P/E Ratio

These results clearly shows that environment ratings are a significant predictor of P/E ratio in both India and US because for Indian p=0.008 which is much lesser than our acceptable significance level of alpha=0.05 and for US p=0.000, again highly significant at alpha=0.05 level, though in US the environment ratings have a higher impact on P/E ratio as compared to India, because the value of beta value for standardized coefficients for US, 0.364 is larger than that for India, 0.194. This means that in US the investors may be more aware of the environmental performance of their companies and would likely lose confidence in the future performance of the company if they believe that the company is not adhering to the environmental policies. Hence, this supports our second hypothesis that the relation between a firm's environmental performance and investors' perception about the reputation and certainty of the firm as reflected by the firm's P/E ratio would vary between US and India.

DISCUSSION

This is the first study which analyzed the effects of Environmental Performance of Consumer Goods Industry and the Financial Perception of the Investors in Indian and US consumer goods industry. We confirmed to the majority of the literature which shows a positive relation between a firm's environmental

practices and the financial performance. We also found that the US investors as compared to those from India, of at least the consumers goods industry are more aware of the environmental attentiveness of their companies and lose their confidence in them in case the environmental performance is found low, hence panelizing them in the future.

CONCLUSION

With the help of our study we have concluded that environmental performance of the companies, at least for the consumer goods industry, has an impact on investors' financial perception. This has the implications for the managers because in case they do not adopt adequate environmental measures, investors may start to perceive that the company may not have certain and blooming future, which would be reflected by a lowering P/E Ratio. This could result to a low market earning in the future for the company.

LIMITATIONS

The biggest drawback in our study has been that a highly comprehensive measure for the financial performance of the firms was not adopted which would include past, present and future financial performance of the company. By concentrating on the financial perception of the investors, we focused on the future aspect of the financial performance of the company. Also, the results could have been more conclusive in case we had considered more than one industry. In our research, we focused only on the Consumer Goods industry because of it being a highly risky industry for the environment. We expected that investors of such industry would more likely pay attention to the environmental performance in the industry.

SCOPE FOR FUTURE RESEARCH

It would be interesting if a research would combine past, present and future aspects of the financial performance of the company while establishing a relation between its environmental and financial performance. Also future researchers should compare the performance over a variety of industry. It would more clearly establish the relation between environmental and financial performance if a comparison is made between low risk industries like finance and IT and high risk industries like consumer goods, and construction. Future researchers should also focus to establish a reciprocal relation between the environmental and financial performance of a company which has a very limited literature.

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