DO GREEN ALLIANCES INCREASE FIRM VALUE? EVIDENCE FROM AN EVENT STUDY

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INTRODUCTION

A number of studies have looked at the relationship between corporate social responsibility and financial performance. Corporate social responsibility, although without a strong consensus on the definition [7], generally refers to a firm's engagement in activities that benefit the firm's stakeholders besides shareholders, including employees, customers, suppliers, communities, and the like. It often goes beyond serving the interest of the firm's shareholders solely and also beyond what is required by law. Researchers have adopted different views of corporate social responsibility, some believing it to be a burden of a firm, while others arguing that it can lead to a competitive advantage. Besides the conceptual work, there has been a rich body of empirical studies that examined the relationship between a firm's social responsibility and financial performance. Unfortunately the existing findings regarding the social-financial performance link have yet to converge. There has been evidence of both negative [1] and positive effects [3][8] of corporate social responsibility on a firm's financial performance. Therefore the question as to whether it pays off to do good has not been answered in an unequivocal way.

In the meantime, the literature of strategic management has examined a firm's alliances as an important resource that the firm can tap into to become more competitive [4]. There has been abundant research looking into the different aspects of alliances, including the structure of a firm's alliance network, the strength of the ties, the resources and capabilities of partners, the learning between alliance partners, and the like. The research on alliances suggests that alliances can be used as a strategic resource, which should add value to the firm. As a result, investors would in general react favorably to a firm's announcement of new alliances. Empirical research using the event study methodology has provided strong evidence that alliances create value for the firm [2][6]. However, the existing research has looked mostly at alliances between firms of which the goal is to maximize shareholders' value. Firms may also partner with organizations that are not for profit such as environmental groups. When they do so, these firms are motivated to become more socially responsible by enforcing stricter environmental standards or promoting efforts of environmental preservation. Very little research has examined whether and how such alliances create value for firms.

In this study, I plan to investigate how the stock market would react when a firm announces a green alliance [5], defined as the type of partnership between a firm and an environmental organization aiming at promoting environmental welfare. Would investors view such efforts favorably as they may build up the firm's reputation as a socially responsible player? Or would investors view them as a distraction from the firm's efforts of profit maximization? Are there any contingencies that would affect the valuation effect? So far no study has been able to answer these questions. Given the research gap and also the increasing popularity of green alliances nowadays, my study attempts to integrate the two lines of research i.e. corporate social responsibility and strategic alliances. It is hoped that the study will contribute to both literatures and offer important insights to both researchers and practitioners.

METHODOLOGY AND DATA

Primarily the event study methodology will be used. It is based on a standard asset pricing model to predict firms' stock returns and uses the residuals obtained from the model as a proxy for firms' excess returns. The event study method has become an increasingly important research methodology in the strategy field. Particularly in alliance-related studies, abnormal returns have been widely used as a measure for the incremental value expected from an alliance i.e. ex-ante value gains, the reason probably being that abnormal returns measure the unusual movement of the stock price as a result of the alliance announcement and therefore can isolate the event from other confounding factors that may potentially affect firm value. The methodology is also widely used in the research on corporate social responsibility.

I will collect data from multiple secondary sources for conducting the empirical analysis. Data on alliances will be collected from the Mergers, Acquisitions, and Alliances' database of the Securities Data Company (SDC). SDC maintains complete records of firms' alliances for all years beginning in 1988 by obtaining information from publicly available sources such as SEC filings, trade publications and international counterparts, and news and wire sources. The time period from 1997 to 2003, a period for which I believe SDC has the most comprehensive coverage, will be used. In addition, I plan to compile data from Compustat as well, from which the measures for such variables as firm size, primary industry, and environmental characteristics can be obtained.

IMPLICATIONS

My study will contribute to the alliance literature by examining an important type of partnership i.e. those with environmental groups. Particularly I will focus on how investors will react to such partnerships and what factors will impact the value of such partnerships. I expect to find that the so-called green alliances will add value to the firm. The identification of contingency factors such as the type of the partner and/or the environmental characteristics will provide important policy implications for alliance managers and corporate executives when they weigh the choice of forming such alliances.

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