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The Value Relevance of Environmental and Social Performance: Evidence from Swedish SIX 300 Companies

Environmental, social, and governance performance has attracted close attention around the world and is becoming a focus of many companies, investors, financial analysts, and accounting policymakers. This paper provides insight into how environmental and social performance is reflected in the market value of listed 300 SIX companies on OMX Stockholm. Most of the previous research has been limited to US- and UK-based companies in MSCI World Index. In Sweden, the environmental and social concerns of the government and labor unions impose powerful and unique regulatory and le-

gal constraints on company activities. Institutional investors, such as the Swedish state pension funds, and the Swedish Society of Financial Analysts have provided guidelines for the integration of environmental and social performance into the investment process.

According to our model, financial performance does not alone explain the market value of the companies, but the value relevance of financial statement data is enhanced if it is combined with environmental/social performance that has been compiled into company ratings. One of the key distinctions of this study is that it investigates both environmental and social performance also at disaggregated levels. Previous studies have been inconclusive on the social dimension and the effect of mixed attributes does not relate social performance to the market value at the aggregate level. In order to understand the value relevance of social performance, the sub-dimensions of employee, community, and supplier relations have to be separated.

By applying the Ohlson valuation model (1995), we express market value of equity as a function of book value of equity, accounting earnings, and environmental and social performance, where the last two variables are the proxies for other value-relevant information. We provide empirical evidence from the SIX 300 Index of Swedish companies by using the GES Investment Services risk rating for the period 2005–2008 for both environmental and social performance scores and their sub-dimensions. The SIX 300 Index represents the market performance of the 300 large, medium, and small stocks on OMX Stockholm. The panel data analysis applies fixed and random effects models, which control bias from omitted variables. The parameters of the model are computed by using

the fixed effects (within) OLS estimator and the random effects GLS estimator with clustered standard errors.

This paper suggests that environmental performance and some dimensions of social performance are reflected in the market value of large and medium cap companies on OMX Stockholm during the period 2005–2008. Financial markets have started to integrate the extra-financial performance into the investment decisions. A relatively weak effect of extra-financial performance indicates that the stock

market had not yet fully valued environmental and social intangibles. With an increased environmental awareness and a more full-scale pricing of externalities, the value relevance of environmental and social performance is likely in the future to increase in the financial markets. In addition, this paper suggests that the integration of extra-financial value approach into traditional financial investment analysis provides a richer picture of the long-term corporate performance. ■