



## Effects of ownership and financial performance on corporate environmental performance <sup>☆</sup>

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This paper analyzes the effects of ownership structure on corporate environmental performance and examines the relationship between financial performance and environmental performance in a transition economy. Using an unbalanced panel of Czech firms from 1993 to 1998, we consider state ownership and contrast concentrated with diffuse forms of private ownership. Additionally, we investigate whether successful financial performance begets or undermines good environmental performance. *Journal of Comparative Economics* 34 (1) (2006) 111–129. 213 Summerfield Hall, University of Kansas, Lawrence, KS 66045, USA; William Davidson Institute (WDI), University of Michigan, Ann Arbor, MI 48109, USA; CERGE-EI (joint workplace of Charles University and the Academy of Sciences of the Czech Republic), Prague, Czech Republic 111 21; Centre for Economic Policy Research, London, EC1V 7RR, UK.

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## 1. Introduction

Frydman et al. (1999), Djankov (1999), and Claessens and Djankov (1999) investigate the effects of different ownership structures on standard measures of corporate financial performance, such as revenue and capital investment, in the transition economies of Central and Eastern Europe. In this paper, we estimate the effects of different ownership structures on corporate environmental performance, measured by air pollutant emissions, in the transition economy of the Czech Republic from 1993 to 1998.<sup>1</sup> Similar to previous studies on ownership, we focus on the impact of privatization by comparing state and private ownership. Alchian (1965) and De Alessi (1995) argue that ownership structure affects the incentives to pursue value-maximizing strategies and that private ownership provides strong incentives to exploit revenue-enhancing and cost-reducing options. For our purpose, revenue-enhancing options such as the sale of marketable permits are not related to environmental performance; thus, we focus on cost-reducing options. However, cost-reducing options may increase or decrease emissions because costs are incurred by both emissions fees and emission reductions. If private ownership promotes cutting emission-related costs, relative to state ownership, private ownership leads to a decrease in emissions. Conversely, if private ownership promotes cutting reduction-related costs, private ownership leads to an increase in emissions. In our empirical analysis, we test these two competing effects.

To investigate variation across different types of private ownership, we distinguish between concentrated ownership, e.g., the presence of a strategic investor, and diffuse ownership, e.g., the predominance of investment funds. More concentrated ownership may improve the owners' ability to control the firm's costs, including environmentally-related costs, by enhancing its monitoring of management. However, more concentrated ownership may also thwart a manager's ability to control costs by reducing incentives to acquire information. If the improvement in the owner's ability to monitor management is dominant, greater ownership concentration results in better cost control. Conversely, if the decrease in managerial incentives is dominant, greater ownership concentration leads to less cost control. In addition, we investigate the link between financial performance, measured by profitability, and environmental performance. If firms face liquidity constraints, successful financial performance should be associated with good environmental performance. In our empirical analysis, we test these hypotheses.

In the next section, we survey the related economic literature and develop a simple conceptual framework. Section 3 contains a description of the database, focusing on corporate financial performance, ownership structure, and air pollutant emissions. In Section 4, we estimate and interpret the effects of ownership and financial performance on corporate environmental performance. The final section concludes with policy and research implications.

## 2. Related economic literature

Recent studies estimate the effects of different ownership structures on standard measures of corporate financial performance in the transition economies of Central and Eastern Europe (CEE). Frydman et al. (1999) compare the performance of privatized and state firms in CEE by examining growth rates of key financial indicators, namely, sales revenues, employment, labor

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<sup>1</sup> Earnhart (1997, 2000a, 2000b) also examine environmental issues in the Czech Republic but focus on government regulatory decisions rather than firm performance.

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