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Financial Performance and Environmental Protection Agency Penalties: Commentary

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Abstract

The impact of U.S. Environmental Protection Agency (EPA) penalties on financial performance has not been explored in detail, and more empirical research in the area is needed. One empirical study looked at the impact of EPA penalties on earnings. They found that higher EPA penalties lead to lower earnings, therefore having an additional negative financial impact on the firm and forcing firms to behave more responsibly in environmental matters.

Keywords: Environmental accounting • Environmental penalties • EPA penalties • Green business • Cooperation

Introduction

The U.S. Environmental Protection Agency (EPA) is a federal entity in the U.S. in charge of protecting the environment and enforcing environmental laws. Looked at the effects of EPA penalties on earning using a set of U.S. publicly traded firms. From the few empirical studies on EPA penalties, this study is the first to link EPA penalties to earnings. This study provides insights and helps us understand the impact of environmental penalties on firm performance. They mainly looked at the impact on earnings. Earnings is an important variable used widely by firms to quantify profitability, and it has a direct relationship with performance. Following defined earnings as the earnings before interest, taxes, depreciation, and amortization scaled by lagged total assets [1,2].

They also found a correlation between firm size and penalty assessment. Larger firms got higher penalties, which suggests that larger firms' ability to negotiate or tap into deeper resources did not yield more favorable results. This result is consistent with previous studies in the management literature where previous studies found that social pressure may play an important role in pushing larger firms to be more transparent in front of stockholders and the public [3,4].

Additional Findings

In unablated results, found that firms that are penalized more have higher research and development costs after the environmental violation, either as part of the enforcement recommendation or as part of a collaboration with the EPA. Moreover, in unablated results, they also found that firms that received larger environmental fines invested more money in environmentally friendly projects and firms that received more than one penalty in a single year invested more money in upgrading their facilities. Hence, after the environmental violation and before the monetary penalty is assigned, there is a period of enforcement. During this period, firms had an incentive to improve processes to mitigate the size of the fine and show stockholders and the public their concern for the environment. However, in the period after the environmental penalty is assigned to the firm, do firms still have an incentive to keep investing in environmentally friendly projects and try to appear greener or not anymore? This is a future research avenue that can also be explored. Effect relationships between IM and self-efficacy, internal customer satisfaction, service innovation, and internal service quality and competitive advantage. These results showed some significant implications [1].

Future Research

In future studies, expenses in research and development (R and D) can be analyzed deeper because R and D may behave as a proxy for cooperation. If a firm already incurred an environmental violation, the firm knows that an environmental penalty is coming. So, after the violation and during the enforcement period, firms may want to appear greener as a way to signal that they want to improve processes and may start investing more in R and D.

Looked into the fact that some firms received multiple environmental penalties. Because their study used annual data, if there were multiple penalties in a single year, they aggregated all those penalties per year. They used the total amount per year in their

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analysis. Another area to explore is that if in later years they get penalized again, what kind of firms get fined again? [1].

Future studies could also look at the effects of EPA penalties on Tobin's' Q. Tobin's' Q is another measure of firm performance that quantifies the forward-looking performance of a firm looking at the ratio of the market value of the firm to the book value of assets. The market value of the firm is defined as the market value of equity plus the book value of debt. Information from financial statements may provide incomplete information about the firm because it uses past and current accounting and financial ratios that will be used to make decisions about future performance [5]. In summary, these are some additional exciting areas for future research that can be explored.

Conclusion

That impacting earnings may significantly influence inducing firms to behave more responsibly in matters relating to the environment. Accordingly, this review contributes to the existing literature providing new avenues for future research showing researchers, managers, investors, and regulators where to focus when they are looking for specific forward-looking performance information.

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