

Executive Summary

This paper outlines the issuer's incentives on why it is counterintuitively a falsely superior strategy to simply raise conventional debt and allocate the proceeds to an environmentally benefitting project. I discuss the three prevailing rationales why corporations, sovereigns and municipalities issue green bonds in lieu of brown (i.e., conventional or nongreen) bonds and also examine the market for green bonds and show its development from the first issued green bond to its present stage.

This paper further looks at a corporation's share price reaction when the issuing party announces a green bond issue. On the green bond's announcement day, the public is made aware of the firm's intentions of pursuing an eco-friendly business. In a setting with efficient capital markets, Fama (1970) states that, once market participants are granted access to new information, due to the Efficient Market Hypothesis, the added value is directly reflected in the underlying asset, causing an increase or decrease of the quoted price. Hence a share price reaction following a green bond issue will be captured immediately after releasing the green bond issuance statement, since the actual day when the green bond is issued does not convey any notable information. Keeping the pecking order theory in mind, Myers and Majluf (1984) note an upswing in the firm's equity usually precedes a decline of the share price, whereas when (conventional) debt is added to the balance sheet, typically no significant share price reaction is noted.

I intend to determine whether the announcement of a green bond can trigger its issuer's share price to significantly outperform the Standard and Poor's (S&P) 500 benchmark. In order to do so, the specific stock returns will be risk-adjusted, i.e., adjusted for the issuer's historical equity beta and compared to the benchmark returns. Robustness tests will additionally try to determine whether a potential abnormal return can be explained due to the bond's green "earmark" or another variable (e.g., size, maturity, rating, etc.) and the stock returns will further be compared to the estimates the Fama and French (1993) three-factor asset pricing model provide.