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**ESTIMATING THE EFFECTS OF ENVIRONMENTAL
PERFORMANCE ON SHAREHOLDER VALUE**

by

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ABSTRACT

This report demonstrates how environmental issues can successfully be integrated into financial analysis by applying a newly developed methodology to companies in the U.S. pulp and paper industry. The results show clearly that companies within this industry face environmental risks that vary widely in magnitude from firm to firm. These risks are not evident in companies' financial statements nor are they likely to be incorporate in current market valuations.

The methodology is based on developing many possible scenarios of future environmental issues and seeing how companies are materially affected under each. Weighting scenarios by their probability of occurring allows one to forecast a likely financial impact. The approach is conceptually similar to methods already used by managers and Wall Street analysts to evaluate other business risks.

The analysis reveals that companies within the industry face quite different levels of exposure and associated risk from environmental issues. For some companies, these issues will have little or no impact on financial performance, and for one company could be a source of increased value. For others, environmental issues may entail costs that approach 15 percent of a company's current valuation. Even companies that face similar expected impacts may differ significantly in the associated risks, as measured by the variance in potential outcomes.

Typically, because the impending environmental issues are still subject to considerable uncertainty, the potential impacts are not discussed in financial reports. Therefore, financial analysts can gain additional insights regarding companies' fundamental values and risks from this kind of analysis.