Chapter 5
Climate Policy Uncertainty and Corporate Investment:
A Governance and Life Cycle Approach

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ABSTRACT

This study investigates the relationship between Climate Policy Uncertainty (CPU) and Corporate Investment (CI). Further, assert that better corporate governance reduces the negative impact of climate policy uncertainty on corporate investment. Additionally, we evaluate that the negative impact of CPU on CI varies according to the different life cycle stages of the firm. We utilised the panel data of 548 Indian non-financial listed firms from 2010 to 2023. We use fixed effect regression to examine the relationship between CPU and CI. This paper has the following main conclusions: There is an inverse relationship between CPU and CI, suggesting that corporate investment declines as climate policy uncertainty increases. Furthermore, when considering the moderating effects of firm lifecycle and corporate governance, strong governance practices lessen the detrimental impact of CPU on investment.

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Additionally, firms react differently to CPU depending on the stage of their lifecycle.

1. INTRODUCTION

As climate change intensifies, the significance of climate finance escalates, rendering it the paramount issue in present climate change negotiations (Stroebel and Wurgler, 2021). It is important to note that climate finance represents not merely an economic expenditure but also an investment in natural capital, considering the potential synergies involved. Consequently, climate change exerts a substantial economic impact on capital and the entire economy. According to the analysis of S&P Global environmental, social, and governance data, 40% of companies with headquarters in India conduct physical risk assessments, and nearly one-third of large Indian companies rank climate strategy as one of their top three material issues. As in many other parts of the world, climate change's physical risks are getting worse and happening more frequently in India. Future challenges for the nation include rising heat waves and floods, which will endanger its economy, businesses, and quickly expanding population. Investment will be essential to overcoming these obstacles, and businesses will be crucial in providing the funding required for the nation's energy transition. Companies can be better prepared for the repercussions of severe weather on their firms and the overall economy by reviewing physical risks and putting adaptation plans into place (Laidlaw, 2023).

In light of an increased awareness of the potential effects of weather events and climate change on the corporate sector, there is an expanding body of literature examining the impact of climate risk on corporations, resulting from both physical and transition risks. Governments have developed corresponding climate policies to regulate industry in response to climate change uncertainties. The manufacturing and production sectors are particularly affected by climate policy uncertainty (CPU), as it impacts the production and operational procedures (Dietz and Stern, 2015). According to previous studies, businesses frequently halt capital investment to "wait and see" when market and economic policy uncertainty is at its highest (Akron et al., 2020; Gulen and Ion,2016). Thus, the evidence supports the real options theory, which states managers should wait for uncertainties to be resolved and wait for new information before investing in new projects (Trigeorgis, 1996). When deciding which investments to make, market participants frequently take climate change into account as a significant source of risk (Krueger et al., 2020).

In the process of asset reshaping due to climate change, information avoidance and information asymmetry are likely to cause financial performance crashes in the future. A group of researchers have supported the role of information asymmetry in decision-making. The information asymmetry theory in corporate investment

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