Environmental Disclosure: A Study of Disclosure Choices

This is a work in progress. Please do not cite without permission of the author.

Thomas Thijssens
PhD Candidate
Department of Accounting and Information Management
University Maastricht
The Netherlands
t.thijssens@aim.unimaas.nl

Abstract

Decision making with regard to Corporate Social Responsibility (CSR) disclosure goes beyond the binary decision to either include CSR information in the annual report or not. Research has revealed that companies purposefully make choices about disclosure content (positive versus negative and quantitative versus qualitative information) and form (such as annual report versus stand-alone report or website). Given the bottom line imperative for public companies in most industrialized societies and the subsequent pre-eminence of efficiency, this study focuses on the role of costs in CSR disclosure. Our main objective is to find out to what extent variations in disclosure choices between companies can be explained by their associated disclosure costs. This study will address disclosure choices that have hardly received any (empirical) research attention before, mainly due to a lack of data availability. Through detailed analysis of the environmental disclosures of a sample of 199 large public companies using a proprietary database, this study provides insight into the choice between public and private disclosure, as well as on what performance categories - policies, programs and impact - are disclosed. In addition, our analysis presents initial empirical data on the company departments and employees that are involved in private environmental disclosure. Studying these particular choices and the conditions under which they appear adds to the development of a theoretic framework for CSR disclosure.
1. Introduction

Companies generally are considered to be the main drivers of the progress that most industrialized nations have experienced since the 18th century Enlightenment, due to their innovating power. Provided that progress, next to prosperity, has resulted in a number of major environmental, social and economic challenges, most managers and academia nowadays hold the opinion that companies consequently have a role in bringing about a more sustainable world. Corresponding to this belief is the idea that a company’s financial performance is no longer the one and only company focus. Companies increasingly acknowledge the importance of social and environmental aspects of corporate conduct, captured by terms such as Corporate Sustainability or Corporate Social Responsibility (CSR). In the light of these developments socio-political theories (such as stakeholder and legitimacy theory) have grown in popularity, both in business practice and in academia. These theories recognize the fact that companies are embedded in a pluralistic society in which many different interests are represented.

Information provision, in this paper referred to as CSR disclosure, is generally seen as an important tool for companies to manage their relationship with society at large, and its subsequent stakeholders in particular (Roberts 1992; Gray, Javad et al. 2001). Research has revealed that public CSR disclosures (such as annual or stand-alone environmental reports) are not representative for the actual CSR performance (CSP) of companies. This is possible due to a lack of a comprehensive regulatory framework for CSR disclosure. Most researchers argue that this lack of congruence can be attributed to legitimacy perceptions of the public and subsequent company attempts to influence these perceptions. Consequently, in CSR disclosure research legitimacy theory is currently the dominating theoretic constructs. Legitimacy is defined as: “A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman 1995). Legitimacy theory builds on the idea that companies do not have an inherent right to exist; a company has to ‘deserve’ this right by acting in congruence with the generalized norms and values of the ones with which it interacts.
However, whereas empirical CSR disclosure research typically has been based on disclosures in public reports, recent studies have stressed the increased importance of private communication of CSR information. In a CSR context, we define private communication as the dissemination of information in response to a specific request, uniquely to the one (whether it be an individual or an organization) making the request. Examples of private communication are information provided through questionnaires, one-to-one meetings, or e-mail requests. This raises the question whether legitimacy theory is also the appropriate theoretic construct for private CSR disclosure, as it is for public CSR disclosure. In addition, the lack of correspondence between actual and publicly disclosed CSP raises the question which parts of CSR information are omitted in public disclosure; and whether the omitted information is disclosed via other disclosure types (i.e. private disclosure) or not disclosed at all.

We argue that legitimacy theory alone cannot answer such questions. For example, potential illegitimacy perceptions of the public may provide incentives for public disclosure or non-disclosure, yet not for private disclosure. Alternatively we suggest that, given the quintessence of efficiency in companies at the present time, costs are the important determinants of disclosure choices. That is why this research will focus on disclosure costs. This study proposes that, in a CSR context, the legitimacy perceptions of the public and their subsequent actions represent considerable potential costs for a company. Consequently, legitimacy theory is set in a cost framework. In so doing, it becomes apparent that legitimacy-driven stakeholder actions are just one among a number of potential costs to take into account in decision making regarding CSR disclosure. Disclosure choices should thus not only be assessed on their legitimacy-enhancing capacity.

Summarizing, this study starts from the observation that decision making on CSR disclosure appears to be much more complicated than a binary decision to either disclose or not. Between non-disclosure and full disclosure there are a range of disclosure decisions that will be made, each of them with different consequences for not only the costs related to legitimacy inducing behaviour of the public, but also for other disclosure costs.

The previous discussion translates into the following research questions: To what extent can variations in environmental disclosure choices between companies be explained by their associated disclosure costs?
The disclosure choices addressed in this study can be broadly divided into disclosure form and disclosure content decisions. Disclosure form is operationalized using the following voluntary disclosure types: public, private and non-disclosure. Disclosure content choices take into account disclosure of three categories of CSP: environmental policies, environmental programs and environmental impacts. These disclosure choices have hardly received any empirical research attention before, mainly due to a lack of data availability.

Based on a sample of 199 large public companies this study provides insight into these disclosure choices through detailed analysis of a subset of their total CSR disclosure: environmental disclosure. The necessary information is retrieved from a proprietary database, containing more than 40 items related to environmental reporting, environmental principles and policies, environmental management systems and environmental impact data per company. For each of the information items it is stated whether the company discloses the information or not, and if so it is mentioned whether it is publicly or privately disclosed.

The study adds to previous research by providing a first empirical view into the relative importance and determinants of a fairly new and under-researched phenomenon: private CSR disclosure. Besides, it also explores another largely unexplored research area: what is not disclosed. Next to that it also fine tunes our current knowledge about environmental disclosure by providing insight into the content of such disclosures. In so doing it adds to our understanding of the motives of companies for voluntary engaging in environmental disclosure and helps in building a theoretic framework for this type of corporate communication.
2. Research design

As previously mentioned, legitimacy theory is currently one of the dominating theoretic constructs in CSR disclosure research and is defined as: “A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman 1995). The appropriateness of company actions may be assessed on the basis of CSP. Wood (1991) defines CSP as “a business organization’s configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm’s societal relationships”.

Although from a strict legitimacy point of view a company’s motive for CSR disclosure might be the felt duty to demonstrate accountability about its CSP, most CSR disclosure research focuses on more instrumental motivations (see for example Gray, Owen et al. 1996). In this context companies seek to enhance or maintain legitimacy to mitigate the risk of stakeholder actions that jeopardize their ‘going concern’. As a result, companies have incentives to voluntary disclose only those parts of CSP that enhance or sustain public perceptions of legitimacy. This instrumental approach corresponds to outcomes of legitimacy theory research, revealing that public CSR disclosures in general are not representative for the actual CSR performance of companies (Rockness, Schlachter et al. 1986; Guthrie and Parker 1989; Deegan and Gordon 1996; Deegan and Rankin 1996; Patten 2002; Hibbitt 2004). The lack of correspondence between actual and disclosed performance is possible due to a lack of a comprehensive regulatory framework and is supported by empirical findings which indicate that companies disclose mainly positive information and tend to abstain from monetary CSR disclosures (Cho and Patten 2007).

A large part of the existing empirical research on legitimacy theory is based upon environmental disclosure in public (annual) reports. This study will also focus on environmental disclosure, however it will not only be limited to public disclosure. Recent studies have stressed the increased importance of private communication of CSR information (such as information provided through questionnaires, analyst meetings, or e-mail requests), particularly towards institutional investors and related institutions (Hockerts and Moir 2004; Solomon and Darby 2005; Laan 2006; Solomon and Solomon 2006). This raises the question whether legitimacy theory is also the appropriate theoretic construct for private disclosure, as it is for public disclosure.
In line with Cormier & Magnan (2001) we propose that the environmental disclosure strategy of companies is dependent on the associated benefits and costs of disclosure. That is why this research will focus on disclosure costs. This study proposes that, in a CSR context, the legitimacy perceptions of the public and their subsequent actions represent considerable potential costs for a company. Consequently, legitimacy theory is set in a cost framework. In so doing, it becomes apparent that legitimacy-driven stakeholder actions are just one among a number of potential costs to take into account in decision making regarding CSR disclosure.

Lev (1992) suggests that both direct and indirect costs are associated with voluntary financial disclosure. Where the direct costs refer to all costs of processing and disseminating the information, indirect costs consist of the costs from the impact of the disclosure on the company, the costs associated with the loss of competitive position through disclosure of proprietary information, and costs from possible litigation.

Disclosure choices made by companies will have different implications for the various costs involved. The disclosure choices addressed in this study can be broadly divided into disclosure form and disclosure content decisions. Disclosure form is operationalized using the following voluntary disclosure types, based on research by Holland (2005): public, private and non-disclosure. For each disclosure type it is hypothesized to what extent the various costs are relevant.

Disclosure content choices take into account disclosure of three categories of CSR performance as defined by Wood (1991): social policies, social programs and social impacts. There is evidence that companies make rational choices with regards to the content of their disclosures. Cho & Patten (2007) put forward that from proprietary cost theory point of view (Verecchia, 1983), companies in general prefer non-monetary disclosure over monetary disclosure about environmental expenditures and costs, because monetary disclosures have higher proprietary value. Quantitative CSR information has a higher quality perception than qualitative information (Ernst & Ernst, 1977), and is perceived to be more informative to the users of the information (Al-Tuwarijri et al., 2004).

The previous leads to the following table of disclosure types.
Based on the following assumptions, a number of hypotheses will be formulated, which will be tested by means of statistical analysis.

1. When companies do not disclose environmental information, this might be due to the fact that
   o they do not have the information (not processed the information because no systems that generate this); higher chance for this with Low Environmental Impact Industry (LEII) companies; legitimacy costs for LEII are lower.
   o They do not want to disclose this information since it signals bad performance; higher chance for this with LEII companies; High Environmental Impact Industry (HEII) companies/LEII with bad performance have incentives to disclose publicly in order to alter public perception.
2. Companies only disclose positive information publicly; there are no incentives for public disclosure of negative information; there are incentives however, to disclose negative information in a positive way, particularly for companies which are perceived to have a bad CSP (HEII industries or companies with actual bad CSP).

3. Negative information is kept secret (Not Disclosed, more for LEII/good performance companies) or presented positively (more for HEII/bad performance companies); e.g. negative impact figures might be presented as relative figures, such as relative to worse industry averages or past impact figures.

4. Public disclosure will be more appropriate to disclose negative information positively than private disclosure, since public disclosure offers more freedom in presenting the information; so it might be better to disclose negative information publicly in a positive way, than to not disclose it and wait until there is a concrete request for the information. From a legitimacy point of view, HEII/bad performing LEII consequently have incentives for public disclosure rather than private disclosure.

5. Private disclosure signals that companies do have information that they do not want to disclose publicly.

6. For the decision between disclosure and non-disclosure, the following relevant costs (that differ between alternatives) should be considered: processing costs, proprietary costs and dissemination costs. Only disclose when benefits outweigh the costs. Benefits of disclosure: enhance legitimacy, which benefits are greater when illegitimacy is bigger (only relevant for HEII and bad-performing companies, since good performing companies and LEII might not have illegitimacy problems). The benefits are basically: overcoming legitimacy costs, which costs are higher when performance is worse. Therefore companies have incentives to signal good CSR.

7. Those companies that decide to disclose certain environmental information will choose between type and form alternatives of disclosure so as to minimize the associated disclosure costs. Concerning the choice between public and private disclosure, there are two types of costs that vary between the alternatives: legitimacy and proprietary costs. In order to minimize legitimacy costs companies tend to disclose publicly. In order to minimize proprietary costs companies will
tend to disclose privately. Given that disclosure is part of a company’s CSP (Wood) even companies that are generally perceived to be legitimate, might loose (part of) their legitimacy when not disclosing anything at all in public. However, even if a basic level of public disclosure is needed, LEII companies will tend LEII companies might have no legitimacy problems, public disclosure

8. The most costly disclosure types will invoke the least costly disclosure categories.

9. Inclusion in SRI portfolios might signal good CSR without giving away all the details (proprietary costs). Many information intermediaries do not want to alter corporate behaviour. Companies like to be included in SRI portfolios, because it enhances legitimacy at relatively low proprietary costs.

The previous boils down to the following research design:

To test our hypotheses, a sample of 199 large public companies is used, of which companies the environmental disclosures are analysed in detail. The necessary information is retrieved from a proprietary database, containing more than 40 items related to environmental reporting, environmental principles and policies, environmental management systems and environmental impact data per company. For each of the information items it is stated whether the company discloses the information or not, and if so it is mentioned whether it is publicly or privately disclosed. In the appendix some descriptives about the disclosure types and categories for this sample are provided.
Reference list


APPENDIX

<table>
<thead>
<tr>
<th>Disclosure Type</th>
<th>Total Public</th>
<th>Private</th>
<th>Private +</th>
<th>Non-Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Firm size (in sales)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(&lt; 10 billion $) small</td>
<td>35.42</td>
<td>13.37</td>
<td>18.34</td>
<td>46.24</td>
</tr>
<tr>
<td>(10 - 27 billion $) medium</td>
<td>42.65</td>
<td>9.25</td>
<td>14.93</td>
<td>42.42</td>
</tr>
<tr>
<td>(&gt; 27 billion $) large</td>
<td>50.10</td>
<td>8.48</td>
<td>16.18</td>
<td>33.72</td>
</tr>
<tr>
<td><strong>Industry</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Materials</td>
<td>52.80</td>
<td>12.37</td>
<td>24.36</td>
<td>22.84</td>
</tr>
<tr>
<td>Financials</td>
<td>26.83</td>
<td>15.40</td>
<td>20.35</td>
<td>52.82</td>
</tr>
<tr>
<td>Information technology</td>
<td>39.85</td>
<td>10.15</td>
<td>17.22</td>
<td>42.93</td>
</tr>
<tr>
<td>Energy</td>
<td>49.12</td>
<td>11.92</td>
<td>17.19</td>
<td>33.69</td>
</tr>
<tr>
<td>Industrials</td>
<td>42.41</td>
<td>10.82</td>
<td>15.67</td>
<td>41.92</td>
</tr>
<tr>
<td>Consumer staples</td>
<td>46.78</td>
<td>9.70</td>
<td>15.51</td>
<td>37.72</td>
</tr>
<tr>
<td>Consumer discretionary</td>
<td>42.83</td>
<td>8.98</td>
<td>15.07</td>
<td>42.10</td>
</tr>
<tr>
<td>Telecom</td>
<td>50.12</td>
<td>6.69</td>
<td>10.55</td>
<td>39.33</td>
</tr>
<tr>
<td>Utilities</td>
<td>64.16</td>
<td>6.03</td>
<td>10.54</td>
<td>25.30</td>
</tr>
<tr>
<td>Health care</td>
<td>44.45</td>
<td>4.31</td>
<td>9.28</td>
<td>46.27</td>
</tr>
<tr>
<td>Disclosure Types</td>
<td>Disclosure Categories</td>
<td>High impact industries</td>
<td>Low impact industries</td>
<td></td>
</tr>
<tr>
<td>-----------------------</td>
<td>-----------------------</td>
<td>------------------------</td>
<td>-----------------------</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Policies</td>
<td>Programs</td>
<td>Impact</td>
<td>Policies</td>
</tr>
<tr>
<td>Public</td>
<td>0,87</td>
<td>0,54</td>
<td>0,36</td>
<td>0,79</td>
</tr>
<tr>
<td>Private</td>
<td>0,02</td>
<td>0,14</td>
<td>0,03</td>
<td>0,06</td>
</tr>
<tr>
<td>Private + other sources</td>
<td>0,10</td>
<td>0,10</td>
<td>0,03</td>
<td>0,10</td>
</tr>
<tr>
<td>Not Disclosed</td>
<td>0,01</td>
<td>0,22</td>
<td>0,57</td>
<td>0,05</td>
</tr>
<tr>
<td>Total</td>
<td>1,00</td>
<td>1,00</td>
<td>1,00</td>
<td>1,00</td>
</tr>
</tbody>
</table>