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Do actions speak louder than words? An empirical investigation of corporate environmental reputation

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A B S T R A C T

In this study, we investigate the extent to which firms' environmental performance is reflected in perceptions of their environmental reputation and whether environmental disclosure serves to mediate the negative aspects of poorer environmental performance associated with those assessments. We also examine whether differences in environmental performance and environmental disclosure appear to be associated with membership selection to the Dow Jones Sustainability Index (DJSI), a factor we also believe may be associated with perceptions of environmental reputation. Based on a cross-sectional sample of 92 US firms from environmentally sensitive industries, we find that environmental performance measured using Trucost environmental performance scores is *negatively* related to both reputation scores and membership in the DJSI. We argue this is due to the more extensive disclosure levels of firms that are worse performers and the finding of a significant *positive* relation between environmental disclosure and both the environmental reputation measures and DJSI membership. Finally, we show that the DJSI designation positively influences perceptions of corporate reputation. Overall, our results suggest that voluntary environmental disclosure appears to mediate the effect of poor environmental performance on environmental reputation. Perhaps more troubling, our results also suggest that membership in the DJSI appears to be driven more by what firms say than what they do. Thus, like voluntary disclosure, the DJSI may actually be hindering improved future corporate environmental performance.

Introduction

This investigation is concerned with the extent to which a company's environmental performance is reflected in perceptions of its environmental reputation. Certainly, major environmental catastrophes such as the 2010 British Petroleum oil spill in the Gulf of Mexico seriously affect corporate reputations. What is less clear is whether general levels of environmental performance influence perceptions of corporate environmental reputation and whether voluntary environmental disclosure serves to mediate that effect.

Our study integrates two prior streams of environmental disclosure research. First, we build on recent studies claiming a negative relation between environmental performance and environmental disclosure. Cho and Patten (2007), for example, argue that because companies with worse environmental performance face greater exposure to social and political pressures, they have an incentive to use disclosure to address these exposures (see also Hughes, Anderson, & Golden, 2001; Patten, 2002). We extend this research by examining not only whether

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environmental performance is associated with levels of environmental disclosure, but also whether differences in environmental performance appear to influence membership in the Dow Jones Sustainability Index (DJSI) (and thus, indirectly, perceptions of environmental reputation). Second, we add to the limited number of studies examining the relation between social and/or environmental disclosure and perceptions of corporate reputation. Both Toms (2002), using UK company annual report disclosures, and Brown, Guidry, and Patten (2010), investigating the impact of first-time issuances of sustainability-type reports in the US, report positive associations between the extent of disclosure and measures of corporate reputation. Neither of these prior studies, however, considers the potential concurrent effect of actual environmental performance, and neither considers the potential indirect relation disclosure (and/or performance) may have through its influence on inclusion in the DJSI.

Based on a sample of 92 US companies from environmentally sensitive industries and using environmental reputation scores reported in the first-ever *Newsweek* magazine ranking of the "greenest" companies in America (McGinn, 2009, p. 35), we explore the relations between environmental performance, environmental disclosure, membership in the DJSI, and perceptions of corporate environmental reputation. Using path analysis, we find that environmental performance scores also reported in the *Newsweek* rankings are *negatively* (and significantly) related to both reputation and membership in the DJSI. We contend that these unexpected results are a function of the relation between environmental performance and environmental disclosure. Our analysis also finds that the extent of voluntary environmental disclosure included in annual financial reports and, where issued, stand-alone corporate social responsibility (CSR) reports is negatively related to environmental performance (worse performers have more extensive disclosures). Further, our results indicate environmental disclosure is positively (and significantly) associated with both environmental reputation scores and membership in the DJSI. Our results are thus consistent with the argument that companies use voluntary environmental disclosure to offset the potential reputational effects of poor environmental performance. Perhaps most troubling, our results show that while inclusion in the DJSI is associated with positive reputational effects, membership in the Index appears to be related more to what companies say (their environmental disclosure) than what they do (their environmental performance). As such, the DJSI may be reducing the incentives for companies included as members to improve their future environmental performance.

Background and hypotheses development

One reason that firms may use environmental disclosures to lessen their exposure to social and political pressures is to obtain *legitimacy*. Suchman (1995, p. 574) broadly proposes that "legitimacy is 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." The concept of legitimacy therefore refers to organizational actions that are congruent with overall social expectations (Mathews, 1993). Legitimacy theory holds that legitimacy is a necessary input for an organization's survival and that communication strategies can be used as a tool to "become identified with symbols, values and institutions which have a strong base of social legitimacy" (Dowling & Pfeffer, 1975, p.127). One such method involves the management of environmental disclosures in corporate reports (Deegan, 2002; Lindblom, 1994).

The major concern we address in this investigation is whether voluntary environmental reporting, spurred by concerns of enhancing social legitimacy, may actually be serving as a potential impediment to future improvements in corporate environmental performance. Freedman and Patten (2004) note that voluntary disclosure, by projecting a positive, more favorable picture of the firm, may lessen the impacts of poorer environmental performance. They further argue that such an effect may reduce the incentives for companies to work toward improving their actual future performance. This study explores this issue relative to the association between environmental performance, environmental disclosure, and perceptions of corporate environmental reputation. We also investigate the intervening role the DJSI may be playing relative to the effects of disclosure and performance on reputation.

Performance, disclosure, and reputation

Fombrun (1996, p. 37) defines corporate reputation as "the overall estimation in which a company is held by its constituents" and further notes (p. 61), that in at least the normative sense, it ought to be based upon underlying performance. Often, that appears to hold true. For example, several studies (e.g., Brammer & Pavelin, 2006; Brown & Perry, 1994; Brown et al., 2010) provide evidence that actual financial performance is clearly aligned with measures of companies' general reputations. Similarly, anecdotal evidence suggests that highly visible instances of poor operating performance erode the reputational stock of affected companies. Both Toyota, in response to its massive recall due to acceleration problems in its automobiles, and British Petroleum, owing to the major oil spill in the Gulf of Mexico, appear to have taken major hits on their reputation within the recent past.[4] Normatively, therefore, we would expect companies that are better environmental performers to enjoy more positive environmental reputations. We state this hypothesis as:

H1a. Ceteris paribus, perceptions of corporate environmental reputation are positively associated with firm environmental performance.

However, Bebbington, Larrinaga, and Moneva (2008, p. 339) argue that while reputations may be viewed "as having some basis in organizations' actions," they are also "constructed by others via their perceptions of these activities." Similarly, Brady (2005) notes that reputation is

[4] See, e.g., Ahrens (2010), Ferguson (2010).