A Synergetic Approach to Examine Environmental and Financial Performance: Two Sides of the Same Coin?

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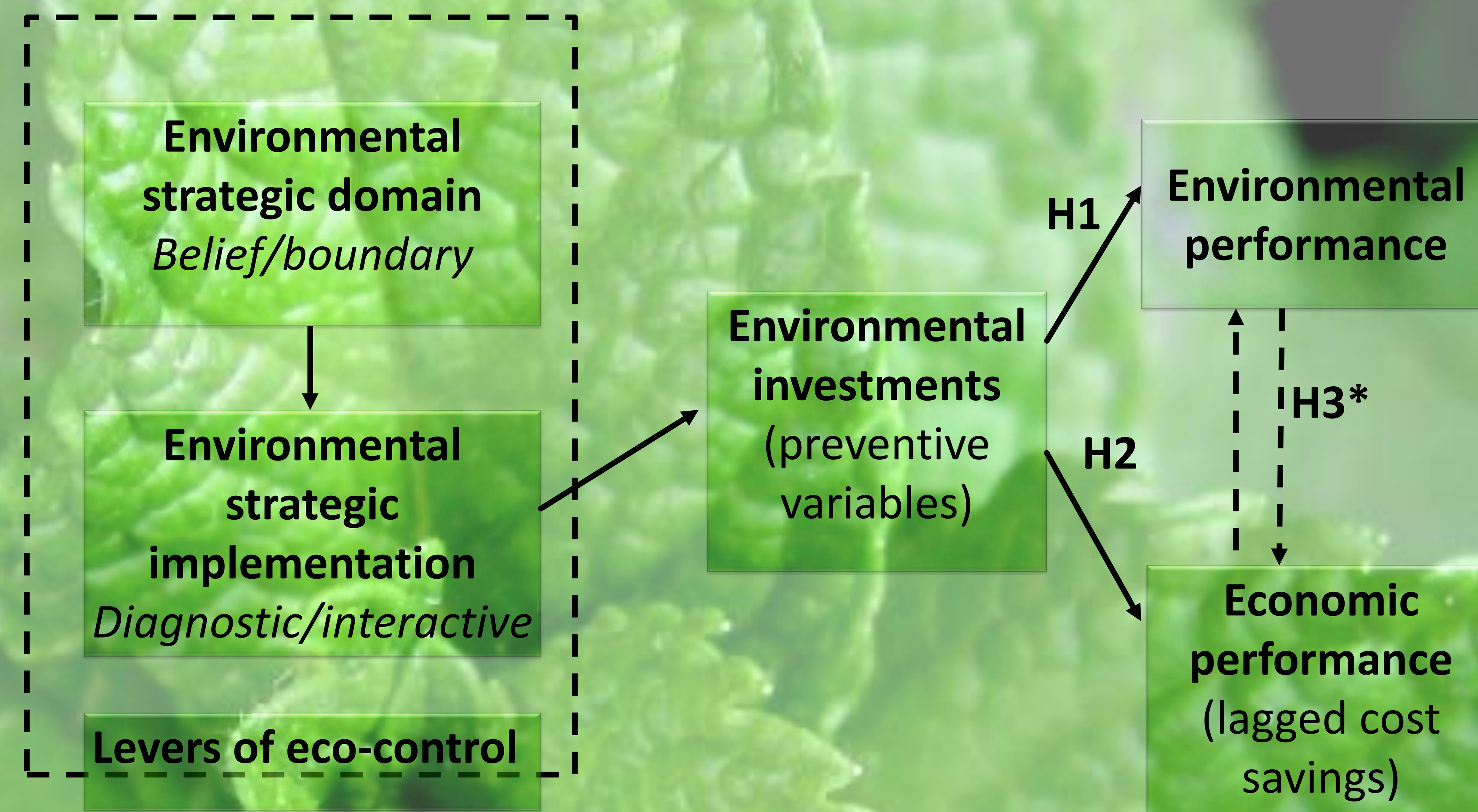
Abstract

The purpose of this research is to explore, from a control perspective, the process by which a firm's environmental performance maps on to its financial performance. The evaluation relies on complementary conceptual and empirical foundations drawn from both accounting and management literature.

While environmental accountability is one of the many social responsibilities of a firm, it is the focus of much attention from both researchers and practitioners in accounting. Hence, the plan is to examine how several variables that capture or reflect a firm's environmental activities ultimately translate into improved performance. Prior research provides mixed results regarding the link between environmental performance variables and corporate financial performance. However, the intention is to use a different approach in establishing a linkage between environmental performance and financial performance, mostly by looking at preventive environmental investments as an input variable with delayed impact, as I believe most of the benefits from environmental investments will be realized in the future. This idea is different from the popular measures such as cleanup or abatement costs, which are mostly reactive.

In distinguishing between the impact of preventive and reactive environmental investments, I rely on a modified version Robert Simons' levers of control framework. Moreover, I try to identify appropriate representative variables to establish a stronger relationship between environmental investments, environmental performance, as well as financial performance.



Hypotheses

- H1: Environmental investments that fit the long term goals of the company will lead to cost savings in long run (lagged).
- H2: Environmental investments that fit the long term goals of the company will lead to better environmental performance through minimizing waste and consumption of non-renewable resources.
- H3: Superior environmental performance is associated with better financial performance. (*possible testing of causality)

Implications – Why Should You Care?

- For the practitioners, the identifications of adequate, influential variables in the environmental management system can amplify the benefits received.
- Breaking the silos: Builds awareness for both accounting and management researchers, and potentially initiating collaboration among other disciplines.

Proposed Methodology

Due to the consolidated nature of external financial reporting, I believe the best avenue to collecting data is to obtain internal management report or information.

I wish to propose a case study to internally validate my hypotheses, because preventive environmental investments will be impossible to collect unless I can gain access to very specific and detailed management information.

Despite the lack of external validity a case study inherits, the benefit received from acquiring an insight to a company's environmental management system can outweigh the cons.

Capital Market Perspective: Shareholder focused view, Friedman (1970)

The only responsibility of a firm is to increase the shareholder's value.
Anything other than the company's core business will deviate from this main responsibility.

Accounting	*Management*
[+/0] Clarkson et al. (2004): Positive economic benefits associated with low-polluting firms but not for high-pollutors. **[0]** Filbeck & Gorman (2004): No significant relationship between environmental and stock performance. **[-]** Makni et al. (2009): Significant negative relationships between environmental performance and stock return or accounting performance.	**[+]** Moneva & Ortas (2010): Environmental performance has positive implications on the following year's financial performance. **[+]** King & Lenox (2002): Lower emissions significantly associated with higher financial performance in the following year. **[0]** McWilliams & Siegel (2000): Social performance has no impact on financial performance after controlling R&D investments.

Societal Perspective: Stakeholder focused view, Freeman (1980)

The responsibility of a company extends beyond the shareholders.
Firms will try to please as many stakeholders as possible to outperform the competitions.

Accounting	*Management*
[+] Bernett & Hansen (2008): Plants can reduce pollution and increase efficiency by implementing of Federal 1990 Clean Air Amendments. **[-]** Cho et al. (2006): Poor environmental performers have more political expenditure as a part of strategy, to manage public pressure. **[0]** Link & Naveh (2004): ISO 14001 firms had superior environmental performance, but not associated with financial performance.	**[-]** Graces-Ayerbe & Galve Gorriz (2001): Environmental regulation is not productive economically, but productive environmentally. **[+]** Abbott & Monsen (1979): Large firms try to gain legitimacy by environmental investments, especially for companies with positive correlation between social investment & profit. **[+]** Melnyk et al. (2003): Possession of formal EMS (ISO14000) has positive impact on operations.

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