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Sustainability reporting: The role of "Search", "Experience" and "Credence" information

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ABSTRACT

Corporate sustainability reporting quality has been frequently criticised as being unbalanced, presenting an overly positive view or failing to address material issues. The purpose of this article is to provide a fresh explanation for poor quality sustainability reporting and to propose how quality issues may be addressed. The theoretical framework combines the legitimacy and accountability perspectives using Akerlof's (1970) Market for Lemons theory. Akerlof's approach is extended by differentiating between three types of information in sustainability reports namely *search*, *experience* and *credence*. The article concludes that the type of information must be considered when determining measures to improve report quality.

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1. Introduction

The number of companies voluntarily producing environmental or sustainability reports has increased dramatically since Shell Canada produced one of the first environmental reports in 1991 (Maharaj & Herremans, 2008). According to the 2011 KPMG benchmarking survey (KPMG, 2011) 95 percent of Fortune Global 250 (G250) companies now disclose social and environmental information either in a standalone or in an integrated report compared to just 35 percent of G250 companies undertaking environmental reporting in 1999 (KPMG, 1999). Scholarly research in this area has also grown significantly with sustainability reporting quality in particular being the subject of research and benchmarking studies (Adams, 2004; Davis-Walling & Batterman, 1997; Deegan & Rankin, 1996; Dong & Burritt, 2010; Günther, Hoppe, & Poser, 2007; Guthrie, Cuganesan, & Ward, 2008; Morhardt, Baird, & Freeman, 2002; Skouloudis, Evangelins, & Kourmousis, 2009; SustainAbility & UNEP, 1997, 2000, 2002, 2004, 2006; Wiseman, 1982). The overall consensus of this research is that although the number of sustainability reports has increased, reporting quality remains poor. For example Dong and Burritt (2010) found that a large gap exists between reporting by Australian oil and gas companies and the industry benchmark with reporting quality well below that which would be expected. Comparing reporting by Greek companies to the Global Reporting Initiative (GRI) reporting guidelines, Skouloudis et al. (2009) found major gaps in the comprehensiveness of reports with important indicators such as those concerning environmental performance, human rights and product responsibility being omitted. Günther et al. (2007) found that reporting quality was particularly low for quantitative indicators such as greenhouse emissions. In relation to materiality, it was observed by KPMG in their 2008 study that many companies in "at risk" sectors such as automotive, construction and transport are lagging behind when it comes to reporting on climate change risk, one of the biggest global environmental problems (KPMG, 2008). Regarding balance, Deegan and Rankin (1996) found that

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Australian companies successfully prosecuted for violations of environmental regulation did not disclose this information, focusing instead on more positive aspects of their operations. Even within this overall poor quality, it has been found that there is a wide range of qualities depending on geographical location, company size and industry sector with typically larger companies in more polluting sectors producing better quality reports (Brammer & Pavelin, 2008; Hackston & Milne, 1996; Kolk, 2003, 2004; Kolk, Walhain, & van de Wateringen, 2001). This research has led to sustainability reporting being labelled as little more than an impression management tool (Bansal & Clelland, 2004; Hooghiemstra, 2000; Jones, 2011) or a "smokescreen diverting attention from core issues of ethical and moral accountability" (Owen, 2005, p. 397).

The motivation for companies to produce sustainability reports as well as the quality and extent of reporting has been examined in the literature using several theoretical perspectives. Two widely adopted perspectives are legitimacy and accountability. The legitimacy perspective is management orientated. It supports the view that companies use sustainability reports as a legitimising tool to demonstrate to stakeholders and to society that their activities and behaviours are within the accepted norms (Branco, Eugenio, & Ribeiro, 2008; Cuganesan, Guthrie, & Ward, 2010; Deegan, 2002; Deegan, Rankin, & Tobin, 2002; Milne & Patten, 2002; O'Donovan, 2002; Wilmshurst & Frost, 1999; Woodward, Edwards, & Birkin, 1996). This perspective also supports the view that sustainability reports are used to respond to negative external pressures or events by increasing the extent of disclosure as well as the amount of positive disclosure (Deegan et al., 2002; Deegan, Rankin, & Voght, 2000; Islam & Deegan, 2010). From this perspective sustainability reporting appears as symbolic action so that reports may not be an accurate reflection of company performance but are used to present a socially responsible image and manage public perceptions (Bansal & Clelland, 2004; Hooghiemstra, 2000; Jones, 2010; Neu, Warsame, & Pedwell, 1998). The accountability perspective views sustainability reporting as the duty of organisations to provide an account of their activities, even if they are not in the best interests of the company (Gray, 2007; Gray, Javad, Power, & Sinclair, 2001). The accountability perspective recognises the gap between what companies are reporting and what is required, and also be-moans the current quality of sustainability reports. Issues such as lack of regulation in the reporting process (Laufer, 2003; Maltby, 1997; Unerman & O'Dwyer, 2007) as well as information asymmetry between the company and its stakeholders (Brammer & Pavelin, 2008; Schaltegger, 1997) have been identified within this literature as obstacles to high reporting quality.

This article provides an alternative explanation of the quality of sustainability reporting by combining the perspectives of legitimacy and accountability. Legitimacy is management orientated and accountability is a more normative or idealist perspective. However as both perspectives provide insights into the quality of sustainability reporting this article links them using Akerlof's (1970) Market for Lemons theory. According to Akerlof's theory "lemons" refer to low quality goods or services which are inadvertently chosen by buyers since quality cannot be deciphered due to information asymmetry. In the Market for Lemons, due to a desire to maximise profits sellers, taking advantage of information asymmetry reduce the quality of the products or services offered. Buyers, being unable to detect quality pay the same price for high and low quality products and so quality deteriorates until no trade can take place. Akerlof describes how a lemons market occurs where there are specific market characteristics namely

- an information asymmetry between buyers and sellers,
- a motivation for the seller to cheat the buyer,
- a range of product qualities as well as
- a lack of regulation.

This characterisation is used to examine the market for sustainability reporting linking the motivational aspects from legitimacy theory with issues of information asymmetry, range of reporting qualities and lack of regulation as discussed within the accountability literature. Akerlof uses the example of a used car to explain this theory. He describes used cars as being of uniform quality in that the car is either good quality or poor quality. This is limiting when applied to the sustainability reporting market. Sustainability reports are not of uniform quality as they contain different types of information which may or may not be verifiable by the report reader. The different types of information are considered using the typology of search, experience (Nelson, 1970; Stigler, 1961) and credence (Darby & Karni, 1973) goods as described in the literature on information economics. This typology is used to extend Akerlof's theory as applied to the sustainability reporting market and a model is presented which predicts sustainability reporting quality over time for each of the different types of information. In addition to explaining sustainability reporting quality this model also helps to identify how the classification of information type is important with regard to targeted quality improvement. Through this argument, we make a two-fold contribution. First, we develop a conceptual model based on Akerlof's Market for Lemons theory that brings together two mainstream social accounting theories to explain (poor) sustainability reporting quality. The synthesis of mainstream social accounting theories with established theories such as that described by Akerlof can offer new theoretical insights and this contribution is perhaps overdue in social accounting literature. Second and by distinguishing between different types of information we provide a more fine-grained analysis of the quality of sustainability reporting and its development over time. This analysis not only takes into account the wide range of diverse aspects covered by sustainability reports, it also leads into more precise policy implications on the question whether and when there is a need for regulation to prevent the market for sustainability reporting from failing. Overall, our argument offers a more comprehensive understanding of the conditions under which the market for sustainability reporting is expected to fail and produces low quality disclosures.

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