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The relationship between sustainability performance and sustainability disclosure – Reconciling voluntary disclosure theory and legitimacy theory

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A B S T R A C T

The relationship between sustainability performance and sustainability disclosure remains ambiguous, both theoretically and empirically. Voluntary disclosure theory would suggest that the relationship should be positive, whereas legitimacy theory points toward a negative relationship. However, the empirical evidence regarding this relationship is mixed, which indicates that the two theories are not necessarily contradictory but that they are instead two sides of the same coin. This paper refines the theoretical reasoning associated with the two theories and provides empirical evidence for their reconciliation by moving the focus of inquiry from the quantity of sustainability disclosure toward its quality. Our results reveal that – consistent with voluntary disclosure theory – superior sustainability performers choose high-quality sustainability disclosure to signal their superior performance to the market. In addition, based on legitimacy theory, poor sustainability performers prefer low-quality sustainability disclosure to disguise their true performance and to simultaneously protect their legitimacy. The results remain robust to various additional analyses. Thus, the paper indicates that the two theories dovetail with one another by redirecting the focus toward the quality of sustainability disclosure.

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1. Introduction

Previous research has not yet established a consistent understanding regarding the relationship between sustainability performance and sustainability disclosure. In essence, two theoretical concepts are involved. On the one hand, voluntary disclosure theory predicts that a company with good sustainability performance is incentivized to disclose information regarding its performance to increase its market value. This stream of research posits a positive relationship between sustainability performance and the quantity of sustainability disclosure (i.e., superior sustainability performers disclose more). On the other hand, legitimacy theory argues that companies employ sustainability disclosure to improve the public perception of their sustainability performance (Deegan, 2002).

Researchers therefore interpret a negative relationship between sustainability performance and the quantity of sustainability disclosure (i.e., poor sustainability performers disclose more) as an indication of the applicability of legitimacy theory (Cho et al., 2012; Patten, 2002). Thus, these two theories yield opposing predictions regarding the relationship between sustainability performance and sustainability disclosure, and the mixed empirical results from prior studies have not yet clarified this relationship (for a positive relationship between sustainability performance and sustainability disclosure, see Al-Tuwaijri et al., 2004; Clarkson et al., 2008; for a negative relationship, see Cho and Patten, 2007; De Villiers and van Staden, 2006).

Recent research has therefore inquired whether these two theories are not mutually exclusive but are instead two sides of the same coin and has found some preliminary evidence to justify this line of analysis. For instance, Clarkson et al. (2008) ascribe a positive relationship between environmental performance and environmental disclosure as evidence for the application of voluntary disclosure theory but refer to legitimacy theory to explain "interesting patterns in the data" (Clarkson et al., 2008). They call for a switch in the "focus of enquiry" of future environmental disclosure research to investigate the concurrent applicability of the two theories more rigorously (Clarkson et al., 2008).

Whereas previous studies focus primarily on the *quantity* of sustainability disclosure by classifying disclosure items as either disclosed or non-disclosed, future research must illuminate *how* information is disclosed. In addition, to precisely assess the theoretical implications derived from voluntary disclosure theory and legitimacy theory, proxies for sustainability disclosure and sustainability performance must capture similar content. However, prior research is characterized by a variety of different approaches to measuring sustainability performance that range from the use of single indicators of environmental performance, such as emissions or waste (Clarkson et al., 2011), to rating metrics provided by specialized rating agencies, such as Kinder, Lydenberg, Domini (KLD, today MSCI) (Cho and Patten, 2007; Cho et al., 2006; Dawkins and Fraas, 2011).

Taken together, the measurement of both sustainability disclosure and sustainability performance is essential to reconcile the two theories. This paper therefore provides refined measurement approaches for sustainability disclosure and sustainability performance. With respect to measuring sustainability disclosure, we focus on the *quality* – rather than the *quantity* – of sustainability disclosure. While the (mandatory) financial disclosure literature, in particular, is concerned with the quality of reported *earnings* (for a literature review, see Beyer et al., 2010; Leuz and Wysocki, 2008), any metric used to measure the quality of sustainability disclosure must account for its voluntary nature and cover a broader spectrum of information. We therefore concentrate on the reporting quality of 14 disclosure items in the environmental and social dimensions of sustainability. In contrast to earnings quality studies, our measure for high-quality disclosure does not relate to the ex post truthfulness of the disclosed information but instead accounts for traditional disclosure quality criteria such as verifiability, reliability, comparability and consistency (Leuz and Wysocki, 2008, p. 25). We argue that only high-quality reporting of quantitative sustainability information allows outsiders to assess the true sustainability performance of a company. Our measurement of sustainability performance is based on manually collected data regarding four environmental and four social performance indicators to ensure content-based congruence between the measurement of sustainability disclosure and sustainability performance. The data are rescaled on an industry-group basis and aggregated into an overall sustainability performance score.

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