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Environmental Disclosure Transparency and Corporate Financial Performance: A Conceptual Study

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ABSTRACT

Environmental issues have been emerging as a significant concern for organizations, investors, governments, and society. The demand on corporate environmental disclosures has been growing, and such aspects as energy use, emissions, waste disposal, water use, environmental policies, and sustainable practices of corporations need to be revealed. Environmental disclosures provide the information about how a corporation deals with its environmental responsibilities. However, disclosure is not only about the quantity of the information that is released but also about transparency, clarity, relevance, and reliability of the information that has been disclosed. This conceptual research focuses on the link between environmental disclosure transparency and corporate financial performance. The research is built on the basis of the two theories: Stakeholder Theory and Legitimacy Theory. However, previous empirical studies have reported mixed findings. For example, Qiu et al. (2016) found no significant relationship between environmental disclosure and profitability, whereas Plumlee et al. (2015) found that the quality of voluntary environmental disclosure was associated with firm value. The paper proposes a simple conceptual framework in which environmental disclosure transparency influences corporate financial performance. The study concludes that transparent and credible environmental disclosure can potentially contribute to improved corporate financial performance by strengthening stakeholder relationships and reducing information uncertainty.

1. Introduction

Interaction between business and nature has gained increasing interest over the past decades. Firms rely on natural resources for business purposes and might cause various environmental effects due to emissions, waste, energy and water consumption and other actions. Hence, stakeholders have started to demand that companies disclose the information about environmental performance of firms.

Environmental disclosure can be defined as information disclosed by firms in respect of their environmental policy, performance, risks and effects. This kind of information can be disclosed in annual, sustainability, business responsibility reports and via other corporate communication media.

Environmental disclosure has become an essential element of corporate reporting since stakeholders want to know how firms fulfill their environmental obligations. In particular, investors can find environmental information useful when evaluating risks and prospects of firms. The significance of environmental disclosure is further demonstrated by the emergence of sustainability reporting frameworks. Global Reporting Initiative (GRI) offers guidelines for companies on how to report their impact on the economy, environment, and people. Likewise, the International Sustainability Standards Board (ISSB) has prepared sustainability disclosure standards that emphasize sustainability-related risks and opportunities affecting the potential future of the business.

But the existence of environmental disclosure doesn't guarantee the transparency of the information disclosed. A company could disclose plenty of environmental information while failing to disclose specific, comparable, and reliable data. Thus, the issue of environmental disclosure transparency becomes highly important.

Environmental disclosure transparency can be defined as the degree to which environmental information disclosed by a company is clear, relevant, complete, understandable, and reliable.

The effects of environmental disclosures on a company's finances have been studied extensively in academia. However, the results aren't unanimous. Qiu et al. (2016) examined environmental and social disclosures and corporate financial performance and found no significant relationship between environmental disclosure and profitability. In contrast, Plumlee et al. (2015) found that the quality of voluntary environmental disclosure was associated with firm value through expected future cash flows and the cost of equity.

These mixed findings provide an important basis for examining the relationship between environmental disclosure transparency and corporate financial performance from a conceptual perspective.

2. Meaning of Environmental Disclosure

Environmental Disclosure is the way by which businesses give out their environmental-related information to stakeholders.

Environmental information may include:

- Environmental policies
- Energy usage
- Greenhouse gases emissions
- Water usage
- Waste management
- Recycling operations
- Environmental expenses
- Pollution control
- Environmental goals
- Environmental risks
- Environmental programs
- Conformity with environmental legislation

Businesses may give out this information voluntarily or because of the need for reporting.Clarkson et al. (2008) examined discretionary environmental disclosures using an index based on the Global Reporting Initiative guidelines. Their study found a positive association between environmental performance and the level of discretionary environmental disclosure among firms in highly polluting industries.

This suggests that environmental disclosure can provide useful information about a company's environmental performance.

3. Environmental Disclosure Transparency

Environmental disclosure transparency is more than just disclosing environmental information.

Transparent disclosure will provide information which is:

1. Clear – the information should be clear.
2. Relevant – the information should be relevant to any environmental issue.
3. Complete – no selective omission of important environmental information.
4. Specific – the companies should disclose information that can be measured.
5. Comparable – the information should be compared to previous years.
6. Reliable – the stakeholders should be confident with the information provided.

For instance, the statement,

"The company is dedicated to protect the environment"

Provides little amount of information. A more transparent disclosure will provide information like "The company cut down its electricity consumption by 8% during the year and the target is 20% by the year 2030." The second type of information is more useful because it is measurable and specific information. Plumlee et al. (2015) emphasize that the quality of environmental disclosure is more significant than just existence of the environmental disclosure itself. Their study showed that the quality of the environmental disclosure was positively correlated with firm value and cost of equity through future cash flows.

Thus, this research paper will consider transparency and quality of the environmental disclosure as very important features.

4. Corporate Financial Performance

Corporate financial performance refers to the financial results achieved by a company during a particular period. Financial performance can be evaluated through accounting-based and market-based measures.

Common accounting-based measures

- Return on Assets (ROA)
- Return on Equity (ROE)
- Net Profit Margin

- Operating Profit
- Earnings per Share

Common market-based measures

- Tobin's Q
- Market value
- Stock returns
- Market-to-book ratio

ROA and ROE are particularly common measures of corporate financial performance. ROA indicates how effectively a company uses its assets to generate profits. ROE indicates how effectively a company generates returns from shareholders' investment. Financial performance is important because it reflects the economic success and sustainability of a business.

5. Importance of Environmental Disclosure Transparency

The importance of environmental disclosure transparency may include:

5.1 Increases Stakeholder Confidence

Stakeholders need information regarding the environmental conduct of organizations. Transparency in reporting increases the confidence of the stakeholders since the latter will have more information about the conduct of the organization.

5.2 Enhances Organizational Reputations

Organizations which openly disclose their environmental practices are likely to build good reputations amongst their customers, investors, employees, and the community.

5.3 Decreases Information Asymmetry

The managers tend to have more information about the organization than the external stakeholders. Environmental disclosure helps in decreasing this asymmetry of information since the stakeholders get more information.

5.4 Aids Investment Decisions

Non-financial information is becoming increasingly important in investment decisions due to increased awareness regarding the risks of an organization. Environmental disclosure can also help in this regard.

5.5 Promotes Sustainability

Environmental disclosure can help the organizations to monitor their environmental performance and discover the environmental risks and opportunities.

6. Theoretical Foundation

This conceptual paper uses two simple theories to explain the importance of environmental disclosure transparency.

6.1 Stakeholder Theory

Stakeholder Theory is associated particularly with Freeman (1984), who argued that organisations should consider the interests of stakeholders who can affect or are affected by organisational activities.

Stakeholders include:

- shareholders;
- investors;
- employees;
- customers;
- suppliers;
- government;
- local communities; and
- society.

Environmental activities can affect many of these stakeholders. Therefore, stakeholders may expect companies to disclose information about environmental performance.

From the stakeholder perspective, environmental disclosure is a communication mechanism between the organisation and its stakeholders.

Transparent environmental disclosure can therefore strengthen stakeholder relationships.

6.2 Legitimacy Theory

Legitimacy Theory suggests that organisations seek to ensure that their activities are consistent with the expectations and values of the society in which they operate.

Deegan, Rankin, and Tobin (2002) examined the environmental and social disclosures of BHP and found evidence consistent with legitimacy explanations for corporate environmental and social disclosure. Companies may therefore disclose environmental information to demonstrate that their activities are acceptable to society. For example, companies operating in environmentally sensitive industries may face greater public attention. Environmental disclosure can help these companies communicate their environmental policies and performance. Thus, environmental disclosure can contribute to maintaining organisational legitimacy.

7. Environmental Disclosure and Corporate Financial Performance

There are several possible explanations for the link between environmental disclosure and financial performance. Firstly, environmental disclosure may enhance corporate reputation. A positive reputation may facilitate attracting customers and investors to the company. Secondly, environmental disclosure may decrease information asymmetry. It allows investors to make more informed decisions based on available information about environmental matters. Thirdly, environmental transparency may increase stakeholder relations. Good relations with customers, employees, regulatory bodies, and investors are useful for future business performance. Fourthly, environmental disclosure may motivate firms to increase environmental efficiency. For instance, decreasing energy usage and waste generation may be helpful for reducing expenses. On the other hand, environmental disclosure is associated with costs. There may be costs related to environmental management systems, gathering of information, disclosure, audit and assurance. Thus, the financial implications of environmental disclosure may not always be positive. This is confirmed by inconsistent results of previous studies.

There is a wealth of research emerging from India that highlights the relationship between environmental disclosure and corporate performance. Kumar and Firoz (2018) studied the climate-change disclosure practices of Indian firms and used ROA and ROE as indicators of financial performance. Charumathi and Ramesh (2017), in their study of BSE-100 firms, observed a positive influence of social and environmental disclosures on market valuation. Also, Sehgal et al. (2022), in their study of 56 Indian firms in 2014-2021, found a positive impact of environmental and social sustainability disclosure on ROA and ROE in the long term. Agarwala et al. (2024) analyzed 305 NSE 500 firms and analyzed the relationship between disaggregated ESG disclosure and corporate performance. Additionally, Sharma et al. (2025) highlighted a significant relationship between environmental disclosure and financial performance of the firms that were a part of the BSE Carbonex Index. These pieces of evidence clearly suggest that there can be some kind of financial implications associated with environmental disclosure of Indian firms. Qiu et al. (2016) found that environmental disclosure was not significantly related to profitability, although their study found a relationship between social disclosure and market value. On the other hand, Plumlee et al. (2015) found that environmental disclosure quality was associated with firm value. Similarly, research examining the relationships among environmental performance, environmental disclosure, and financial performance has reported complex relationships among these three variables rather than a simple one-way relationship.

Therefore, the relationship should not be considered automatic. The quality and transparency of environmental disclosure may be more important than the amount of information disclosed.

8. Conceptual Framework

Based on the literature and theoretical discussion, this paper proposes a simple conceptual relationship:

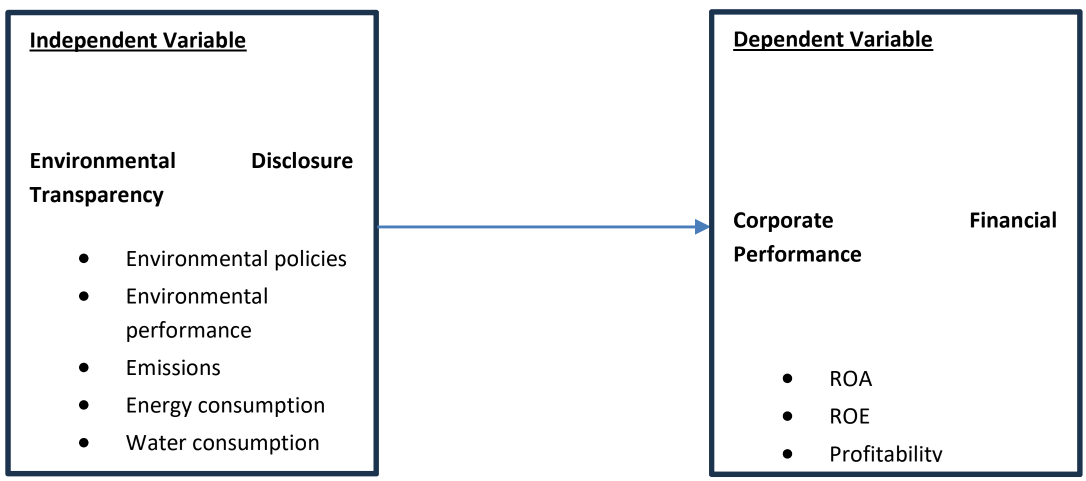

Fig.1 Conceptual Framework

The framework proposes that greater transparency in environmental disclosure may contribute to better corporate financial performance.

9. Proposed Hypothesis

Based on Stakeholder Theory, Legitimacy Theory, and previous literature, the following hypothesis can be proposed:

H_0: Environmental disclosure transparency has no significant influence on corporate financial performance.

H_1: Environmental disclosure transparency has a positive influence on corporate financial performance.

10. Discussion

Environmental disclosure has become more and more important in terms of corporate reporting in the modern times. It is important for companies to not only report financial figures but also to provide information regarding the companies' environmental responsibilities. According to the conceptual part of the paper, the transparency may play a role in the improvement of financial performance via the formation of good stakeholder relationships, reputation, investor confidence, and availability of information. But the relation between environmental disclosure and financial performance does not have to be positive.

Qiu et al. (2016) did not find any significant relation between environmental disclosure and profitability, which means that environmental disclosure does not guarantee the improvement of the financial performance.

However, Plumlee et al. (2015) found that environmental disclosure quality had a connection with firm value.

It means that the researchers have to take into account the quality and transparency of environmental disclosure and not only the number of environmental disclosures.

Therefore, the conceptual framework of the paper is going to consider environmental disclosure transparency as an important communication tool of corporations.

11. Managerial Implications

There are many implications of the study for the management of firms. First, firms must communicate environment-related information that is comprehensible to stakeholders. Second, firms must provide quantifiable information related to the environment instead of generic statements. Third, firms must disclose their success as well as failures when it comes to meeting environment-related objectives. Fourth, environment-related information must remain consistent in order for comparison to take place in successive reporting periods. Finally, firms must realize that environmental disclosure is a form of strategic communication.

12. Implications for Investors

Environmental information can help the investors understand environmental risks and opportunities. But the investors must not take it for granted that just because the companies disclose their environmental information in detail, they are performing well environmentally.

They have to check whether the environmental claims of the companies are backed up by concrete data such as:

- Emissions;
- Energy use;
- Environmental objectives;
- Waste reduction;
- Water use; and
- Environmental costs.

13. Conclusion

Disclosure of environmental information transparency is one of the most important trends in corporate reporting. Companies receive increasing demands from various stakeholders to report on their environmental information and performance.

This conceptual paper investigates the relationship between environmental disclosure transparency and corporate financial performance based on Stakeholder Theory and Legitimacy Theory.

As a result of the discussion, it was revealed that transparent environmental disclosure may have potential benefits for firms including building up stakeholder confidence, reputation, information and long-term stakeholder relations.

Nevertheless, empirical literature has revealed the contradictory results about the relationship between environmental disclosure quality and corporate financial performance. While some papers reveal positive relationships between environmental disclosure quality and firm value, other papers state that there is no significant relationship between environmental disclosure and profitability.

Thus, the impact of environmental disclosure on corporate financial performance should not be considered only through the lens of volume of information disclosure. Information quality, credibility, completeness, etc. are important. This paper concludes that environmental disclosure transparency may positively affect financial performance of companies and provides a simple conceptual model for future empirical research.

Future researchers are able to check the proposed relationship based on secondary data from publicly traded companies and use. Future researchers can test this relationship using secondary data from listed companies and measures such as ROA, ROE, profitability, and firm value.

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