International Review of Accounting, Banking and Finance
Vol 3, No.3, Fall 2011 Page 1~26

Corporate Environmental Performance, Disclosure and Leverage: An Integrated Approach

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Abstract: Corporate capital financing decisions are an integral part of overall corporate strategy. This study analyses the effect of environmental performance and disclosure on the capital structure of U.S. firms in the electric utility industry. The hypothesized relationships account for endogeneity in the three factors of strategy and are estimated using a simultaneous equations model. Our results suggest that firms with lower toxics emissions exhibit higher leverage and voluntary disclosure and that leverage is negatively associated with disclosure.

Keywords: corporate environmental strategy, environmental performance, environmental disclosure, leverage, capital structure.

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1. Introduction

Capital structure decisions are fundamental for the firm's financial strategy and have important implications for risk-taking and investment behavior of the firm, research and development, innovation, competition, costs, and relationships with non-financial stakeholders such as customers and employees.[1] In practice, capital structure decisions and corporate strategy are interrelated (Parsons and Titman, 2008) and the question of how to finance the firm should support and be consistent with its long-term strategy (Andrews, 1980; Barton and Gordon, 1987).

Parsons and Titman (2008) argue that empirical studies that attempt to shed light on the connection between capital structure and a firm's corporate strategy potentially suffer from endogeneity problems. For example, studies of the effect of debt on a

[1] See for example Titman (1984), Titman and Wessels (1988), Hall et al. (1990), Bronars and Deere (1991), Opler and Titman (1994), Chevalier (1995), Kale and Noe (1995), Zingales (1998), Khanna and Tice (2000), Myers (2001), Campello (2002), Mauer and Sarkar (2005).