Voluntary Environmental Disclosures and Equity Risk: Should Firms Tell All?

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Abstract
In this study we explore the relationship between the quality of a firm's voluntary environmental disclosure and the cost of equity capital. Extant financial theory suggests that voluntary disclosures impact stock prices through a direct effect on a firm's cost of equity capital (Barry and Brown, 1985; Botosan, 1997; Diamond and Verrecchia, 1991; Lambert, Leuz, and Verrecchia, 2005). However, current empirical work in this area focuses on the direct effect of the voluntary disclosures and provides mixed evidence in supporting the theory. We extend empirical research by re-examining the relation between expected cost of capital and voluntary disclosures using data drawn from an analysis of Corporate Environmental Reports (CER). These data provide an appealing context to examine this relation, as CER's provide extensive detailed information regarding long-term fundamental issues related to the firm's sustainability.

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