SPRING CLEANING?
THE RELATIONSHIP BETWEEN ENVIRONMENTAL PERFORMANCE AND DIVESTITURES

I investigate the impact of firm environmental performance on divestitures. Building on the behavioral theory of the firm, I argue that failure to meet environmental performance aspirations—even if considered secondary to financial performance aspirations—triggers firms to divest assets. I further posit that the nature of the assets—environmentally dirtier or cleaner relative to the other assets in the portfolio—that firms choose to divest is contingent on whether firms meet their financial aspirations. Firms that fail to meet financial aspirations in addition to their environmental aspirations are more likely to divest cleaner than dirtier assets in hopes of charging a full price in the asset sale, thereby helping them improve their financial position. In contrast, firms that fail to meet environmental aspirations but satisfy financial aspirations are more likely to divest dirtier than cleaner assets, as they can be more strategic about renewing their portfolio and thus may retain those assets that help them effectively address their current or future environmental liabilities.

The sample includes 646 public firms operating facilities mandated to report greenhouse gas emissions to the U.S. Environmental Protection Agency's Greenhouse Gas Reporting Program between 2010 and 2018, for a total of 4,558 firm-year observations. I rely on a random-effects paneled logistic regression for the analysis of the dependent variables regarding divestitures.

The findings are two-fold. First, I demonstrate that as firms' environmental performance falls farther and farther below aspirations, they are more likely to engage in risky strategic change in the form of divesting assets from their portfolio.

Second, complementing and extending the current literature on divestitures and performance feedback, I further show that the joint performance feedback of environmental and financial goals influences the nature of assets that firms choose to eliminate from their portfolio. On the one hand, I find that firms failing to satisfy both environmental and financial aspirations are more likely to divest cleaner than dirtier assets. These firms may prioritize addressing financial performance gaps over environmental performance gaps, and thus they likely choose to divest a cleaner asset to which they can charge a full price to improve their financial position immediately. On the other, firms that fail to meet environmental aspirations but succeed in surpassing financial aspirations are more likely to divest dirtier than cleaner assets. These firms have slack to pay attention to environmental performance gaps, thereby focusing on retaining assets that help them address the current or future environmental liabilities. This mechanism will likely lead firms to consider eliminating dirtier assets as an attractive strategic option.

This paper contributes to our understanding of divestitures and has more general implications for performance feedback and corporate sustainability.

Implications for Drivers of Divestitures

These results have implications for what drives divestitures. Traditionally, studies on divestitures focus on firm financials—such as financial performance and financial constraints—as a primary driver of triggering firms to undertake divestitures. While this role remains valid for a number of divestiture cases, this paper extends these arguments by assessing the relationship of divestitures to firm environmental performance, which is a somewhat neglected but increasingly relevant performance metric. Environmental issues, including climate change and global warming, have become more urgent to address as they are getting worse across the globe. Environmental issues threaten to make an extensive impact on the way in which firms operate, the extent of stakeholder pressures on firm behavior, and the cost of doing business. Hence, it has become essential for firms to address their environmental liabilities and performance. Under these circumstances, firms may need to evaluate if their current strategies can be redirected toward an environmental strategy to meet their environmental goals. Although risky, divestitures may serve as an environmental strategy to enhance firms' environmental performance, as transferring the ownership of assets can help firms remove their environmental liabilities from the books. This paper contributes to offering a framework on how firms use divestitures as an environmental strategy to respond to weak environmental performance.

Implications for Performance Feedback Theory

The findings also have implications for performance feedback theory. Recent performance feedback arguments go beyond the extent of the strategic change that firms undertake and investigate the nature of such a change. This paper examines the mechanisms through which joint performance feedback of multiple goals serves as a different signal to firms to assess varying strategic risks based on the nature of assets they choose to divest. The results highlight that firms prioritize their strategic responses to a failure to meet financial aspirations over a failure to meet environmental aspirations because firms may consider immediate financial needs as a crucial issue to guarantee their survival. Hence, firms facing below-aspiration financial and environmental performance are likely to seek a quick way to enhance their financial position, triggering them to choose to divest cleaner assets over dirtier assets. In contrast, firms facing above-aspiration financial performance and below-aspiration environmental performance have slack to prioritize their responses to a failure to satisfy environmental aspirations, leading them to remove dirtier assets to be better equipped to cope with their current or future environmental liabilities. This paper contributes to the literature on performance feedback theory by suggesting the need to take the nature of firms' various strategic responses to performance feedback of multiple goals into account.

Implications for Corporate Sustainability

This paper has implications for corporate sustainability because the results illustrate a situation wherein firms neither deliver responsibilities to negative environmental externalities generated by their business activities nor do they completely ignore the controls imposed upon them. Recent anecdotal evidence from oil and gas companies indicates that firms could use divestitures to restructure their portfolio as they seek to achieve environmental goals. Thus, divestitures of facilities have the potential to improve firm-level environmental performance ostensibly, as environmental footprint accounts are just based on firms' actual operational activities. By getting rid of some of their assets, firms generate the illusion of a positive environmental footprint in their books. Divestitures of assets are not considered illegal attempts but merely strategic options that firms can choose to implement. Yet, such divestitures may not be a way to attain societal-level environmental goals, potentially making it more difficult to achieve these goals depending on who purchases those assets. This study sheds light on a particular corporate behavior concerning divestitures as a strategic reaction to poor environmental performance.

Overall, this paper extends our understanding of the conditions under which firms consider divestitures as a strategic tool to enhance financial performance and environmental performance simultaneously. The findings offer a basis for future studies on the role of environmental performance in driving a strategic change and the effects of joint performance feedback on multiple organizational goals on the nature of organizational responses.