Taming polluters: Ratings have spillover effects, leading to reduced toxic emissions

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A new study by the University of Chicago Booth School of Business Assistant Professor Amanda Sharkey and University of Utah Assistant Professor Patricia Bromley found that environmental ratings have spillover effects on other companies' behavior. Rated firms reduce their toxic emissions even more when their peers are also rated. In addition, rated peers can even motivate some unrated companies to reduce their emissions.

The research is unusual in that the role of peers in conditioning how firms respond to ratings systems has received little examination.

The study, "Can Ratings Have Indirect Effects? Evidence from the Organizational Response to Peers' Environmental Ratings," found that being rated, regardless of the rating received, did prompt a company to reduce its toxic emission, consistent with prior research. But it went a step further to discover that, on average, the more peers that were rated in an industry, the greater a rated firm's drop in emissions.

The researchers looked at the indirect effects of environmental rankings, paying special attention to how manufacturers that were excluded from the rankings reacted as more of their peer companies were rated on their ability to lower toxic emissions. Surprisingly, even companies that were not rated changed their behavior knowing that their peers were being evaluated. However, the spillover effect on unrated firms occurred only in highly regulated industries.

"If managers believe their firms will be rated eventually—an expectation that may be especially strong if many of their peers are already rated—they may take immediate steps to reduce their emissions," the report said.

The researchers focused on the environmental ratings of public firms in the United States issued by KLD Research and Analytics, Inc., a pioneer in socially responsible investing. They also relied on data that firms are required to report to the government about their pollution levels.

One key discovery of the research is the potential for ratings systems to drive field-wide change when only some firms are formally subject to evaluation. This is important because many ratings systems are not comprehensive in their coverage, and there has been little evidence on the reactions of unrated firms.

The *American Sociological Review* published the study in its February 2015 issue.

More information: Can Ratings Have Indirect Effects? Evidence from the Organizational Response to Peers' Environmental Ratings, asr.sagepub.com/content/80/1/63.abstract

Provided by University of Chicago

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