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Does reaction to controversy in corporate narratives depend on its significance for various stakeholders?

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Abstract

Purpose – The study aims to determine whether a relationship exists between the potential significance of corporate controversies for stakeholders and how organisations respond to them in their annual and sustainability reports.

Design/methodology/approach – This paper employs content analysis on annual and sustainability reports of 48 listed companies from the Refinitiv database. The logit regression was used to estimate the model.

Findings – The study revealed that the main factors increasing the probability of a controversial issue being addressed in a corporate report are the controversy's potential significance, companies' financial performance and lawsuits.

Research limitations/implications – Our study has three major limitations. These are a relatively small sample of companies and reports, focusing on disclosures made in corporate reports and omitting other channels of communication, for example, social media, and a certain amount of subjectivity in the process of coding information.

Social implications – Former studies show that corporations face a serious risk of their hypocritical strategies becoming too evident for stakeholder groups. Our findings suggest that the risk is already materialising and may undermine the idea of CSR and sustainability reporting.

Originality/value – Our research focuses on high-profile adverse incidents widely reported in the media, the omission of which from corporate reports seems to constitute a particular case of organised hypocrite. It also demonstrates that companies use an impression management strategy to defuse adverse publicity and that major controversies cause minor ones to be omitted from their reports.

Keywords Controversy, Narratives, Stakeholders, Incremental, Information, Impression, Strategy

Paper type Research paper

Introduction

Pollock, Lashley, Rindova, and Han (2019, p. 465) state that social evaluations (including reputation, status, celebrity and stigma) are an exciting and growing field of inquiry in management studies that are becoming more important to how firms operate and create value. Reputation is regarded as a valuable intangible asset that helps organisations gain and maintain a sustained competitive advantage. Prior research suggest that a better reputation enables organisations to access critical resources more easily, lowers uncertainty about them and leads to better organisational performance (Roberts & Dowling, 2002; Sauder, Lynn, & Podolny, 2012; Adamska, Dąbrowski, Homa, Mościbrodzka, & Tomaszewski, 2022). Firms

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put great effort into gaining, improving and recovering their reputation (Chelli, Durocher, & Fortin, 2019). However, controversies arising around a firm may severely damage its reputation. When such controversies arise, companies use a variety of communication strategies (including impression management) to reduce their negative reputational impact.

The paper investigates how firms' reports account for their involvement in controversial incidents (accidents, catastrophes, frauds, etc.), understood as any action taken by a company or associated with its operations, which may harm its stakeholders and the environment or be negatively perceived by the stakeholders. Controversial incidents attracting the media's attention involve the risk of damaging companies' reputations.

In the study, we seek to determine whether an association exists between potential significance for a firm's stakeholders and the type of a company's reaction to a controversial incident. We assume that the strength of the response increases with the significance of a controversy for the stakeholders. We also posit that companies are more willing to apologise or shift the blame for controversies onto external factors when the risk of damage to their reputation is substantial and an adverse reaction from their stakeholders is expected. Therefore, we aim to determine whether a relationship exists between the potential significance of corporate controversies for stakeholders and how organisations respond to them in their annual and sustainability reports. Based on the results of other studies (i.e. Hadro, Klimczak, & Pauka, 2017; Bitter & Gardner, 2018), we posit that attribution is the most common impression management strategy companies employ. Research results also support this assumption (Clatworthy & Jones, 2003), which shows companies seek to put themselves in the best possible light. This tendency is even stronger for companies with poor financial performance (Caserio, Panaro, & Trucco, 2019).

To reach the goal, we used the content analysis on corporate reports of 48 companies and built the logit regression model. We identified 133 corporate controversies and analysed 248 reports, including 130 annual reports, 56 sustainability reports, 47 CSR and ESG reports and 15 miscellaneous reports of these companies. The first part of this empirical study presents the content analysis on reports and disclosure strategies companies adopt to explain controversial incidents or their inappropriate behaviours. The second part of the study uses logit regression to determine whether companies considering the type of disclosure strategy take account of how controversial an incident they need to explain may seem to various stakeholders.

This study contributes to the growing literature on organisational reputation, impression management and reaction to controversies. The novel aspect of the study is that it analyses companies' responses to their involvement in controversies from the perspective of their potential impact on stakeholders. Apart from advancing the knowledge of corporate social responsibility and corporate reactions to controversial incidents, the study also provides a deeper insight into the informational reliability of corporate reports. It has been found that companies seeking to avoid the disclosure of potentially harmful information try to obfuscate it, emphasise the positive aspects of their operations and exaggerate their benefits (Koonce, Leitter, & White, 2021). According to research, blaming others for one's failures is a natural reaction driven by a sense of shame and guilt (Graham, 2020). Corporate executives sometimes resort to a technique known in social psychology as attribution. Explaining the occurrence of adverse developments through the operation of external factors helps them conserve their self-esteem.

The results of our study show that companies' reporting on reputationally damaging issues does have an association with their potential influence on stakeholders, and that the probability of disclosing information on such issues increases with the expected strength of that influence.

The paper proceeds as follows. In the next section, we briefly present the theoretical background for the development of our hypothesis. Later, we introduce our data and research design. Next, we present our findings on the content of the disclosures published by the companies and the results of the regression analysis. In the last section, we discuss our findings and study limitations.

Theoretical background and hypothesis development

Previous research on the corporate response to controversies frequently utilises legitimacy theory as its primary theoretical framework (Cho, 2009; Guo, Zhao, & Yang, 2022). Legitimacy theory argues that organisations persistently attempt to ensure their activities are perceived as legitimate stakeholders (Deegan, 2002). Deegan (2002) provides evidence that companies with poorer environmental records tend to make more comprehensive disclosures, and suggests that disclosure is an effective way to change stakeholders' perspectives. Cho, Roberts and Patten (2010) demonstrate that companies with weaker environmental performance also manipulate language in their environmental disclosures to obfuscate their subpar performance.

The reputation concept is also used in the newer literature on corporate reactions to controversies (Cho, Laine, Roberts, & Rodrigue, 2015; Cho, 2022). Prior literature (Vidaver-Cohen, 2007; Sauder *et al.*, 2012; Pires & Trez, 2018) suggests that a sound reputation is ranked among organisations' most valuable intangible resources for a number of reasons. First, it facilitates easier access to critical resources. Second, it lowers uncertainty about them more easily and leads to better organisational performance. Third, it contributes to the target audience's trust and value creation, maximising the ability to offer products and services with high added value. Fourth, it helps organisations gain and maintain a competitive advantage and superior financial performance. Fifth, reputation reduces stakeholders' uncertainty about the organisation's future performance (Vidaver-Cohen, 2007). Therefore, firms put considerable effort into gaining and protecting their reputation. Recent literature suggests the importance of organisational reputation dynamics, especially reputation momentum (Kim, Kim & Rhee, 2021).

Legitimacy and reputation concepts bear many similarities and have been mentioned in the same papers (e.g. Elsbach, 1994, pp. 66, 69; Brown, 1997, p. 668). However, Deephouse and Carter (2005) recognise essential distinctions between these concepts and propose the following two criteria: the nature of the assessment stated, and the dimensions on which legitimacy and reputation can be assessed. According to the nature of the assessment, legitimacy is centred on meeting and adhering to the expectations of a social system's norms and values, while central to reputation is a comparison of organisations to determine their relative standing.

In their literature review on reputation and legitimacy, Pollock *et al.* (2019) emphasise that organisations have various stakeholder groups with diverse interests and values, and they call for further exploration concerning various reputations for different stakeholders. Our article aims to follow their recommendation by including a number of stakeholders' (investors, customers, employees, community and government) reaction to controversy in corporate narratives. Stakeholder theory emphasises the importance of balancing the interests of multiple stakeholders (Torelli, Balluchi, & Furlotti, 2020). It holds that organisations should seek to satisfy the needs of diverse stakeholders, such as shareholders, customers, employees, governmental agencies and local communities (Freeman, Wicks, & Parmar, 2004; Stahl, Brewster, Collings, & Hajro, 2020). The corporate stakeholders have different values, motives and interests, and their level of success in their involvement activities can vary (Georgakopoulos & Thomson, 2008). Stakeholder theory is used in studies on reputational issues (e.g. Javed, Rashid, Hussain, & Ali, 2020) and voluntary disclosures (e.g. Bourveau & Schoenfeld, 2017; Zarzycka, Krasodomska, & Dobija, 2021) that companies use to win the support of various stakeholder groups and be successful in the long term (Flammer, Toffel, & Viswanathan, 2021). However, trying to meet their information satisfactorily needs carries some risks, as giving too much information by a company can compromise its competitive advantage and consequently hurt its shareholders (Hanley & Hoberg, 2010; Dolinšek & Lutar-Skerbinjek, 2018). Stakeholder theory translates into the multi-dimensionality of reputation, or different kinds of reputations, in the eyes of stakeholders, such as customers, investors, employees, communities and the government (Freeman & Dmytriyev, 2017).

Based on the literature review, Garcia, Carvalho, Boaventura, and Souza Filho (2021) identified the following determinants of corporate disclosure in studies utilising stakeholder theory: stakeholder power and pressure, culture, industry, size and risk. Stakeholder power and pressure, which are the main topics of our paper, impact the demand for information and guide the priories in the choice of disclosure strategy. National and organisational culture drives the amount of information revealed and the choice of which disclosure strategies are socially acceptable and expected. Similarly, corporations tend to compare themselves and imitate other entities operating in the same industry. Size is also a significant determinant of disclosure strategy choice as large companies gain greater visibility. Therefore, they use disclosure strategy to shape external stakeholder perceptions (Garcia *et al.*, 2021). Involvement in significant risky operations causes both changes in management behaviour and the increase of stakeholder pressure, which, in turn, affects the choice of disclosure strategy.

A corporation's financial performance may also impact the choice of disclosure strategy (Dammak, Triki, & Boujelbene, 2008). Poor financial performance may lead to an impression management strategy aimed at image improvement in the eyes of stakeholders. This tendency might be intensified by the fears of the negative effect of controversy on financial performance. The negative effect relates both to the direct outflow of money or other resources triggered by controversy and to the indirect long-term consequences, including tarnished future relationships with stakeholders like customers, suppliers, creditors and the government, which finally hit the bottom line (Nirinio *et al.*, 2021).

Corporate controversies arise when the media report that companies act inappropriately or negligently, which violates values held by the public. The most appropriate way to handle such crises appears to be the voluntary disclosure of information addressing the concerns of various stakeholder groups and the public (Deegan, 2002). An increasing number of authors (Dillard & Vinnari, 2019; Bellucci, Simoni, Acuti, & Manetti, 2019) are of the opinion that corporate reports (including sustainability reports) should be a form of dialogue with stakeholders rather than an opportunity to bury controversies under an ancient genre of rhetoric with apologia and a defensive stance (Greenwood, Jack, & Haylock, 2019). Nevertheless, defending oneself against accusations, evil rumours and formal lawsuits is crucial for both individual actors and organisations to restore their public image and reputation (Ferguson, Wallace, & Chandler, 2018). After reviewing the literature, Merkl-Davies and Brennan (2007) and Merkl-Davies, Brennan, and McLeay (2011) concluded that corporate narrative documents are built around two competing discretionary disclosure strategies: impression management and the incremental information approach.

Some of the first scholars who introduced the concept of impression management into the scientific debate on corporate reporting were Hooghiemstra (2000), Clatworthy and Jones (2001) and Yuthas, Rogers, and Dillard (2002). Its elaboration and popularisation are credited to Merkl-Davies and Brennan. Hooghiemstra (2000, p. 60) defined the concept as "a field of study within social psychology studying how individuals present themselves to others to be perceived favourably by others". According to Clatworthy and Jones (2001), the purpose of impression management in the corporate reporting context is to control and manipulate the impression conveyed to the accounting information users. Merkl and Brenan (2007) have pointed to the risk of managers trying to turn corporate reports into impression management tools, enabling them to "strategically… manipulate the perceptions and decisions of stakeholders" (Yuthas *et al.*, 2002, p. 142).

The intention behind the use of an incremental information strategy is to provide stakeholders with value-relevant information improving their decision-making capability (Holthausen, 1990). The reasoning underlying an incremental information strategy is that using additional objective information pays off to both organisations and their executives as long as it is perceived as value-relevant by investors (Baginski, Hassell, & Hillison, 2000), including ESG information (Giakoumelou, Salvi, Bertinetti, & Micheli, 2022). Furthermore, recent research has shown that non- or less optimistically biased reporting can actually have a positive effect, be beneficial and translate into a better corporate reputation (Cho, Fabrizi, Pilonato, & Ricceri, 2022).

Based on stakeholder theory, we hypothesised that the way companies would report the negative consequences of their operations covered by the media would depend on their potential significance for stakeholders. The hypothesis draws on the statement by Sahari, Nichol, and Yusof (2019) that stakeholders' opinions and participation are one of the main drivers of corporate sustainability reporting. As stakeholders can ratchet up pressure on organisations to disclose certain information (Kowalczyk & Kucharska, 2020; Vitolla, Raimo, Rubino, & Garzoni, 2019), the content of corporate reports should reflect the importance they attach to particular issues (Vitolla *et al.*, 2019; Torelli *et al.*, 2020). Stakeholder theory holds that companies constantly need stakeholder support and approval for their actions (García-Sánchez, Suárez-Fernández, & Martínez-Ferrero, 2019). In the opinion of some authors, corporate stakeholders play a vital role in ensuring social sustainability and standardising the reporting and measurement of achievements in this area (Toussaint, Cabanelas, & Blanco-González, 2021). Their reactions to companies' behaviour are key to the success of long-term corporate strategies. The discrepancies between the information presented in corporate reports and that shared with the media indicated by earlier studies imply that companies select information for disclosure based on its perceived importance or impact (Casonato, Farneti, & Dumay, 2018). We assumed that companies would use an incremental information strategy to handle controversies that appear significant and, consequently, value-relevant.

Fernandez-Feijo, Romero and Ruiz (2014) distinguished four categories of companies sensitive to stakeholder pressure: investor-oriented, customer-proximity, employee-oriented and operating in environmentally sensitive industries. Stakeholder groups and the main consequences of controversial incidents for each of them were identified from the available literature (Table 1).

In addition to the significance of controversy, we used two other variables: the company's ROA as a measure of its financial performance, and a filed lawsuit. Because the financial performance of companies is reported to be positively influenced by their ESG (environment-social-governance) activities (La Torre, Leo, & Panetta, 2021), we assumed that stakeholders' criticism of companies' actions was likely to impair their financial performance (Lin, Ho, Lee, & Ng, 2020). Mure, Spallone, Mango, Marzioni, and Bittucci (2021) have demonstrated that the higher the risk of legal or regulatory sanctions, the lower the ESG score (published by Thomson Reuters), and vice versa. They also postulated that the risk of sanctions motivates businesses to step up their efforts to rebuild their reputation and improve their ESG score.

Based on the literature review, we formulated the hypothesis:

H1. An association exists between the potential significance of a controversy for stakeholders and the disclosure strategy adopted by a corporation after a controversy.

Disclosure strategy	Disclosure sub-strategy	Definition	Characteristics
Impression management		is "a field of study within social psychology studying how individuals present themselves to others to be perceived favourably by others" (Hooghiemstra, 2000, p. 60) is an attempt "to control and manipulate the impression conveyed to users of accounting information" (Clatworthy & Jones, 2001, p. 311) is a disclosure that "strategically. . .manipulates the perceptions and decisions of stakeholders" (Yuthas *et al.*, 2002, p. 142)	
	Attribution	is "a defensive framing tactic that shifts the blame for negative outcomes away" (Merkl-Davies & Brennan, 2007, p. 11) is ". . .a self-serving bias involving individuals' perceptions and explanations of events that manifests itself in a tendency to claim more responsibility for successes than for failures. In a financial reporting context, it entails managers attributing positive organizational outcomes to internal factors ('entitlements') and negative organizational outcomes to external factors ('excuses')" (Merkl-Davies & Brennan, 2007, p. 12)	Enumeration of external factors that contributed to the catastrophe; enumeration of firms or people that may also be to blame; explaining how the corporation tried to prevent the controversy; assurances that it will do everything to explain its causes
	Concealment	can ". . .be achieved in two ways: by either (1a) obfuscating negative outcomes (bad news) or (1b) emphasizing positive organizational outcomes ('good news')" (Merkl-Davies & Brennan, 2007, p. 11)	Highlighting corporation's efforts to prevent the occurrence of catastrophes or controversies and its achievements and successes in the sustainability disclosure area; avoiding information about the current controversy and related issues
Incremental information		The most useful information for stakeholders including components valued by investors, which determines the preferred level of disaggregation (Jennings, 1990)	
	Objective information	Information presented in a way to avoid the impression that its author(s) expresses their stance or personal feelings	A neutral description of a controversy; omitting words implying remorsefulness or an apology such as sorry, terrible, apologize, regret
	Apology	The expression of how the author feels about some information	An apologetic description of a controversy expressing guilty consciousness through words such as sorry, terrible, apologise, regret

Source(s): Own elaboration

Table 1.
Taxonomy of disclosure strategies

Research design

A mixed method of qualitative and quantitative analysis was used in the research.

We examined the sustainability reports and annual reports of 48 listed companies for information about corporate controversies (see Appendix 1). All companies were randomly sampled from the Refinitiv database. When selecting reports, we focused on the period from 2010 to 2021, because some types of reports (mainly CSR reports, sustainability reports and integrated reports) had rarely been prepared and released before 2010. In total, we analysed 131 controversies along with 248 reports, including 130 annual reports, 56 sustainability reports, 47 CSR and ESG reports and 15 miscellaneous reports (integrated reports, environmental reports, global social impact reports, green bond reports, green bond reports and non-financial reports).

The qualitative analysis (content analysis) aimed to answer the following question: "*Do firms involved in controversies adopt an incremental information strategy and explain the measures they took to repair the damage, or do they use an impression management strategy*"?

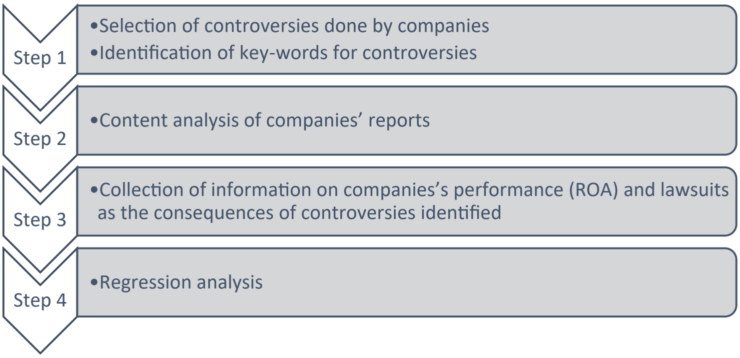
The purpose of the quantitative analysis was to test the hypothesis. Using logit regression, we sought to determine if there was an association between the type of a company's disclosure strategy and the potential significance of the controversy it was involved in. We posited that the probability of a company using an incremental disclosure strategy would be lower in the case of minor controversies. The significance of controversy was represented by the number of stakeholder groups considering it important (Table 2), weighted by the involved company's sensitivity to stakeholder pressure.

The research comprised the steps presented in Figure 1. We chose the companies and selected the controversies they did from the Refinitiv database. We identified stakeholder groups affected by the controversy based on its nature and consequences reported by the media (the Refinitiv database provides links to media materials). We searched reports for information about corporate controversies to determine whether the reports' authors provided factual accounts of the causes of controversial incidents or whether they focused on apologising to the stakeholders. Following Leong (2019), who has defined a text unit as a sentence, a paragraph, a section and a page, we chose to select sentences that referred to controversies or contained appropriate keywords while taking account of their linguistic context. The data were analysed according to the taxonomy of narrative types presented in Table 1, and then classified independently by both authors. We used the NVivo software to

Stakeholder group	Significance of a controversy in the eyes of a specific group of stakeholders
I = investors (shareholders, creditors, suppliers)	1 if the controversy concerns governance, otherwise 0 (Mallin, 2008[1])
C = customers	1 if the controversy concerns product quality, otherwise 0
E = employees	1 if the controversy concerns workplace discrimination or work conditions, otherwise 0
COM1 and COM2 = community (society, the media, NGOs)	1 if the controversy concerns the safety of human health, otherwise 0
	1 if the controversy concerns environmental issues, otherwise 0
	1 if the controversy concerns other issues (unspecified elsewhere), otherwise 0
G = government	1 if the controversy concerns corruption or fraud, otherwise 0

Note(s): [1]https://www.inderscienceonline.com/doi/abs/10.1504/IJCG.2008.017652
Source(s): Own elaboration

Table 2.
Issues important for stakeholders



Source(s): Own elaboration

Figure 1.
Steps of the research

code the information, and then compare the results. Differences in classifications were resolved through consensus discussions.

The analysis of the reports revealed 133 corporate controversies. The attempt to assign each controversy to a specific stakeholder group proved unsuccessful because some incidents affected the interests of various stakeholders. Consequently, there were more connections between controversies and stakeholder groups than in controversies. The most frequent cause of controversies was the quality of products or services, followed by working conditions and discriminatory practices. These controversies were deemed important by consumers and employees, respectively.

Variables definition

Significance of a controversy (SC). Our study introduces a controversy significance index based on the number of stakeholder groups affected and the potential impact on these groups. We distinguished the following groups of stakeholders: investors, customers, employees, community and government. We utilised Fernandez-Feijo *et al.*'s (2014) study to identify the key stakeholder groups for various companies in order to assess their potential influence.

The significance of controversy in the eyes of investors follows the research of Rizwan (2019) and Bonini and Boraschi-Diaz (2012), which suggests that investors are particularly sensitive to corporate fraud. In industries with high investor pressure, where 50% of companies are traded on the stock exchange, we double the value of this component. The component takes a value of 1 if the controversy concerns governance, 2 if the company belongs to an industry with high investor pressure and 0 in all other cases.

The significance of controversy for customers is based on the product's quality or customers' satisfaction. We follow Drucker (Webster, 2009), who suggests that every organisation's key role is to create value for its customers. Thus, we considered all controversies concerning product quality, service or other aspects of customer satisfaction (i.e. the relation between product features and price) as controversies belonging to this category. The component equals 1 if the controversy concerns product quality, service or other aspects of customer satisfaction. For companies in industries of high importance for customers, defined by Fernandez-Feijo *et al.* (2014), the component's value is multiplied by 2.

Regarding the significance of controversy in the eyes of the employees, former studies indicate that employees react particularly negatively when harmed by customers (Rupp & Spencer, 2006; Spencer & Rupp, 2009) and supervisors (Mitchell, Van Buren, Greenwood, & Freeman, 2015). Therefore, the value of this component will be 1 if the controversy concerns workplace discrimination or work conditions; otherwise, it will be 0. We did not include the significance of the controversy for employees, as Fernandez-Feijo *et al.*'s (2014) research indicates that this group is most important for large companies. All the firms in our sample were classified as large enterprises, using Fernandes' measurement approach.

The significance of controversy in the eyes of the community includes three central issues: human safety and health, environmental issues and other issues not matching any other topic (such as cybersecurity or personal data). The controversies concerning environmental aspects are more important for companies belonging to environmentally sensitive industries. The maximum value for this component is 3 if the controversy covers all three topics, or 4 if the company belongs to an environmentally sensitive industry, in which case the environment issue value is multiplied by 2.

The significance of controversy in the eyes of the government is based on its potential negative impact on the whole economy, such as financial fraud. The government is especially interested in controversial activities like financial fraud that cause negative consequences for the whole economy. Then, the officials feel obliged to react and introduce new laws and regulations (Van Driel, 2018). The component equals 1 if the controversy concerns fraud or corruption, or 0 otherwise.

We measure the significance of controversy using a formula presented in Table 3. The independent variable, "strength of the controversies", is obtained by summing the values of the components, which can range from 1 to 10. In our sample, the minimum value was 1, while the maximum was 6.

Financial performance (ROA). We measure financial performance with return on assets (ROA). ROA, ROE, ROI are financial performance measures commonly used in disclosure variable research on corporate reporting (e.g. Orlitzky, Schmidt, & Rynes, 2003; Porcena, Parboteeah, & Mero, 2021). Former results show large companies and those with good financial performance were observed to disclose more information (Cormier & Magnan, 1999), while financially distressed companies tend to withhold information (Gantyowati & Nugraheni, 2014). To distinguish good performers from bad performers, we used a dummy variable of the firm's ROA at the end of the year when a controversy arose, which equals 1 when ROA was negative, and 0 when positive.

Litigation (L). Litigation and litigation risk are widely used variables in the research on corporate disclosure (Skinner, 1994; Field, Lowry, & Shu, 2005; Marinovic & Varas, 2016). In theory, an expectation of litigation can either encourage or discourage corporate voluntary disclosure (Healy & Palepu, 2001). On the other hand, high litigation risk may deter firms' voluntary disclosure, especially forward-looking disclosures, because such disclosures may be inaccurate ex-post and thereby provoke lawsuits (Baginski, Hassell, & Kimbrough, 2002; Rogers & Van Buskirk, 2009). Skinner (1994) argues that disclosures weaken the claim that managers act improperly by failing to disclose information promptly, thus lowering the probability of a lawsuit. With lower potential damages, plaintiffs' incentives to bring a lawsuit are reduced. Lawsuits tend to be precipitated by large stock price drops (Francis, Philbrick, & Schipper, 1994). Partially revealing bad news in a voluntary disclosure may reduce the probability of a lawsuit by preventing a single, large stock price drop later when the earnings are announced.

In contrast to most previous studies, we focused not on litigation risk, but on the fact of being sued. This is based on the assumption that the occurrence of controversy strongly increases litigation risk. However, being sued may change a company's approach to a voluntary disclosure of the controversy. We used a dummy variable of lawsuit L at the end of the year when a controversy arose, which equals 1 when the lawsuit was filed (otherwise 0).

Corporate disclosure research commonly uses "litigation" and "litigation risk" as variables. Scholars have suggested that the prospect of litigation can either incentivise or discourage companies from making voluntary disclosures and that high litigation risk may

Table 3. Variables in the regression model

Variable's name	Variable's type	Description	Measurement	Expected sign	Source
Disclosure strategy	Dependent	Disclosure strategies of firms involved in controversies	Binary variable: 1 for an information strategy, and 0 for impression management		Merkl-Davies and Brennan (2007) and Merkl-Davies *et al.* (2011)
Significance of a controversy	Independent	The number of stakeholder groups considering it important weighted by the involved company's sensitivity to stakeholder pressure	$SS_i = I_i{*}IN_i + C_i{*}CU_i + COM1_i{*}EC_i + COM2_i + G_i + E_i$ where SS_i – the significance of a controversy for a company I_i – the significance of a controversy for investors IN_i – a company's sensitivity to shareholder pressure (a dummy variable; yes – 2; no – 1) C_i – the significance of a controversy for customers CU_i – industries under pressure from customers (yes – 2, no – 1) $COM1_i$ – the significance of an environmental controversy for a local community EC_i – an environmentally sensitive industry (highly sensitive – 2, otherwise – 1) $COM2_i$ – the significance of a controversy relating to human life or health for a local community G_i – the significance of a controversy for the government E_i the significance of a controversy for employees	+	Fernandez-Feijo *et al.* (2014)
Financial performance (ROA	Independent	The sign of return on assets in the year when the controversy occurred	Binary variable: 1 when ROA is negative, and 0 when ROA is positive	+	La Torre *et al.* (2021) and Lin *et al.* (2020)
Litigation (L)	Independent	The legal consequences of controversies occurred	Binary variable: 1 when as a result of the controversy, lawsuits against the company were filed. 1 when any lawsuit started, and 0 otherwise	+	Mure *et al.* (2021)

Source(s): Own elaboration

dissuade firms from providing forward-looking information due to the potential for inaccurate disclosures leading to lawsuits. Skinner (1994) posits that disclosures may decrease the likelihood of a lawsuit by demonstrating that managers acted properly by providing information promptly. In turn, this may reduce the potential damages and plaintiffs' incentives to sue. Lawsuits often stem from significant stock price declines, which could be mitigated by partially revealing negative news in a voluntary disclosure. However, our study diverges from previous research in that we focus on the occurrence of a lawsuit itself rather than solely on litigation risk. We assume that a company's chances of being sued increase significantly in the event of controversy, which may impact their approach to voluntary disclosures concerning controversy. We want to check if the fact of being sued is associated with how firms react to controversies.

SC – the significance of a controversy (rated on a ten-point scale, where 1 is low and 10 is high),

L – a lawsuit, 1 when filed, otherwise 0,

a0 – a constant,

b1, b2 – the coefficients of the independent variables,

DS – the disclosure strategy (1 for an information strategy, and 0 for impression management).

Regression equation (1) has the following form:

$$DS(1/ROE, SC, L) = \frac{e^{a_0 + b_1 * ROA + b_2 * SC + b_3 * L}}{1 + e^{a_0 + b_1 * ROA + b_2 * SC + b_3 * L}} \qquad (1)$$

where:

ROA – a company's ROA at the end of the year in which a controversy arose (0 when positive, and 1 when negative),

SC – the significance of a controversy (rated on a ten-point scale, where 1 is low, and 10 is high),

L – a lawsuit, 1 when filed, otherwise 0,

a_0 – a constant,

b1, b2 – the coefficients of the independent variables,

DS – the disclosure strategy (1 for an information strategy, and 0 for an impression management strategy).

Results

The analysis of sustainable and integrated reports demonstrated that most tended to obfuscate controversies and their consequences by stressing companies' engagement in the field where a controversy arose. For instance, after having been alleged to use suppliers employing child workers, H&M widely described in the CSR report for 2014 (p. 27) its child-supporting and human rights-oriented activities: "We have seen great improvements over the years in many areas. Child labour, for example, is very rare today in the textile industry (. . .). We use our influence to promote better working conditions, ensure that human rights are respected and reduce environmental impacts throughout our value chain – from working with individual factories to pushing for systemic change in countries and in the textile industry. This includes working for fair living wages and decent working hours for all garment workers". The report did not mention the alleged abuse of workers and the use of child labour in Cambodian factories in 2015. A comparison of reports utilising impression management and incremental information strategies showed that most companies opted for narrative disclosure reports to improve their reputation and defuse bad publicity. Notably, reports addressing corporate incidents and/or apologising for controversies or catastrophes outnumbered those trying to blame their occurrence on external factors.

The CSR reports also proved to be an inferior source of knowledge about controversies caused by companies' operations. This type of information is mainly provided by annual or integrated reports (90%). Most companies prepare their sustainability and environmental reports to possibly downplay the environmental or local consequences of controversial incidents. Corciolani, Nieri, and Tuan (2020) and Li, Haider, Jin, and Yuan (2019) observed that companies also use sustainability reports to whitewash their role in corporate controversies and repair reputational damage following a corporate controversy.

The next analysis step involved determining whether the type of reporting on a controversy was related to its significance.

Because the review of studies conducted by Hahn and Kühnen (2013) pointed out that stakeholders' perceptions are important for corporations, we assumed that corporate strategies for dealing with controversial issues were selected based on their significance for three main groups of stakeholders: employees, customers and shareholders. Stakeholder theory recommends that companies should engage in dialogue with stakeholders and explain their involvement in controversies attracting special interest from stakeholder groups. It also posits that because shareholders in companies embroiled in controversies may be concerned about how they will perform financially in the future, they will expect objective information on what precautionary measures their companies are implementing to prevent similar controversies from occurring in the future.

Shareholders are particularly concerned about financial controversies, which erode their confidence and undermine the credibility of corporate financial reports. For most customers, a matter of special concern is potentially unsafe products for the environment and human health. Employees' concerns tend to focus on job security, work safety and the life and health of personnel.

Our study showed a significant relationship between a controversy-coping strategy adopted by a company and its ROA. A negative ROA (48%) was found for almost half of the companies, using an incremental information strategy. The maximum significance of the controversy was 6. The result was for Volkswagen. In 2015, they installed software in millions of cars to cheat the Environmental Protection Agency's emissions testers and convince them (and clients) that the cars are more environmentally friendly than they really are. Volkswagen became the target of investigations in many countries, and the share price of the group fell by a third within days of the scandal erupting. The controversy affected investors (the fraud and changes in the management board) and customers (product quality) and was related to environmental issues.

In 44% of the cases analysed, the companies used incremental strategy. In 85% of reports bringing up incidents involving fatalities or serious injuries, companies provided objective information and usually apologised. Environmental catastrophes were accompanied by a more frequent use of the incremental information strategy. Even though all companies reported on how they contributed to disasters and the remedial actions they took, only 62% expressed regret for the disasters' consequences. The overwhelming majority of organisations (88%) addressed allegations concerning financial misreporting or fraud in their reports, but only 20% apologised for causing controversy.

As much as 80% of the companies were silent about controversies surrounding defective products, corruption, discriminatory workplace practices or the use of underage labour. Their strategies were intended to help them deflect public criticism by spotlighting their efforts to make improvements to the area where a controversy occurred. For the sake of illustration, companies that allegedly used child labour emphasised their commitment to initiatives on behalf of children.

Most other types of controversies circulated in newspapers and the Internet. Only a fraction of them were filed with courts to be verified.

Given that disasters resulting in fatalities or environmental damage trigger formal investigations, and the risk of litigation may influence a company's attitude to allegations and the way of handling them, two variables were included in the regression model to account for these factors: a company's ROA in the year when a controversy broke out, and the existence of a lawsuit (a dummy variable). We considered that the ROA result from the year in which the controversy occurred would be the most relevant, as other studies indicate that stakeholders' emotions and the controversy's importance fade over time (Swaminathan & Mah, 2016). Despite emerging consequences over a longer period of time, negative stakeholders' reactions may lose strength. We also only took the sign of the ROA into account, and not the ROA values due to the excessive number of factors that can affect ROA values.

The logit regression results in Table 4 indicate that the type of the company's narrative strategy, its financial performance, the significance of controversy and the likely outcome of the lawsuit are interrelated.

The statistical significance of the association between the significance of a controversy and the strategy adopted to deal with it confirms the hypothesis, according to which the probability of an organisation disclosing negative information about the consequences of its operations increases with their potential significance for stakeholder groups.

The type of narrative strategy was also found to be associated with companies' financial performance (indicated by the sign on their ROA) and the existence of a lawsuit. A more frequent use of the incremental information strategy by companies with a negative ROA suggests that they deemed a controversy significant and tried convincing stakeholders that their reporting was credible. However, whether a company's ROA was negative as a result of a controversy (the payment of damages ordered by a court, a falling volume of sales (Sharpe & Hanson, 2021), etc.) or because of some external factors affecting the whole of the company's industry was impossible to establish.

Several companies with negative ROAs were selective in reporting controversies, which may have been due to their involvement in lengthy court trials that made some controversies look relatively unimportant. For instance, in the wake of the crash of Lion Air Flight 610 and Ethiopian Airlines Flight 302, the Boeing Corporation faced several lawsuits and challenges, including having to pay damages to the victims' families and falling stock prices. Other relevant cases include BHP Biliton, which was accused of contributing to the mining dam disaster in the Brazilian state of Minas, the repercussions of which persisted for several years,

Table 4. Logit regression statistics

	Beta	St. Dev	Wald	df	Sig	Exp. (b)
ROA	1.197	0.663	3.263	1	0.071	3.312
Strength	1.308	0.292	20.072	1	0.000	3.700
Lawsuit	2.377	0.513	21.509	1	0.000	10.773
Constant	−4.548	0.802	32.160	1	0.000	0.011
R^2 Cox and Snell	0.43					
R^2 Nagelkerkeg	0.58					

Source(s): Own elaboration

and BP PLC, which was blamed for negligence leading to the explosion of the Deepwater Horizon oil rig and a catastrophic oil spill. None of these corporations openly referred to these incidents in their reports, choosing instead to mention them in general terms as potentially harmful to shareholders' interests. The only comment that Boeing made on the crashes in its annual report in 2019 (p. 111) was: "We are subject to ongoing governmental and regulatory investigations and inquiries relating to the accidents and the 737 MAX, including investigations by the U.S. Department of Justice and the Securities and Exchange Commission".

The existence of a lawsuit was found to be associated with the disclosure of objective information about corporate controversies. This finding is unsurprising because shareholders are sensitive to lawsuits that may have bad consequences for their companies (litigation costs, the payment of damages and long-term reputational loss). There are known cases of individual and class lawsuits following environmental affairs or disasters that dragged on for years (e.g. the Volkswagen emissions scandal, or the BHP Billiton dam disaster (Appendix 2)).

Discussion and conclusions

The results of our study show that mainly the sustainability reports of most of the sampled companies lacked information about corporate controversies and their consequences.

Thus, they are consistent with the findings reported by Clatworthy and Jones (2003), who have demonstrated that companies build their narrative disclosures around the positive outcomes of their operations and try to deflect public attention from bad news. They are also supported by earlier observations that companies may use their CSR and sustainability reporting to protect or improve their reputation rather than increase their transparency (Karwowski & Raulinajtys-Grzybek, 2021; Corciolani *et al.*, 2020). Cho *et al.* (2015) explain this behaviour in terms of the nuanced theoretical lens of organised hypocrite proposed by Brunsson (1990), and rational, progressive or reputation facades propounded by Abrahamson and Baumard (2008).

Our findings indicate that organisations attempt to keep positive CSR communication separate from negative CSR messages. Similar results were reported by Lin *et al.* (2020). Following their suggestions for further research, our study is one of the relatively few works that analyse the disclosure of the negative impacts of corporations on the environment and society.

It makes several contributions to the knowledge of corporate narrative reporting.

Unlike some previous studies (Clatworthy & Jones, 2003; Lin *et al.*, 2020), our research focuses on high-profile adverse incidents widely reported in the media, whose omission from corporate reports seems to constitute a particular case of organised hypocrisy.

It also demonstrates that companies use an impression management strategy to defuse adverse publicity and that major controversies cause minor ones to be omitted from their reports.

The logistic regression analysis has pointed out that the relationship between the significance of controversy and the adopted disclosure strategy was statistically significant. The association between the type of disclosure strategy and companies' financial performance (ROA) and lawsuits was also significant. Companies with a negative ROA frequently used an incremental information strategy than those with a positive ROA. Moreover, because of their potential consequences for financial performance, companies faced with lawsuits provided detailed accounts of their actions, mainly in the annual reports.

Our research has also shown that companies tended to match their disclosure strategies with the context of controversy. The probability of using an obfuscation strategy increased in the case of serious controversies that might attract media interest.

Generally, however, the CSR and sustainability reports of the analysed companies contained relatively little information about corporate controversies. Therefore, researchers using these reports as the main source of research data should bear in mind that their informational value is limited.

Our study offers some social implications. La Cour and Kromann (2011) have concluded that corporations face a serious risk of their hypocritical strategies becoming too evident for stakeholder groups. Our findings suggest that the risk is already materialising and may undermine the idea of CSR and sustainability reporting. The external validation of CSR and sustainability reports proposed by many authors does not seem to be an effective solution, as organisations may simply omit negative information rather than falsify it. In these circumstances, independent rating agencies, the media and non-governmental watchdogs may remain the only reliable source of information on the corporate impacts on society and the environment.

Our study has four major limitations. The first limitation is a relatively small sample of companies and reports that we analysed in terms of their coverage of controversial issues. The second limitation is the omission of the potential influence of factors such as the characteristics of companies' managers (gender, nationality, education, etc.) on the choice of disclosure strategies.

A limitation of the study is also the recognition of only one of the most important aspects of the controversy for each stakeholder group. We are aware that each group and each stakeholder may have other additional preferences and concerns (e.g. a shareholder may place great emphasis on environmental protection). Still, it would be impossible to include this diversity in the study.

The last limitation is that the study exclusively focuses on disclosures made in corporate reports, omitting other channels of communication, for example, social media.

The findings of our study indicate several trajectories for future research. For instance, there seems to be a need to better explore the relationships between willing and unwilling reporting on corporate controversies. Also, as CSR and sustainability reports may evolve from impression management tools into organisational change tools, monitoring them over longer time horizons is advisable. A more thorough analysis of information on controversies disclosed by corporations is also necessary. Future research should primarily focus on the following questions: What factors other than the significance of a corporate controversy, financial performance and the existence of a lawsuit make companies disclose controversies they caused in their reports? How are such disclosures perceived by stakeholders?

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Appendix 1

Table A1. Examples of analysed international incidents causing controversies in 2010 to 2015

Number	Corporation	The cause of a controversy	Incidents and their consequences	Keywords	Issues important for stakeholders	Stakeholders
1	BP	The Deepwater Horizon explosion and oil spill in the Gulf of Mexico in 2010	11 employees dead, and 17 employees hurt. The oil spill damaged marine and wildlife habitats and affected the fishing and tourism industries. In Louisiana, 4,900,000 pounds (2,200 t) of oily material was removed from the beaches in 2013, over double the amount collected in 2012. Many fish and dolphins continued to die in record numbers, with infant dolphins dying at six times the normal rate	• Deepwater Horizon • Mexico bay • Disaster • Louisiana • Oil spill • dead/died	• Environment • Human lives and health • Work conditions	• Community • Community • Employees
2	Wells Fargo	Wells Fargo's discrimination against thousands of Blacks, Latinos and other minority borrowers between 2004 and 2009. Minority borrowers paid higher interest rates and fees on home loans compared with white borrowers with similar credit ratings	Wells Fargo was made to pay $175 million in compensation. The bank stopped issuing subprime loans in 2008	• Latinos • Discrimin*** • inority • Subprime loans • Allegat*** • Litigat***	• Governance • Product quality • Others (racism, client discrimination)	• Investors • Clients • Community

Source(s): Own elaboration

Appendix 2

Name of the company	Years of controversies
Apple	2010, 2016, 2017, 2019, 2020
Barclays	2012, 2018, 2020
BASF	2010, 2018, 2020
BHP Biliton	2015, 2018, 2019
Bilfinger Berger	2010, 2016
Boeing	2018, 2019, 2019
BP	2010, 2016, 2016
Chevron	2011, 2016, 2020
Citigroup	2012, 2018, 2020
Credit Suisse Group	2018, 2018, 2019
Daewoo Shipbuilding & Marine Engineering	2016
Daimler	2010, 2016, 2016, 2017
Deutsche Bank	2012.2019.2020
DuPont	2015, 2019, 2020
Eni	2018, 2018, 2019, 2020, 2020
Equifax	2017, 2018
ExxonMobil	2015, 2017, 2019
Facebook	2018, 2018, 2019, 2020, 2020
Foxconn	2010
GlaxoSmithKline	2013, 2017
Goldman Sachs	2015, 2017, 2018
H&M	2015, 2019, 2020
Hewlett-Packard	2010, 2016, 2017
HSBC	2012, 2016, 2017, 2018
IBM	2011, 2016
Johnson & Johnson	2019, 2019
Microsoft	2010, 2018, 2019
Nestle	2010, 2016, 2017
Nike	2018, 2019
Olympus	2011
Pegatron	2013
Petrobras	2014, 2016, 2018, 2019
Philip Morris	2010, 2019
Vale SA	2015, 2020
Samsung	2014, 2016, 2017, 2018, 2019
Shell	2016, 2016, 2018, 2019, 2019
Southwest Airlines	2016, 2018
Starbucks	2016, 2018
Steinhoff International	2017, 2018
Target	2013, 2016, 2018
Telia Company	2013
Tesco	2013, 2016, 2018
Tokyo Electric Power	2011
Toshiba	2015, 2017
Volkswagen	2015, 2017, 2017, 2018
Wells Fargo	2012, 2016, 2017, 2020
Yahoo	2016
Zijin Mining Company	2010, 2020, 2020

Source(s): Own elaboration

Table A2. List of companies in the sample