**Abstract**

Firms frequently respond to prior environmental wrongdoing with positive, offsetting actions. Yet research shows offsetting environmental wrongdoing is financially ineffective. 

**This is puzzling:** why do managers persistently attempt to offset misdeeds with good deeds despite neither ecological nor financial benefits to offsetting?

Drawing insights from how corporations respond to crises and managing paradoxes, we identify a novel, two-stage investment process examining if firms persist in offsetting behaviors despite no economic payoff.

We break the offsetting decision into two, sequential components: to invest in environmental good deeds? and then, if so, how much to invest in offsetting actions.

We find that **larger firms** are more likely to take actions - yet only limited, **token transparency** - to offset environmental misdeeds.

Interestingly, **IF small firms offset.** they deploy a significantly greater number of environmental activities; that is, **hyper-engagement** after persistent environmental misdeeds IF investment occurs.

3. **Become hyper-engaged in activity** perceived at attempting to **offset** prior environmental misdeeds.

We argue that managers are faced with a two-step investment decision after environmental misdeeds: first, should the company invest in good deeds after chronic misdeeds? And if the firm is to invest, will the firm’s environmental actions be sufficient such that others will pick up on attempts at positive impacts?

Alternatively, a choice to do nothing, forbearance, may be considered viable in the absence of penalties or social pressures (Campbell, 2007).

Further, we argue that firm size moderates how a firm will react to its prior environmental misdeeds. Larger firms having more resources have a greater propensity to act after misdeeds; yet, due to scale and costs of implementation are more likely to engage in token transparency – limited environmental activities. Small firms, however, have relatively lower implementation costs and a relative cost advantage in taking action.

**Hypotheses**

**H1:** A significant interaction between firm size and misdeeds, such that larger firms are more likely to engage in offsetting with good deeds after misdeeds.

**H2:** A significant interaction between firm size and misdeeds, such that larger firms are likely to have a smaller effect on the amount of (non-zero, token) good deeds after misdeeds.

**Research Design**

Using publicly available data from the MSCI/KLD database, to measure firm’s environmental strengths and environmental concerns (wrongdoing). Financial data was compiled from Compustat.

**SAMPLE:** 7,769 complete observations using 2,469 different U.S. publicly traded firms from 2013 - 2016 across multiple sectors.

**METHOD:** We use a hurdle model\(^1\) to predict environmental strengths (CSR) for a firm in a year using environmental misdeeds (CSiRxSize) in the previous year.

**Dependent Variable, CSR:** the sum of all positive environmental indicators (previously known as strengths) in the KLD/MSCI database.

**Independent Variable, CSiRxSize:** the sum of environmental controversies associated with a firm’s products and services, business practices, and effects on the environment.

**Moderating Variable, Firm Size:** measured as natural logarithm of the number of employees.

**Control Variables:** Rivals’ CSR and CSiRxSize activity, industry capital intensity, industry growth, firm-level innovation spend, firm-level advertising spend, financial risk tolerance, firm-level profitability (ROA, EPS, and Dividends Per Share), and the number of CSR opportunities researched by KLD/firm, limited environmental activities.

**Methods**

We use a novel, two-step, sequential investment strategy approach (a hurdle model) separating if a firm is willing to invest in actions and if so, then how much to invest after environmental misdeeds. In doing so, we explore the opportunity for inaction; and the consequences / paradoxes inherent in taking little or no action.

A two-stage decision model is consistent with how organizations make R&D decision: if a firm will invest and then, if so, how much will it invest in R&D (Crépon et al., 1998). Individuals also make two-stage decisions. For example, psychological research shows individuals first decide whether to gamble, if the decision is yes, then they then make the decision how much to gamble (Dickert, et al., 2011).

This two-stage decision process, however, is hidden from observers, the only thing visible are the firm actions.

**Do some good deeds to offset prior environmental misdeeds?**

If yes, what to do? and how much?

**Environmental Actions**

( Observable) “Good” Environmental Actions

**Results**

Hypothesis 1 predicts larger firms are more likely to invest in environmental activities after environmental misdeeds. Examining the interaction of CSiRxSize and firm size, we find that the first-stage, logistic regression component, of the hurdle model supports our prediction with a statistically significant interaction ($\gamma_{CSiRxSize} = 0.19$, $z = 2.37$, $p = .02$).

**H1 is supported.**

Hypothesis 2 suggests the number/count of environmental activities after environmental misdeeds is contingent on firm size. This is supported by the statistically significant interaction in the Truncated Poisson Component ($\beta_{CSiRxSize} = -0.10$, $z = -3.76$, $p < .01$). Both components of the interaction term are significant and, as expected, move in opposite directions. **H2 is supported.**

**Conclusions**

Overall, our results affirm, with the superior fitting model, that managers face two, sequential decisions regarding offsetting environmental misdeeds. If investment is to occur, then a separate decision of ‘how much’ to invest is relevant. Investigating widespread non-action to wrongdoing is important, too.

For managers of large, visible firms: Token transparency after environmental misdeeds may backfire, costing the firm more in reputation, credibility, and sunk costs.

For managers of smaller firms: Once engaged, smaller firms are likely to be hyper-engaged after environmental misdeeds. Getting engaged is the key hurdle to overcome, as experimentation blossoms in smaller firms.

For policy makers – a nuanced approach towards offsetting; encourage more actions (of smaller firms; potential for a significant impact in the aggregate) and more substantive actions of larger firms with accountability to avoid token transparency.