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Sustainability Reporting: Where are we at and where are we heading?

by Professor Gaizka Ormazabal

In a context in which society is demanding initiatives to combat climate change, the debate on corporate sustainability reporting is more pressing than ever. The growing demand for this alternative type of reporting has led to two important developments. First, the view that sustainability reporting should be mandatory is gradually gaining ground (unlike financial information, non-financial information is reported on a voluntary basis). Second, there is a growing perception that we need to improve the consistency and comparability in sustainability reporting. This issue is especially important considering the multiplicity of private organizations issuing standards and recommendations for sustainability reporting. Notable examples are the Sustainability Accounting Standards Board, the Global Reporting Initiative, the Climate Disclosure Standards Board, the International Integrated Reporting Council, and the Task Force on Climate-related Financial Disclosures (established by the Financial Stability Board).

As a result, there have been several recent calls for the IFRS Foundation to establish a global set of internationally recognized sustainability reporting standards. Such calls are based on the IFRS Foundation's track-record and expertise in standard-setting, and its relationships with global regulators and governments around the world. The foundation is currently seeking public consultation on whether -and how- to carry out this complex tax. The European Union has already taken a step forward by introducing Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector.

The regulatory debate on sustainability reporting should be framed around three questions. The first one is what kind of (non-financial) information should firms be required to disclose. The question is not trivial, as the current regulatory regime already requires firms to disclose any "material" information (that is, anything that could affect their financial results). Granted, some corporate activities could be beneficial for shareholders while having a negative impact on society and the environment (pollution is one example). To account for this and for the potential effect of climate risk on financial performance, some have introduced the concept of "double materiality" (see, for example, European Commission's Guidelines on Reporting Climate-Related Information).

The second important question for the regulatory debate is how to enforce the sustainability reporting standards. A consistent and comparable set of standards would not be useful if firms do not implement it correctly. Because public enforcement is subject to important limitations (e.g., resource constraints), it is important to understand whether there are alternative forces potentially shaping managers' reporting incentives. Social pressure is an important one; a growing number of consumers are sensitive to environmental and social issues. The higher social sensitivity towards sustainability could also result in an increase of shareholder activism. Beyond altruistic reasons, investment funds could pressure firms to disclose non-financial information because, by doing so, they attract or retain clients that care about sustainability.

The debate on how to enforce sustainability reporting standards should also consider that climate risks and sustainability issues are difficult to measure and longer term in nature. As a consequence, it is hard to know for regulators and investors whether a piece of such information is material. This means, among other things, that it would be difficult to verify in court that a firm withholds sustainability information.

The third key regulatory issue is the potential effect of mandatory sustainability reporting on firm behavior. On the positive side, it is possible that, for example, the need to disclose carbon emissions would induce firms to decrease those emissions. "Sunlight is the best disinfectant", as the old saying goes. But an increase in transparency regarding sustainability issues could also have unintended consequences. To begin, processing and producing sustainability information is expensive, and firms will probably pass on this cost to consumers. Moreover, the responses to publicly disseminated information are sometimes difficult to foresee. For example, a recent study on the public disclosure of patient health outcomes at the level of the individual physician and/or hospital documents that the reporting mandate induced doctors and hospitals to decline to treat more difficult, severely ill patients.

In sum, the response to the growing demand on sustainability reporting needs to be judicious and well thought-out. If regulating financial reporting is complex, the standardization and enforcement of non-financial disclosures is likely to be even more problematic. But we will figure it out; the demand for sustainability reporting cannot be ignored.

Gaizka Ormazabal
Academic Director
IESE Center for Corporate Governance

Corporate Governance News

More than 60 global businesses -including Mastercard, Nestlé, and Unilever- announce commitment to transparency
At the World Economic Forum annual gathering in Davos, the companies committed to publishing information on 21 environmental, social, and governance metrics, from greenhouse gas emissions to diversity, to taxes paid… read more

The top 5 takeaways from BlackRock head Larry Fink's 2021 letter to CEOs
This year's letter reflects the pandemic and its resultant economic distortions. But it's clear from the start, that these unprecedented events only strengthened Fink's focus on addressing climate change and his commitment to stakeholder capitalism… read more

The G-Force in ESG: What will shape corporate governance in 2021?
According to Forbes contributor Michael Spellacy, the world's intense focus on environmental, social and governance (ESG) issues has catapulted corporate governance to the top of the financial agenda. Some trends in the landscape indicate why the 'G' in ESG needs to be much more in focus moving forward… read more

The power of purpose: Fostering authentic consumer relationships in an era of woke capitalism
The pandemic, as well as some historic social movements, is amplifying the importance of brands' deeper meaning in the world, including the connections they make with those they serve… read more

"ESG" isn't just about feel-good investing. It can be a framework for global accountability
With over 600 ESG frameworks in common use, the growing number of socially conscious investors still lack a single reliable source of information on where to put their hard-earned money. A single standard for measuring ESG would generate more transparency and, as a result, more investment… read more

In Case You're Interested...

2020-2021 Global Director Survey Report: Board governance during the COVID-19 crisis

New research conducted by the Global Network of Director Institutes (GNDI) member institutes reveals directors' perspectives on Covid-19 impacts as well as directors' views on the trajectory of boardroom and external trends. Over 60% of the nearly 2,000 global survey respondents note that the pandemic will accelerate growing attention on ESG, sustainability, and stakeholder value issues. In addition, the pandemic has shifted how directors will approach risk oversight, strategy oversight and human capital risks going forward. In terms of board operations, Covid-19 has accelerated the use of digital tools and virtual meetings will become a regular component of board operations… read more

NEF spotlight: The path forward for retail's sustainable future

Retail is undergoing an unprecedented transition. The internet has led to new sales channels and new opportunities to reach out to customers, and globalization has opened markets and introduced new competitors. The COVID-19 has rocked the industry to its core, as stores around the world closed and consumers had no choice but to buy online. Simultaneously, sustainability has moved up the agenda for retail players. Again, COVID-19 has accelerated this trend. Alan Jope, CEO of Unilever, emphasized that "any company that wants to stay relevant in the future should think about sustainable behavior"… read more

The EU's unsustainable approach to stakeholder capitalism

A recent report by the EU claims that investor-driven short-termism is encouraging firms to return cash rather than invest it, which reduces capital available for investment in growth. The authors show that the data behind the report do not support its claims and argue that if the EU implements the recommendations of the report, EU-listed firms will struggle to compete as decision-making slows up and capital gets allocated to questionable ventures… read more

How do you measure success in digital? Five metrics for CEOs

In a time of seemingly nonstop digital disruptions, which have only been accelerated during the COVID-19 pandemic, the business imperative to embrace digital, data, and analytics is widely accepted. The link to business value, however, is not. According to this McKinsey's study, when CEOs are asked how their transition to digital is progressing, they often respond with a list of initiatives under way across the business—building a new tech platform, launching new products, or investing in infrastructure, to name a few. But when asked to quantify the impact on the bottom line, there's usually a long silence. As organizations launch more and more digital initiatives, CEOs must monitor whether they are delivering business results. These metrics are the ones to watch… read more

IESE's Recent Research on Corporate Governance

"Predicting Employee Wrongdoing: The Complementary Effect of CEO Option Pay and the Pay Gap"

Journal article (January 2021)

Authors: Stephen J. Smulowitz, John Almandoz
Journal: *Organizational Behavior and Human Decision Processes*
Read more

"The Big Three and Corporate Carbon Emissions Around the World"

Journal article (December 2020)

Authors: Azar, J., Duro, M., Kadach, I., Ormazabal, G.
Journal: *Journal of Financial Economics*
Read more

IESE CCG-ECGI Corporate Governance Conference

In the context of the current shareholder vs. stakeholder debate, the IESE Center for Corporate Governance (IESE CCG) and the European Corporate Governance Institute (ECGI) organized the "Can Purpose Deliver Better Corporate Governance?" Conference, which took place on **October 28-30, 2020**.

Leading scholars together with prominent CEOs and board directors, delved into some of the pressing issues surrounding corporate purpose and governance. Over 1,900 people participated in the conference.

The conference sessions are now available for viewing and you can download the conference report. Find all the papers and presentations on the conference website under the tab "Program & Papers".

Upcoming Programs

Executive Program: "Consejos de Administración Responsables"

Date: March 16-17, 2021

Location: IESE, Madrid Campus

Visit the program website

Executive Program: "Mujeres en Consejos de Administración"

Date: April 12-13 and May 10-11, 2021

Location: IESE, Madrid Campus

Visit the program website

Executive Program: "Value Creation Through Effective Boards"

Date: May 24-27, 2021

Location: IESE, Barcelona Campus

Visit the program website

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