Enabling Conditions for Environmental Sustainability: 
Private and Public Roles

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The views expressed in this paper are those of the author and do not necessarily reflect those of OECD or its Member countries. The work on this paper is still in progress and the author would welcome your comments to kathryn.gordon@oecd.org.
Executive Summary

1. Host and home governments are moving beyond traditional investment facilitation -- they now embrace a broader set of policies designed to enhance the contribution of investment to economic, social and environmental welfare. This broad set of policies is called the “enabling framework”. The present paper focuses on the steps taken by the business sector to act in harmony with this framework and the new approaches adopted by governments to improve the “fit” between private action and public policy.

2. The principal findings of this paper are as follows:

   Significant progress in business practice. A recent OECD Study, using databases covering over two thousand organisations in thirty countries, shows that over the last fifteen years or so, principles and management methods have emerged that allow businesses to address ethical issues about which they would have been incapable of organising any systematic response even as recently as two decades ago.

   − Global phenomenon. OECD research suggests that most major multinational enterprises have participated in this trend. For example, nearly all of the top 100 multinational enterprises publish material outlining the principles and management techniques they use to control environmental, health or safety outcomes or in the area of labour relations. The study of policy statements -- or codes of conduct -- suggests that companies, often working in business associations, have formulated an impressive array of concepts and principles for thinking about sustainable development issues.

   − Emerging principles for business conduct. Businesses and business associations, through their published policy statements, have given serious consideration to many of the ethical challenges they face and, in particular, to how they can contribute to the sustainable development agenda. The policy statements -- or codes of conduct -- studied cover a vast array of issues including labour relations, environment, human rights, information disclosure, the fight against corruption and consumer protection. However, although these policy statements often represent serious reflections on the challenges facing business, they do not, viewed as a whole, constitute a uniform standard of business conduct in any area. This suggests that, in areas where a uniform standard of behaviour is desirable, there may be a need for inputs from governments, international organisations, or civil society.
Growing expertise. A new pool of international management expertise has been created. This new cadre of managers combines knowledge of regulatory and legal compliance with management control expertise. The accumulation of expertise has been especially strong in the environmental field.

Emerging standards. Standards in support of improved non-financial accountability and performance have been developed and these are now being used, refined and tested through day-to-day use by companies. For example, about two-thirds of the high environmental impact companies examined in this paper use a standard environmental management system (either ISO 14001 or EMAS). Other examples of standardisation are the Global Reporting Initiative for corporate reporting in support of sustainable development and the Voluntary Principles on Security and Human Rights.

Effective corporate action in support of sustainable development requires an effective enabling environment. The progress cited above is a response to market pressures (the “business case” for corporate responsibility, the need to manage legal and regulatory compliance and to “softer” pressures not written down in law books. Thus, although these initiatives are essentially private, they are influenced in various ways by the broader environment -- economic, cultural, social, legal and political -- from which they emerge. The immediate implication of this is that, if broader environment is not functioning well, the business sector will not be able to do its job either. Societies provide essential influences and inputs that promote appropriate business conduct in subtle ways (for example, through informal enforcement stemming from peer pressure -- so-called “voluntary compliance”). Media also play a role. But in order for these influences to work, basic rights -- human, political, civil and labour -- need to be respected.

New approaches to regulation are emerging. New approaches to law and regulation try to use private managerial capacity to advance sustainable development goals. The OECD study shows that a co-operative form of regulation is gradually emerging that attempts to induce companies to use their private compliance expertise to advance public enforcement objectives. For example, OECD governments have integrated private compliance efforts into their regulatory and law enforcement strategies in such areas as environment, competition, anti-money laundering and food safety. Although they are often referred to as co-operative regulation, these new approaches rely on more than just trust and good faith. They can create powerful incentives for companies to adopt initiatives in support of corporate responsibility while allowing them the flexibility they need to adapt their management system to their own business situation.
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I. Introduction

The challenge of creating an effective investment environment touches upon virtually all policy areas. Companies contribute to the effectiveness of this environment through their management decisions.

An effective enabling environment for investment is one that allows societies to achieve higher levels of economic, social and environmental welfare. The challenge of creating an effective investment environment touches upon virtually all policy areas—fiscal, public sector management, competition, environment, labour and so forth. Improving policy in all these areas helps countries reap the full benefits of foreign direct investment. Governments have also attempted to enlist the support of the business community in improving the effectiveness of their policies and companies have made progress in responding to this co-operative effort.

Firms have been responding to these concerns and challenges with managerial innovations, including codes of conduct and associated management systems.

Firms have contributed in various ways to the sustainable development agenda, including its environmental dimension. Some twenty years ago, firms began formulating policy statements—or codes of conduct. These set forth their commitments in various areas of business ethics and legal compliance. Another step was the development of management systems designed to help them comply with these commitments and the development of standardised management systems. A new management discipline has emerged involving professionals that specialise in regulatory, legal and ethical compliance. More recently, steps have been taken to formulate standards providing guidance for business reporting on non-financial performance.

The practice of issuing codes is a relatively recent development.

These private initiatives are a prominent recent development in international business. OECD research shows that well over 95 per cent of the top 100 multinational enterprises (surveyed in 2001) have issued policy statements or codes in such areas as labour relations and environment, health and safety (EHS). The compliance tools now used routinely in international business hardly existed three decades ago. The now-widespread practice of issuing codes of conduct dates roughly to twenty-five years ago.

Firms have not developed these management innovations on their own. Business associations, NGOs and governments have also played important roles.

Companies have not acted alone in making these innovations. They have consulted with local communities, NGOs and with employees. They have also co-operated with other companies. Business associations have undertaken many initiatives to help their members have played important and varied roles. Governments also have influenced the shape of these initiatives in various ways. In particular, many have incorporated them into their regulatory and law enforcement strategies, giving rise to hybrid systems involving both public and private action.
II. Thinking about the Business Contribution to Sustainable Development

All aspects of the sustainable development agenda -- environment, anti-corruption, human rights, technology etc -- are covered in this inventory of codes.

One way that businesses communicate their views on their roles in and obligations to society is through the publication of policy statements or codes of conduct. Viewed as a whole, the corporate policy statements or codes of conduct surveyed by the OECD cover a broad range of issues and cover each of the economic, social and environmental “pillars” of the sustainable development agenda. They address such issues as environmental management, human rights, labour standards, anti-corruption, consumer protection and information disclosure, competition and science and technology (Figure 1). The most common issue areas addressed in the inventory are labour standards and environmental stewardship. Tables 1 shows the frequency of mention of companies’ environmental commitments.

Compliance with law is one of the most common commitments made in the code.

A look at the commitments made by individual companies in narrowly defined issues in relation to a particular activity (e.g. extractive industries) shows that the codes vary widely in their approach to ethical commitment. The extractive industry codes -- all produced by large companies -- show wide divergences of commitment. Most deal with the environment, but treatment of other issues (human rights, corruption) is sporadic and the concepts used vary widely among companies. OECD (2001) shows that similar divergences exist in relation to the fight against corruption and core labour standards. These divergences may reflect differences in individual companies’ business situations. Nevertheless, they also suggest that the codes do not generally constitute a de facto standard of commitments in the areas they cover. One exception to this finding are the association codes, where groups of companies, NGOs and banks, work together to establish a private standard. Business activity in standards setting has been a major feature of business activity, especially in the environment. Box 1 reviews selected initiatives.
Figure 1. **Issues addressed in codes of corporate conduct**
*(number of codes mentioning issue; out of 246 codes)*

Source: OECD

Table 1. **Environmental Policy Statements -- Commitments**

<table>
<thead>
<tr>
<th>Commitment</th>
<th>Percent of codes mentioning attribute*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comply with laws</td>
<td>67.6</td>
</tr>
<tr>
<td>Openness to community concerns</td>
<td>40.0</td>
</tr>
<tr>
<td>Environmentally friendly products and services</td>
<td>37.9</td>
</tr>
<tr>
<td>Employee training, awareness and dialogue</td>
<td>35.9</td>
</tr>
<tr>
<td>Transparency to Public</td>
<td>35.9</td>
</tr>
<tr>
<td>Contractors, suppliers &amp; partners</td>
<td>35.2</td>
</tr>
<tr>
<td>Continual improvement</td>
<td>33.8</td>
</tr>
<tr>
<td>Global application</td>
<td>33.8</td>
</tr>
<tr>
<td>Water, waste &amp; effluent management</td>
<td>33.1</td>
</tr>
<tr>
<td>Conservation of Materials &amp; Recycling</td>
<td>33.1</td>
</tr>
<tr>
<td>Public/customer awareness</td>
<td>33.1</td>
</tr>
<tr>
<td>Internal Reporting &amp; Performance audits</td>
<td>28.3</td>
</tr>
<tr>
<td>Research</td>
<td>26.2</td>
</tr>
<tr>
<td>Accountability of Management</td>
<td>24.8</td>
</tr>
<tr>
<td>Energy Conservation</td>
<td>24.8</td>
</tr>
<tr>
<td>Prior assessment</td>
<td>23.4</td>
</tr>
<tr>
<td>Hazardous waste disposal/management</td>
<td>23.4</td>
</tr>
<tr>
<td>Sustainable development</td>
<td>23.4</td>
</tr>
<tr>
<td>Exceed legal requirements</td>
<td>20.7</td>
</tr>
<tr>
<td>Measurable objectives</td>
<td>17.9</td>
</tr>
<tr>
<td>Emergency Preparedness</td>
<td>17.2</td>
</tr>
<tr>
<td>Contribute to sound legislation</td>
<td>16.6</td>
</tr>
<tr>
<td>Design, construction and decommissioning sites/facilities</td>
<td>15.2</td>
</tr>
<tr>
<td>Bio-diversity</td>
<td>11.7</td>
</tr>
<tr>
<td>Transfer of technology</td>
<td>9.7</td>
</tr>
</tbody>
</table>

Source: OECD; inventory of 246 codes collected between 1998 and 2000.
Accumulation of managerial expertise -- especially in environmental management -- has been impressive. This section suggests that this accumulation is global, but that rates of uptake are uneven among business communities of different nationalities. It also suggests that the uptake of environmental management standards -- which allow companies to economise on the development costs of environmental management systems and, possibly, to increase their credibility and effectiveness as well -- has been significant.

Implementing legal and ethical compliance programmes can be a formidable task requiring considerable managerial know-how. Normally all aspects of the firm’s operations will be affected -- structure of responsibilities, hiring, record keeping, incentive systems, external communications, training, production, legal services, emergency preparedness, etc. This section looks at how common such practices among European, Japanese and non-member Asian companies. It sheds light on the frequency of adoption of various environmental management and reporting practices and compares practices across countries and sectors of activities.

The data sets used here include a database covering over 1600 European companies and 100 non-member Asian companies. A different data set on Japanese companies’ environmental practices is also presented.

The analysis suggests that 75% of the high impact firms in the sample publish environmental statements.

The information on European companies comes from Secretariat aggregations of data from an existing database on corporate environmental practices -- the database of the Ethical Investment Research Service (EIRIS) covering over 1600 companies. This discussion focuses on the more than 400 firms in this database that operate in “high environmental impact” (HEI) sectors such as chemicals, air transport and forestry. The Secretariat has also duplicated the EIRIS methodology and created another database on a matched set of non-OECD Asian companies in high environmental impact sectors. The Secretariat has also aggregated survey data on corporate environmental practices in Japan compiled by the Asahi Foundation. All three databases cover firms’ environmental commitments, management practices and reporting.

The statistical results for the HEI firms in Europe are shown by country and by environmental practice (statement of environmental commitment; formal environmental management system; reporting). Seventy-five per cent of the HEI firms in the EIRIS sample publish a formal “environmental policy statement” (i.e. a type of detailed code of conduct setting forth the company’s commitments for its environmental performance). The equivalent figure for all firms (high and low impact) is 42%. All HEI companies from Sweden, Belgium and Norway issue policy statements, whereas less than 30% of the Greek HEI companies do (Figure 2).
Companies sometimes use formal environmental management systems to help achieve their environmental commitments. Fifty-two per cent of the HEI firms have such a system (Figure 2). The data point to wide differences among countries in the rate of implementation of such systems. Countries whose HEI companies have high rates of EMS implementation are Sweden (93% of HEI companies), Finland (89%), and Germany (82%). Countries whose high environmental impact companies have relatively low rates of adoption include Greece (7%) and Ireland (10%).

An important development in this area in recent years is the marked progress made in standardisation of environmental management systems (EMS). Two main EMS standards are available -- ISO 14001 and European Union’s Eco-Management and Audit Scheme (EMAS). The purpose of management standards is to lower the cost of implementation for companies (since they can take a management system “off the shelf”) and to increase the credibility to external stakeholders of firms’ efforts to achieve appropriate environmental standards (since their environmental practices are then recognised as being standard). The disadvantage of a standard is that it may not be well suited to a firm’s individual management problems or style. The data show that the majority of European firms using an EMS use an EMS standard (ISO or EMAS), while 34% use only tailor-made systems (Figure 3).

Environmental reporting is the least common among the three main practices studied. Forty-one per cent of the HEI firms publish a stand-alone report on their environmental performance. Figure 2 suggests that significant differences exist between countries in the area of environmental reporting by HEI companies. Countries whose HEI companies are likely to publish stand-alone reports include Sweden (64%), Finland (56%) and Switzerland (50%). In Ireland and Greece, none of the HEI firms produce stand-alone reports.
Figure 2. The environmental practices of European companies:  
Policy, management systems and reporting  
(Percentage of firms adopting practice and operating in high environmental impact sectors)

Source: EIRIS and OECD; data from year 2000 concerning 422 companies from high environmental impact sectors.
The EIRIS methodology has been duplicated for a sample of 100 publicly traded non-member Asian companies. The results show quite advanced environmental management practices in some cases.

OECD-based companies are not the only firms involved in the adoption of advanced environmental management practices. The Secretariat duplicated the EIRIS methodology for a matched sample of 100 high environmental impact companies based in five non-member Asia companies (Indonesia, Malaysia, Philippines, Chinese Taipei and Thailand). Note that, as with the EIRIS database, the nationality of a company depends on the stock exchange where its shares are quoted (in both cases, foreign ownership is often high). The results show reasonably high rates of adoption of such practices, especially in Chinese Taipei and Thailand for EMS adoption (Figure 4). These numbers place the rate of corporate adoption of formal EMSs in those two countries at only slightly lower than in the United Kingdom and France. An interesting difference between the Asian and European samples is the much higher reliance of Asian firms on standardised environmental management systems. All of the firms with an EMS in the Asian sample are certified for ISO 14001 (that is, none of the Asian firms use a tailor-made system).
A survey-based data source suggests that Japanese companies have high rates of adoption of advanced environmental management and reporting practices.

The Secretariat has also looked at the environmental practices of Japanese companies by aggregating survey data compiled by Asahi Foundation. The methodology underpinning this data is quite different than that of the two studies reported above (see OECD 2001) and so comparisons should be made with caution. However, the data suggests that Japanese companies have very high rates of adoption of advanced environmental management practices: 78% of the companies publish a statement of environmental policy, 58% have one or more units certified for ISO 14001 and 54% publish information on their environmental performance. The Japanese data -- viewed along with the European and non-member Asian data -- suggests that there are important international differences in styles of environmental management (e.g. in the use of standardised management systems). There are also differences in the degree to which advanced management practices are adopted. Nevertheless such practices have become an important part of business practice in a very diverse array of countries.
IV. Societies’ Contributions -- Values and Partnership

Companies need the inputs and influences from surrounding societies. These take the form of law, regulation and “softer” pressures.

Corporate initiatives are only meaningful if they are successful in helping companies conform more closely to society’s values and aspirations and the preceding discussion shows that they have acquired expertise that helps them to do this. But in order to make good use of this expertise, they necessarily rely on inputs from surrounding societies. These inputs are communicated to business via law, regulation and less formal pressures. These communicate society’s answers to some fundamental questions. For example, many EHS regulatory and compliance decisions hinge on answers to a question that only society can provide -- How much is it willing to spend to avoid the loss of a human life? The successful creation of these inputs is closely linked to broader frameworks of political, economic and social institutions. Basic institutions such police and judicial systems and respect of fundamental rights needed to function effectively if society is to be successful in communicating its values and aspirations in any sphere, including the environment.

Societal inputs are also necessary to allow law and regulation to be enforced in a cost-effective manner.

Societal inputs are also important for other reasons. The role of informal institutions in supporting the enabling framework -- especially in enforcing law and regulation -- is not sufficiently recognised. If laws and regulation are to be successful, they have to benefit from “voluntary compliance” (a major concept among the enforcement practitioners) stemming from highly diffuse, individual actions, each of which draws on society’s traditions, norms and beliefs (Slemrod 1998). This means that, quite apart from formal enforcement or compliance efforts, people choose to comply with law or regulation based on personal convictions or due to peer pressures. Voluntary compliance enters in the many situations where formal enforcement cannot do the whole job -- where it would be too expensive to put a policeman on every corner and an inspector in every factory. Protection of basic rights -- human, labour, political and civil -- is a pre-condition for allowing this “informal enforcement” to take place.

One of the most important ways that governments have promoted voluntary initiatives is by explicitly incorporating them into their regulatory enforcement strategies.

Within the OECD area, the design of law and regulation has shifted to reflect the collective nature of the regulatory process -- that is, to recognise that companies are as important as governments in determining the effectiveness of law and regulation. Governments have sought to do this by explicitly incorporating corporate actions into their regulatory strategies (OECD 1997). This approach recognises that firms and their employees are often best placed to identify non-compliance with regulation (Punch 1996). Under this approach, incentives are created to encourage firms to participate and to become, in effect, the first line of enforcement of public policy. Examples include the European Union’s environmental enforcement strategy (involving EMAS) and the United States’ co-operative programme in
occupational health and safety. Other examples have been noted in food safety and truth in advertising (see OECD 1997) and in reduction of toxic chemical releases.
They also use them in their enforcement of corporate criminal law. A closely related development can be found in enforcement of corporate criminal law (Scholz 1997). Several OECD members have explicitly incorporated consideration of companies’ compliance and risk management practices into their approaches to punishing and correcting illegal corporate activity. Some countries refer to corporate compliance practices in their sentencing guidelines for corporate crime. A company that can show it exercised due care in avoiding criminal misconduct by its employees may receive less severe punishment than a company that cannot show it took reasonable measures to discourage misconduct. Examples are found in Australia and Canada (competition law), and the United States (Federal Sentencing Guidelines). Tort law in the United States a similar effect. These create powerful incentives for firms to implement formal compliance practices and management systems of the type discussed in this paper.

Governments have also contributed to the development of intangible capital -- mainly expertise and standards -- that are crucial to these private initiatives. Governments also have contributed to the accumulation of intangible capital that is important in this area. They have contributed to the development of management and reporting standards (e.g. they contributed expertise when the ISO 14000 series of environmental standards was being developed). They have promoted the accumulation of human capital through their systems of higher education which now offer special course work and degree programmes in various field of corporate ethics and compliance. They have contributed to broader thinking in this area by promoting specific initiatives (e.g. the Ethical Trading Initiative in the United Kingdom) and by creating information services designed to promote “best practice” (e.g. in the European Union, Australia and Canada).

International organisations-- notably the OECD and the IFC -- have also contributed to the development of expertise and standards. Finally, international organisations have been active in this area as well. The OECD member countries, as well as six non-members, have adhered to the OECD Guidelines for Multinational Enterprises, a comprehensive code of conduct for international business covering 10 areas of business ethics (see Box 2). The International Finance Corporation (IFC) has issued a series of environmental and social policies and environmental, health and safety guidelines for projects it finances. The environmental, health and safety guidelines provide examples of best practices and detailed guidance on pollution reduction techniques and targets for a whole range of industrial sectors. As such, the IFC guidelines represent a benchmark for good environmental management practices that can and have been applied by business throughout the developing world, in the absence of or in addition to national legislation (see Box 3).
<table>
<thead>
<tr>
<th>Name of Initiative</th>
<th>Sponsor</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CERES Principles</td>
<td>A coalition of environmental, investor and advocacy groups and a “community” of companies (from website)</td>
<td>A code of corporate environmental conduct to be publicly endorsed by companies that strive to improve their overall performance.</td>
</tr>
<tr>
<td>Australian Minerals Industry Code</td>
<td>Australian Minerals Industry Association; and International Council on Mining, respectively</td>
<td>Codes for environmental performance and management and reporting practices in the mining industry. The Australian code requires verification by an external auditor.</td>
</tr>
<tr>
<td>Environmental Management; the</td>
<td>Originally, Canadian Chemical Producers Association; since extended to chemical industry actors across the world</td>
<td>A standard for safe management across the life cycle of chemical products. Contains a series of codes of practice, voluntary public disclosure. It relies on peer pressures, technical assistance and “leadership groups”.</td>
</tr>
<tr>
<td>Environmental Charter</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ISO 14001</td>
<td>International Organisation of Standards</td>
<td>An environmental management standard.</td>
</tr>
<tr>
<td>Forest Stewardship Council Certificate</td>
<td>Forest Stewardship Council is an association of environmental groups, timber and forestry business associations, indigenous people’s organisations, community forestry groups and forest product certification organisations.</td>
<td>A forest certification scheme designed to be used by producers and retailers.</td>
</tr>
<tr>
<td>Wolfsberg Principles</td>
<td>A consortium of major international banks.</td>
<td>A standard describing due diligence by banks in the fight against money laundering.</td>
</tr>
<tr>
<td>Global Reporting Initiative</td>
<td>Corporations, NGOs, accountancy organisations, business associations, and other stakeholders from around the world.</td>
<td>A global framework for &quot;triple bottom line&quot; reporting.</td>
</tr>
<tr>
<td>SPI Finance</td>
<td>A consortium of major international banks</td>
<td>A reporting system for financial companies wishing to disclose their triple bottom-line performance.</td>
</tr>
</tbody>
</table>
## Box 2 -- The OECD Guidelines for Multinational Enterprises

*The OECD Guidelines for Multinational Enterprises* are recommendations addressed by 36 (OECD and non-OECD) governments to multinational enterprises operating in and from their countries. They provide voluntary principles and standards for responsible business conduct in areas such as product safety, environment, labour management, supply chain responsibilities, disclosure of major risks and competition. The recommendations express the shared values of the nations that are the source of most of the world’s direct investment flows and home to most multinational enterprises.

A key value added of the Guidelines resides in the unique follow-up procedures created by governments and business. Governments of the 36 adhering countries have established a system of National Contact Points to promote the observance of the Guidelines by multinational enterprises operating “in or from” their territories.

Evidence so far suggests that the Guidelines are making a difference. Many companies have publicly acknowledged that they use the Guidelines as a benchmark for good behaviour. The Guidelines are being used to help prevent misunderstandings and promote mutual confidence and predictability between the business community and home and host societies. About twenty specific instances where there are questions about whether or not a company has observed the Guidelines in a particular business situation, have been considered so far.

The Guidelines are part of a broader instrument -- the OECD Declaration on International Investment and Multinational Enterprises. The Declaration promotes a comprehensive and balanced approach for governments’ fair treatment of foreign direct investment and for corporate responsibility.
Box 3 -- The IFC Guidelines for Multinational Enterprises

The International Finance Corporation (IFC) applies its policies and guidelines to projects it finances, requiring on-going compliance as a condition of financing. Other commercial lenders and financial service companies use IFC’s guidelines, making compliance a condition of financing or using it as a benchmark of best practice in the sector that can be realistically applied in developing countries.

IFC is evolving its focus to help its private sector clients understand the business case for sustainable development and structure their business to achieve sustainable operations. IFC is introducing a “sustainable development framework” for projects it finances to better assess a given project’s environmental, social and corporate governance impacts. The framework provides guidance on specific initiatives to achieve better sustainability outcomes from projects and provides an objective, comparable, and credible basis for assessing these initiatives and their long-term contribution to a project’s sustainability. The framework will be made public in the near future with the hope that it will provide a valuable tool not only for IFC and other financiers but the broader business community in analysing and improving businesses’ sustainable development performance.
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