Chair's Summary

The Evolution of Corporate Reporting for Integrated Performance

30th Round Table on Sustainable Development
held 25 June 2014
OECD Headquarters, Paris

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On June 25 2014, the OECD Round Table on Sustainable Development, in partnership with the World Business Council for Sustainable Development, gathered government officials, senior private sector executives, investors and experts to discuss the evolution of corporate reporting for integrated performance. The meeting was held under the Chatham House Rule. This summary presents the main points of the discussion along with the questions that participants were asked to answer. Participants had also received a background paper commissioned for the event [http://www.oecd.org/sd-roundtable/meetings/30throundtableonsustainabledevelopment.htm].

By way of preamble, it was stressed that the financial crisis had triggered a general loss of trust, and that corporate reporting must be considered in that light. Corporate reporting also raises a more fundamental issue about how corporate performance is measured, given that companies have clear impacts, negative and positive, on forms of capital other than financial (i.e. natural, human and social), and that companies face a wider range of stakeholders than their immediate shareholders.

Question 1: **Are corporate disclosures on non-financial performance being made use of?**

Objective, credible data on corporate social responsibility (CSR) can be hard to find, whereas information on financial performance is more homogeneous and better understood by investors. Comparisons of environmental, social and governance performance (ESG) prove particularly difficult across sectors.

Existing guidelines, standards and metrics provide a point of departure, but do not go all the way to guide investment, especially with regard to uncertainties that may lie ahead for any given company. There is progress in ESG reporting, however, with a new focus on materiality, but comparability on ESG performance has not yet been achieved.

Efforts are underway to bring together ESG and traditional financial disclosures, including the corporate reporting dialogue launched by the International Integrated Reporting Council, but fragmentation may limit progress.

At the moment, the ESG data gathering process inside companies is sometimes of poor quality. Third-party assurance would be necessary to place ESG disclosure on a par with financial information, and should trigger much improvement, including more trust in the reliability of disclosed data.

ESG disclosures are used more and more and by a range of stakeholders. On the investors' side, there is a growing capacity to assess the ESG performance of companies. This relies on more than their ESG disclosures. Other screening criteria include country of operation, policy uncertainty, area of activity, CO_2 emissions levels, or even information on operations at the level of a specific site. Investors ideally need objective, credible and auditable information.

Current ESG disclosures are in fact not produced for the information of investors and shareholders alone – other stakeholders make use of them as well. Consumers increasingly take note of corporate ESG disclosures for health, environment or fair trade reasons. As one participant put it, stakeholders are interested in *values*, shareholders are interested in *value*.

Nonetheless, shareholders and other asset owners would not ignore ESG information if there were an easy way to access and compare it, and would be more likely to act on it. Standards would go some way towards providing this information. Some thought it may be too early to regulate what that information should be.

Question 2: Do we need a new, more specific definition of corporate performance?

A key part of the answer is what the objective of a new definition would be – i.e. which audience is meant to be influenced. One suggestion was that companies with a better integrated performance (reflecting their impact on all capitals and their ability to create value in the near, medium and long term) should have access to a lower cost of capital. One company indicated that they managed to lower their risk premium on the basis of their integration of natural and other capitals in their strategic choices.

Looking at ESG, a new definition of corporate performance would have to reflect companies' consumption of non-financial capitals (i.e. a shift from shareholder to stakeholder capitalism). One approach may be integrated thinking, i.e. the identification of interdependencies between non-financial and financial aspects, and of strategic decisions deriving from this understanding. Quantitative information is important, but it needs a contextualised and qualitative narrative to be fully understood.

One participant called for a better understanding of how corporate responsibility affects financial accounts. The Group of Friends of Paragraph 47 of the Rio+20 Declaration, which brings together ten governments to promote sustainability reporting through a mix of mandatory and voluntary measures, currently seeks to develop the business case for corporate responsibility.

Some thought that materiality should be defined in relation to the actual financial returns of a company, and to its value, if investors are the primary target. What is material to civil society can be different, e.g. to inform about good corporate behaviour and ensure a company's licence to operate. New media are an important development in this regard.

One side of this question is about companies' ability to anticipate material risks with proper information systems and management responses that feed into internal investment decisions (e.g. to reflect a price on CO_2 emissions or water use). Developing an environmental profit and loss (EP&L) statement is a major step in this direction.

Companies do generate economic returns for investors through the use of forms of capital that are not accounted for in financial statements and not owned by these companies. A definition of corporate performance that integrates non-financial capitals would probably require thinking about an overhaul of national accounts, be it for coherence's sake.

Some process would be needed to arrive at a consensus on any new definition of corporate performance, and many terms need precise definitions to engage in a productive discussion. The OECD model tax convention was mentioned as an example.

Question 3: What role can governments and regulations play in an area where voluntary initiatives abound? What role can stock exchanges play?

The debate was essentially around two aspects: first, the voluntary vs. mandatory nature of ESG disclosure; and second, on 'what' exactly would be mandated, from a simple "comply or explain" requirement to the use of specific reporting guidelines. A related question is whether stakeholders, not governments, are best placed to define the contents of disclosures.

Governments have been far from inactive in the area of ESG reporting, as shown in the background paper. In countries with a decade-long experience in this area (e.g. France), some clear gaps remain (e.g. in social reporting or the engagement of trade unions).

The EU has created a common basis for extra-financial reporting by passing legislation requiring large companies in its 28 Member States to look at and report on their environmental and social impacts. The European Commission wants to develop guidance to assist companies in non-financial reporting. There are signs that companies have been affected differently by the decision to disclose ESG aspects.

Mandatory ESG disclosure is seen by some as an historical trend. However, the mandate to disclose ESG aspects may not be enough to enhance the usability and relevance of these disclosures. Reporting guidelines are still open to interpretation. Further, mandatory reporting may have to reflect the economic structure of countries (large publicly listed companies, SMEs, etc.).

Indices provided by stock exchanges, including sustainability indices, are useful for portfolio holders that wish to screen companies or activities. Some saw value in developing sector-specific indicators of ESG performance as part of the standard information provided to market operators. Stock exchanges tend to oppose mandatory reporting, maybe out of fear that listed companies would migrate to other countries and exchanges.

It was noted that governments rarely lead by example in ESG reporting and performance. As they set a poor example for companies to follow, this undermines their legitimacy to regulate in this area.

Participants disagreed on whether social indicators were as advanced as the environmental metrics (CO_2, local pollutants, etc.) There is now a project (SHIFT) on the reporting and assurance of impacts on human rights, an area where corporate reporting remains difficult. Some noted progress in social metrics, however.

International convergence (in policy or in the nature of ESG disclosures) may take some time, because of different starting points in corporate governance, and differences in local context. There is evidence that companies respond differently to ESG reporting rules in different countries, e.g. with some disclosures provided by lawyers strictly for compliance reasons with little relevant information.

The objective of ESG efforts is not the production of corporate ESG disclosure, but to trigger an internal process that enables a company to focus its efforts on sustainability and better risk management. On the one hand, there is a risk of turning corporate reporting into a bureaucratic compliance exercise. On the other, if a number of large companies have understood the strategic nature of ESG aspects, and engaged voluntarily, the vast majority of companies are not following. The question of whether or not to mandate ESG disclosure should be cast in that light.

One milestone in the debate over governments' role may be the ongoing OECD work to revise its Principles of Corporate Governance [http://www.oecd.org/daf/ca/2014-review-oecd-corporate-governance-principles.htm], which includes a chapter on disclosure issues.

Question 4: What information would give incentives for financial markets to take more interest in a long-term sustainable trajectory?

It is probably illusory to expect an end to the short-term focus of financial markets, i.e. corporate responsibility (sustainability) and high-frequency trading (market liquidity) do not belong in the same discussion. The question is whether capital markets can eventually add a risk-premium to the cost of capital of companies that are focused on the short-term, at the expense of their access to a wide range of capitals.

At the moment, however, there is a deficiency of appropriate and useable information for those investors who wish to make investments on the basis of companies' full value, including their ability to create value in the near, medium and long term taking all capitals into account (i.e. integrated performance). Despite this lack of information there is mounting pressure for more disclosure about long-term vulnerability, e.g. on pension fund managers to publish the carbon exposure of their portfolios.

Major gaps remain in the valuation by companies of services provided by natural capital. Pricing these externalities would go a long way towards shifting investment decisions in the right direction.

In the meantime, participants agreed to the need (and the responsibility of issuing companies) to initiate dialogues to "educate" investors on the material implications of sustainability risks to a company's continuous ability to create value – resulting in shareholders progressively recognising the value of sustainability investments.

In a show of hands, Round Table participants appeared split on whether financial investors should take the lead on a new definition of financial performance that includes ESG aspects. They generally agreed that standards are needed for the reporting of natural and social capitals, in order to establish materiality and comparability of ESG aspects. Over half believed that in order to establish the true value of corporations, financial, social and natural capital ought to be linked (e.g. via the establishment of environmental and social profit-and-loss accounts).