Council for European Studies

Perspectives on Europe

From Private Regulation to Public Policy: The Case of Corporate Non-Financial Reporting

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Autumn 2013
Volume 43
Issue 2

More than 2,500 of Europe's largest companies now disclose information related to social and environmental performance on a regular basis – up from nearly zero in the early 1990s (European Commission, 2013). Though critics of so-called corporate *non-financial* reporting often claim that these disclosures amount to little more than public relations 'greenwash', others argue that transparency of this kind has improved significantly over the past decade, helping companies to better understand their own impact on society and the environment and improving their long-term financial (as well as non-financial) performance. Whatever the final judgment is, and it is likely far too soon to know, the upward trend in reporting shows no sign of stopping. For while corporate non-financial reporting began largely as a voluntary enterprise – something companies did either on their own or under the guidance of private regulatory organizations like the Global Reporting Initiative (GRI), the Carbon Disclosure Project (CDP), and the United Nations Global Compact (GC) – it has now caught the eye of policymakers, most recently in Brussels, who look to extend this practice to more companies through mandatory reporting legislation.

This project uses the case of corporate non-financial reporting to examine the relationship between private business regulation – that is, regulation by non-state actors – and public policy. Recent work in political science has called

attention to the increased role of private actors at various stages of the regulatory process, including agenda-setting, rule-making, and implementation (Büthe and Mattli, 2011; Vogel, 2008). To some, the delegation of regulatory authority by government to the private sector, whether done implicitly or explicitly, is emblematic of the declining power of the state and the further entrenchment of 'neo-liberal' ideas. Contrary to these views, the case of corporate non-financial reporting illustrates how private actors can use voluntary standards and frameworks, not to replace government, but to drag it into policy areas that have been neglected or ignored. At the same time, while private regulation has the potential to 'bring the state back in', so to speak, it also provides business interests with new opportunities to influence the development of public policy.

Although corporate non-financial reporting is already commonplace among the world's largest corporations (approximately 80 percent of the world's largest 250 companies currently report), the vast majority of companies still do not report at all. In Europe, the 2,500 companies that are currently reporting make up only about 6 percent of the approximately 42,000 large companies currently in operation (European Commission, 2013). Thus, while corporate non-financial reporting has come a long way in a relatively short period of time, it still has a long way to go – especially when compared with financial reporting. Preliminary results from my research identify this as a key dynamic linking private regulation to public policy. On the one hand, private regulatory organizations have created powerful incentives for companies to improve their disclosure practices above and beyond existing legal requirements. In the process, they have also established rules and frameworks with widespread legitimacy and influence in the corporate sphere, placing non-financial reporting high on the agenda of many large, high-profile companies. At the same time, they have run up against problems that state regulators are in a unique position to solve, namely problems of implementation (e.g., getting companies to report according to a common standard) and enforcement (e.g., getting more companies to report by penalizing those that do not). Although policymakers today typically refrain from imposing additional regulations on business, it appears that the work done by private regulatory organizations has provided sufficient political cover for them to intervene in this case.

This analysis is based on approximately 40 in-depth interviews with large, mostly multinational companies based in France, Sweden, and the United Kingdom, as well as several of the most prominent private regulatory organizations operating in the area of corporate non-financial reporting, including the GRI, the CDP, and the GC. In part, these interviews were intended to uncover how companies form their own preferences toward non-financial reporting (i.e., why/how do companies report?), and to determine the extent to which these preferences vary cross-nationally (Martin and Swank, 2012). In addition, these interviews were also designed to reveal the strategies that private regulatory organizations employ to incentivize companies and to standardize and legitimize the practice of corporate non-financial reporting more generally.

Most of the companies interviewed engage in at least some form of non-financial reporting. Indeed, a number of them are now required to report by law. For example, most large companies in France are required to report on a number of specific non-financial indicators as a result of the Grenelle II regulations, passed in 2012. The reporting requirement in Grenelle II greatly expanded upon a previous requirement included in the 2001 New Economic Regulations. A more limited, narrative reporting requirement has been in place for listed companies in the United Kingdom since 2006. Interestingly, a more extensive requirement, called the 'Operating and Financial Review', had been set to roll out that same year, only to be scrapped at the last minute by then-Chancellor of the Exchequer Gordon Brown (and despite significant support from the business community). In Sweden, no comprehensive reporting requirement exists for large or listed companies, although state-owned companies must now report in accordance with the GRI's Sustainability Reporting Guidelines

(through legislation passed in 2007). In some ways the timing of the interviews is unfortunate, as private regulations predate almost all of these state regulations, and many of the companies interviewed started reporting before these laws were passed. Still, it remains true that much of the reporting done by the companies interviewed exceeds (often substantially) even these newer, more rigorous legal requirements, leaving open the question of *why* companies report.

For most companies, the decision to go 'beyond compliance' in their non-financial reporting is an explicit part of a larger business strategy. The purpose of this strategy is often to improve *financial* performance by identifying risks and protecting brand reputation, attracting new investment, recruiting and retaining talented employees, identifying new opportunities for growth, or gaining access to new markets. As a result, many companies target their reporting at investors and 'non-financial analysts' (i.e., the gatekeepers of various indices, ratings, and rankings of 'responsible' companies), current and prospective employees, and, to a lesser extent, local communities and governments (i.e., reporting as part of the 'license to operate'). Many companies also see reporting as a way to avoid scandal. For example, many claim that the process of reporting helps to identify and address potential risks (as one put it, "what gets measured gets managed") and thus adds value regardless of whether anyone actually reads the report. Of course, some companies also say that reporting on non-financial performance is simply the right thing to do. As one can imagine, the particular reasons a company has for reporting vary according to a number of contextual factors, including the company's leadership, industry, size, ownership, and regulatory environment.

Private regulatory organizations play a key role not only in convincing companies *why* they should disclose non-financial information but also in helping them to figure out exactly *how* and *what* to report. For example, the GC's 'Ten Principles' give companies a rough overview of major non-financial issues, covering human rights, labor, the environment, and anti-corruption – something which may be particularly helpful for companies reporting for the first time. For those that want to produce a more extensive report, the GRI's Sustainability Reporting Guidelines (currently in its fourth version, 'G4') provide detailed discussion of general reporting principles (including materiality, comparability, reliability, etc.) as well as 91 specific indicators of social, environmental, and economic performance that companies can begin to track and report. Many other organizations – such as the Carbon Disclosure Project and the Dow Jones Sustainability Index – solicit non-financial information from companies directly through questionnaires. These questionnaires may contain 100 or more questions and take a month or more to complete; nevertheless, many companies take them seriously (as they are required for many of the most competitive ratings and rankings), and as a result they operate as *de facto* reporting standards.

The voluntary aspect of reporting presents a challenge for private regulators – they must incentivize companies to commit to self-regulation while also making sure that these regulations have enough bite to actually make a difference. Bob Massie, co-founder of the GRI, describes it as the challenge of being both "bold and visionary" as well as "practical and incrementalist." Once these organizations succeed in gaining companies' support – for example, by building their own 'brand' and offering exclusive reputational benefits based on the value of that brand – they need to be careful not to move too fast too quickly. Early drafts of 'G4', for instance, received a negative reaction at several of the companies interviewed for this project. One manager dismissed it as a "wish list for NGOs," while another claimed that it "could undermine the existence of the [GRI]." The GRI is certainly not alone in having this kind of problem. In general, while private regulatory organizations have succeeded in getting a relatively large number of companies to report on non-financial performance, they have also run into limitations that are in some sense inherent to voluntary self-regulation.

As noted, only about 6 percent of large companies in Europe currently report on non-financial performance (European Commission, 2013). Although this group includes many of the largest and most recognizable corporations in the region, many observers agree that more companies need to begin reporting. Unfortunately, while more companies continue to report each year, growth in non-financial reporting is slowing (CorporateRegister.com, 2013). In addition, among those companies that *do* report, there is still a great deal of variance as to the standard(s) used as well as the content and quality of the actual disclosures. All this has raised demand for new mandatory non-financial reporting legislation. In response to this demand, the European Commission hosted a number of multi-stakeholder roundtables in 2009–10, launched a general public consultation in 2010–11, and gathered experts (including those from private regulatory organizations) for an impact assessment in 2012. In April 2013, it released its proposal for a new directive that would require large companies (i.e., those with more than 500 employees, a balance sheet exceeding EUR 20 million, or revenue exceeding EUR 40 million) to include non-financial information in their annual reports. The Commission estimates that this requirement, if accepted, would increase the number of companies reporting from 2,500 to 18,000 – a threshold that private regulatory organizations appear unlikely to reach on their own.

The rise of non-financial reporting, as with ‘corporate social responsibility’ in general, is often associated with the rise of neo-liberalism and the erosion of institutionalized forms of social solidarity in Europe (Kinderman, 2013). Although the absence of effective public policy is key to the rise of private regulation, this research paints a somewhat different picture by illustrating how private actors can use voluntary standards and frameworks to bring government into policy domains that have been left vacant *as a result of* neo-liberalism. That said, neo-liberal *rhetoric* can be a powerful tool (Schmidt and Thatcher, 2013), and it is partly through their use of this tool that private regulatory organizations have been able to secure the support not only of business but of government as well. The idea that companies can create ‘shared value’, benefiting both themselves and society at large, has been particularly powerful, for instance (Porter and Kramer, 2011). Still, while private regulation may lay the groundwork for new public policy in some cases, its reliance upon voluntary self-regulation also raises questions about corporate influence in processes and discussions that are largely hidden from public view (Culpepper, 2011).

For many, the most important question about corporate non-financial reporting relates not to how it is regulated but to whether it actually makes any difference. Among individual companies, those that report often refer to it both as a “learning process,” in which they come to understand their own social and environmental impacts, and as a catalyst for positive change within the company (e.g., “to *say* something, you have to *do* something”). Of course, others are more skeptical, pointing out that while they agree with the idea of reporting, they find many faults in its implementation (e.g., too many companies with poor performance still managing to do well in rankings, ratings, etc.). At a structural or systemic level, one can look at the development of non-financial reporting over the past two decades as part of a gradual change in expectations about large corporations and their role in society. The transition from private regulation to public policy appears perhaps more natural from this perspective. For, as one manager noted, “what is voluntary becomes expected; what is expected can become mandatory.”

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