BBL Seminar

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"Global Developments in Corporate Responsibility from a European Perspective"

SUMMARY

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Last year at KPMG together with the University of Amsterdam we carried out an international survey of corporate responsibility reporting, and the results were really striking for us. We have carried out these kinds of surveys every three years since 1993. We look at the sustainability and environmental reporting behavior of companies. This time especially we were very surprised because of the top 250 companies worldwide and the top 100 companies in 16 developed countries, for the first time since the beginning of the 1990s, we observed that now the majority of the top 250 companies produced besides their financial report, a separate sustainability or corporate responsibility (CR) report. Three years ago, it was only 45%, and now it is already 52%.

Three years ago, most of the non-financial reports that were published were still environmental reports, but this has changed dramatically. Most of the reports are now integrated reports on social, environmental and economic performance of companies. Surprisingly, especially for Europeans, the top countries we found were Japan as number one, followed by the United Kingdom. Another surprising thing was that we found a strong increase in the financial sector, a sector that 10 years ago seemed to have very little interest in sustainability. There, we observed a more than twofold increase since 2002. The results of this survey show that something special has happened in the last few years, a sort of breakthrough, and we have had many reactions from all over the world.

I will come back later in my introduction in more detail on the results of the survey, but first I need to explain the expression, "corporate responsibility." I have used here the definition used by the World Business Council for Sustainable Development, which is that corporate responsibility is "the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life." The World Business Council has chosen this definition because there are many names circulating in different countries for sustainability. Sometimes they have a slightly different meaning; we have names like "sustainability," "triple bottom line," "corporate social responsibility," etc. In some countries, like the U.S., corporate social responsibility is often confused with "philanthropy." In some countries, sustainability is often seen as an environmental issue, and I think that is also not true. Please do not get confused when I now and then use the term CR in place of corporate responsibility or sustainability, I mean the same thing.

It is clear that corporate responsibility is an international phenomenon, but where do we find CR? Just to give you an idea of where we find CR activities, we find them in Japan, but I think the cradle of CR is Western Europe. We also find activities in the slipstream of Japan, activities in South Korea; we have also had them for a long time in North America. Australia and South Africa have been booming in the last few years, and we find also now activities in South America, Chile and Brazil, so it really is a worldwide activity. A few weeks ago, I was in China and I could see that the Chinese Business Council for Sustainable Development now already has 50 members. Maybe that is not much for such a big country, but it is a start. If you look at CR and CR activities, they are globally distributed by multinational companies through their subsidiaries and their suppliers. I have the impression that these activities will be further spread around the world.

I will give my views from a European perspective, because I am a European, but I will also try to give you an international picture, and to show some regional differences. I have done this based on my work in different countries, the experiences of my colleagues, and discussions with professionals in this field.

As I told you, the survey we have carried out is a big survey, covering more than 16,000 companies worldwide. In the research more than 50 people from the University of Amsterdam and from KPMG International Network were involved for more than a half a year in collecting information. We now have a database with more than 50,000 data on corporate responsibility reporting. This gave us some very good insight into developments, and for the University of Amsterdam they form a source of many academic publications.

We have been carrying out these surveys since 1993, and we have looked at companies that are producing corporate responsibility reports, separate from their annual financial reports. We looked at hardcopy reports and reports on the Internet, but we excluded company brochures, public relations materials and so on. When we started these surveys in 1993, many people said, "We do not believe in environmental reporting, it is just a fashion trend, it will fade away. Companies will only do this because of public relations. It is advertising, and in a few years time it will all be over." On the contrary, you can see here over the course of time there was a steady increase in non-financial reporting. What you can see here is that it is a sustainable trend.

In one sense, the critics were right; standalone environmental reporting has almost vanished. You can see that if you look at the global 250 companies. I think in 2002 you could see most of the reports were still environmental reports and if you look at 2005, most of the reports were integrated reports. You find the same in the top 100 companies. Three years ago most of the reports were environmental reports, now we see that most of the reports are integrated social, economic and environmental reports. Something has really changed here.

What sectors are active? We have looked at different business sectors. Here again, we have a number of interesting observations. Compared to 2002 there has been a relative increase of reporting in all sectors. All are involved, but while the activities of CR and CR reporting are not restricted to certain sectors, there are marked differences. The sectors that have a high impact on the environment, and the sectors that already had a tradition of environmental reporting — utilities, chemicals, oil/gas and mining — have a very strong position, and a sector like construction is always lagging behind. However, in all sectors, there is a relative increase. In the financial sector, we can see a more than twofold increase in reporting. This is not only about the top 100 companies; if you look at the global 250 you find the same pattern. I will come back to this later; it is an interesting phenomenon in the reporting activities of the financial world.

Looking at the countries, I already told you that Japan is the absolute champion, but even in Japan, which has a very strong position, the number of reports in the top 100 companies has increased. Many Europeans are surprised here because they consider Europe the cradle of CR and sustainability. But as you can see, the European countries are also very well represented, with the UK following Japan very closely. What is also very interesting for Europe, is a number of countries that were traditionally lagging behind, for instance Spain or Italy, show strong increases, which are quite remarkable. There are strong increases also in Canada and North America. Strange, maybe disappointing, is that the U.S. has decreased a little. Also, Norway and Sweden, countries that were traditionally strong have now fallen back a little.

Let us look at the content of the CR report. What sort of information do these CR reports contain? We find still the traditional environmental issues about emissions, the water, air, hazardous materials, waste, those sorts of things, but with a strong focus on climate change. We see lots of information about social performance, diversity issues, equal opportunity, human rights, collective bargaining, child and forced labor, freedom of association of workers, working conditions, health and safety, training of employees, employee satisfaction and lots of information about community involvement. For example, schooling and educational programs, employee volunteering programs, health programs, HIV/AIDS support programs in developing countries. Also, lots of information on philanthropy and philanthropic foundations, especially for American companies. Last but not least, we see that companies are reporting on economic issues. We try to show the economic footprint, what is the economic contribution to the shareholders, to society? Many companies just give a summary of the highlights from their financial report.

Maybe it is more interesting to look at emerging issues in the report. The first emerging issue is stakeholder engagement. More and more companies have seen in the last few years that stakeholders are very important for them and they are very busy with the questions, who are my stakeholders, what do they expect from me, and what sort of information do they want from me. Of course these questions are not new, but many companies in the past said, "I know my stakeholders, I know who they are, do not tell me what the stakeholders want from me, I know it all." Maybe this was the wrong attitude. I think that at this moment what we see is that companies are more structurally busy with analyzing their stakeholders and investigating what the stakeholders need. They ask stakeholders for feedback, and a small number of companies also started measuring the impact of CR reports on their stakeholders.

A new issue is also supply chain management. The companies are not restricting corporate responsibility to their own activities but also require their suppliers to follow them. Seventy percent of the companies require a supplier declaration from their suppliers, that they also follow their CR codes. A growing number of companies also carry out supply chain audits. What we also could see is that a number of companies have actually reduced their supply chain network based on those audits because of risk considerations.

Climate change is really high on the agenda. In the reports it is clear that business now takes this issue seriously and 67% of the companies report on their CO_2 emissions, with about 25% of the companies also investigating the consequences of greenhouse gas trading; looking at risks as well as opportunities for the company.

The last emerging issue I want to mention here is corporate governance. Companies discuss their codes of ethics, and have a special section on corporate governance in many reports. It is not strange, because in most codes of ethics, there is a relationship with CR and sustainability issues.

I have shown you a number of facts about CR. It is a global activity. An increasing number of companies in all sectors show their performance in the non-financial field. We see a stronger focus on stakeholders, suppliers, corporate governance and of course, it is not only about reporting. The most important thing is what is behind this. Why do companies do this? What has happened in society that impels companies to do this? Let us make some reflections. If I summarize the developments in society in the last five years, I observe a few things: a stronger focus on the responsibilities of companies, a stronger focus toward all of the stakeholders, stronger focus on respect for the environment, and a stronger focus for the society in which the companies operate.

The public ideal of multinational companies is very high. Sometimes it is possible for multinational companies to do more than a government because they have the resources, networks, knowledge, and they often have tools that go beyond the scope of governments. At the same time, we see that the trust of the public in big companies is diminishing. We have seen in recent years that in the eyes of the public some companies behaved disappointingly. As a consequence, there is a strong appeal for better corporate governance, transparency and accountability.

We also see a growing number of non-governmental organizations (NGOs) closely watching companies worldwide and reporting on poor performance. According to surveys the public has greater trust in NGOs than large multinational corporations. Governments, the United Nations, the European Union, and the OECD also play active roles. The pressures from civil society and governments make companies aware of their responsibilities beyond financial responsibilities to their stakeholders. Environmental and social risks are brought to the attention of companies by NGOs. These issues can often impact company image and brand name, and a number of companies had to face serious financial consequences because of business interruption, sales drop, liabilities and drop of stock value. In response, many companies have started to think about their economic and environmental responsibilities as well as their responsibilities toward people inside and outside of their company.

Companies invest a lot of energy, money and resources in CR not only for risk management, but also to create value for the company. Economic drivers for CR include innovation and learning, employee motivation, access to capital, reputation and brand, market position, supplier relations,

relations with the authorities, and cost savings. CR has forced companies to look at new dimensions of the business, finding new opportunities and new markets. Companies which have developed green products in response to demand for CR have been able to turn in a high profit on them.

Employee motivation is also an important driver for many companies. CR is now important to attract and retain people. Young students are more critical about employers, with a high percentage of students unwilling to work for a company that does not behave responsibly.

Access to capital is another driver. Professionally managed investments based on ethical, social or environmental considerations are affected by CR activities. Worldwide, about 6% of all professionally managed assets are in some way managed or screened for ethical, social and environmental criteria. This is about ¥350 trillion. There is a significant number of investment managers that believe these things will become more commonly incorporated into investment decisions. CR reports will need to offer investors more information in this direction. The Dow Jones Sustainability Index and the FTSE4Good Index rate companies on sustainability, in addition to financial performance. These sustainability indexes produce lists of companies with good performance in each sector and companies are very eager to be listed highly, demonstrating leadership in the financial world. We see specialized SRI funds which have been screened on social and environmental performance emerging. These SRI funds are very active and have about $76 billion under management worldwide.

Currently many companies are still busy with CR and CR implementation with regard to risk and reputation management. A lot of companies are very much occupied with integration of CR into their business, which is rather complex and difficult in a large organization. In a big company spread across many countries, organization of CR poses a lot of challenges. That is the reason that implementation of CR takes a lot of time.

A small percentage of the effort is involved in creating business value. What we expect is that in the course of time, the effort needed with risk interpretation management and integration of CR in the business processes will diminish, and there will be more time and effort available for creating value by using CR as a competitive edge.

The meaning of CR in different countries may be a little bit different. If you talk about CR, still many people in North America think that it is shareholder-focused, focused a lot on philanthropy, corporate volunteering, and community involvement. There is also a lot of focus on corporate governance and compliance. If you look at Japan, I have the feeling that CR is here more based on a philosophy; living in harmony with nature and society, respect for people, and *san pou yoshi*, a triple win in business. You are as much focused on suppliers as products, and a lot of focus on environmental issues. Japanese companies are really good at realizing that there is a strong link between CR and product branding, and they use that. There is also a shift from environmental issues to social issues as well, but a lot of Japanese companies seem to struggle with this. It is important for global organizations to realize that the interpretation of CR is very different in different regions, especially between the U.S. and Europe.

CR is a mainstream activity driven by economic motives; it helps stimulate innovative thinking and helps to open new markets. Through increasing supply chain pressures, smaller companies (SMEs) will be stimulated to adopt CR practices. Investors' interests will also continue to increase, putting more emphasis on business cases from a financial perspective. All companies still have a lot to achieve, and despite good intentions some companies still have problems, but I think that companies that do not follow this road to improved CR will find it difficult to survive.

Question and Answer Session

Q: I have three questions for you. The first is do you think the litigation risk is the reason for CR reports being scaled back in Nordic countries and the U.S.?

A: Yes, I think that is right. Many experts agree that it has to do with litigation risk, companies are afraid to disclose too much information. There have been some companies that have been sued over statements that they failed to live up to. Also, in some countries in Europe, this information must now be disclosed in financial reports, so some companies do not want to disclose it twice in a separate report. Another explanation might be that a number of big multinational companies have moved out of these countries, so the activities are reduced.

Q: My second question is about the regional differences you showed. Given those differences, do global companies digest them and create their own CR program that is applicable regardless of the region or are they restrained or influenced by their home country's point of view?

A: I think at this moment that their views are influenced, with CR in the U.S. being different to CR in Europe. However, there is a group in the World Business Council developing a global model not just for CR but for the role of companies in society. I see that Japanese and American companies are struggling in Europe because their ideas and concepts are different. The more companies work globally and the more work that is done in the World Business Council, the more we will come to one model or concept.

Q: Those differences seen among regions, do you see a tendency of convergence?

A: Yes, I think they will converge. I think that it is part of globalization, a lot of people are migrating and so a lot of ideas are being exchanged quickly. In 5-10 years I think we will still have some regional differences but not that strong.

Q: My third question is that given that companies' efforts toward the environment might be more easily converted to a monetary value compared with social efforts, do you think that the innovation and learning issue can be applied to social efforts too?

A: Yes, I think that can be applied. For example, companies are saying that they now have new markets at the bottom of the pyramid. In this world we have about half a billion people who can afford to buy products for the rich, and we have 4.5 billion people who live in poverty, who cannot buy expensive products. But their different needs form a new market. If you make products for the poor, you make smaller margins, but the market is bigger. Companies are finding new markets in poor countries and at the same time they are also helping to solve the problems of the poor.

Q: In Asia, we have our own way of doing business, what do you think of the differences? Do we have to converge, or should we respect the historical or cultural background?

A: Yes, I think you are right. What I mean by converge is that we have a common understanding about what corporate responsibility is. A basic understanding of respect for the environment, people and your economic situation is necessary for understanding regional differences. By converging, I do not mean one model or one standard for CR, but what I do mean is one common idea for what CR is. If we do not have this common understanding, we cannot get everyone to work with the concept. We are interested in collecting different regional CR models in order to get a better global understanding of CR.

Q: How far do you think the UK and other European countries will go in terms of accounting systems and standards?

A: In the UK they have already gone very far with Operating and Financial Review (OFR), which is also bringing social and environmental indicators in the financial reports. However, in the opinion of the State Secretary of Finance they went a little too far, and he withdrew the proposal. In the EU there is the Accounts Modernization Directive that must be followed by all EU member states. Therefore, although the OFR proposal was withdrawn, the UK will have to implement the measures contained in the EU directive.

Q: I would like to know if there is a standard auditing system for CR reports, or can any company create whatever standard they want for CR? Can we guarantee the content of such reports?

A: At this time, there are no global standards for CR reports, but there are some important standards that are coming up such as the Global Reporting Initiative, which gives some guidance, but at this moment we do not have global standards. We have a number of standards for the assurance of the reliability of these corporate reports, and we have a new accountancy standard, the ISAE 3000, for the certification of non-financial information. You have to read very carefully in the report what the assurance statement says about the reliability of the report. Most of the reports that are certified are certified on a "moderate level" of assurance.

Q: The Kyoto Protocol has been ratified by Japan and the EU, but not by the U.S. If that is the case, would you then see less reporting on climate change coming from the U.S., compared to the reports that come from Europe and Japan? And if that is the case, can you attribute it to governments' ratification of the Kyoto Protocol. And if you do not see a difference, what should the conclusions be then?

A: I think when it comes to CO2 reporting, American companies are still behind, but I see more and more companies taking this seriously as an issue because they feel it will have a business impact even if America did not ratify the Kyoto Protocol. Even if America has not ratified the Kyoto Protocol, American companies are very eager to join CO2 reporting projects. Globalization is stronger than legalization.

Q: How many copies of these reports do companies typically publish? And who is the audience for the reports?

A: I do not know the circulation figures. As for the audience, some companies are very specific in targeting their audience; maybe their suppliers, maybe their clients, shareholders, but also their own employees are very important. Sometimes companies just publish the report and send it out with the annual financial report. Some companies only publish it on the Internet, so it can be quite difficult to know who the audience is. Most companies think about who their stakeholders are, and then they selectively target their audience. The tendency now though is to publish more and more on the Internet, rather than hardcopies.

Q: Who are the key stakeholders in CR and how are key stakeholders defined by the companies?

A: I think that every company has different stakeholder groups, but I can see a number of stakeholders that are always important. One group that is always important is the employees; the other group is the shareholders. There are now several models to find out who a company's stakeholders are, where they are, what they want and how important they are.

*This transcript was compiled by RIETI editorial staff.