Pegasus

A newsletter for the Caux Round Table Network
looking at business above the clutter and confetti

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Moral Capitalism At Work

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Pegasus

INTRODUCTION

This June 2013 Issue of *Pegasus* brings you four comments. The first two are reflections from the newly elected Co-Chairs of the Caux Round Table's Global Governing Board, Robert MacGregor and Tunku Abdul Aziz Ibrahim.

We are both fortunate and delighted to have their commitments and skills at the helm of our efforts. Robert MacGregor is returning to a leadership role after nearly 20 years of dedicated support. A practical visionary, Bob took the lead in 1992 to advance the idea of global standards for business. This once pioneering concept, now embodied in the U.N. Global Compact and ISO 26000 and many other codes of conduct, is a commonplace for a new form of responsible capitalism. Tunku Abdul Aziz Ibrahim is also a visionary, seeing that corruption in government, aided and abetted by the private sector, has no place in a just society that cares for all its members. His early efforts with Transparency International in Malaysia have become echoed by a global movement, supported by an international convention against corruption.

I then thought it appropriate to distribute to you remarks by the new Holy Father, Pope Francis 1. His personal comments bring to the fore the pressure of high ideals to see themselves realized in our daily activities. Pope Francis represents a Church concerned for the world as it may be better aligned with principles of good and right. We at the Caux Round Table take comfort from this leadership stepping forth from a standpoint of humane and most constructive values that can enhance our lives, even in business and finance.

Finally, the issue brings to you, with my thanks to the National Association of Corporate Directors for giving us permission to republish a commentary by one of our fellows, Alexandra Lajoux, and her colleague Cheryl Soltis Martel. Their assessment of where the corporate social responsibility (CSR) movement is today is both comprehensive and enlightening. After reading their exposition, we can understand why it is not possible to put the genie of CSR back in some small bottle on the back shelf of global capitalism.

Stephen B. Young
Global Executive Director
Caux Round Table

THE CAUX ROUND TABLE: AN HISTORICAL REVIEW OF ITS REMARKABLE HISTORY

BY ROBERT W. MACGREGOR

It has been some 20 years since Minnesota business leaders crafted the Minnesota Principles and presented them to a group of international business leaders at Caux, Switzerland. These global Chairmen and CEO's agreed that global ethical principles for business were essential to undergird free markets.

I remember that meeting and now, that I am returning to a position of advocacy some years later for business responsibility as essential for the progress of humanity, I would like to share my appreciation for work done in the past by so many of dedication and integrity and my hopes for more work to be done now with equal thought-leadership and success.

After endorsing this Minnesota intellectual initiative, the group gathered at Mountain House in Caux asked that the proposed principles be repositioned with help from a representative group from Asia and the U.S. and renamed as --- *The Caux Round Table Principles For Business*. The editorial committee was hosted by the University of St. Thomas in Minnesota.

This was a major contribution by a dedicated global team of business leaders. The Caux Round Table Principles for Business have been translated into numerous languages and taken to the world. They became the most recognized business principles across the globe and a model for other business ethics initiatives, such as the U.N. Global Compact.

It is time to again salute our earliest visionary founders, such as the late CEO's Fritz Philips of Philips Company, Ryuzaburo Kaku of Canon and his visionary Kyosei Principles, and Win Wallin of Medtronic, for their effective leadership. There is a long list of others to whom we are indebted, such as Chuck Denny, former Chairman, ADC Telecommunications; Morihia Kaneko, former President, Panasonic Deutschland GmbH. Germany; Neville Cooper, a prominent former British business leader; Jean-Loup Dherse, former Vice Chairman, World Bank; George Frem, Chairman, Indevco; Professor Ken Goodpaster, Koch Endowed Chair in Business Ethics, University of St. Thomas; Walter Hoadley, former Chief Economist, Bank of America; Ron Baukol and Harry Hammerly, former Executive Vice Presidents, 3M; Anthony Andersen, former CEO, H.B. Fuller; Dave Koch, Chairman, Graco; Heidi Von Hoivik, a thought leader from Norway; Fredrick Schock and Frank Straub, German business owners; Karel Noordzy, former Chairman, PGGM Pension Fund; Olivier Giscard d'Estang, founding Dean, INSEAD Business School; Lord Dan Brennan, member, House of Lords; Ari Kahan, Mexican business owner; James Renier, former Chairman, Honeywell; Dominic Tarantino, former Chairman, Price Waterhouse World Firm; Robert Gurnitz, former CEO, Northwestern Steel & Wire; Roger Parkinson, former Chairman, Globe & Mail; and Dr. Noel Purcell, Australian senior banker and former Chairman, Caux Round Table.

These are but a few of a long list of the many business leaders from many countries who have contributed to the Caux Round Table and with whom I have had the privilege to work.

It is also timely to recall some of the significant annual meetings held with senior business and government leaders, in Germany, Poland, numerous sessions at the Caux Conference Center in Switzerland, Great Britain, Mexico, Japan, Turkey (major U.N. meeting), and China several times, as well as the U.S.

In particular, I highlight Canon's Ryuzaburo Kaku in assembling Japan's top leaders in several significant meetings for the Caux Round Table in Tokyo, and organizing with China's Governor of Guangdong, a tour of that country's largest province, at the time the leader of China's economic development.

I cherish riding several days on a bus with Yoshikazu Hanawa, former CEO of Nissan, and learning more about the concerns from an Asian auto expert and sharing a bus ride with Ernie Micek, the former Chairman of Cargill, a company that flagships the word "integrity" with all its employees, through Poland.

We had significant meetings with Kofi Annan, when he served as Secretary General of the U.N., and we've made progress with promising Caux Round Table chapters in Malaysia, Thailand, Mexico, Kenya, Germany, Lebanon and elsewhere, including South America.

The Caux Round Table has updated its Principles for Business and has recently added Principles for Governments, Principles for Civil Societies, Principles for NGOs and Principles for the Ownership of Wealth, as well as published many significant papers. Our Global Executive Director, Steve Young, and other Caux Round Table leaders are called on all over the world to highlight the strong message of the Caux Round Table that capitalism flourishes and contributes best when undergirded by our Caux Round Table values and principles.

As we review the crucial issues daily facing world citizens everywhere, we are reminded that business represents the world's most powerful institution. Business, for example, has the most resources and hires the largest numbers of talented employees. Thus business, as our late Chairman, Win Wallin, stated in his paper, *The Greatest Challenge to the World's Business Community: Making it Possible for the Poor Nations to Share in Global Prosperity*, must and can shape the best futures for world citizens. This includes the ethical responsibilities of developing decent jobs for the large numbers of unemployed, especially addressing the plight of unemployed youth worldwide.

The Caux Round Table's Principles highlight the responsibility of business to take care of our precious environment for future generations, and underscores business responsibility to all stakeholders, not just the owners.

A recent lead editorial in the Wall Street Journal rightly highlighted the need for our message: "An enormous body of economic literature now exists confirming that corruption keeps the poor down....The International Monetary Fund concludes that widespread corruption contributes to low economic growth across the world....and underscores global poverty persists because corruption kills capitalism." The Caux Round Table's mission and programs address these critical issues.

As a leadership criterion, the word "integrity" is front and center as the salient quality of a proper business leader. I often quote the founder of Target, the late Ken Dayton, to whom I once reported: *"The purpose of business is to serve society. Profit is our reward for serving well with integrity."*

The Caux Round Table's value message builds the best case and foundation for a long-term profitability. Our message is the most relevant to undergird capitalism and release its potential energy. Business can responsibly unleash the old wise advice of capitalism guru, Adam Smith, who highlighted the moral foundation as the unique engine to best address our most critical issues of growth and opportunity for world citizens.

We believe the Caux Round Table is one of the most useful and necessary organizations for business today. It is in our enlightened self-interest to strengthen this timely organization. With a growing list of others, I champion the opportunity to participate in this vital, value-centered global business leadership group.

Onward and upward with confidence for the Caux Round Table!

Robert W. MacGregor
Co-Chairman
Caux Round Table

WHY THE CAUX ROUND TABLE IS **NECESSARY**

BY TUNKU ABDUL AZIZ IBRAHIM

In 1982, I attended the European Management Forum in Davos, Switzerland. The organization was soon to change its name to the World Economic Forum. It was, for me, an exciting, heady experience to be thrown into the melee, among the giants of international politics and business. I have since attended regional gatherings as a speaker in Hong Kong, New Delhi and Kuala Lumpur. Neither the form, nor the substance, has changed much, a good example of sticking to a proven, winning formula.

Then, unlike the present, the world was greatly exercised by, and preoccupied with, the threat of total annihilation of the human race, engendered by the unpredictable behaviour of the Soviet leadership. The Cold War was at its hottest and the world was coming to terms with the fact of the new reality. There I was sitting, on a very cold February morning, in the stark grey, reinforced concrete bunker-like auditorium, overawed by the whole atmosphere, trying to concentrate, without much success, on a panel discussion led by such political luminaries as Edward Heath of Great Britain, Hans-Dietrich Genscher of Germany and Raymond Barre of France. I became distracted for a moment, thinking what an inspired choice the venue was, a state of the art underground nuclear bomb shelter! It was not without a touch of irony that a forum calculated to bring about world peace and drive the global economy to dizzying heights with the new industrial technologies, freer movement of capital and labour was being held within the formidable walls of a nuclear bomb shelter. It was, I suppose, a reflection of the times in which we lived.

What I still remember quite vividly about the forum is that all the business discussions centered on profits, and no one really bothered enough to ask whether it mattered how they were made. In other words, profits, however made, were the “be all, and end all” of a business enterprise. The espousal of that approach to international business dealings made me wonder if there could ever be a morally acceptable alternative. Edward Heath, when he was British Prime Minister, felt constrained to comment in parliament on what became known as the Lonrho Affair, as representing “the unpleasant and unacceptable face of capitalism.”

I am proud to say that the Caux Round Table has been, for many years now, at the forefront of the fight for a morally enriching, as well as financially rewarding, form of capitalism. While much remains to be done in transforming the way business is conducted, we have seen, particularly during the last couple of decades, some small signs of growing interest in corporate social responsibility, underpinned by the Caux Round Table Principles for Business. We may yet see the pleasant and acceptable face of capitalism in both domestic and international business. However, lest we get carried away, based on the present showing, we have many miles of the road less travelled ahead of us to negotiate.

We may have weathered the threat of a nuclear holocaust, but a more sinister and devastating enemy has replaced the nuclear warheads of instant destruction. Unregulated capitalism has become the new financial business model. Many countries today submit themselves happily to being judged on how “free” their economies are. The rating is nearly always based on the number of state-imposed regulations that are in place.

The premise that fewer is better, in so far as regulations are concerned, is unsupported by the results we have seen, at least thus far. We must work out and put in train a regulatory regime that allows business to thrive without destroying the social values and value systems that will allow societies to prosper, as the economies themselves prosper. This is particularly important for developing economies where social safety nets do not exist in any shape or form.

I am not against business making profits. Unprofitable companies are not only incapable of fulfilling their obligations to society, but also justifying their reason for existence. Even George Soros, the archetype of American free trade and all that it implies, after years of fighting a rear guard action against any form of regulation in the financial sector, now seems to think that regulations could be a good thing. In a world where winning is the name of the game, and winners take all, the Caux Round Table Principles for Business are becoming increasingly vital for the promotion of business in the public interest.

It was the lessons of the Davos forum that prompted my old friend, the eminent Australian ethicist, Professor Charles Samford, and me to come up with the idea of setting up the World Ethics Forum as an ethical counterbalance to the World Economic Forum’s unadulterated emphasis on materialism. The first World Ethics Forum, held at Keble College, Oxford University in 2006, was attended by some 300 participants from around the world. There is scope for the Caux Round Table to work with the International Institute for Public Ethics, the “owner” of the World Ethics Forum, to promote ethical business principles.

Tunku Abdul Aziz Ibrahim
Co-Chairman
Caux Round Table

ADDRESS TO **THE NEW NON-RESIDENT AMBASSADORS** TO THE HOLY SEE

BY POPE FRANCIS
CLEMENTINE HALL
THURSDAY, 16 MAY 2013

Your Excellencies,

I am pleased to receive you for the presentation of the Letters accrediting you as Ambassadors Extraordinary and Plenipotentiary to the Holy See on the part of your respective countries: Kyrgyzstan, Antigua and Barbuda, the Grand Duchy of Luxembourg and Botswana. The gracious words which you have addressed to me, for which I thank you heartily, have testified that the Heads of State of your countries are concerned to develop relations of respect and cooperation with the Holy See. I would ask you kindly to convey to them my sentiments of gratitude and esteem, together with the assurance of my prayers for them and their fellow citizens.

Ladies and Gentlemen, our human family is presently experiencing something of a turning point in its own history, if we consider the advances made in various areas. We can only praise the positive achievements which contribute to the authentic welfare of mankind, in fields such as those of health, education and communications. At the same time, we must also acknowledge that the majority of the men and women of our time continue to live daily in situations of insecurity, with dire consequences. Certain pathologies are increasing, with their psychological consequences; fear and desperation grip the hearts of many people, even in the so-called rich countries; the joy of life is diminishing; indecency and violence are on the rise; poverty is becoming more and more evident. People have to struggle to live and, frequently, to live in an undignified way. One cause of this situation, in my opinion, is in our relationship with money, and our acceptance of its power over ourselves and our society. Consequently the financial crisis which we are experiencing makes us forget that its ultimate origin is to be found in a profound human crisis. In the denial of the primacy of human beings!

We have created new idols. The worship of the golden calf of old (cf. *Ex* 32:15-34) has found a new and heartless image in the cult of money and the dictatorship of an economy which is faceless and lacking any truly humane goal.

The worldwide financial and economic crisis seems to highlight their distortions and above all the gravely deficient human perspective, which reduces man to one of his needs alone, namely, consumption. Worse yet, human beings themselves are nowadays considered as consumer goods which can be used and thrown away. We have started a throw-away culture. This tendency is seen on the level of individuals and whole societies; and it is being promoted! In circumstances like these, solidarity, which is the treasure of the poor, is often considered counterproductive, opposed to the logic of finance and the economy. While the income of a minority is increasing exponentially, that of the majority is crumbling. This imbalance results from ideologies which uphold the absolute autonomy of markets and financial speculation, and thus deny the right of control to States, which are themselves charged with providing for the common good. A new, invisible and at times virtual, tyranny is established; one which unilaterally and irremediably imposes its own laws and rules. Moreover, indebtedness and credit distance countries from their real economy and citizens from their real buying power. Added to this, as if it were needed, is widespread corruption and selfish fiscal evasion which have taken on worldwide dimensions. The will to power and of possession has become limitless.

Concealed behind this attitude is a rejection of ethics, a rejection of God. Ethics, like solidarity, is a nuisance! It is regarded as counterproductive: as something too human, because it relativizes money and power; as a threat, because it rejects manipulation and subjection of people: because ethics leads to God, who is situated outside the categories of the market. God is thought to be unmanageable by these financiers, economists and politicians; God is unmanageable, even dangerous, because he calls man to his full realization and to independence from any kind of slavery. Ethics – naturally, not the ethics of ideology – makes it possible, in my view, to create a balanced social order that is more humane. In this sense, I encourage the financial experts and the political leaders of your countries to consider the words of Saint John Chrysostom: "Not to share one's goods with the poor is to rob them and to deprive them of life. It is not our goods that we possess, but theirs" (*Homily on Lazarus,* 1:6 – PG 48, 992D).

Dear Ambassadors, there is a need for financial reform along ethical lines that would produce in its turn an economic reform to benefit everyone. This would nevertheless require a courageous change of attitude on the part of political leaders. I urge them to face this challenge with determination and farsightedness, taking account, naturally, of their particular situations. Money has to serve, not to rule! The Pope loves everyone, rich and poor alike, but the Pope has the duty, in Christ's name, to remind the rich to help the poor, to respect them, to promote them. The Pope appeals for disinterested solidarity and for a return to person-centred ethics in the world of finance and economics.

For her part, the Church always works for the integral development of every person. In this sense, she reiterates that the common good should not be simply an extra, simply a conceptual scheme of inferior quality tacked onto political programmes. The Church encourages those in power to be truly at the service of the common good of their peoples. She urges financial leaders to take account of ethics and solidarity. And why should they not turn to God to draw inspiration from his designs? In this way, a new political and economic mindset would arise that would help to transform the absolute dichotomy between the economic and social spheres into a healthy symbiosis.

Finally, through you, I greet with affection the Pastors and the faithful of the Catholic communities present in your countries. I urge them to continue their courageous and joyful witness of faith and fraternal love in accordance with Christ's teaching. Let them not be afraid to offer their contribution to the development of their countries, through initiatives and attitudes inspired by the Sacred Scriptures! And as you inaugurate your mission, I extend to you, dear Ambassadors, my very best wishes, assuring you of the assistance of the Roman Curia for the fulfilment of your duties. To this end, upon you and your families, and also upon your Embassy staff, I willingly invoke abundant divine blessings. Thank you.

SUSTAINABILITY **RISING**

BY ALEXANDRA R. LAJOUX AND
CHERYL SOLTIS MARTEL

From a distance—the idealized "30,000 feet" that separates oversight from operations—sustainability exists in a harmonious world. It's one where companies operate in tune with their stakeholders and the environment, and they report on their actions in inspiring detail. Viewed more closely, however—at the arm's length of those responsible for meeting this challenge—sustainability can look very different. For the unwary, it can become a battlefield of trade-offs among stakeholders and a minefield of disclosure risks.

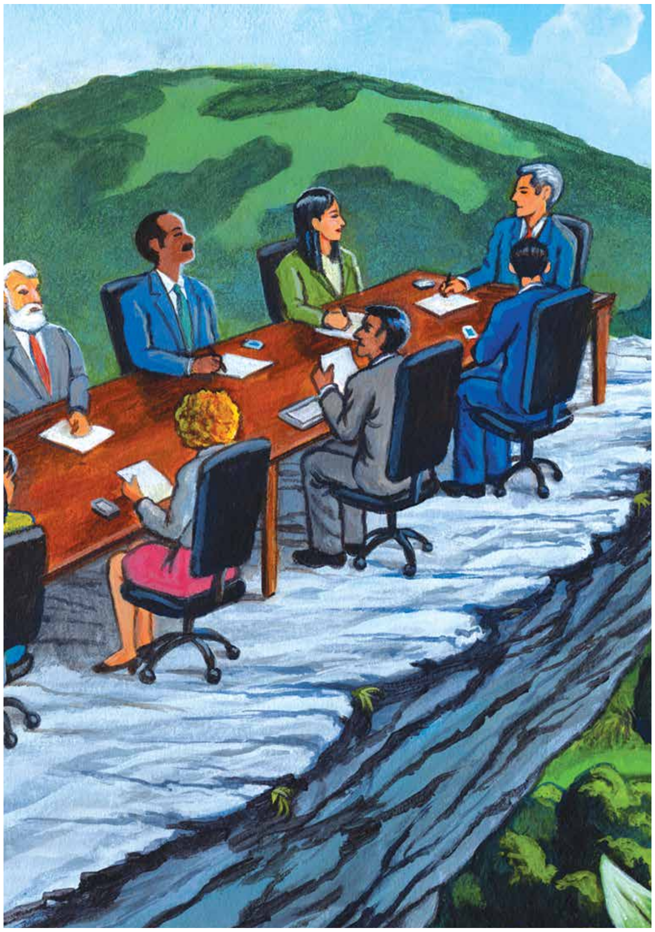
The governance reality lies somewhere in between these two zones—in boardrooms where directors fulfill their fiduciary duty of care. Yes, directors do need to see sustainability programs from a distance, reading the final sustainability reports often produced with the help of company marketing mavens. And yes, directors need to see those programs up close and personal, asking management about operational and disclosure challenges. In the end, however, directors need to be focused on a middle ground: protecting and enhancing company assets—not just for today, but also for tomorrow.

In short, directors need to ask themselves—and management—this key question: How will "sustainable" practices help this company stay in business over the long term?

WHAT IS CORPORATE SUSTAINABILITY?

The Dow Jones World Sustainability Index provides public company directors with a good working definition of this enigmatic term: "An approach to creating long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social trends and challenges."

Clearly, the term "corporate sustainability" is associated with good environmental practices, but it is much broader—and newer. While the environmental movement can be traced back a half century to the publication of ecologist



Rachel Carson's *Silent Spring* in 1962, the modern concept of sustainability did not enter the world's business lexicon until a quarter century later, following the release of *Our Common Future,* the 1987 report of the U.N. World Commission on Environment and Development, chaired by Norway's then-Prime Minister Gro Harlem Brundtland. Before that, the word "sustainable" referred to legal arguments, and "sustainability" did not even appear in any dictionaries, much less daily conversations. The Brundtland report changed that. In her foreword to this landmark work, Brundtland explains the connection to the environment. "[The] 'environment' is where we all live; and 'development' is what we all do in attempting to improve our lot within that abode. The two are inseparable." Sustainability is the connection. The Brundtland report famously defined this as development that "meets the needs of the present without compromising the ability of future generations to meet their own needs."

The term "sustainability" caught on and has overtaken other buzzwords referring to high-value intangibles not captured by traditional accounting. Other popular terms include CSR, for corporate social responsibility (or simply CR, for corporate responsibility); GRC, for governance, risk, and compliance; green business, referring to companies with good top-down environmental practices; ESG, for environmental, social, and governance policies; CRE, for compliance, risk, and ethics; triple bottom line, a way to perceive and record the social impact of companies; conscious capitalism, referring to corporate cultures; and various other modifiers for capitalism, including moral and enlightened.

While these terms illustrate various ways to define sustainability, companies should be careful in selecting which word to use. "The terms need to be depoliticized," says Brendan LeBlanc, executive director of Climate Change and Sustainability Services at Ernst & Young. "Some of the words become like kryptonite." No matter how it's described, sustainability is more than a "feel-good" issue. Progressive companies have realized that employing sustainable practices in the environmental, social, and governance realms—and reporting on them—can lead to stronger economic performance. Furthermore, company leaders are seeing a connection between these non-financial issues and long-term financial performance.

THE BOARD'S ROLE

Sustainability is not just an issue for management—directors also have a role to play. A 2012 study by Harvard Business School, "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," by Robert G. Eccles, George Serafeim, and Ioannis Ioannou, suggests that companies with a culture of sustainability—meaning that environmental, social, and governance issues are fully integrated with the company's strategy and business model—are more likely to assign responsibility to directors and to form a separate board committee. A 2012 article by social scientists Edward Lawler and Chris Worley, "Why Boards Need to Change," published in *MIT Sloan Management Review,* suggests that boards have some room for improvement when it comes to embracing sustainable business practices. Boards may approve corporate social responsibility and sustainability programs that add to the bottom line or improve the corporation's image, but this is only the beginning. They need to learn "how to manage, organize, and hold their organizations accountable for performance that is targeted at optimizing a combination of financial, social, and environmental outcomes," the authors write.

NACD Project Sustainability: A Focus on Community

Corporate social responsibility can take many forms, but it usually boils down to community service. More than any other form of philanthropy, such service can reveal and strengthen the link between an organization's financial success and its social environment.

In recognition of the importance of this service, NACD has launched Project Sustainability. A joint team from NACD's membership and research departments is currently working with a paid intern from Covenant House, a youth employment organization, to produce a white paper on community involvement by major public corporations, including NACD member companies.

The project began when NACD Business Development Officer Kelly Dodd, who serves on the Covenant House board, organized a successful sales internship with Marcus Foster, a young client of the organization. Observing the success of this internship, Abdullah Jones, a manager in the membership sales department, began working with Alexandra R. Lajoux of the research department, to recruit and train Javonte Moore, another promising Covenant House client. Moore is studying sustainability reports from NACD member companies—all leaders in their industries—to determine their community involvement. So far, this research has identified 25 companies with strong engagement in their local communities. These companies and others will be featured in an NACD white paper on corporate community service, to be published this summer.

To date, NACD has worked with Covenant House on six internships. These mutual opportunities benefit NACD because of the talent of the interns, and they benefit the local community by providing job training to promising youth in Washington, D.C. They are typical of the "win-win" formula for corporate community service.

THE FIRST SUSTAINABILITY REPORT: ROYAL DUTCH SHELL

Companies with sustainable business practices have been reporting on them for many years, but formal reporting did not storm the sustainability stage until April 1998, with the publication of a Royal Dutch Shell report, *Profits and Principles: Does There Have to Be a Choice?* The Shell report provided an unprecedented level of information on environmental, social, and governance issues, and devoted space to the reflections of the consultant John Elkington, who coined the term "triple bottom line," which refers to "people, planet, and profit," as measures of sustainability.

The report gave Elkington, founder of the consultancy SustainAbility, a platform to challenge the accountancy order: "We not only need new forms of accountability but also new forms of accounting," he declared in the Shell report. "This does not mean that every aspect of a company's performance can—or should—be reduced to a 'common currency' of money values. But if we are to manage a given company's performance effectively we also need to be able to measure it. We must find accurate, useful and credible indicators of progress in terms of economic prosperity, environmental quality and social justice."

Elkington's statement exposed tensions between financial accounting and sustainability reporting—and he offered approaches to resolve them.

ACCOUNTING VS. VALUATION

The story of sustainability reporting runs parallel to the history of financial accounting: oil and water that never quite mix—or can they? Financial accounting is rooted in transactions. It began when Italian merchants used balance sheets to note the symmetrical impact of each transaction on both the debit (positive) and credit (negative) sides—a practice famously codified in 1494 by friar and mathematician Luca de Pacioli. To this very day, half a millennium later, accountants record each transaction's value at a specific point in time and leave that value unchanged on the books—except for stock transactions, which get updated according to fair market value. Aside from that one exception—the result of decades of pressure from investors who rebelled at book values out of step with the times—accounting is still historical rather than forward looking. Basic concepts of accounting include money measurement, historic cost, realism, and matching; accounting conventions include consistency and conservatism. All of these values tend to discourage reporting values outside the scope of known cash transactions. Sustainability reporting, by contrast, is rooted in valuation. Its origins can be traced to the 1970s, a time known for social activism. In 1971, the husband and wife team of Lee J. and Lynn Seidler of Abt Consulting published a treatise on social accounting that advocated "social balance sheets" and "social income statements." The next year saw the rise of the Investor Responsibility Research Center (IRRC), which tracked a growing number of shareholder resolutions on all issues including the environment and social issues—activism that would later find expression in Institutional Shareholder Services (ISS), a proxy advisory firm founded a decade later.

In 1978, James E. Heard (of IRRC and later ISS) authored a report titled *Corporate Social Reporting in the United States and Western Europe.* Further progress occurred in 1980, when the Securities and Exchange Commission (SEC) first required a management discussion and analysis (MD&A) within the annual report, opening the door to disclosures about company activities beyond strictly financial matters. But it would take another 15 years for formal sustainability reporting movements to arise.

A VOICE IN THE WILDERNESS

While these two initiatives were being launched, activist Robert A. G. Monks, the founder of ISS, was writing *The Emperor's Nightingale,* which argued for both corporate profits and goodness. More than a decade later he would co-author *Corporate Valuation for Portfolio Investment,* again advising investors to consider environmental, social, and governance issues. "There are two kinds of assets," Monks wrote, "accounting assets and real assets. In their totality, real assets approximate market value…." *(See related story on Monks' new book in "Readings.")*

Since long-term market value is what investors and, for that matter, corporate boards, care about, it is certainly worth exploring the value of the "real assets" revealed by sustainability reports—whether integrated into financial reports or separate.

LACK OF U.S. LEGISLATION

One of the least common phrases heard in the boardroom is, "I wish we had more regulation." When it comes to the environment, the U.S. Environmental Protection Agency (EPA) already has numerous statutes companies must abide by, including the Clean Water Act, Clean Air Act, Toxic Substances Control Act, and Resource Conservation and Recovery Act. And as for social outreach, companies already willingly disclose the considerable good they do in communities— as evidenced by the rise of the Business Civic Leadership Center of the U.S. Chamber of Commerce, which encourages, supports, and publicizes leadership in corporate social responsibility. Additionally, the Interfaith Center on Corporate Responsibility has been at the forefront of corporate accountability for 41 years, filing shareholder resolutions on a range of ESG issues.

Nonetheless, there is no clear evaluation standard for reporting on these and other sustainability activities in the United States, and no legislators appear to be lobbying for one. "Elected officials have precious little knowledge or inclination to stay abreast of this now-burgeoning field, for the chief reason that they're reluctant to bite the hand that feeds them," says Marcy Murninghan, a member of the advisory council at Sustainability Accounting Standards Board (SASB) and founder of The Murninghan Post, a blog focused on corporate and capital markets reform. "Corporate money in politics has tilted the scales quite a bit—away from mandatory anything when it comes to corporate activity."

The lack of U.S. policy stands in contrast to numerous countries that have instituted mandatory sustainability reporting, including Australia, Canada, Denmark, France, Germany, Italy, Malaysia, the Netherlands, Sweden, and the United Kingdom.

While the United States may not mandate reporting on general sustainability issues, there are some laws already in place requiring specific disclosures. Last year the SEC issued a final rule, mandated by Dodd-Frank, on conflict minerals. Companies must publicly disclose their use of any minerals that originated in the Democratic Republic of the Congo or adjoining countries in their Form 10-K. This disclosure must also be audited by a third party—the first time audits of non-financial disclosure have been mandated.

While more legislation may not be the best route forward for sustainability reports, particularly because Regulation S-K already requires that all material information be disclosed in a 10-K (through the MD&A), additional guidance would be useful. "What is needed is clarity around materiality—that's the missing link," says Jean Rogers, founder and executive director of SASB. "We know that there are certain ESG issues that affect the financial performance of every company in a particular industry. How can we disclose them in a way that's useful to investors (by enabling peer-to-peer comparison) and corporations (by creating a focus on the issues that matter)?"

BENEFITS OF SUSTAINABILITY DISCLOSURE

Sustainability reporting that falls outside the realm of complying with disclosure laws already in place, such as EPA rules, Dodd- Frank, and Reg S-K, is voluntary. Why, then, do a majority of S&P 500 companies use the GRI framework to report on their practices? Mike Wallace, director of GRI Focal Point USA, cites several advantages. "What we're seeing from a Governance and Accountability Institute study and Bloomberg resources is that companies that embed sustainability into their governance structure outperform their peers," he explains.

Several other studies back up those findings. California Public Employees' Retirement System (CalPERS) and Mercer examined the link between ESG issues and financial performance using 36 existing academic and broker research reports and found that 86 percent of studies show either a neutral or positive impact of ESG factors on risk and return. The Carbon Disclosure Project's 2011 global survey reported that companies in its Carbon Disclosure Leadership Index (CDLI) and Carbon Performance Leadership Index (CPLI) provided double the average total return of the Global 500 between January 2005 and May 2011. Additionally, a Harvard Business School working paper found that sustainability leaders tend to have better stock performance, lower volatility, and greater return on assets and return on equity because of superior governance structures and better constructive engagement with stakeholders.

More indexes that rank sustainability reporting are cropping up. *The Financial Times and Businessweek* both highlight companies committed to sustainability practices and reporting. These reputational rankings provide incentives to issue a report. "There is a U.S. competitive spirit," Wallace says. "If a majority of S&P 500 companies are reporting on sustainability, do you want to be the only one that's not?"

Improved transparency is another benefit of reporting, which was one of the main reasons CVS Caremark began issuing a sustainability report. "By voluntarily disclosing information on our CSR/sustainability commitments and performance, we are in essence letting our stakeholders know that we take our commitments seriously and are taking accountability for our performance related to these commitments," says Larry J. Merlo, president and CEO of CVS Caremark. "This is an important factor in building trusted relationships with our stakeholders."

Disclosing this type of information also aids in talent acquisition and future retention. "Employees are increasingly attracted to companies whose values and mission are more closely aligned to their own," notes Ioannou, currently assistant professor of strategy and entrepreneurship at the London Business School. "When a company discloses, it not only allows employees to see how they match up, but it also becomes more transparent as well as accountable in the public domain."

BEWARE 'MATERIALITY'

With all opportunities comes risk, and one risk of voluntarily issuing a sustainability report is ensuring the information reported is consistent across all communications. What's more, companies should not make the mistake of assuming that sustainability reporting only takes the form of a document similar to the annual report or 10-K. They may be reporting about sustainability efforts through social media, press releases, advertising, responses to investor inquiries, and other internal and external communications. A Deloitte report, *Sustainability Reporting Managing Risks and Opportunities,* notes that these types of statements, "including commentary appearing in social media, may appear to be inconsistent with what is being reflected in a company's financial and/or environmental regulatory reporting."

It's also essential that the term "materiality" not be misused in communications outside of the 10-K. "There is a legal liability created when there are communications outside the 10-K, such as CSR reports, that use terms like 'materiality,' but then that information doesn't also appear in the 10-K," cautions SASB's Rogers.

Another risk in reporting is fraud. In order to appear to have achieved "green" targets or to avoid the public spotlight shining on poor performance, companies may misstate their environmental performance. Once again, social media can be a prime contributor to the problem. "Even inflated claims in blogs and electronic shareholder forums may subject the company to claims of fraud," the Deloitte report notes. Sometimes fraud can come from the outside. Sustainability-minded companies may find themselves the target of fraudsters selling fake carbon offsets, falsely certified green electricity, or phony investments in sustainable projects.

Setting a sustainability goal can attract negative attention to the company as well. "If we say we'll be 20 to 30 percent more efficient in X number of years, it implies we're inefficient to some degree now," says Ioannou.

There is also a risk in disclosing ESG goals and then failing to meet them, or reporting on problem-solving programs that falter. These concerns, however, should not make companies fear disclosure. "Stakeholders tend to understand that no company is perfect, and they respect a company that acknowledges when it has fallen short of a sustainability goal it may have set and then explains how it plans to address the issue going forward," says Merlo.

Along with the risks come internal and external challenges to reporting. GRI's Wallace says the biggest one is lack of buy-in. Some managers view ESG issues as problems to address, and without a mandate to disclose this type of information, they see little to no value in doing so. "Some corporate counsel have stated that voluntary disclosure is bad disclosure," Wallace explains. "They'll say, 'We're never going to disclose this type of information.'"

In addition, many companies may believe they lack the resources to put toward yet another form of reporting. "Our biggest challenge has been the resources required to publish a report—from the gathering of data to the finished published product," says Ralph Reid, vice president of corporate responsibility at Sprint. "It's a lot of man-hours, so it's a fine balance of truly being 'more sustainable' versus providing the data and measurement our stakeholders need. We continue to wrestle with what is needed versus what's nice to have."

"By voluntarily disclosing information…we are in essence letting our stakeholders know that we take our commitments seriously and are taking accountability for our performance related to these commitments."

— Larry J. Merlo

WALKING THE TALK

Despite the risks, many public companies have embraced sustainability reporting and incorporated it into their overall business strategy. Microsoft has been voluntarily disclosing information through the Carbon Disclosure Project since 2005 and issues an annual corporate citizenship report based on the GRI's G3 Sustainability Reporting Guidelines, according to Josh Henretig, director of environmental sustainability at Microsoft. "We also provide more in-depth information to socially responsible investors through the One Report reporting platform, a database of GRI indicators, and others used by socially responsible investors and corporate responsibility analysts."

Bloomberg is walking the talk by implementing both internal and external initiatives. In 2007, Bloomberg started its internal sustainability initiative with the goal of reducing its carbon footprint 50 percent by 2013 and receiving at least a 15 percent return on investment. By the end of 2011, Bloomberg had already reached its environmental goal—two years ahead of schedule— and exceeded its financial target by a factor of 10. "We were surprised by the financial returns— they were quite high," says Curtis Ravenel, head of Bloomberg's Global Sustainability Group. "We look at issues through three lenses: environmental, financial, and cultural fit. Generally, we try to pursue initiatives that reflect all three, but occasionally they just have a high environmental return and not so great economic return, but our sustainability initiative worked in all three areas."

Ravenel notes that another internal benefit was added collaboration. "Big companies get siloed pretty quickly," he explains. "When you work on a project like this, it's an opportunity for departments that may not work together frequently to engage."

In addition to its internal initiatives, Bloomberg has made sustainability a priority externally by integrating ESG content across its terminals (computer systems provided by Bloomberg to customers). When Bloomberg customers check their screens, they see, side by side with financial information, data on greenhouse-gas intensity per sales and water usage trends, and even bad news such as toxic discharges and employee fatalities. Providing this information offers Bloomberg both an opportunity and a responsibility to lead, Ravenel says. "We want to use that role and our strength to accelerate the integration of ESG into reporting," he explains. "Financial information has been commoditized, and stakeholders need more information to understand the long-term prospects of their firms. This information is a peek into how the company manages issues outside of the financial realm."

Sprint was the first wireless company in the United States to issue a sustainability report and to develop long-term related goals. "We knew that if we weren't voluntarily reporting on sustainability practices, we wouldn't be taken seriously, internally or externally," says Reid. "We also knew that in order to measure our achievements, we had to report our efforts and be transparent about our successes and our challenges." He stresses that aside from being transparent with external stakeholders, that it was equally important internally to ensure continuous improvement in CR practices. "I believe many companies are uncomfortable reporting publicly in case they fall short, but it's the transparency that drives accountability," explains Reid.

INVESTING IN SUSTAINABILITY

In recent years there has been more investor attention on environmental and social practices. In 2011, ISS reported that average support for environmental and social shareholder resolutions topped 20 percent for the first time, up from 18.1 percent from 2010 and 16.3 percent in 2009.

Between 2006 and 2012, large investors—including the California State Teachers' Retirement System (CalSTRS), AFL-CIO, NYC Pension Funds, and Free Enterprise Action Fund—filed 242 shareholder proposals targeting Fortune 200 companies on environmental issues. Such proposals may have spurred the uptick in the number of companies issuing sustainability reports. "Not all companies are reporting because they have been engaged directly, but I would argue that many are doing so because they've been engaged or recognize the trend that engagement started and either saw the value play or want to get out in front of the engagement letter," says Anne Sheehan, director of corporate governance at CalSTRS. "Of course, some companies recognized

Buzz Meter

Google Hits

Term	Hits
"Sustainability"	**96,900,000**
"Corporate social responsibility"	**17,000,000**
"Governance, risk, and compliance"	**14,100,000**
"Green business"	**10,300,000**
"Environmental, social, and governance"	**3,120,000**
"Compliance, risk, and ethics"	**1,440,000**
"Triple bottom line"	**966,000**
"Environment, health, and safety"	**879,000**
"Conscious capitalism"	**373,000**
"Enlightened capitalism"	**35,300**
"Moral capitalism"	**20,400**

Source: Google, Feb. 15, 2013

that this was just a good business move and would have done so absent any engagement."

Some companies are using sustainability reports as another means of communicating with investors. "At Microsoft we believe that transparency achieved through sustainability reporting is an important ingredient in establishing trust with a wide range of stakeholders," Henretig says. "Transparency incents organizations to continue reducing their impact while encouraging industry peers to be transparent about their own sustainability measures."

While none of these shareholder proposals on sustainability matters has passed to date, they serve as a reminder that institutional investors are clamoring for more information related to sustainable practices.

It's not only long-term investors who seek greater sustainability reporting, though there is a high correlation between the time an investor owns a stock and long-term value creation. "Some issues can result in acute events that affect all investors—short and long-term," notes Rogers. "SASB examines whether issues have the potential, if mismanaged, to result in a crisis or headline risk, which tend to be acute near-term events, or whether they are more like climate change, where over the long-term there can be a chronic erosion of value."

That's a message understood at Sprint. While the telecommunications giant has received positive feedback from the investor community for its sustainability reports, the company hopes to cast a wider net as more investors come to understand that longer-term investments are sometimes needed to support more sustainable business practices. "This is a challenge for all companies, but we believe the proof is in the success we've already experienced—where sustainable business objectives drove bottom-line results," Reid says. "That doesn't mean we won't continue to be challenged by 'green' business strategies that have a longer term pay-off. It's a mind shift in the market, but awareness and understanding of sustainable investments and sustainable companies is definitely growing."

A LINK TO COMPENSATION

The Eccles study also suggested that "high sustainability companies"—those that have adopted a substantial number of environmental and social policies over time (since the 1990s)—are more likely to tie executive compensation to environmental, social, and external perception metrics. In a similar vein, the *2010 Report of the NACD Blue Ribbon Commission on Performance Metrics* recommended that boards consider non-financial as well as financial metrics in assessing executive and company performance. Intel is one such company that links compensation to sustainability, and it has been doing so since the mid-1990s. In 2008, Intel also began linking all employee bonuses to environmental metrics, the Eccles study notes.

Nonetheless, linking executive compensation to sustainability has not exactly spread like wildfire. "Certainly companies are becoming more conscious regarding sustainability in terms of how they run their businesses and make decisions, but in general, that hasn't really translated into a specific focus in incentive plans," says Jannice Koors, managing director and head of Pearl Meyer & Partners' Chicago office. "That said, you might find aspects of sustainability rise to the level of an incentive consideration in specific industries—for example, environmental metrics at companies that use natural resources such as timber, mining, or oil and gas exploration."

SASB's Rogers adds that this practice may not be prevalent because it's not mature enough yet. "Some companies have internal goals related to sustainability and those are part of performance objectives but not tied to actual incentives," she explains.

Typically, companies may link certain executives' compensation to performance, but not all. Sprint is one such company. "When we looked at short-term and long-term incentive plans, we really had to ask ourselves, across the board, does this make sense for every executive? The answer was no," says Reid. Different executives influenced environmental impacts more than others. Sprint, however, includes sustainability measures in its performance objectives and company performance targets. "In fact, all employees have varying corporate responsibility objectives as part of their performance metrics, which indicates its importance in our corporate culture," Reid adds.

Kimberly Gladman, director of research and risk analytics at GMI Ratings, an independent provider of research and ratings on ESG and accounting-related risks affecting public companies, suggests that compensation committees include environmental performance metrics in executive compensation plans for named executive officers, including the CEO. "Many companies already do this to some extent, but many firms with both social and environmental risks are only addressing some of them in compensation plans," Gladman says. "For example, a coal-fired utility might include a worker safety metric, but nothing about carbon emissions." Metrics can be structured in a variety of ways. Some companies require a certain level of performance on a metric for a certain element of compensation to be paid out, while others link compensation to the number of regulatory violations or other incidents.

ADDING CLOUT THROUGH AUDITS

To add strength to the quality of sustainability reports, some companies are seeking third-party audits. One such company is Chicken of the Sea International. In August 2012, it released its first sustainability report and engaged Strategic Sustainability Consulting as an auditor. The audit examined practices throughout the company and its supply chain, and focused on developing a systematic approach to managing and developing the company's sustainability initiatives and to set goals. Strategic Sustainability Consulting suggested several areas of improvement for Chicken of the Sea: implementing better data collection for carbon, waste, and water, which will allow the company to benchmark progress toward reducing its environmental impact; establishing a more formal auditing plan for its supply chain; stressing sustainability expectations to employees; and committing to share this information with its retail partners, suppliers, and customers.

"Where we have direct control over our operations, we are taking direct steps to optimize and reduce our possible impact and footprint," said John Sawyer, Chicken of the Sea's senior vice president of sales and marketing, in a statement. "Where we do not have direct control, such as our supply chain, we have established clear expectations and are building a concrete review process."

In addition to Strategic Sustainability Consulting, EY, KPMG, Deloitte, and PwC all

"In 5 to 10 years, all companies will disclose sustainability information, either because of regulation or market demand."

— Curtis Ravenel

offer sustainability audits. With the increase in companies reporting on sustainability comes an uptick in the number of firms seeking external audits of their reports. An audited sustainability report offers a window into company operations, notes EY's LeBlanc. "It's increasingly seen as a proxy for good risk management," he says. "The primary reason companies engage third-party auditors is for credibility of their disclosure. It signals to stakeholders this is something we take seriously."

While more disclosure tends to be good news for investors, not all sustainability reports are created equal. Some companies use reporting as a means to disclose only their strengths and quietly play down weaker areas. "Not many reports list all the areas where a company didn't do well," says LeBlanc. "It's not uncommon to find a report with 17 pages about volunteerism and corporate giving and little to no discussion of other practices."

Another hurdle is that some data is easier to audit, such as health and safety data, compared to employee engagement. "The ability to audit is challenging for some areas that haven't been measured for a long time," says LeBlanc. "There are other attributes companies would like to report on, but it gets tricky when it comes to human rights and working conditions. Management must ask, 'Do we know what they are, and are we comfortable with them?' And more stakeholders are demanding access to this data."

PROXY ADVISORS WEIGH IN

To support directors and management in identifying and mitigating risks, GMI Ratings provides ratings for almost 5,500 companies globally. The ratings are useful to investors in assessing the "sustainable investment value" of corporations.

At the end of January, GMI Ratings released a report flagging 10 companies for environmental impact events, noting that companies that have been involved in substantial environmental damage may be more likely to be fined or to suffer reputational damage. The report also suggested that poor oversight of environmental matters may be an indicator of management quality on a broader scale.

When such an event occurs, companies must act to reassure investors. "A successful response needs to happen both at a high level— through statements and actions from the board and top management— and at deeper, more operational levels," says Gladman. "It is essential that both work together for companies to effectively manage reputational risk."

Proxy advisors are also more closely examining companies' sustainable practices. Last year, ISS unveiled a global Sustainability Risk Reports database, which offers in-depth company profiles, analysis, and a scoring system that compares companies against industry peers. Scoring factors include carbon emissions, energy use, labor standards, and ethics, along with an analysis of disclosure practices, adherence to ESG policies, and board oversight of ESG issues.

The database allows investors to evaluate potential sustainability-related risks and opportunities. "Shareholders not only expect their asset managers to know whether companies are acting as good corporate citizens, but also to consider ESG performance when managing their portfolios," said John Deosaran, ISS vice president of ESG analytics, in a statement. The database allows "investment managers to identify those ESG factors that best align with their client-driven mandates, and determine appropriate investment weightings, turning compliance priorities into a competitive edge."

GETTING STARTED

For companies interested in engaging in sustainability reporting, GRI provides a strong framework for establishing a structure. But before companies begin developing a strategy for reporting, there must be buy-in from top management. "If the initiative doesn't have support from the C-suite and is not run by someone who is actively promoted by senior management, you'll have a hard time getting projects the air time they deserve," Bloomberg's Ravenel says.

Ioannou echoes this statement, noting that grassroots support is essential. "Employees need to know what sustainability means to the company and how it's integrated into strategy," he says. "Sustainability is not a Friday afternoon activity; it's not a Monday morning strategy decision either. It's an organizational change that brings about a new identity with a stakeholder understanding the integration of financial and non-financial issues."

The Benefits of Being a B Corp

Sustainability is a given for benefit corporations, a type of socially oriented corporation now allowed in a growing number of states. As of January, 12 states allowed B corporations and another 14 were considering them.

As stated in a white paper published by a group of prominent attorneys writing for a newly formed Benefit Corp Information Center (benefitcorp.net), "the major characteristics of the benefit corporation form are: 1) a requirement that a benefit corporation must have a corporate purpose to create a material positive impact on society and the environment; 2) an expansion of the duties of directors to require consideration of non-financial stakeholders as well as the financial interests of shareholders; and 3) an obligation to report on its overall social and environmental performance using a comprehensive, credible, independent and transparent third-party standard."

Some B corps are voluntarily certified under the aegis of a nonprofit called B-Lab, which to date has certified more than 600 B corps in a full range of industries. Are B corps really any different from a far-thinking regular corporation? Perhaps not, but in their focus on social good, they are substantially different from the for-profit corporations that have been the subject of most federal and state regulation.

After all, in the eyes of federal law and the words of the Internal Revenue Service (IRS), the for-profit C corporation "conducts business, realizes net income or loss, pays taxes, and distributes profits to shareholders."

Furthermore, under state law, corporations are generally considered to operate for the benefit of their shareholders. While no state corporation law specifically requires corporations to operate for their shareholders, this goal is implied in much of their language about profits. And various court decisions have cited the Michigan Supreme Court's 1919 declaration in *Dodge v. Ford*, that "a business corporation is organized and carried on primarily for the profit of the shareholders." Certainly corporate directors have been sued and CEOs fired for reasons linked to poor profits.

For directors who want to keep up with jargon, it's notable that the B corp term is entering an already crowded dictionary, as there are already several kinds of state corporations and federal labels for them.

Each state has its own nomenclature but most recognize general corporations (the dominant kind), close corporations (30 stockholders or less), professional service corporations (for law firms and the like), limited liability corporations (used by qualified small businesses), and, standing apart from all of these for-profit taxable entities, nonprofit corporations.

At tax time federal nomenclature gets added—namely C versus S for for-profits, and a variety of 501 codes for nonprofits. Most for-profit corporations are considered to be C corporations, according to the IRS. As mentioned, the C corp "distributes profits to shareholders." As directors well know, those profits are taxed twice—once to the corporation when earned, and again to the shareholders when distributed as dividends. But companies with 100 or fewer shareholders can get S corporation status, and can pass corporate income, losses, deductions, and credit directly through to their shareholders for a single tax.

The tax status of B corps is not yet determined, but there is an expectation that they will be "tax preferred," much like the nontaxable nonprofits that are their near cousins.

Once management is on board, the initiative and its goals must be communicated to all employees—and potentially provide employees with incentives for meeting these goals. "Sustainability reporting is in its infancy, and readily available data to analyze isn't there," explains Ravenel, once again emphasizing the value of collaboration. "You have to seek it out—it's scattered and siloed—and you want to create a coalition of the willing internally. You need allies in certain departments to help you."

THE FUTURE OF SUSTAINABILITY REPORTING

While some companies may hope that sustainability reporting continues to be voluntary and elect not to disclose this type of information, if the increase in reporting continues, this will not be a viable option. "We're beyond the tipping point—it's part of our reality," says Ioannou. "Companies that don't address and report on sustainability won't be around 20 or 30 years down the road."

Ravenel adds, "In 5 to 10 years, all companies will disclose sustainability information, either because of regulation or market demand."

More disclosure is good news for investors as well. "My vision is that any investor will pull up a ticker with sustainability factors right next to financial ones, and be able to see the impact of the total business and how companies are positioned on the total mix of information," says Rogers of SASB.

From an auditor's perspective, LeBlanc of EY wants to see companies tell their corporate strategy story through the lens of sustainability. "My hope is that companies report and move toward knitting together information in the sustainability report with their overall business strategy," he says.

Aside from acting as communications vehicles to stakeholders, sustainability reports may in the future alter the face of the company's C-suite. Corporate social responsibility officers do exist—as evidenced by the Corporate Responsibility Officers Association, dedicated to that important function—but this is a new role. GRI's Wallace notes that in the not-too-distant past there were relatively few, if any, chief human resources officers or technology officers. "We hope to see more chief sustainability officers," he says.

Wallace also hopes to see more U.S. companies using GRI guidelines for reporting. "Many companies and stakeholders are unfamiliar with how much GRI activity is around them. In the past few years, companies are beginning to ask their suppliers to report according to GRI guidelines, stock exchanges are suggesting listed companies report, and GRI reports are coming from federal, state, local, and academic institutions," Wallace says. "Before anyone initiates a new 'sustainability strategy', I hope they have a look at the GRI reporting that is already happening, learn from these examples, and leverage the momentum. There's no need to re-create the wheel."

INTEGRATED AND GRI REPORTING

Sustainability reporting as we know it today began in the mid-1990s, when two key events launched parallel movements: integrated reporting and Global Reporting Initiative (GRI)

“We knew that if we weren’t voluntarily reporting on sustainability practices, we wouldn’t be taken seriously, internally or externally.”

— Ralph Reid

reporting. Over time, both have incorporated the insights and language of other major sustainability initiatives, such as the Caux Round Table’s 1994 Principles for Business and the U.N. 2005 Principles of Responsible Investment.

ONE REPORT

The integrated reporting movement, whose international champions include famed attorney and professor Mervyn King, chair of the seminal King Committee on Corporate Governance in South Africa, emphasizes integrating non-financial information into the financial report. (Comparability from company to company, while of value, is not the main focus of this movement.) The movement dates to the American Institute of Certified Public Accountants’ massive report Improving Business Reporting (1995). This 200-page tome (called the Jenkins report after its chair, Edmund Jenkins) contained an “enhanced business reporting framework” to enable companies to “focus more on the factors that create longer-term value, including non-financial measures indicating how key business processes are performing.”

Out of that early initiative emerged the Enhanced Business Reporting Consortium, now affiliated with the International Integrated Reporting Council (IIRC). A leader of that initiative, accountant Mike Kruz (then with Grant Thornton), co-authored a book with Robert Eccles in 2010 called One Report, which would become an influential manifesto. More than 80 of the world’s largest global companies are piloting integrated reporting, including Coca-Cola, HSBC, Microsoft, Volvo, and Unilever.

But despite progress, actual standards for integrated reporting remain under development—chiefly by the Sustainability Accounting Standards Board (SASB), which is now working to create and disseminate sustainability accounting standards for public companies to disclose material sustainability issues in a single report. With what began as an academic paper authored by Jean Rogers, Steve Lydenberg, and David Wood, SASB is developing standards for 88 industries in 10 sectors to be disclosed in Forms 10-K and 20-F. Rogers, founder and executive director of SASB, says the organization is dedicated to developing key performance indicators to enable benchmarking and peer-to-peer performance analysis. "We won't set quantitative targets for key performance indicators—we don't want to be prescriptive," she notes. "We're offering a comparable way to account for material issues."

Integrated reporting has other benefits. "It's a cost-effective way for companies to focus on and manage the issues that truly matter to long-term value creation, and to disclose these issues in a streamlined manner," says Rogers.

Ioannis Ioannou, assistant professor of strategy and entrepreneurship at the London Business School, believes integrated reporting should be part of the strategy and DNA of a corporation. "It's a way to go beyond sustainability and financial reports, and explain how financial and non-financial information are integrated and how this enables the corporation to be around in the future," says Ioannou. "This is a powerful tool to communicate your place in the environment and social domain, and how you earn a living in a way that creates value and doesn't hurt the planet. There are companies that say it doesn't make sense anymore to have both a sustainability and a strategy practice—they should be one and the same."

Interest in integrated reporting has given rise to World Intellectual Capital Initiative (WICI), a global consortium that promotes this cause. In a 2012 speech to WICI, the Hon. Jane Diplock, founding chair of the International Organization of Securities Commissioners and a director based in New Zealand, put it plainly: "There is a growing realization that capitalism needs some new compasses to enable the rest of the 21st century to be different from the first decade. Our challenge is to provide these compasses, the appropriate frameworks, incentives, and tools to align behaviors, which will ensure both financial stability and sustainability, and to communicate them widely."

A STANDARD FRAMEWORK

To convey their sustainability profile, some but not all integrated reporters follow a comprehensive template. GRI offers a standard framework for sustainability reporting so that results can be compared from company to company. (Integration of that same information into the financial report, while possible, is not GRI's focus.) GRI was launched in 1997 by the Coalition for Environmentally Responsible Economies (CERES). The founders, mostly shareholders, wanted companies to report on their environmental, social, and governance activities in a methodical, comprehensive, and consistent way common to all companies, so that shareholders could compare company sustainability efforts, just as they can revenues or profits.

The GRI framework, used by some 5,000 companies worldwide, has six main categories for disclosing a company's sustainability profile—environmental, human rights, labor practices, society, product responsibility, and economic performance—with subcategories to ensure comprehensive reporting. In May, GRI will publish the fourth edition of its framework, which evolves over time with input from stakeholders. By the end of 2012, 53 percent of companies on the S&P 500 Index had published sustainability reports, and 63 percent of those reported using GRI guidelines. Some are integrated reports, but many remain separate.

Existing regulations related to sustainability already require some disclosure, such as the conflict minerals rule under Dodd-Frank and SEC guidelines on climate change. Couple these regulations with human resources and corporate governance requirements—particularly those on board composition and compensation—and companies are already making sustainability information public. "Smart companies see that this disclosure is already happening, and they are capitalizing on the opportunity to issue this information in one report," says Mike Wallace, director of GRI Focal Point USA, an initiative launched two years ago to raise awareness of the globally recognized voluntary standards.

CVS Caremark is one company that issues its sustainability reports following GRI guidelines. "The Global Reporting Initiative is the most widely accepted framework used by organizations worldwide to report on their sustainability and CSR activities," says Larry J. Merlo, president and CEO of CVS Caremark. "Using the framework allows stakeholders to more easily compare companies against their industry peers, and it provides them a level of assurance that the company has applied best practices to its reporting endeavor."

Sprint is also a GRI reporter. "GRI provides the full scope of requirements global stakeholders want corporations to report on and allows us to meet stakeholder reporting expectations. Collecting the data needed for the GRI reporting requires that we engage nearly all functional Sprint teams and directly educate them on sustainability standards and stakeholder expectations," explains Ralph Reid, vice president of corporate responsibility at Sprint. "We now have much broader participation in and support for our corporate responsibility efforts in total as functional teams understand how their efforts directly contribute to our performance."

In addition to GRI and integrated reporting frameworks, some companies disclose sustainability information as a separate section in annual reports, with no special integration. While all methods of reporting can be effective, disclosure quality is key. "Sustainability reports reveal what issues companies are focused on and how deep that focus is," says Anne Sheehan, director of corporate governance at the California State Teachers' Retirement System (CalSTRS.) "Are some providing goals, metrics, measurements, and outcomes, while others are just providing statements and glossy photos? Are some companies focused on material issues relative to their sector while others are not?"

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