

SUSTAINABILITY REPORTING PART 3

Adding Value beyond Regulatory Compliance



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Sustainability Reporting (SR) has been gaining traction in recent years as stakeholders are increasingly placing importance and demanding higher transparency on organisations' performance beyond the financial outcomes. A Singapore Exchange (SGX) survey¹ of institutional investors found that over 90% of respondents consider environmental, social and governance (ESG) factors when investing, and SR is a way for businesses to disclose their sustainability efforts to the various stakeholders. In support of this paradigm shift, SGX has announced that listed companies must issue a sustainability report on a "comply or explain" basis for financial years ending on or after 31 December 2017. The five key primary components of SR, and the requisite actions by the listed companies, are:

- 1) **Material ESG factors**
Identify material ESG factors, provide reasons for their choice and describe the selection process;
- 2) **Policies, Practices and Performance (3Ps)** Provide disclosure on the 3Ps of the company in relation to each of the material ESG factors;



¹ SGX consults on "comply or explain" sustainability reporting rules and guide, Singapore Exchange, January 2016; http://infopub.sgx.com/FileOpen/20160105_SGX_consults_on_sustainability_reporting_rules.aspx?App=Announcement&FileID=384639



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- 3) **Targets** Provide disclosure on targets regarding material ESG issues for the forthcoming year;
- 4) **Reporting Framework** Highlight the reporting framework used to guide the disclosure of relevant information on the ESG factors;
- 5) **Board Statement** Statement from the board regarding their material sustainability issues and their role in determining, overseeing and monitoring those factors.

Satisfying the compliance requirements is only one element of the immense value that SR brings to organisations.

BENEFITS OF SR: MORE THAN JUST COMPLIANCE BENEFITS

Sustainability helps businesses' short-term financial performance while driving long-term growth (Figure 1).

Figure 1 Business case for sustainability reporting



Source: Global Reporting Initiative

1 Reduce waste, water usage, CO₂ outputs

Extrapolating past information – for example, on waste flow or carbon dioxide emissions of a company – can be a significant prediction of future outcomes as it reflects possible risk factors. For example, the risk of costly chemical accidents is shown to be greater at facilities that emit more toxic waste.² SR presents opportunities for companies to reconsider strategic waste management, thus minimising the risk of negative legal and reputational consequences.

2 Improve management process

Mismanagement of ESG aspects can lead to crisis, such as the 2010 explosion which had killed 29 miners at Massey Energy's Upper Big Branch mine in Montcoal, West Virginia. The incident resulted in a drop of 33% in stock price within a month.³ Quite often, direct losses associated with ESG catastrophes are dwarfed by the investors' loss of confidence in management's ability to deal with the aftermath.

3 Attract and retain talent

Getting employees to understand and engage in sustainability efforts contributes to the success of a sustainability programme. Not only will employees feel a sense of pride at having achieved the sustainability targets, being recognised as an industry leader in sustainability will also bolster the company's image among prospective employees and help to attract talents.⁴

4 Attract investors

There has been growing interest among investors to use SR for investment analysis as it requires higher levels of internal controls, audit and assurance. A study by Caroline Flammer⁵ revealed that since 1980, investors have shown adverse reactions toward negative environmental news (1980–1989: 0.42% drop in stock returns; 1990–1999: -0.66%; 2000–2009: -1.12%).

The same study also indicated that a company's environmental conservation efforts were rewarded by an average increase in stock returns of 0.84%.

5 Stakeholder engagement

SR addresses a wide range of issues with an aim to engage all stakeholders. Governance issues are regarded as high priority by investors while concerns regarding resource scarcity and a firm's impact on society are of high interest for environmental NGOs and social activists.⁶

6 Enhanced reputation and customer loyalty

A positive ESG reputation adds a layer of protection to sales, or what may be termed as an "ESG halo". Companies with an ESG halo were shielded from a decline in stock price during the dramatic protests that disrupted the 1999 World Trade Organization ministerial meetings in Seattle, even if these companies operated in industries more broadly

regarded as environmentally-damaging and labour-abusing.⁷

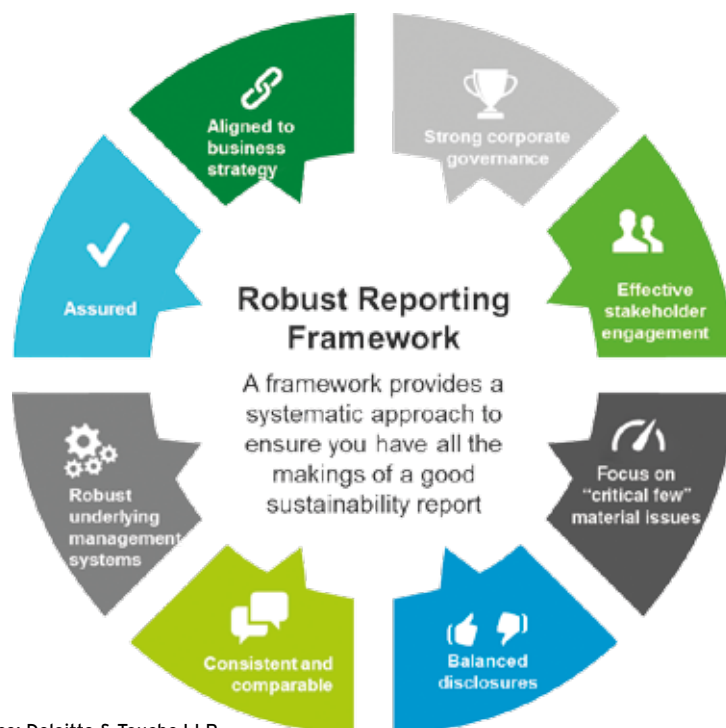
7 Competitive advantage

Sustainability practices can be a source of differentiation. For example, Friulintagli, an Italian furniture firm, was able to sustain a competitive advantage over other firms located in lower-cost countries by adopting sustainability practices (that is, reducing energy, effectively using materials, refining waste management and improving production efficiency in general).⁸

FROM THOUGHT TO ACTION; THE MAKINGS OF A GOOD SR

In order to realise the significant benefits of SR, a company needs to clearly communicate its ESG performance that are material to its stakeholders. Our research indicates that for a company to fully benefit from its SR, it should focus on the following eight factors (Figure 2):

Figure 2 Robust framework for sustainability reporting



Source: Deloitte & Touche LLP

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1 Strong corporate governance

Long-term investors expect sound management, with greater governance and transparency of ESG performance. Good corporate governance needs to begin at the top, with an effective governance model that takes into account broader risks. Accountability and support at the highest level of the organisation is key to building sustained value.

2 Effective stakeholder engagement

Stakeholders will constantly demand increased transparency and disclosure of ESG practices. A study from the

Journal of Business Ethics found five sustainability reporting characteristics associated with the company's stakeholder engagement strategy: directness of communication, clarity of stakeholder identity, deliberateness of collecting feedback, broadness of stakeholder inclusiveness, and utilisation of stakeholder engagement for learning.⁹

3 Focus on "critical few" material issues

By undertaking a materiality assessment and engaging internal and external stakeholders, companies can define the "critical few" material factors in their sustainability efforts, versus the "important many".¹⁰ Focusing on material issues and spending less time on issues less relevant to the business is key to successful SR.

4 Balanced disclosures

A balanced sustainability statement should reflect both the positive and negative aspects of the organisation's sustainability performance, enabling a reasonable and unbiased assessment of its overall performance.

5 Consistent and comparable

Good SR should help investors understand the key strategic issues for a company and benchmark the company's performance across a sector or a region. Thus, it is crucial for the disclosure of performance data to be comprehensive, consistent across markets, and comparable against similar organisations.

6 Robust underlying management systems

Robust internal reporting systems and controls play an important role in managing sustainability performance and impacts, and provide the infrastructure to manage the requirements of stakeholders in a coordinated manner. For example, Alcan Composites, a global leader in several markets in the areas of construction and wind energy, has developed its own

unique Alcan Integrated Management System (AIMS) to integrate various stakeholder requirements and the goals set by management, allowing the company to effectively address sustainability issues.

7 Assurance

External assurance provides benefits such as increased recognition, credibility and public trust. Investors, rating agencies and other analysts increasingly look for assurance of sustainability reports. An externally assured report provides stakeholders increased confidence in the quality of sustainability performance data.

8 Aligned to business strategy

There is increasing awareness of the impact sustainability can have on financial performance. As such, companies should integrate and align their sustainability vision, goals and targets into their business strategy to achieve greater synergy.

CONCLUSION

The goal of sustainable development is to meet the needs of the present without compromising the ability of future generations to meet their own needs. In the present business world, financial and ESG goals overlap. With financial performance and sustainability increasingly aligned, companies should seek to incorporate and integrate sustainability strategies into their businesses. Ultimately, by embracing the aforementioned eight factors of SR, companies would be able to strategically position themselves to reap the full benefits of SR and enjoy a long-term, sustainable performance. ISCA

This is the third article in the ISCA Corporate Reporting Committee's series of articles on sustainability reporting to raise awareness and quality of sustainability reporting in Singapore.

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^{2,3} Koehler, D & Hespenheide, E (2013) "Finding the value in environmental, social, and governance performance"; <http://dupress.com/articles/finding-the-value-in-environmental-social-and-governance-performance/>

⁴ Wong, D. (2011) "Top talents attracted to socially responsible companies"; *Environmental Leader*; www.environmentalleader.com/2011/07/11/top-talents-attracted-to-socially-responsible-companies/

⁵ Caroline Flammer (2012) "Corporate social responsibility and shareholder value: The environmental consciousness of investors"; MIT Sloan School of Management; <http://corporate-sustainability.org/wp-content/uploads/arcs-2012-Flammer.pdf>

⁶ Verdantix (2015) "The future of sustainability disclosures"; www.verdantix.com

⁷ Karen E Schnietz & Marc J Epstein (2005) "Exploring the financial value of a reputation for corporate social responsibility during a crisis"; *Corporate Reputation Review*; <http://link.springer.com/article/10.1057/palgrave.crr.1540230>

⁸ De Marchi, V., Di Maria, E., & Micelli, S (2013) "Environmental strategies, upgrading and competitive advantage in global value chains"; *Business Strategy and the Environment*; https://www.researchgate.net/publication/264372373_Environmental_Strategies_Upgrading_and_Competitive_Advantage_in_Global_Value_Chains

⁹ Herremans, I., Nazari, J., & Mahmoudian, F (2015) "Stakeholder relationships, engagement, and sustainability reporting"; *Journal of Business Ethics*

¹⁰ Flynn, M & Wallace, M (2015) "Corporate governance and sustainability: Who's connecting the dots?"; www.greenbiz.com/article/corporate-governance-and-sustainability-whos-connecting-dots