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Sustainability Reporting in the Light of Business Environments

Linking Business Environment, Strategy,
Communication and Accounting

Discussion Paper



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ABSTRACT

An increasing body of literature deals with empirical investigations analysing the publication outlets from different theoretical perspectives. Sustainability reports have also been in the focus of a large array of publications about the design of sustainability reports, whether as a print product or on the internet, and what criteria they should fulfil. Much less thought has been devoted to the internal processes of establishing and developing corporate sustainability reporting. However, if sustainability reporting is to go beyond rhetoric and an isolated communications project, then it has to involve the whole organization and to be developed strategically by establishing a process of organizational learning and development.

This paper develops a framework which distinguishes four basically different organizational approaches towards sustainability reporting. PR-driven reporting is solely run by the corporate communications department as a satellite activity isolated from core business processes. It does not affect that organization as such. The outside-in approach aims at securing legitimacy whereas the inside-out approach is concerned with performance management implementing the corporate strategy. The twin approach combines inside-out and outside-in by involving stakeholders and establishing a management approach in which reporting is integrated. The basic logic and elements of the approaches are discussed and conclusions drawn.

1. INTRODUCTION

For the last two decades sustainability reporting has received considerable attention throughout the management, accounting and CSR literature as well as in corporate practice. Sustainability reporting has been in the focus of a large array of theoretical and empirical investigations analysing the publication outlets from different theory perspectives (e.g. Brown and Deegan 1998; Cho and Patten 2007; Guthrie et al. 2004; KPMG 2011) and for international comparisons (e.g. Guthrie and Parker 1990). In this context reporting has to be distinguished from communication of sustainability issues (Section 2). Furthermore, companies may have very different motivations to engage in sustainability reporting (Section 3). Whereas most of the literature deals with external drivers and purposes of reporting some scholars have focused on the role of sustainability reporting as part of strategy development and implementation (e.g. Porter and van der Linde 1995a,b; Porter and Kramer 2011).

Compared to the analysis of external reporting much less thought has been devoted to the internal processes of establishing and developing corporate sustainability reporting. However, if sustainability reporting is to go beyond rhetoric and an isolated communications project, then it has to involve the whole organization and its stakeholder environment to be developed strategically by assigning responsibilities, involving all departments and stakeholders to establish a process of organizational network learning and development.

This paper develops a framework which distinguishes four basically different organizational approaches towards sustainability reporting on the basis of different distinct perceptions of the business environment. The basic logic and elements of these approaches are discussed (Section 3) and conclusions drawn (Section 4).

2. FACETS AND FORMS OF SUSTAINABILITY REPORTING

Sustainability reporting encompasses the formal and official corporate communication which provides information about corporate sustainability issues. This includes in particular information about the social, environmental and economic performance and the relationships between these aspects of corporate performance (similarly see Deegan and Blomquist, 2006; 2007a; Adams and Frost 2008; Herzig and Schaltegger 2011; Lodhia 2011; Schaltegger et al. 2006; Schaltegger and Burritt 2000). Different assessments exist whether the term “sustainability” may be justifiably applied to reporting on more specific subsets of sustainability, like carbon reporting, CSR reporting, environmental reporting or water reporting or taking a more holistic view, whether sustainability reporting always has to cover all aspects of sustainability. Furthermore, the notion has been challenged insofar as sustainability reporting usually does not deal and maybe should not deal with sustainability but rather with un-sustainability (e.g. Gray et al. 1996).

There is no doubt that in corporate practice, sustainability reporting does (currently) not comprehensively capture all sustainability aspects (e.g. Bouten 2011). This is reflected by the view that all or most of the reports and much of the existing corporate communication would be exaggerated and many would use unjustified claims (e.g. Gray et al. 1996; Gray and Bebbington 2000; Gray and Milne 2002; Milne 1996). Other authors emphasize that sustainability as a complex multidimensional vision has different facets of relevance in each company and corporate context, thus making it inevitable and a result of systematic management to focus on core topics (Burritt and Schaltegger 2010; Herzig and Schaltegger 2011; Schaltegger and Burritt 2010). The second view is, of course, only justified if really the core sustainability topics are addressed and not if marginal topics are in the foreground or if substantial sustainability issues are omitted.

No matter what view is taken, sustainability reporting has to be distinguished from corporate sustainability communication (e.g. Griffin 1994) which exceeds written formal communication as it includes further, direct and indirect forms of oral and written communication such as the use of labels on products, statements by board members, marketing in general, public relations, media coverage, brand communication and informal communication for example by staff in various official and unofficial contexts (see e.g. Herzig and Schaltegger 2011). Sustainability reporting encompasses printed and internet forms of disclosure (e.g. Lodhia 2010; Lodhia et al. 2004). Thus, reporting is intentional, official, formalized and can be assumed to be purposeful. This, in turn, challenges research to explore the different purposes sustainability reporting may have.

3. A FRAMEWORK OF SUSTAINABILITY REPORTING APPROACHES

Based on these strands of literature on sustainability reporting this paper places different attitudes and approaches of sustainability reporting into the context of (perceived) business environments and distinguishes four fundamentally different approaches of organizing and aligning sustainability accounting and reporting inside the company.

3.1 Business Environment, Sustainability Reporting and Accounting

The purpose(s) and form(s) of sustainability reporting may differ with the business environment. Depending on the societal expectations and the management's views about what stakeholder expect different kinds of sustainability reporting may be seen as adequate. Societal business climates can be distinguished between "trust me", "tell me", "show me", "prove to me" (similar to Shell 1998; see also Schaltegger et al. 2006) and "integrate me" worlds. Table 1 provides a framework of sustainability reporting which distinguishes business environments, societal expectations the relevance of sustainability accounting and reporting in such environments and the types of sustainability reporting which correspond to these expectations.

In a "*trust me*" world, accounting for relevant sustainability issues happens only in few cases of purely internal reasons, e.g. to improve the efficiency of production processes. In a society which trusts corporations, management can limit its communication and reporting on obviously economically relevant environmental and social information can stick to conventional financial reporting. Stakeholders neither expect nor receive specific sustainability information. Sustainability reporting will either not be a topic at all or will serve to facilitate internal management processes for example for efficiency improvements.

Table 1. Sustainability reporting in different societal business environments (adapted from Schaltegger et al. 2006, 18)

Business environment	Societal expectation	Relevance of sustainability accounting	Relevance of sustainability reporting	Type of reporting
Trust me	None	Internal efficiency improvements	Internal communication to achieve efficiency improvements	No external reporting needed, internal communication as part of normal operations
Tell me	Communicate	Information creation for highly visible and formally required issues	Sustainability as an important external communication element of partial internal relevance	PR-driven reporting
Show me	Communicate and illustrate	Information creation to meet stakeholder expectations and information demands	Essential communication element as part of a set of "voluntary" communication activities	Outside-in approach to communications and reporting driven accounting
Prove to me	Measure, account for, communicate and illustrate	Disclosure result of what has been achieved with sustainability performance management; basis to create transparency and verification	Additional element in a systematic approach of performance management and disclosure	Inside-out approach to performance management and accounting driven reporting
Involve me	Involve, empower, integrate and exchange	Basis to support exchange and joint development, implementation and responsibility sharing	One integrated element in a systematic approach of interactive collaboration and involvement of stakeholders	Twin approach of involving stakeholders and jointly developing strategy, reporting, communication and accounting

A "*tell me*" world is characterized by the expectation that companies should communicate with society and that they inform society about their social and environmental activities.

Sustainability reporting is PR- and regulatory shaped. Sometimes societal representatives such as environmental or tax agencies have been entrusted by society to require, receive and evaluate certain corporate information. An outside-only perspective of selective, preferentially positive reporting and maybe even window dressing dominate. Public relations considers those sustainability issues for reporting which are highly visible and addressed by society, or for which reporting and information requirements are defined by society.

A “*show me*” world requires further sustainability accounting and reporting activities. Reporting is expected to be linked to the actual social and environmental impacts of the company and whether it has improved with regard to societal expectations. Sustainability reporting is thus an essential communication element as part of a set of more-or-less voluntary communication activities. The outside-in perspective is of primary relevance and the internal organization of information management and reporting is aligned to meeting the external requirements, reporting standards and stakeholder demands. Awards for excellent sustainability reporting or the consideration in social responsibility investment funds are drivers of company-internal performance measurement and management as well as strategy development.

The “*prove to me*” business environment requires substantial efforts towards and improvements in corporate sustainability, combined with the effective communication of these efforts. Sustainability performance management is designed to capture the efficacy of strategy implementation. Accounting and reporting serve to prove the excellence of sustainability performance. The inside-out perspective is reflected by the dominance of sustainability performance management. To prove performance transparency is created and sustainability accounting is designed. Verification by professional auditors and accounting firms is organized for all reporting. Although the importance of accounting and reporting for sustainability performance management increases substantially in a “*prove to me*” world, its role nevertheless is supplementary to other management tools. Sustainability accounting and reporting become additional elements of a systematic set of trust-building activities such as stakeholder dialogues, sustainability marketing and sustainability strategies.

The “*involve me*” societal environment is the most challenging to corporate management. The enterprise is understood as a network of stakeholders whose involvement is crucial to secure contributions to a sustainable development of the economy and society. Stakeholder empowerment and involvement in committees, decision processes and organizational development are constitutional to the philosophy and strategy of the company. In terms of information, stakeholder involvement is necessary to create transparency and trust in the procedures as well as in those taking actions on behalf of the corporation. A twin approach combining inside-out and outside-in views creates an ongoing management circle of sustainability performance measurement, management and communication of which reporting is a part.

In summary, as in a “*trust me*” world no reporting is expected and conducted, four different kind of reporting can be distinguished: isolated PR-driven reporting in a “*tell me*” world, outside-in driven reporting in a “*show me*” environment, inside-out driven reporting in a “*tell me*” world and twin-approach organized sustainability reporting in an “*involve me*” business environment. These approaches are reflected in different responsibilities in the organization and the involvement of different corporate functions or departments.

3.2 Isolated PR-Driven Reporting

Particularly in cases where managers believe in an in-evadable trade-off between business success on one hand and social and environmental goals on the other hand, it can be expected that reporting is designed purely for external communication purposes and not related to performance. If management perceives its company's environment as a "tell me" world sustainability is a question of communication, only. The internal organizational consequence is to assign sustainability reporting as a rather isolated activity for the public relations and corporate communications department and for the legal services department.

Societal expectations are acknowledged that companies should communicate with society, but as sustainability is seen to be in conflict with business success, society will only be very selectively and positively informed about corporate social and environmental activities. Reporting is either driven by media pressure, pressure from strong stakeholders or regulations. Sustainability reporting is PR- and regulatory shaped. Environmental and other public agencies receive the corporate information which is regulatory required. An outside-only perspective of selective, preferentially positive reporting and maybe even window dressing dominate. Public relations considers those sustainability issues for reporting which are highly visible and addressed by society, or for which reporting and information requirements are defined by society.

From this view sustainability reporting can (only) be dealt with in a fairly isolated way as an activity of public relations or to comply with disclosure regulations. It is not linked to other departments and company activities. Reporting is seen either as a regulatory duty or as a public relations activity without further consequences for the company. Legitimacy is believed to be secured by modern designs of reports with enticing photos, catchy slogans, the application of "clever" communication tricks and regulation compliance. As a consequence this approach entails the inherent danger of intended or unintended greenwashing by reporting achievements in a way which are either only "part of the story" or so much exaggerated that they do not reflect the true picture.

In the research on sustainability reporting this view is implied or explicitly expressed in much of the critical accounting literature (e.g. Gray and Bebbington 2000; Gray and Milne 2002) which focuses on the analysis of failures and deficiencies in reporting as well as the blurring effects of selective reporting of the positive only.

3.3 Outside-In: Reporting Driven Accounting

For outside-in, reporting-driven sustainability accounting, external guidelines, rating and assessment schemes define information requirements and indicators which in turn guide the accounting methods and systems. Sustainability accounting and performance management are derived from reporting and communication needs. The starting points are thus external expectations of stakeholders, guidelines and requirements about what should be reported and how (e.g. Azzone et al. 1997;). The management perceptions of the business environment relate to a "show me" world. The reputation of the company and the management and securing social legitimacy may be driving forces to deal with sustainability reporting (e.g. Cho and Patten 2007; Deegan 2002; Guthrie and Parker 1989; Hogan and Lodhia 2011; O'Donovan 1999; Patten and Crampton 2004).

Ideally a discussion between management and stakeholders would unveil the stakeholders' expectations which then would be defined as the topics of sustainability reporting. As a direct discussion may not be possible in many cases, either stakeholder dialogues with representatives of different stakeholder groups or reporting guidelines and standards which propose themes and performance indicators will replace such a discussion. Guidelines such as the Global Reporting Initiative (GRI; e.g. GRI 2006), EC or ISO requirements for environmental management system certifications (e.g. EC 1993; ISO 1999), environmental and sustainability rankings, rating assessment and award schemes serve to identify the reporting and information requirements. Furthermore, as shown for carbon reporting, dominant environmental discourses can influence and shape disclosure regulation and reporting (see e.g. Andrew and Cortese 2011; Deegan and Blomquist 2006).

With the outside-in approach, the company's external corporate reporting information is deduced from (published) external expectations about the contents of reports. According to this rationale the company develops its sustainability reporting and internal corporate information and communication systems. Based on the defined information requirements, the accounting and information management system are designed to create the information which is desired from the stakeholders. Sustainability accounting and sustainability performance management are determined by reporting requirements.

The interests of various stakeholders may drive the development of sustainability performance measurement. These aim to support not just regulatory data requirements and pressure group demands for detailed information and data, but also requirements of financial institutions, mainly banks, insurers and funds. Customer interests in environmental and sustainability performance and requirements of environmental and social management standards may also be important drivers. Another set of driving forces stems from the final objectives of sustainability performance measurement and management. Issues may be whether sustainability performance measurement and management should be business-linked or solely oriented towards environmental and social improvements and whether they should be more long-term or short-term orientated.

The outside-in view is characterized by responsiveness and truly striving to secure legitimacy. Thus sustainability reporting defines the design principles of the internal organization of accounting and performance management in a one-directional way. Sustainability accounting and performance management could for example be directed towards improving in terms of the key performance indicators defined by the Global Reporting Guidelines. As a consequence, all departments dealing with reporting information serve the public relations department for conducting "socially compliant" reporting.

In summary, from an outside-in view, sustainability reporting is understood as a social responsibility activity responding to stakeholder demands and requirements and setting up internal responsibilities and systems to secure legitimacy and social conformity.

3.4 Inside-Out: Strategy and Accounting Driven Reporting

The inside-out organizational principle to sustainability reporting is characterized by a strategically developed approach and reports which are design on the basis of corporate strategy, strategically aligned accounting systems and corporate performance achievements.

In this view sustainability reporting is logically derived from the company's strategy and disclosure is part of performance management. Based on the strategic analysis of the corporate relevance of environmental and social issues, information needs are identified and key performance indicators deducted. A strategic management approach to support the process of developing key performance indicators (KPIs) from the company's strategy is the Sustainability Balanced Scorecard (Figge et al. 2002; Schaltegger and Dyllick 2002; Schaltegger and Wagner 2006). Based on the strategy KPIs are developed (e.g. Kaplan and Norton 2001; 2004; Neely 1993; Olve et al. 1999), and requirements for the accounting methods and reporting systems are derived to provide materially relevant information through internal reporting to the management and through external reporting to the company-external stakeholders.

The inside-out approach follows a rather technocratic logic of a responsible sustainability manager who tries to capture sustainability challenges as rationally as possible. From a performance management perspective, reporting is the disclosing statement resulting from the process of managing strategically relevant issues and indicators. The strategy-driven inside-out principle of organizing sustainability reporting is characterized by a rationally developed top-down approach where strategy determines the key performance indicators which in turn define the accounting methods and the contents of sustainability reporting. Core challenges are the design of an integrated system of performance management and measurement which reflects the translation of the corporate strategy into action and disclosure. The choice of disclosed performance measures is based on the identified core sustainability issues of the company. With this approach each company will use other performance measures out of the large choice of possible indicators to measure social and environmental impacts and sustainability improvements (see also Gasparatos et al. 2009; Neely 1993). Sustainability reporting is integrated into strategic accounting (e.g. Ratnatunga et al. 1993) and reflection of the management practices (see e.g. Adams and Frost 2008; Ratnatunga et al. 2011).

The inside-out approach is characterized by the management's belief that excellent performance will be understood and appreciated by society. It is thus sufficient to concentrate on organizational performance, to achieve large improvements and to disclose the achievements. Furthermore, this view assumes that true disclosure and real improvements can be distinguished sufficiently well by the stakeholders from any kind of exaggeration or greenwashing. Legitimacy does not have to be particularly secured but is rather the result of performance excellence. As a consequence, reporting is the end-point of a strategy process. Strategic planning defines disclosure contents. Public relations and corporate communications are assigned to report about the strategically defined goals and achievements or not yet achieved effects.

3.5 Twin Approach and Stakeholder Involvement

The business environment can be characterized or perceived as an "involve me" world where stakeholders are neither the starting point nor the "take-it-or-leave-it" recipients of reporting. The stakeholders are rather understood as part of a network of actors who contribute to value creation. In this case sustainability reporting is the result of discussions and

interactions which create or attempt to create a common understanding of sustainable development, sustainability goals, performance measures and reporting formats.

This perspective reflects on one hand the view that a good corporate strategy has to consider external stakeholder expectations and requirements and thus is not isolated from reporting requirements. On the other hand, good corporate reporting requires substantive performance results if it is to go beyond a show or reactive social compliance. Substantive sustainability performance can be demonstrated only on the basis of relevant, reliable, comparable and understandable information about corporate sustainability. To just adopt reporting guidelines and requirements which do not relate to strategically relevant key aspects of the company's sustainability performance are not likely to create sufficient benefits for the company. They may not even be sufficient to secure effective and efficient contributions to sustainable development.

Improvements in performance, however, which do not respond to social expectations, could also be insufficient as corporate strategies will not be successful if they ignore some of the societal business environment. Sustainability achievements cannot be effective without considering the societal business environment, nor can sustainability reporting be substantiated without real and business specific social and environmental performance. Stakeholder perceptions and expectations must therefore be considered if the improvements in sustainability performance are to be acknowledged. As a consequence, both, the "inside-out" and "outside-in" perspectives have their strengths and weaknesses; they are related to each other and combining them may be beneficial.

From an organization development perspective the twin approach will involve all organizational functions or departments in integrating information collection, communication, reporting and interaction to improve sustainability performance. Furthermore, external stakeholders will be involved to cross-check that the company-internal dynamics are not unrelated to societal expectations.

4. OUTLOOK

Sustainability reporting can serve different purposes. The outside only approach considers sustainability reporting to be a specialist job of public relations to secure continuation of the existing operations whereas the outside-in approach finds its origin in external stakeholder demands or requirements, aligns internal processes and primarily aims at securing legitimacy. The inside-out approach originates from a planned corporate strategy, is concerned with performance management to control implementation and to report and verify achievements. By combining the latter two views the twin approach is concerned with involving stakeholders and all organizational function in an iterative process of continuously further developing performance management, reporting and communication.

Depending on the (perceived) business environment different organizational approaches can be pursued or expected to be pursued. Management is, however, not caught in a passive role of identifying its business environment and adapting corporate sustainability reporting. Managers are not “prisoners” of externally defined structures, but can influence their business environment and contribute to sustainable development by how they design corporate structures and processes.

If corporate sustainability reporting is to be substantiated, it has to go beyond qualitative value statements, statements of future prospects or compliance with guidelines and standards. Glossy reports may be deemed necessary but are definitely insufficient. The credibility of sustainability information for internal and external recipients, and the associated trust which is aimed at, require both, the visibility of activities and achievements as well as material improvements (see also e.g. Patten 2002).

By involving, communicating and interacting with stakeholders in a trustworthy manner an “involve me” world can be jointly created and maintained and sustainability performance improved (e.g. for sustainability innovations Hansen et al. 2010). Management can build up relationships such that business is part of social networks and not just surrounded by a business environment. Stakeholder trust is then the result of a multitude of activities and interactions, not just hoped for by issuing reports which are in accordance with formal guidelines and state-of-the art design recommendations. Central to this is the understanding of how to institutionalise high-trust relations and how to develop accounting and reporting in a way that stakeholders involve in a mutually beneficial interaction with the company. Developing internal company accounting and reporting systems which serve the company and stakeholders the same, and which are part of developing trusting business arrangements are very complex management tasks. Setbacks are in-evadable and may be influenced by many internal and external factors. It is therefore not surprising that reporting approaches and the business environment do not necessarily match.

In an interactive setting of stakeholders, sustainability reporting requires a credible communication and explanation of management efforts and corporate sustainability performance. Sustainability performance is communicated through both qualitative descriptions of activities and, as a necessary element, quantitative measures of environmental and social impacts and achievements along with their economic relevance to business success. Credible substantiated reporting has to be strongly rooted in accounting and performance management. Performance management and accounting, on the other hand, have to prove their usefulness with regard to stakeholder wishes, demands and

requirements. Thus effective contributions to corporate sustainability require that sustainability reporting is embedded in a structured sustainability approach to performance management. Isolated communication and reporting activities which are organized by the PR department only cannot suffice. With this in mind, substantiated sustainability reporting can only be organized effectively either “inside-out” as strategy- and accounting-driven sustainability reporting, “outside-in” as reporting-driven sustainability accounting, or in combination of the “inside-out” and “outside-in” perspectives as twin-approach which combines these two approaches.

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