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the inside track #30

Highlighting CSR Issues of the moment

The importance of materiality in CR Reporting

For many experienced observers, every once in a while a report comes through that gives fresh insights about the development of CR reporting. One such report is Vigeo's "Worldwide evolution of Corporate Responsibility reporting practices 2008-2014". For those unfamiliar, Vigeo is a French based ESG rating company, whose rankings are provided to their institutional investor and asset manager clients.

The report covered research (based on the Vigeo's ratings) comprising 1,309 companies across the world. The basis for the research included both annual report and accounts and CR communications.

It found that most listed companies have understood the importance of talking about their corporate responsibility, and CR reporting has become universal and is not limited to some countries or sectors anymore. In particular, it found that the average information coverage had increased in the past seven years. The research showed that whilst European companies preserved their leadership in terms of information provided, there was an "outstanding effort by North-American and Asia-Pacific companies" which significantly increased information provided.

The research also found a company's sector will determine the relevance and exhaustiveness of reporting (with those companies in waste and water utilities being the leader in the extent of information reported), and a distinct propensity for business to consumer companies to report more extensively than business to business companies.

The research suggests four key factors determining the extensiveness of reporting. One was the presence of legal CR reporting and sector specific disclosure regulations. Two of the other three demonstrated the way in which CR reporting could assist in risk and reputation management. They were firstly exposure of a company's products and services to customers and stakeholder scrutiny, and secondly the presence of controversies that affected brand reputations. The fourth key factor is not surprising – namely the strong engagement of senior management – but it is worrying, since it suggests that without this commitment, companies would play down the extensiveness of their reporting.

The research found that corporate governance has the largest information coverage, with little sector and geographical differences, suggesting that shareholders remain privileged stakeholders for companies despite the increased scope of stakeholder relations. After corporate governance information coverage came reporting on business ethics and relations with customers. Both demonstrate the focus by companies on reputation and legal security.

The area that experienced the largest increase in information coverage over the past seven years is the environment, with more visible commitments being made in the areas of climate change and energy usage.

But perhaps surprising is the research finding that the lowest level of information disclosure related to companies' performance as the employer, and a view that reporting is more focused on external stakeholders than on internal stakeholders.

The final conclusion from the report suggests that a high rate of disclosure does not guarantee relevance – more concise reporting can inform readers more effectively on a company's commitments! Equally, a comment made was that verification does not necessarily "per se" serve as sufficient evidence of accountability by a company in its CR practices.

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It is important to see this research as being a comparison of companies' reporting against a range of ESG topics set by Vigeo. These are topics Vigeo regards as important for those investors evaluating a company's capabilities in the areas of governance and the integration of their environmental, social, societal and ethical activities.

However, equally important is for companies to understand the materiality of their activities (set against the Companies Act 2006 duty of a director "to promote the success of the business…"). Because governance is almost an essential (certainly in a UK context), it is hardly surprising that governance reporting scores are so high. The same is the case for ethics (including procedures to avoid bribery and corruption legal charges) – most developed world countries have some form of legislation on this matter.

However, of concern is that the low level of information coverage about companies' behaviours towards their employees. To our mind, this stems from the still far from adequate description of a company's business model in its annual report (the Strategic Report in the UK). Fundamental to the setting of the business model is understanding the main business drivers (and providing key performance indicators to assess how effective is the company's management of these business drivers). The expectation is that employee matters – ranging from employee satisfaction, employee turnover or investment in employees' learning and development – would be a key business driver. As such it would be reasonable to assume a reasonable degree of information coverage in excess of that provided for environmental matters. The likely introduction of a review of corporate culture and succession planning into the 2016 update for the UK Corporate Governance Code may go some way to redressing the balance of the importance that should be attached to employee matters in annual reporting (both statutory and voluntary CR reporting).

It would be easy for practitioners to take Vigeo's list of ESG topics and assume these are essentials for compliance. However, companies need to take into account their business model, and the risks that may be associated with it. Companies need to decide for themselves what information is material to their key stakeholders (and not the whole range of stakeholders). This should be the basis for constructing a clear and concise annual report – and meeting Vigeo's concern that a concise report informs investors in a more effective and relevant manner on a company's performance and its commitments for the future.

Overall, the research is a worthy contribution to the understanding of the development of corporate responsibility communication. Its comparison of different regional approaches highlights that CR reporting and communication has come of age, and is no longer primarily a European phenomenon. It highlights also that most listed companies have understood the importance of talking about their corporate responsibility in a coherent and meaningful manner. But it is essential for companies to have materiality uppermost in their minds when considering the contents – so that the reporting adds value to the understanding of the company for investors and other key stakeholders.

If you would like to know more about The Virtuous Circle's work with clients on materiality and the business model, and would like an objective and impartial view, contact Melissa Kittermaster or Tony Hoskins via mkittermaster@thevirtuouscircle.co.uk