A thesis submitted to the Department of Environmental Sciences and Policy of Central European University in part fulfilment of the Degree of Master of Science

THE ROAD TO SUSTAINABLE INVESTMENT:

How Can the Global Reporting Initiative G4 Guidelines Improve Environmental, Social and Governance Disclosure?

Dana Maria POP

July, 2013

Budapest

Notes on copyright and the ownership of intellectual property rights:

(3) For bibliographic and reference purposes this thesis should be referred to as:

POP, D.M. 2013. *The road to sustainable investment: How can the Global Reporting Initiative G4 guidelines improve environmental, social and governance disclosure?* Master of Science thesis, Central European University, Budapest.

Author's declaration

No portion of the work referred to in this thesis has been submitted in support of an application for another degree or qualification of this or any other university or other institute of learning.

Dana Maria POP

CENTRAL EUROPEAN UNIVERSITY

ABSTRACT OF THESIS submitted by:
Dana Maria POP for the degree of Master of Science and entitled: “The road to sustainable investment: How can the Global Reporting Initiative G4 guidelines improve environmental, social and governance disclosure?”

Month and Year of submission: July, 2013.

The investment community can play a decisive role in creating a sustainable global economy. More and more investors are acknowledging that non-financial factors such as climate change or human rights may have material implications for a business. Integration of environmental, social and governance (ESG) consideration in the investment decision making is becoming an imperative as increasing evidence shows that failure to do so may be associated with financial and reputational risks.

However, the lack of accurate, relevant and comparable ESG data is impeding the process. In this regard, the Global Reporting Initiative G4 guidelines bring a series of changes which aim to transform sustainability reporting and make the process more useful to all stakeholders, including investors. This thesis seeks to evaluate how sustainability reporting can become more meaningful to investors and how can the G4 guidelines contribute in this process.

The findings show that by shifting the focus on material issues and by embracing integrated reporting the G4 guidelines have a great potential to make sustainable investment more mainstream. At the end of the day however, the GRI has the innate limitations of a voluntary standard: it cannot impose its reporting framework on companies, nor can it hold companies accountable if they fail to follow the guidelines. By mandating sustainability reporting, regulators have the ability to aid both the proliferation and the quality of sustainability reporting worldwide and thus contribute to the expansion of sustainable investment.

Keywords: *sustainability reporting, integrated reporting, Global Reporting Initiative, G4, materiality, environmental social and governance, ESG, investment.*

Table of Contents

1. Introduction

Forty years after The Club of Rome published its seminal book, “The Limits to Growth”, the global systems are experiencing an unprecedented clash: the neoliberal economic construct is in decay, natural resources are being rapidly depleted and social tensions are rising. We have long since crossed the planetary boundaries and we are heading on the “street of last opportunity” (King 2013).

The Enron collapse, the 2008 financial crisis and the “Occupy” movement are just recent examples which stress the need for a paradigm shift. Although seemingly broken, capitalism can still be a viable economic system, provided some structural changes are undertaken. More and more voices are uttering the phrase “sustainable capitalism”, implying the need for a change from the current narrow, backward way at looking at things to a more complex, forward-looking one. The short-termism of the last decades needs to be replaced by a long-term, sustainable approach (Diplock 2013).

Through their investment decisions, investors have the power to make the current economic system more sustainable. While led by different motivations, the socially responsible investors and many mainstream investors came to understand that the environmental, social and governance (ESG) performance of the companies they invest in may impact their financial returns. The United Nations backed Principles for Responsible Investment (UNPRI) currently has 1,209 signatories (271 asset owners, 748 investment managers and 190 professional service partners)[1] who are committed to incorporating ESG criteria in their investment decision making processes. With over USD 34 trillion of assets under management, it is vitally important for the PRI signatories as well as for other interested

[1] http://www.unpri.org/about-pri/about-pri/

investors to be able to access sufficient and adequate ESG information to support their business making-decisions.

At this point however, the **investment industry is still a long way from benefiting from an adequate tool to evaluate the sustainability performance of its assets**. Despite the assiduous research in the area over the past ten years, investors are still faced with several dilemmas: “*how can societal and environmental returns be defined, measured and reported? How can the societal and environmental be weighed against the financial? Can trade-offs be made?”* (Louche and Lydenberg 2011). Moreover, according to a series of research papers published by Deloitte, company managers in charge of sustainability matters lack the tools and the knowledge to identify the most material environmental and social issues pertaining to their business (Koehler and Hespenheide 2012a, 2012b). Consequently, their data is difficult to use for decision-making, both within the company and for existing and potential investors.

Over the past few years, the Global Reporting Initiative (GRI) has provided companies with one of the most useful, structured and straightforward tools for reporting their sustainability performance. The guidelines have been revised periodically so as to incorporate the vast complexity and the outstanding dynamics of the field. The GRI currently has nearly 5,000 registered organizations and its database has over 11,000 reports drafted according to its standards (GRI 2013d).

The 4th generation of GRI reporting guidelines G4 was launched in May 2013. Along with several other major changes, G4 is designed to provide companies with a better tool to determine what ESG factors are material for each business sector and enable investors to better incorporate ESG matters into their investment decisions.

1.1 Objective and research question

The main objective of the research will be to highlight how sustainability reporting can become a strategic tool for investors’ decision making. At the same time, it will attempt to determine which features of the new GRI framework have the potential to address investors' concerns over ESG information, particularly regarding materiality, consistency and benchmarking.

Consequently, the following **research question** was formulated:

How can sustainability reports become more useful to investors and what role can the GRI G4 guidelines play?

In order to answer the research question the following sub-question were subsequently developed:

1. What does "useful information" mean for investors?
2. What are the main challenges that investors face when dealing with corporate sustainability reporting?
3. What are the major changes brought by the GRI G4 guidelines and how do these changes potentially influence the way companies communicate sustainability matters to investors?
4. How can the G4 interact with other policy instruments in order to achieve its full potential?

1.2 Theoretical framework

The present research is built within a broad theoretical framework. At the very core of the research lie the "shareholder value theory" and the "stakeholder theory" (Freeman 1984, Melé 2008) which will be subsequently discussed in Chapter 3. The research was further developed by incorporating theoretical references to concepts such as sustainability, corporate social responsibility, sustainability reporting, socially responsible investment, sustainable investment, etc.

It is noteworthy however that the later concepts (socially responsible investment, sustainable investment) are yet to benefit from a consensus of definitions within the literature. As it is often the case with dynamic research fields, the definitions are lax and often depend on the context and boundaries. Therefore, for the purpose of this thesis, conventional definitions were set based on literature and experts' opinions.

2. Methodology

2.1 Research design

One important feature of this research is that it will attempt to make projections and to outline future trends and trajectories. One could argue that it is purely speculative at this stage, as there is no way of knowing with certainty, or provide data-backed proof of how the GRI G4 guidelines will influence the way investors use sustainability reporting.

Rather, this research aims to determine what features of the GRI G4 are likely to contribute to a higher usability of sustainability reporting by the investment community. To attain this goal, the research was constructed as a **qualitative, exploratory type of research**.

The research design is consistent with the methodological stances of qualitative research as defined by Ritchie and Lewis (2003):

- The research strategy and data generation methods are flexible, context-sensitive and reflect the complexity and dynamic of the field;
- The methods include observation, interviews and analysis of documents;
- The outputs are generally descriptive and consider the various perspectives of the participants.

Once the research process was defined and the data was collected, the interpretation of results was done following the methodology created by Stauss and Corbin (1998).

2.2 Data collection

In order to obtain a clear and holistic view of how the GRI G4 guidelines can influence the way investors use sustainability reporting the author has resorted to three methods of data collection, namely:

- **Literature review**

  The literature review was mostly used as a means to get familiar with some of the most important theoretical aspects of the thesis. As of the submission of the thesis, there were very few academic articles covering the perceptions of investors on the GRI framework. This can be explained by the very short time elapsed between the launch of the G4 guidelines and the submission date of the thesis (2 months). Nevertheless, the literature review included a wide array of publications, both from the business sector and academia, covering several important topics discussed in this thesis such as sustainability, corporate social responsibility, corporate social responsibility/sustainability reporting, stakeholder theory, ethical/socially responsible/sustainable investing, etc.

- **Conference participation**

  The GRI G4 guidelines were officially launched on the 22nd of May 2013 at the Global Conference on Sustainability and Reporting (GCSR) in Amsterdam, The Netherlands. The 3-day conference gathered more than 1,600 sustainability experts and practitioners from 69 countries, along with representatives of academia, governmental institutions and civil society.

  The conference participation facilitated the access to first hand information on the usability of the GRI framework from industry practitioners. Speakers at the conference included representatives from United Nations Environment Programme, Carbon Disclosure Project, Greenpeace, Transparency International, as well as stock exchanges, institutional investors or rating agencies. The conference featured open plenary sessions on topics such as integrated reporting, sustainability data accessibility, harmonization of sustainability frameworks, defining material report content and financial markets and sustainability reporting.[2]

- **Interviews and discussions with experts**

  There were 6 interviews conducted in total, between 22 May 2013 and 24 July 2013. The interviews were designed as semi-structured interviews, consisting of a set of pre-defined questions which served as reference points. The subjects were chosen using the snowball sampling technique (Morgan 2008). The interview period can be structured as follows:

  - 1st Phase: Interviews conducted during the GRI conference in May 2013 included subjects directly involved with the GRI as an organization and with the development of the G4 guidelines;
  - 2nd Phase: Interviews conducted with representatives of ESG research providers and with investors' organization;
  - 3rd Phase: Interviews conducted with investors.

2.3 Research limitations

Given the timing of the research, only 2 months after the publication of the GRI G4 guidelines, the research is at this stage purely exploratory. The GRI G4 guidelines will become mandatory for GRI reporters only as of 2015; therefore statistical data is likely to become available only after this date. However, this has the potential to open the doors for future research. It will surely be interesting to find out how the real outcome of the G4 deployment matched with the estimations and projections made by this research.

In addition, the research is by no means aimed at being truly comprehensive. Given the limited time and resources available, the research is designed as a helicopter view on the subject rather than a precise exploration of a narrow area of the subject. Thus, the research

[2] https://www.globalreporting.org/information/events/conference2013/program/Pages/agenda.aspx

does not focus on a particular type of investors (SRI or mainstream), nor does it cover a specific country or region. The author acknowledges that definite conclusions can only be drawn on a case-by-case basis and that the results of the research are likely not to be applicable when considering numerous variables within a particular case-study.

3. Literature review

3.1 Corporate social responsibility and the role of corporate sustainability reporting

25 years after the World Commission on Environment and Development (WCED) defined sustainable development as *"development that meets the needs of the present without compromising the ability of future generations to meet their own needs"*, the role of the business in meeting this goal is greater than ever (WCED 1987). Questions surrounding the practical and moral aspects of corporate behaviour have gained an unforeseen momentum following the financial markets' crisis of 2008.

Implicitly, the role of sustainability reporting has grown substantially. From the early mandatory disclosures of the 70s and 80s, going through the timid pioneering attempts of the early 90s and the exponential growth witnessed after the beginning of the new millennium, sustainability reporting has come a long way to meeting the expectations of increasingly numerous and often demanding stakeholders.

This chapter will briefly describe and highlight the major milestones of corporate social responsibility and sustainability reporting practices throughout the world.

3.1.1 The origins of corporate social responsibility

Although notions and concepts pertaining to the social responsibility of business can be traced way back in history, it is commonly accepted among scholars that "corporate social responsibility" as defined today, is the product of the socio-economical paradigm of the second half of the 20th century (Caroll 2008).

There are two major theories which have shaped the dynamics of corporate social responsibility in the 20th century: the shareholder value theory (of fiduciary capitalism) and the stakeholder theory (Melé 2008, Koehler and Hespenheide 2012b) which will be briefly discussed below.

In 1970, Milton Friedman famously stated in a New York Times magazine article that "*the only responsibility of business towards the society is the maximization of profits to the shareholders, within the legal framework and the ethical custom of the country*" (Friedman 1970). Friedman, who is often regarded as one of the most preeminent supporters of the shareholder value theory, was a fervent critic of the corporate social responsibility concept. He, along with other supporters of the theory, was arguing that corporate social responsibility could jeopardize the "*very foundations of our free society*" (Friedman and Friedman 1962). However, the theory has been increasingly criticized towards the end of the 20th century, particularly because it promotes short-term profit maximization, a business approach which has proved unsustainable form a social and environmental perspective, and often, from an economic perspective (Melé 2008).

The 1980s marked the emergence of the so-called "stakeholder theory", which, although initially applied to management practices, soon became a central pillar of the corporate social responsibility construct. The stakeholder theory provides that corporations have a duty both towards stockholders and to various society groups which it may impact, called stakeholders. R. Edward Freeman, one of the first scholars to publish research on the stakeholder theory, went as far as to suggest replacing "corporate social responsibility" with "corporate stakeholder responsibility" (Melé 2008).

Wheeler et al. (2003) suggest that the corporate culture can be represented as a three-level model describing an organization's approach to stakeholders and value creation:

Fig. 1 Framework for Classifying Organizational Cultures

Source: Wheeler et al. 2003

- **Level 3**: organizations which seek to "maximize the creation of value" not only on economic, but also on social and environmental level, by consistently engaging with all stakeholders and often going beyond the call of duty (exceed regulations);
- **Level 2**: organizations which acknowledge the added-value of engaging with stakeholders such as employees or customers but maintain shareholders' satisfaction as their highest priority;
- **Level 1**: organizations which abide by the norms and seek regulatory compliance but do little or nothing to engage with stakeholders

Expectedly, the stakeholder theory has its detractors. Jensen (2000) argues that striving to maximize value for a number of stakeholders is detrimental for a company, as it obscures managerial vision and that pursuing a "single-valued" objective is the only rational path for an organization to follow. Likewise, the stakeholder theory fails to address the issue of tradeoffs among stakeholders, which leads to a smallest common denominator compromise and which eventually harms both company value and social welfare (Jensen 2000).

3.1.2 Sustainability reporting

Sustainability reporting first became a visible phenomenon in the business world in the 1970s, mainly as a result of growing concerns over environmental issues and discussions surrounding the role of the corporations in the society (Owen and O'Dwyer 2008).

Sustainability reporting is, or at least should be, the outcome of a comprehensive sustainability assessment exercise within an organization. The process of communicating sustainability should engage all levels of an organization and should incorporate a thorough analysis of the value chain. Similarly, it should be both a backward-looking and a forward-looking process.

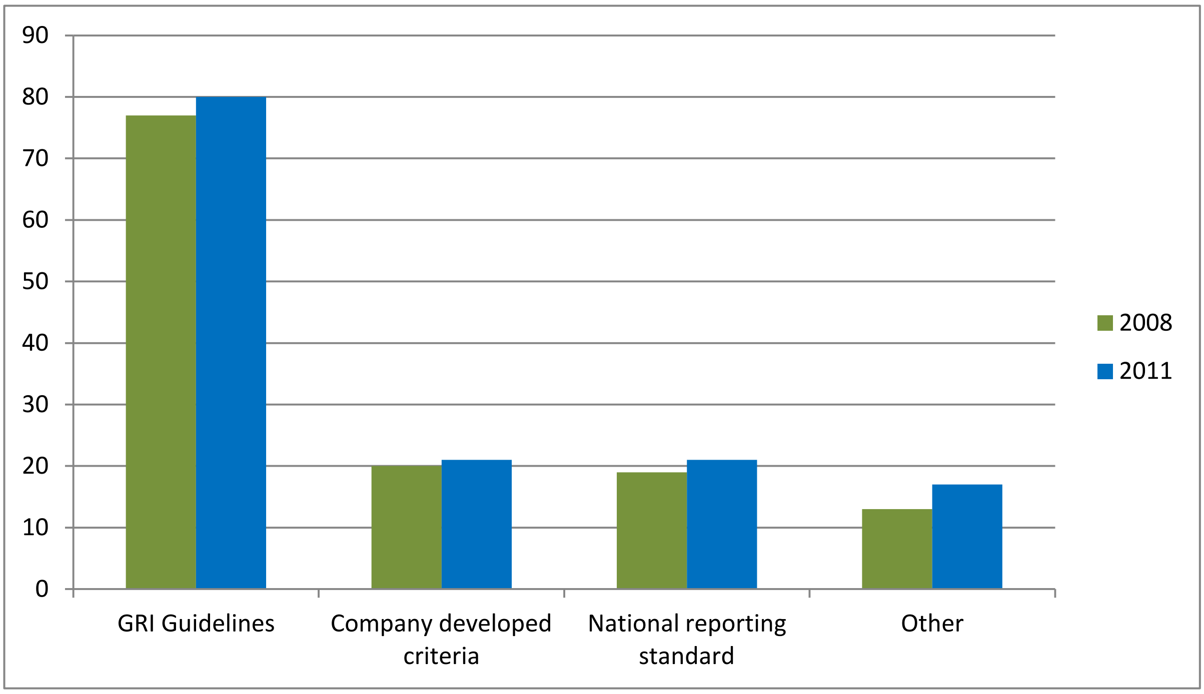
However, sustainability reporting and sustainability practice have often been two separate phenomena. For decades now, companies have been accused of using sustainability reporting as a public relation tool, using a technique called "greenwashing" (Laufer 2003). Admittedly, many CSR/Sustainability reports were, in their early form, merely a compilation of philanthropic activities and unsubstantiated claims on environmental stewardship.

Nevertheless, the past decade has delivered a substantial improvement in the collection, interpretation and presentation of sustainability (corporate term) or ESG (financial term) data, driven mainly by the business community and supported by academic research. The 2011 KPMG triennial survey on sustainability reporting practices throughout the world has revealed an outstanding increase in the number of reporting organizations. The survey covered over 3,400 organizations globally, including the top 250 companies of Fortune 500 (KPMG 2011).

The KPMG survey boldly states that *"corporate responsibility reporting comes of age in 2011"*, noting the shift from a desirable but optional practice, to a "must have" in the business community. Accordingly, 95% of the 250 largest global companies (G250) reported on their sustainability performance, compared to nearly 81% in 2008. The business community is starting to finally acknowledge the financial added-value of sustainability reporting derived both from a better understanding of non-financial risks as well as from reputational benefits. Among other drivers for reporting sustainability performance, the KPMG report has identified ethical considerations, employee motivation, innovation and learning as well as access to capital or increased shareholder value (KPMG 2011).

The most adhered to standard for sustainability reporting as explained by the graph below is the framework developed by the Global Reporting Initiative:

Fig. 2 Sustainability Reporting Standards among G250 companies



Source: KPMG 2011

3.2 The Global Reporting Initiative

The Global Reporting Initiative is a non-profit organization which aims to support the creation of a sustainable global economic system through the development of sustainability reporting guidance (GRI 2013f).

Now headquartered in Amsterdam, the Netherlands, the GRI was founded in 1997 in Boston, by the US based Coalition for Environmentally Responsible Economies (CERES) and the Tellus Institute (Fig. 2). Although initially GRI's target audience was the investment community, the framework came to incorporate the interests of numerous other stakeholders. The multi-stakeholder approach was defined early in its history, so that by the time the G3 was being launched more than 3,000 experts were engaged in the development process. The first generation of guidelines was launched in 2000. By 2002, the GRI was already a reputable standard, being inaugurated as an UNEP collaborating organization and being referenced in the Sustainable Development World Summit's Plan of Implementation.

GRI's Vision

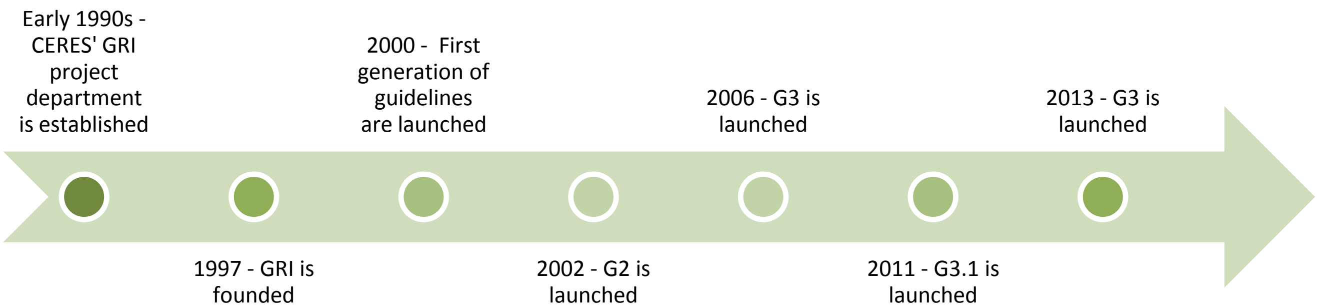
"A sustainable global economy where organizations manage their economic, environmental, social and governance performance and impacts responsibly, and report transparently."

GRI's Mission

"To make sustainability reporting standard practice by providing guidance and support to organizations."

GRI 2013d

Fig. 2 GRI guidelines development timeline



Striving to become a truly global organization, the GRI established gradually several focal points, first in Brazil and Australia and later in China, India, the US and South Africa. The reporting guidelines were soon complemented by numerous sector guidance documents (GRI 2013d).

The governance structure of the GRI is comprised of three major bodies and coordinated by the Secretariat:

- The Board of Directors – bears the ultimate strategic, legal and financial responsibility for GRI
- The Stakeholder Council – strategic advisory role
- The Technical Advisory Committee – provides recommendations and oversees the guidelines development process

The development and revision of the GRI guidelines is an iterative process, which places a great emphasis on the feedback received from stakeholders:

Within the first step, the Technical Advisory Committee **establishes priorities** based on board recommendations and input from the Secretariat and GRI network. Next, the Working Groups[3] will **develop proposals** which are subsequently revised by the TAC. Once the proposed changes are articulated, the revisions are subjected to **public feedback**. Finally, after one or even more if necessary public feedback periods, the guidelines are defined and sent to the Board for **approval** (GRI 2013d).

3.2.1 The G4 Guidelines

Soon after the issue of the G3 guidelines in 2006, the need to supplement the guidelines emerged and thus the G3.1 came to being. However, during the development of the G3.1 supplement, the question of whether a 4th generation of the guidelines would be soon required starter to take shape.

[3] The working groups' members are nominated based on expertise, stakeholder diversity and availability and reflect the variety of the GRI constituents: business representatives, civil society, financial markets (asset owners, managers, research, rating and other financial intermediaries), labour and mediating institutions (accountancy, consulting, academic institutions, standard developers and public organizations). (GRI 2007, 2013b)

Thus, in 2010, the Board of Directors of the GRI announced the start of the work on the G4 guidelines. The objectives of G4, as defined in September 2010, were:

- To provide improved guidance on how to define and how to communicate material issues from a multi-stakeholder perspective
- To improve technical aspects and make the guidelines more clear
- To increase user-friendliness of the guidelines
- To provide tools for harmonization with other international sustainability reporting standards
- To provide guidance on how to create Integrated Reports (GRI 2012a)

The process of developing the G4 guidelines lasted for 2.5 years and was based on a collaborative framework between the GRI Board of Directors, Secretariat and the Technical Advisory Committee on the one hand, and the Working Groups on the other (GRI 2007, 2013a).

The process featured two comment periods, the first from 26 August and 24 November 2011 and the second from 25 June to 25 September 2012 and collected feedback from nearly 2500 individuals and organizations (GRI 2012a, 2012b).

The GRI G4 guidelines were officially launched at the GRI Global Conference on Sustainability and Reporting held in Amsterdam between 22 and 24 May 2013.

3.3 Investors and ESG data

3.3.1 Brief history: from ethical investment to ESG integration

As previously mentioned, this thesis will not focus only focus on (socially) responsible investment, but will also attempt to identify how mainstream investors can be compelled into incorporating ESG information in their decision making process. It would be useful though to highlight some of the most important historical developments which led to investors being concerned with the ESG performance of their assets.

Beforehand however, there is a need for clarification on the terminology. Although the terms "socially responsible investment", "responsible investment" or "ethical investment" are often used interchangeably, for the purpose of this thesis the following distinctions will be made:

- **Ethical investment** will refer to faith-based investments;
- **Socially responsible investment (SRI)** will refer to values-driven investments;
- **Sustainable investment (SI)** will refer investments which address the whole array of ESG factors, seek financial returns and are not determined by values or faith;
- **Responsible investment (RI)** will refer to all types of investment which incorporate ESG considerations regardless of the motivations (includes all three above).

Originally, responsible investment was associated with faith-driven investors, who sought to apply religious principles to their investment decisions. Today, such investors have come to incorporate moral principles of different religions of the world and have joined organizations such as the Interfaith Center on Corporate Responsibility[4]. Faith-based responsible investors are located predominantly in the United States (Kurtz 2003).

In the 70s and 80s, roughly about the same time as corporate social responsibility emerged, the US witnessed a boost in responsible investment along with the civil rights movement and increased awareness on human rights. Thus, the term "socially responsible investors (SRI)" was born, as an umbrella term for all investors concerned about the social implications of their investments. Admittedly, SRI can be seen as an application of CSR in financial markets (Kurzt 2003).

Western Europe, and increasingly Asia-Pacific and numerous emerging markets have taken a slightly different approach to responsible investing. Although sometimes underpinned by

[4] http://www.iccr.org

ethical principles, the responsible investment rationale in these regions is mostly supported by a risk-minimization approach. Investors are increasingly aware of financial risks incurred by climate change or by reputational risks associated with human rights violations. After 2000, the term "sustainable investment" began to take over from the previous "socially responsible investment", so as to reflect the concern for both social and environmental matters, but also for governance, business ethics related matters.

Ultimately, the SRI community alone is unlikely to have a major impact. Kiernan (2009) claims that value-based investment spurs little to no interest to the mainstream investment community because most mainstream investors are neither interested nor willing to make ethical judgment calls on popular SRI issues such as contraception, genetically modified foods or animal testing. And while it may be difficult to estimate the exact size of the conventional SRI market due to varying definitions of the term, it is believed to represent less than 5% of the total USD 60 trillion of assets under management globally (Kiernan 2009). More and more experts agree that the next step in responsible investment is mainstreaming (Fig. 3). Institutional investors are probably the first among the mainstream investment community who acknowledged the importance of incorporating ESG factors into their decision making process. Institutional investors include investors with a long-term investment horizon, such as pension funds, for whom the long-term risks and opportunities are a prime concern (Responsible Investor 2008, CICA 2010).

Fig 3 Responsible investment evolution timeline

Source: Louche and Lydenberg 2011

Mainstreaming however, may have been impeded by the confusion between SRI and SI. Kiernan (2009) states that mainstream investors are generally reluctant to be associated with traditional SRI because the very different underlying investment philosophies. Indeed, deciding on which and whose values are more legitimate is not a matter that mainstream investors are willing to linger on. This confusion however, has been very detrimental, as SI's underlying investment philosophy is closer to that of mainstream investment while still expressing concern for SRI themes such as climate change, labour practices and human rights (Kiernan 2009).

3.3.2 ESG integration: why is it important for investors?

Responsible investors seem to agree that integrating environmental and social considerations into their decision making process does not contradict, but rather enhances the concept of fiduciary duty (UNEPFI 2009). The "best interest" of the beneficiary includes, according to the RI community, sustainable management of the human and environmental capital.

For mainstream investors, the need to supplement traditional financial valuation with ESG valuation is also becoming increasingly evident. If in 1975 the intangible assets represented only 17% of the market value of an asset, the percentage rose substantially up to 81% in 2009[5], where intangible assets include a company's brand and reputation, as well as its environmental externalities and its license to operate. By incorporating non-financial metrics, investors benefit from a clearer picture of a company's long-term performance and can avoid financial and reputational loss caused by shareholder or consumer boycotts or divesture (Koehler and Hespenheide 2012a).

"Universal owner", a term coined by Robert Monks (1994) is used to refer to large institutional investors, such as pension funds, with diversified and long-term investment portfolios. The universal owner theory states that within the same investor's portfolio, there

[5] http://www.oceantomo.com/media/newsreleases/Intangible-Asset-Market-Value-Study

may be companies externalizing environmental costs at the expense of other companies (i.e. acid mine drainage coming from mining company can compromise an agriculture land owned by food and beverage company), therefore the imperative for investors to urge investee companies to internalize externalities (Seitchik 2007, UNEPFI 2011). And with the global pension assets accounting for approximately 40% of the global funds under management[6], the theory is starting to echo within the mainstream investment community.

According to Louche and Lydenberg (2011), the motivations of responsible investors can be grouped into four categories:

- Exclude profits derived from unethical business activities
- Contribute to the development of "positive" business activities (e.g. renewable energy, organic agriculture, etc)
- Minimize financial risk (i.e. identify ESG related risks which are not usually covered by traditional financial analysis)
- Foster positive change in corporate behavior

For mainstream investors the motivations are more straightforward: they either seek to mitigate some risks or they envision an opportunity to create value for their shareholders. Sustainable investment can enable investors to better manage risks and returns by creating an analytical framework which better describes the challenges of today's markets. Rather than focusing on personal values, sustainable investment seeks to increase financial returns by investing in companies which are better equipped to face ESG risks (Kiernan 2009).

3.3.3 How investors use ESG information

Both mainstream investors and responsible investors agree that ESG disclosure is important. However, the degree to which this type of information weights in an investment decision varies greatly.

[6] http://www.thecityuk.com/media/press-releases/global-funds-under-management-reach-84-trillion/

Usually, for mainstream investors, the decision to invest in a particular company is made before any ESG analysis is undertaken. The investment decision is mostly opportunistic, and sustainability is nearly always considered a contingency issue. Sustainability issues do weight in though, but only during the due diligence process, which takes place after the investment decision has already been made. Simply put, sustainability is not a game changer for mainstream investors, but rather a means to mitigate some risks (John Forgach, pers. comm.) As part of the due diligence process, mainstream investors, usually through analysts, will look a company's mandatory and voluntary fillings and general sustainability disclosure. However, as Mr. Forgach pointed out, sustainability disclosure is merely a "comfort element" and will only play a role if:

- Sustainability/ESG data is completely missing
- There is indication/suspicion that information/facts are grossly overestimated

Few mainstream investors do however adhere to high levels of ESG integration. Robeco Investment Management and APG All Pensions Group (APG) are known for integrating ESG considerations throughout their entire portfolios. However, this is a rare occurrence within today's investment community. Most mainstream investors who choose to do some sort of ESG integration are more likely to develop separate products which either use ESG analysis to complement financial analysis or focus exclusively on ESG integration (BSR 2009). Some large institutional investors are also taking steps towards ESG integration. The Norwegian Government Pension Fund Global (GPFG) managed by Norges Bank through its asset management branch Norges Bank Investment Management (NBIM) introduced its first set of ethical guidelines in 2004. The GPFG is the largest sovereign wealth fund in the world, with USD 737.2 billion assets under management[7]. The fund's responsible investment strategy includes environmental investment programmes, active ownership and exclusion of

[7] http://www.swfinstitute.org/fund-rankings/

companies which are involved in the production of weapons (cluster munitions, anti-personal land-mines, and nuclear arms) or production of tobacco as well as companies which have been associated with severe ethical norms violations, human rights abuses or environmental damage. In addition, the fund has defined "expectation documents", on topic such as children's rights, climate and water management that investee companies are required to adhere to (NBIM 2013, NMF 2013).

Within the SI community, ESG analysis is seen as complementary to financial analysis, meaning that it adds an extra layer of understanding to the entire valuation process. Thus, aside from looking at the profitability and stability of a company, sustainable investors will seek to determine if non-financial aspects, such as energy efficiency, water scarcity, health and safety incidents or board members' independence are expected to pose material, operational or reputational risks.

Responsible investors may adopt various strategic investment approaches, depending on their mission and goals. Based on the **motivations**, Louche and Lydenberg (2011) have identified five strategies employed by responsible investors:

- **Avoidance:** Excluding stocks which are not in line with the investors' or society's principles;
- **Inclusion**: Focusing on industries/companies which bring additional benefits to society;
- **Relative selection**: Investing only in best-performing stocks based on a set of criteria;
- **Engagement**: As divesture is usually very costly, investors will seek to influence corporate behavior towards better societal and environmental practices;
- **Integration**: Risk-minimization approach in which investors integrate ESG analysis into traditional financial analysis.

Another classification, proposed by the European Sustainable Investment Forum (EuroSIF) (2012) identifies seven strategies, based on the **processes** used by responsible investors:

- **Sustainability themed investment**: focusing on sustainability issues such as climate change;
- **Best-in-Class investment selection**: selecting best performing companies based on specific ESG themes;
- **Norms-based screening**: screening of investments based on reputable international norms, such as the ones defined by the United Nations;
- **Exclusion of holdings from investment universe**: excluding companies or entire sectors involved in various activities such as weapons or tobacco;
- **Integration of ESG factors in financial analysis**: inclusion of ESG risks and opportunities into financial analysis;
- **Engagement and voting on sustainability matters**: active ownership through engagement on ESG matters with the company;
- **Impact investment**: investments designed to bring both financial returns to the investor but also to bring social and environmental benefits to a community (e.g. microfinance)

4. Results and analysis

Gathering and compiling information for high-quality sustainability reports is a challenging and demanding task for any company, be it large or small, public or private. Communicating sustainability to a wide array of stakeholders, who may have different and often conflicting interests, is equally problematic. While investors do acknowledge that sustainability reporting is not designed to meet their needs exclusively, they cannot help but notice that many sustainability reports fail to address even their most basic demands.

Companies often complain that they have to answer too many questions from investors and ESG research and data providers. This phenomenon even got a name; it's called "survey fatigue"[8]; at the opposite end, investors too report suffering from "information fatigue", claiming that they are overwhelmed by irrelevant ESG data (Waygood 2013).

However, progress, albeit strenuous, is occurring, and GRI plays an important role. GRI bears the merit of providing a robust framework that aims to deliver more meaningful reports to all stakeholders, including investors.

This chapter will outline the major changes brought by the G4 guidelines which are deemed to have a high potential of steering investors' interest more towards ESG data. Based on a thorough literature review, conference participation and personal communication with various sustainability practitioners engaged in the G4 development, investors, NGOs or research agencies, the following major features of the G4 guidelines were identified as having a high potential to address some of the concerns that investors have with regard to sustainability reporting:

- Increased focus on materiality and on embedding sustainability within the organization's management strategy
- Endorsement of integrated reporting

[8] http://www.sustainserv.com/easyblog/entry/sustainability-survey-fatigue.html

In addition, this chapter will also attempt to answer some underlying questions regarding what constitutes useful ESG information for investors, what are the challenges that investors are facing when trying to make use of ESG information, what are the changes brought by the G4 guidelines and how can these influence the way companies communicate sustainability matters to investors. To conclude, this chapter will also describe what additional policy tools are needed to complement G4.

4.1 What are investors expecting in terms of ESG disclosure?

ESG information has witnessed an outstanding momentum within the past 10 years. However, questions regarding the availability and quality of data are still acting as barriers against full ESG integration.

> *"There is a need for need for timely, accurate and comparable data"*
>
> Steve Waygood, AVIVA Investors

Although, as previously mentioned, the degree to which ESG information is incorporated within the decision making process varies among types of investors, most of them seem to agree that ESG information needs to meet several criteria in order to become utilizable. Probably most important, the information needs to be **available**. It often happens that companies do not acknowledge the importance of being transparent and of communicating ESG matters to stakeholders. Further, the information needs to be **accurate**, and preferably audited as well as **relevant**. Some companies will pick certain aspects to report on just because they are easy to obtain rather than because they are material for their core business. Similarly, **comparability** of ESG information is a prime concern for investors. Not least, the information needs to be **timely**. Many companies publish sustainability reports outside their usual annual reporting cycle while others only publish them on a biennial basis. To summarize, the "useful" ESG information needs to be:

> *"The data needs to be more timely, it needs to be more comparable, it needs to be audited"*
>
> James Glifford, UNPRI

Fig. 4 Attributes of "useful information"

Source: CICA 2010

4.2 Are companies communicating ESG information to investors effectively?

Without readily available ESG information investors are likely to continue to use the traditional resource allocation model and prioritize the economic dimension to the detriment of the sustainability dimension. At the same time, companies and sustainability experts often complain that investors do not pay attention to extra-financial information. Consequently, the first step towards breaking out of this vicious circle is for companies to strive to deliver high-quality ESG information (Favaretto 2013).

The number of organizations publishing sustainability reports has grown significantly over the years, especially among large multinational companies. As the KPMG report points out, out of the 95% of the Forbes top 250 companies published sustainability reports in 2011, and 81% used GRI as standards for reporting (KPMG 2011). However, while the KPMG results may be encouraging, only 10% of Europe's largest companies disclose sustainability information (Barnier 2013). Thus, in terms of **availability** of ESG information one **major challenge is to provide a flexible reporting framework which can attract more companies**.

In 2012, a (yet to be published) study conducted by the Vienna University of Economics and Business Institute for Human Resources Management concluded that sustainability reports contain a striking amount of over-estimated claims. The study covered 131 companies from the Forbes 250 list that published a GRI compliant sustainability report. According to the study, 86.2% of the surveyed companies claimed that they had reported on indicator LA1 (Total workforce by employment type, employment contract, and region broken down by gender), whereas only 10.7% did so correctly. The LA (labour) indicators seem to contain most false claims, closely followed by the human rights indicators (Cohen 2012). Mallen Baker, a strategic advisor on CSR, went as far as to suggest that 50% of the information found in sustainability reports is of no interest for anyone[9], let alone investors, who are probably the least likely among a company's stakeholders to peruse large and heavily cosmeticized documents.

Likewise, Transparency International (TI) looked at the sustainability reports of 21 major German companies which had declared their sustainability reports as meeting the requirements for level A/A+ of application and learned that there was a single one that actually met all the requirements (TI 2012).

As these studies point out, there has been a lot of discussion regarding the **accuracy** and **reliability** of the information included in sustainability reports. Elaine Cohen, sustainability consultant, has identified several underlying factors which might have contributed to the situation described by the Vienna University study:

- Lack of GRI training and knowledge among sustainability reporters;

[9] http://www.ethicalcorp.com/communications-reporting/sustainability-reporting-dog-didn%E2%80%99t-bark

- Companies are striving to cover as many indicators as possible in order to receive the A/A+ level and are trading quality for quantity;
- Companies are purposefully embellishing the reports in an attempt to gain PR advantages and are neglecting the possible consequences;
- Companies neither think nor care that the over-statements will be observed or that they even matter (Cohen 2012);

Narina Mnatsakanian, Senior Advisor Responsible Investment & Governance at MN[10] said that the quality of ESG information varies greatly across markets and sectors. For instance, large European companies often provide good quality ESG information while some other companies still mistake sustainability for philanthropy.

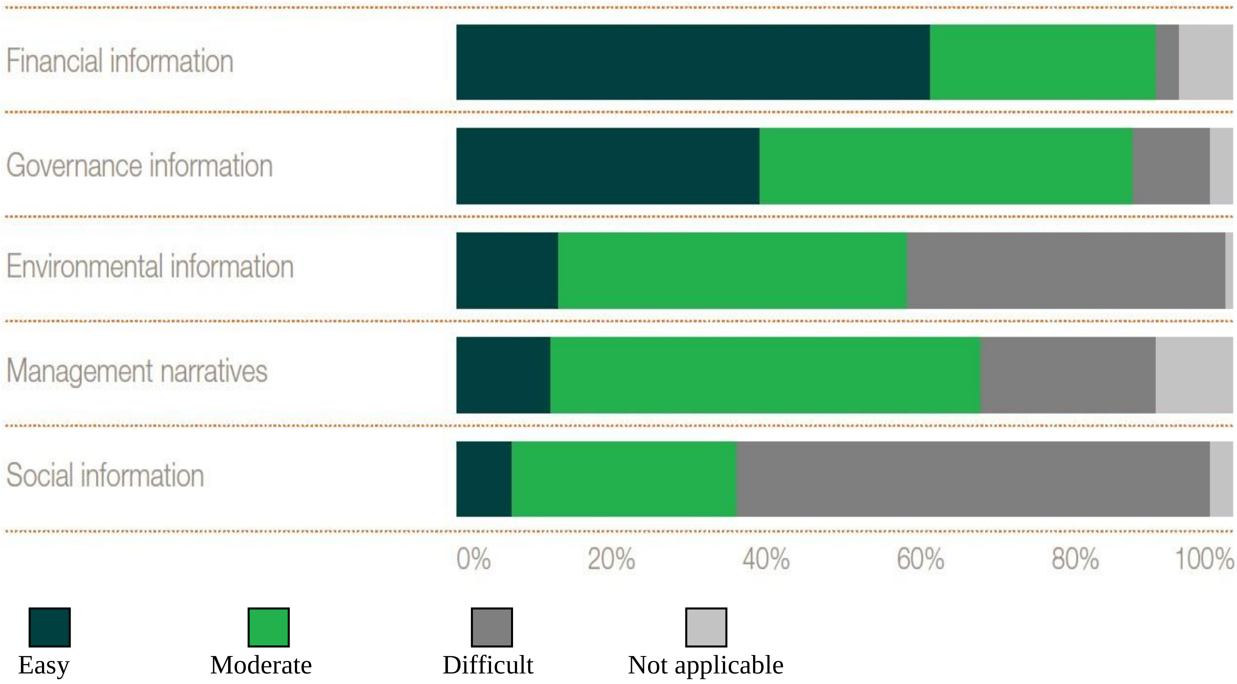
Therefore, **in terms of relevance and accuracy of ESG information most organizations are still a long way from providing meaningful information to investors**.

Another important feature of ESG information is **comparability**. When an investor is looking at data across a sector, it needs to be able to compare the data and obtain meaningful information about the quality of management which can later be factored into its decision making (Glifford, 2013). Comparability is determined by **consistency**, meaning that companies need to follow the same reporting standards both vertically, from one year to another, and horizontally, across sectors.

At the same time, the study conducted by a London based consultancy found that a large share of investors and analysts (61%) report that social information is the most difficult to compare and benchmark within the ESG nexus. The study gathered data from both mainstream and responsible investors and analysts and focused on how they source and use ESG information. The results regarding the ease of comparability of ESG and financial information are presented below:

[10] http://www.mn.nl

Fig. 5 Ease of comparability of ESG and financial information



Source: Radley Yeldar 2011

The financial and governance information are deemed mostly as easy or moderately easy to compare because this type of information is highly standardized and best practices are readily available. In contrast, social and environmental information is a) yet to be mandated in most countries and b) still lacking a robust, standardizes disclosure framework (Radley Yeldar 2011).

The Radley Yeldar study further advances a series of possible solutions to increase the compatibility of ESG information:

- Develop reporting standards
- Align existing standards with reputable accounting standards
- Educate companies and investors
- Mandate extra-financial reporting
- Improve accountability
- Promote integrated research and reporting

4.3 What are the new features of the G4 guidelines?

The G4 guidelines are the outcome of a substantial process which span over 3 years and incorporated more than 2,500 feedback comments from stakeholders. The new guidelines bring several structural changes from the previous G3.1 version, the details of which are described below:

a) Greater focus on materiality

Materiality is a concept often correlated with financial accounting practice. However, for the past 15 years, the term has been increasingly associated with non-financial matters, such as environmental and social aspects of corporate behaviour.

There are two major identifiable features of what constitutes a "material aspect", as per the various definitions provided by literature (Table 1):

- It is likely to influence the position of a stakeholder
- Its omission is likely to have a negative (financial) effect on a stakeholder

Table 1: Materiality definitions

US Securities and Exchange Commission Staff Accounting Bulletin no. 99 m(SAB 99)	"*A matter is "material" if there is a substantial likelihood that a reasonable person … relying upon the report would have been changed or influenced by the inclusion or correction of the item … financial management and the auditor must consider both "quantitative" and "qualitative" factors in assessing an item's materiality."*

IAASB Framework for the Preparation & Presentation of Financial Statements	*"Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic that information must have if it is to be useful."*
AA1000 Assurance Standard	*"A meaningful definition of materiality must effectively identify information that, if omitted or misstated, would significantly misrepresent an organization to its stakeholders and thereby influence their conclusions, decisions and actions for a particular company at a specified place and point in time."*
WBCSD/WRI GHG Protocol, revised	*"Materiality threshold is a concept employed in the process of verification. It is often used to determine whether an error or omission is a material discrepancy or not. It should not be viewed as a de minimis for defining a complete inventory or a permissible quantity of emissions that a company can leave out of its inventory."*

Source: Koehler and Hespenheide 2012a

In 2004, the United Nations Environment Programme Finance Initiative issued its first report discussing the material impact of environmental, social and corporate governance issues. UNEPFI requested the collaboration of several brokerage firms to identify and potentially quantify the ESG impacts on stock price. The report concluded that most material topics can be roughly summarized as follows: climate change, health and safety, labour rights and corporate governance. Admittedly, one of the major issues that analysts preparing the reports were confronted with was the **lack of transparency** mostly associated with **weak regulatory requirements** and the **lack of comparable data** (UNEPFI 2004).

Ever since, the issue of materiality has spurred great debate within the business world. Other UN initiatives such as the PRI have published extensive research on ESG impacts on company value. For instance, the report published by UNPRI and PwC in December 2012 came to several conclusions which support the idea that ESG factors are material:

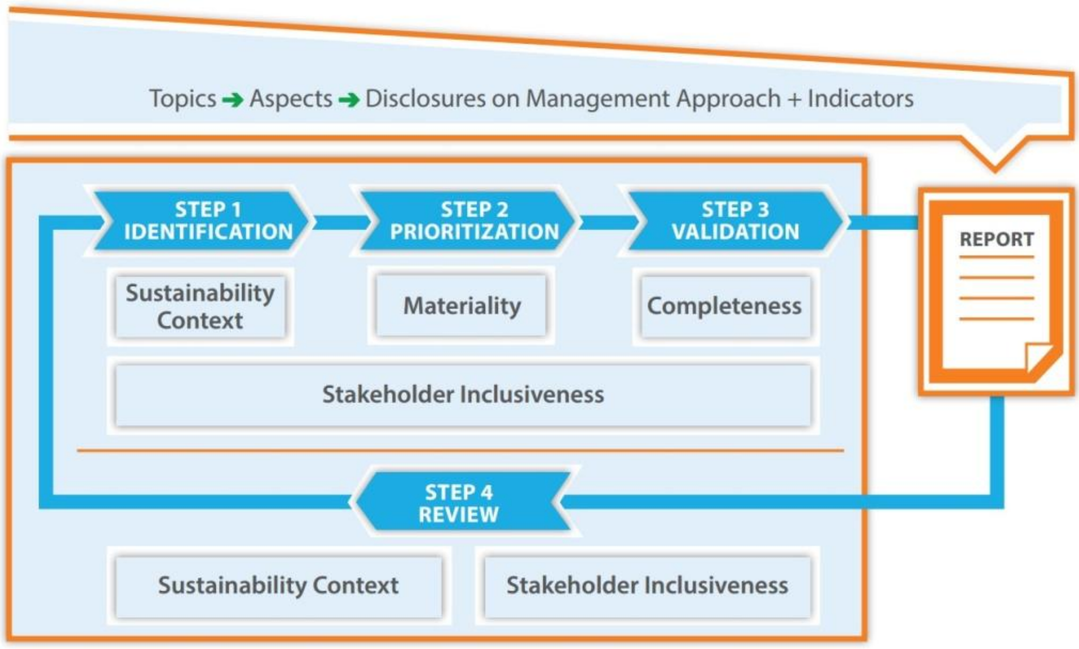
- ESG factors can affect the odds of a deal occurring;
- Poor ESG performance has a negative impact on the valuation and can often be used as leveraging point to negotiate lower prices;
- ESG factors play an increasing role in mergers & acquisitions (UNPRI and PwC 2012).

The launch of the GRI G3 guidelines in 2006 marked the inclusion of the "materiality principle" as part of the list of principles for defining report content. According to the materiality principle, the report should cover aspects that *"reflect the organization's significant economic, environmental and social impacts or that would substantively influence the assessments and decisions of stakeholders"*(GRI 2013a, 2013b).

The definition of materiality has remained the same throughout G3 and G4. However, with G4, materiality shifts from being an underlying principle of sustainability reporting to constituting the very backbone of the process. Thus, the entire framework was revised so as to incorporate *"what matters, where it matters"*(Arbex 2013). Furthermore, G4 brings consistent supplementary guidance on how to interpret and apply the materiality principle. By bringing materiality at the forefront of sustainability reporting, the GRI guidelines are striving to facilitate the delivery of more focused, meaningful reports, and to step away from the "tick-box" exercise that the G3 was becoming.

The materiality principle is closely interlinked with the other three content principles namely stakeholder inclusiveness, sustainability context and completeness. According to the G4 guidelines, the process for defining the report content and boundaries is a 4-step process, with the materiality principle mostly concentrated within the 2nd step:

Figure 6: defining material aspects and boundaries process overview



Source: GRI 2013b

The guidelines further introduce the concept of "threshold", which is defined as "*criteria that render an Aspect material*" (GRI 2013a, 2013b).

G4 emphasizes the importance of documenting the entire process of defining the report content and implicitly identifying material issues.

b) Value-chain approach

In line with its mission "to promote environmental, environmental and social sustainability", GRI has proceeded to expand the boundaries of reporting to the entire value chain of an organization. As per the G4 definition, the boundaries should reflect not only what is measurable and observable by an organization, but provide a map of all impacts, both upstream and downstream.

c) Application levels are phased out

The A, B, C (+) application levels are no longer part of G4. Instead, reporters can now choose between two levels of disclosure which are aimed at better exemplifying the breadth of reporting rather than the quality or the sustainability performance of an organization. Admittedly, the common, although mislead perception of the application levels was that they represented a hierarchy, and that an A level report was something all organizations should strive for. This led to what panellists at the GCSR called “a tick boxing exercise”, where organizations were struggling to report on as many indicators as possible, regardless of whether they were relevant or had a material impact.

The application levels are now replaced by two “in accordance” criteria, namely “core” and “comprehensive”. The two-tiered system has been adopted so as to grant more flexibility to reporters. Thus, the “core” level is deemed to be an achievable target for SMEs and other first-time reporters as organizations need only report on the general standard disclosure indicators and on one single indicator for each material aspect (GRI 2013a, 2013b).

d) Stronger focus on the “Disclosure on Management Approach” section

G4 also introduces revised guidelines for the Disclosure on Management Approach (DMA) section. The DMA consists of a description of how a company manages each identified material aspect or cluster of aspects (i.e. Energy and Emissions can be grouped). The DMA section plays a vital role in understanding a company’s sustainability strategy, by requiring reporters to disclose policies, commitments as well as goals and targets aimed at enhancing the sustainability dimension of the business activities. Likewise, the DMA should also feature transparent information with regard to the assignation of responsibilities, allocation of resources and specific actions undertaken to deliver sustainability within the organization’s value chain. The emphasis on DMA is primarily aimed at bringing sustainability matters into the board room, and thus, making sustainability part of the organization’s strategy and business model. DMA is also a mandatory requirement for reporting “in accordance” with the GRI guidelines (GRI 2013a, 2013b).

e) Supply chain disclosure

Supply chain issues have become more prominent within the G4 guidelines. Accordingly, G4 has introduced several new indicators such as the 3 new indicators for supplier assessment for labour practices and grievance mechanisms. The DMA section also provides extensive new guidance on how to report on supply chain issues (GRI 2013a, 2013b)

f) Compatibility with the proposed IIRC reporting framework and with other global sustainability reporting frameworks

Although a challenging endeavour, integrated reporting is often seen as the ultimate sustainability reporting achievement. G4 provides guidance which will help future reporters bridge the GRI based reports with the future[11] IIRC reporting framework. The G4 guidelines feature guidance on how to link GRI indicators to other common sustainability reporting frameworks such as the UN Global Compact Principles, the OECD Guidelines for Multinational Enterprises as well as the UN Guiding Principles on Business and Human Rights.

g) New content

The new content focuses mostly on widening the boundaries of the report to include the whole value chain, that is impacts that occur both upstream and downstream of the organization. There are also several new indicators which focus on supply chain issues, both in relation to labour standards and to environmental impacts such as scope 3 emissions. Similarly, G4 brings new content in the governance section, focusing mostly on ethics and integrity.

[11] The first version of the IIRC framework is to be published in December 2013.

4.4 How can the GRI G4 guidelines make sustainability reporting more useful to investors?

The G4 guidelines bring, to a large extent, answers for the investment community. Probably the most common objection regarding sustainability reports from the investment professionals is that sustainability reports are overburdened by irrelevant information. Therefore, most investors will seek the services of ESG data and research providers to collect and compile this information. However, the G4 aims, among other things, to deliver a reporting framework that will become increasingly useful to investors. This chapter will describe how the major changes within the G4 guidelines can impact the way investors use sustainability reports.

4.4.1 Make sustainability reporting more strategic and relevant

Companies may not have the knowledge, the tools or the willingness to identify material aspects for their business. In addition, the world of sustainability reporting still suffers from its early day's delusion when a large sustainability report often coincided with a good sustainability report.

The application levels introduced by the G3 framework are likely to have contributed to the over-proliferation of irrelevant ESG information because companies struggled to report on as many indicators as possible for the sake of obtaining the highest application level. By phasing out application levels and by underlying the importance of reporting only on material issues companies will be able to flesh out much of the irrelevant report content and focus on those impact that are identified as material for its business operations.

The value-chain approach is particularly important as the biggest impacts often occur outside the boundaries of an organization. For instance, Puma estimates that 57% of its environmental impact occurs within the first tier of its supply chain, where the raw materials are sourced (Zeitz 2013). As a result, investors will have a clearer view of where the biggest risks, as well as opportunities are located.

Both the literature and the interviewees who were familiar with the GRI G4 contents identified the focus on materiality as the biggest and most important change brought by the new guidelines. The materiality assessment is mandatory for obtaining both the “core” and “comprehensive” *in accordance* accolade. By emphasizing the need for material ESG information the G4 guidelines will provide a framework which will enable companies to identify and organize a hierarchy of its most important impacts. Thus, the companies will be better suited to deliver relevant information to investors.

The materiality assessment is likely to be challenging especially for smaller companies and for first-time reporters. However, once the material aspects are identified, the companies will be able to save time by selecting only indicators which reflect their choice of material aspects, as opposed to reporting on numerous irrelevant indicators.

Aside from emphasizing the need for material information in sustainability reports, G4 also brings improved guidance on how companies should undertake materiality assessments. The G4 implementation manual includes detailed description on how to identify and prioritize material impacts, occurring both within and outside the organization (GRI 2013b).

Publishing sustainability reports is in itself a useful exercise for any company because it engages different organizational levels and helps fine-tune structures and processes (Garz and Volk 2007). The materiality assessment, now mandatory under G4 will strengthen this process by engaging both the strategic and functional levels of an organization and by bringing more focus and clarity as to what is truly meaningful for the company’s stakeholders.

Steven Waygood of AVIVA Investors pointed out during the GCSR that what investors really want is not a list of key performance indicators but rather for the board of a company to get involved and identify what is material for that particular company, within a particular context and then present the results in a structured and coherent manner.

Within the G4 guidelines, the new DMA section will require companies to explain why a certain aspect is material, to explain how they manage each identified material aspect and also to evaluate the management approach by:

a) disclosing the evaluation methods;
b) presenting the results of the evaluation;
c) disclosing all adjustments made to the management approach based on the evaluation outcome (GRI 2013a).

For investors, the new DMA has the potential to provide 2 major benefits:

- Escalate sustainability matters to board-level
- Provide assurance that the company has done its sustainability due diligence and that it has management structures in place to minimize risk (Garcia-Manas 2013).

Engagement is a very popular RI strategy which requires a lot more ESG information that ESG integration. As an important tool in shareholder activism, engagement is used by shareholders to influence the way a company is run. Divesting is an extremely complicated and costly proceeding; therefore shareholders will try to engage with the company in an attempt to "correct" certain business practices.

Engagement specialists will often collect as much information as possible about the sustainability performance of a company before contacting the management. The more information regarding the company's management strategy, policies and programmes are available, the clearer the picture that the investor can make on the organization. The narrative provided by the DMA is very valuable to investors because it enables them to engage in a meaningful dialogue with the company.

4.4.2 Facilitate transition to integrated reporting

There is a common perception within the sustainability community that investors rarely read sustainability reports, mostly because of lack of quantitative information which can be easily embedded in their valuation tools. While responsible investors may take the time and allocate resources to extract meaningful information from sustainability reports, few mainstream investors do so.

Integrated reporting may be the tool to bridge the gap between sustainability and financial reporting, so that investors have access to reliable ESG information. Admittedly, integrated reporting must be supported by integrated thinking (Passant 2013), which enables companies to embed sustainability within their business strategy and translates "sustainability" information to "ESG" information, using a "language" which appeals to the financial community.

What is integrated reporting?

According to the IIRC[12] definition, *"an integrated report is a concise communication about how an organization's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term*." An integrated report is designed to picture a more strategic, complete and balanced image of a company's capital resources (financial, natural or human) as well as of its impacts (financial returns, products and services or externalities).[13]

[12] The IIRC is a global coalition co-founded by the GRI which includes representatives of governments, companies, investors and other bodies and aims to publish the first integrated reporting framework in December 2013

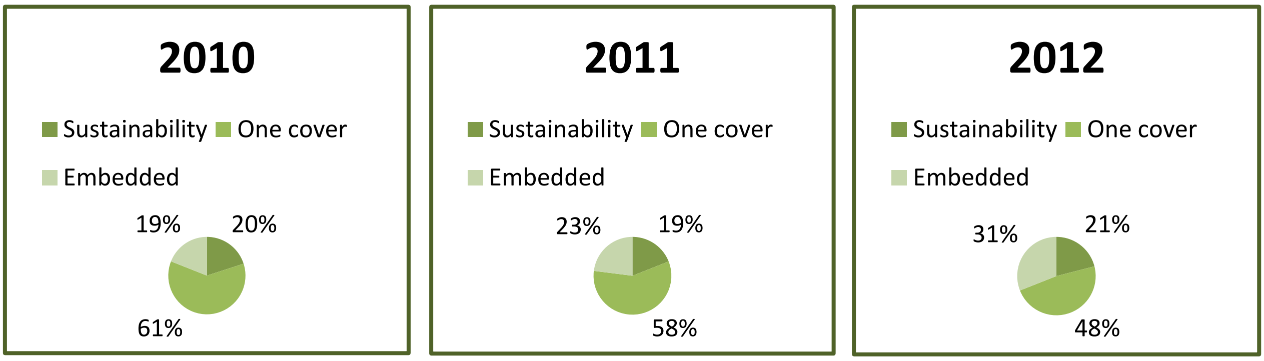
[13] http://www.guardian.co.uk/sustainable-business/sustainable-capitalism-responsible-investment-mainstream?CMP=twt_gu

Current situation

A study conducted by GRI on reports published between 2010 and 2012 which were self-identified as "integrated reports" shows, among others, that there is still a lack of consensus as to what exactly an integrated report entails. The 756 reports included in the study can be divided into three categories:

- Sustainability reports drafted according to the GRI guidelines but which provide no linkage with financial data (**sustainability structure**)
- Sustainability reports published together with a financial report but with no clear linkages between the two (**one cover structure**)
- Reports which show clear linkages between financial and non-financial information and performance (**embedded structure**)

Fig. 7: Integrated reports 2010-2012



Source: GRI 2013c

The number of embedded reports is clearly on the rise, from 19% in 2010 to 31% in 2012 indicating that companies are increasingly aware of the value of integrated reporting. Also, geographically, the number of integrated reports is significantly higher in countries where integrated reporting is mandated, such as through the listing requirements of the Johannesburg Stock Exchange in South Africa[14]. However, the large number of organizations that are still unaware of what an integrated report entails points out to the need for stronger guidance on

[14] http://www.jse.co.za/How-To-List/Listing-requirements.aspx

how to develop an integrated report and how to apply the guidance in different industry sectors so as to increase the **quality** and **comparability** of these reports (GRI 2013c).

How can G4 pave the way to integrated reporting?

While some investors are supportive of the GRI endeavours, others do not find it that relevant and are more interested in the development of integrated reporting frameworks. Some industry practitioners believe that GRI will develop to be more public or external stakeholders oriented, while investors' interest will be geared more towards integrated reporting (anonymous comm.). However, this depends very much on the investment strategy. For instance, when it comes to engagement, investors appreciate the extra sustainability information provided through sustainability reports, websites or other means and believe that while integrated reports are welcome, an organization should not limit its sustainability communications channels (Narina Mnatsakanian pers. comm.).

At the end of the day, this should not be seen as an "either or" problem, but rather as a continuous development process. Even if investors ultimately decide to step away from GRI reports and focus on integrated reports, G4 is an important step-stone in the process. Admittedly, one cannot talk about integrated reporting before reaching a certain level of excellence in sustainability reporting.

The G4 framework, more than any of the previous versions, is conducive to strategic thinking. Companies are compelled to engage all levels of an organization and most importantly the board and the executives and to include the sustainability risk assessment within the broader corporate risk assessment process.

The principles of which the IIRC framework is built are roughly the same as with G4 (Table 2). Both frameworks emphasize the need to engage with all stakeholders in order to identify most material issues while focusing on quality aspects such as clarity, conciseness, reliability, accuracy, comparability and timeliness. Similarly, both frameworks highlight the importance of strategic, long-term thinking, anchored in the sustainability context that the organization operates in.

The IIRC however adds an overarching principle, the "Connectivity of information" principle which refers to both the content and the format of the report. As per the IIRC framework consultation draft the "Connectivity of information" principle refers to connectivity between:

- **Content dimension**: connectivity between the organization's environmental, social and economic context, opportunities and risks, business model, resource allocation, etc.
- **Temporal dimension**: connectivity between the organization's past performance, present strategy and future projections

Table 2 GRI an IIRC principles comparison

IIRC Guiding Principles	G4 Principles for Defining Report Content and Quality
Strategic focus and future orientation	Sustainability context
Connectivity of information	NA
Stakeholder responsiveness	Stakeholder inclusiveness
Materiality and conciseness	Materiality, Clarity
Reliability and completeness	Completeness, Reliability, Accuracy
Consistency and comparability	Comparability, Timeliness

Strong overlap	Medium overlap	Weak overlap

4.5 Policy interactions

13 years after the first guidelines were launched, GRI has undoubtedly become one of the most important, if not *the* most important sustainability reporting standard. However, it is still a voluntary standard, therefore companies cannot be compelled to pursue sustainability reporting, nor can they be held legally accountable for inaccuracies when they do so, as it is the case with financial reporting.

What's then missing in order to attain GRI's vision for a sustainable global economy where ESG impacts are managed responsibly and reported transparently? What can drive sustainability reporting further than any voluntary standard can? The answer, as most of the speakers at the GCSR concluded, is **regulation**.

What are the benefits?

In 2012, Harvard Business School published a study which showed that companies operating in countries where sustainability reporting is mandated, performed better than their counterparts located in countries without such legislation in place. More specifically, the study concluded that the business leaders display greater awareness when it comes to sustainable development, companies abide by stricter ethical standards and employees benefit from better training opportunities. Other benefits of mandatory sustainability reporting as identified by this study also include better supervision of managers by the board of directors as well as improved managerial credibility within society (Ioannou and Serafeim 2012).

Global context

Governments throughout the world are becoming increasingly aware of the role that sustainability reporting can play in the transition to a sustainable economy. Sustainability reporting regulation is as diverse as the countries pursuing it: there are countries which already have a long record of such regulations, just as there are countries which are just beginning to grasp the need for it; some countries have enacted policies which mandate sustainability reporting following a "report or explain" approach, while others, especially among developing countries, are requiring sustainability information disclosure as part of stock exchange listing requirements (Bertazzi 2013).

The Rio+20 conference output document, "The Future We Want", features a paragraph which acknowledges the role of corporate sustainability reporting in meeting the global sustainable development agenda (UN 2012). Following the publication of "The Future We Want", several governments (Brazil, Denmark, France and South Africa) formed the so-called "Group of friends of paragraph 47", to emphasize their commitment to mandating sustainability reporting[15].

> *"We acknowledge the importance of corporate sustainability reporting and encourage companies, where appropriate, especially publicly listed and large companies, to consider integrating sustainability information into their reporting cycle."*
>
> The Future We Want – paragraph 47

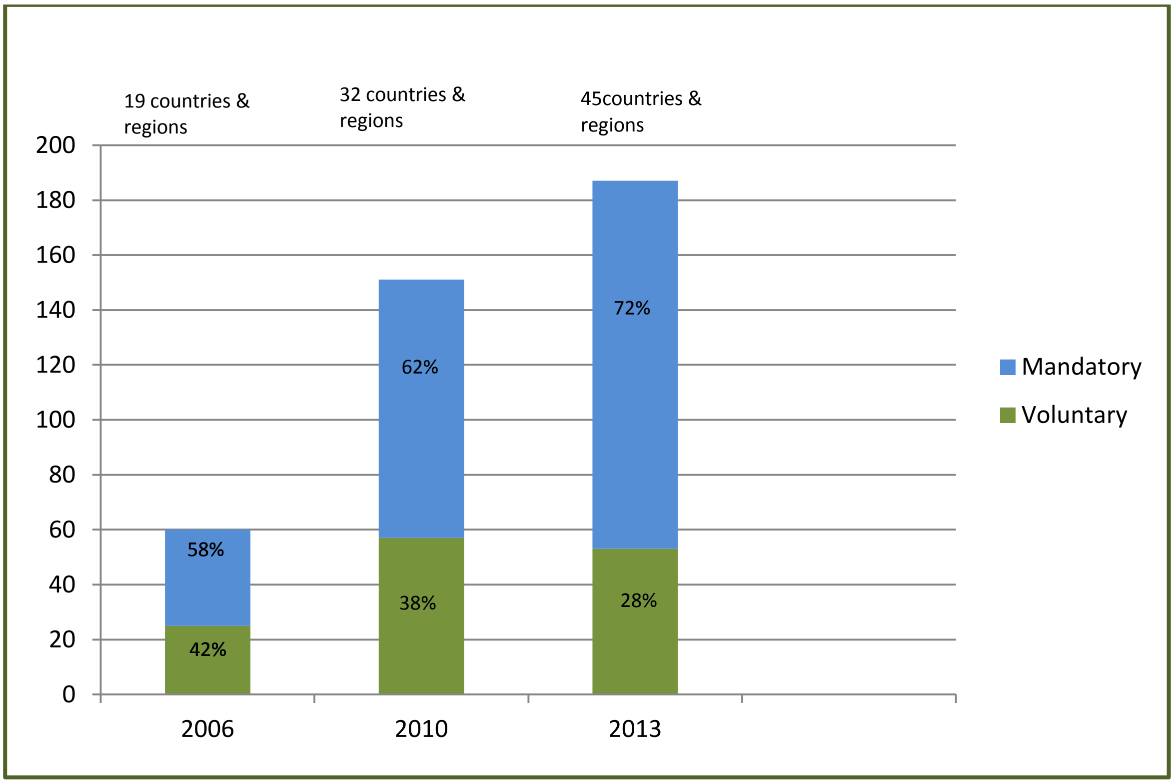
The Sustainable Stock Exchanges (SSE) Initiative is an UN[16] backed organization which includes several major stock exchanges which have committed "to promote long-term, sustainable investment in their markets", by enhancing corporate sustainability disclosure and performance (SSE Initiative 2013). By requiring companies to disclose certain ESG information as a prerequisite of listing, stock exchanges have a major potential to foster sustainable business practices on their markets. Similarly, by offering sustainability indices stock exchanges can create markets for specialized products such as clean tech.

[15] http://www.unep.org/resourceefficiency/Business/SustainableandResponsibleBusiness/Reporting/FriendsofParagraph47/tabid/105011/Default.aspx

[16] SSE Initiative was founded by the UN-supported Principles for Responsible Investment, the United Nations Conference on Trade and Development, the United Nations Environment Programme Finance Initiative, and the UN Global Compact

Regardless of the “recipe”, sustainability reporting regulation is on the rise, as the third “Carrots and Sticks” report points out. Published by a consortium comprised of GRI, UNEP, KPMG and the Centre for Corporate Governance in Africa, the report is an overview of the past years’ developments in sustainability reporting regulation worldwide.

Fig. 8: Trends in mandatory and voluntary sustainability reporting



		Carrots and Sticks Publications					
		2006		2010		2013	
Initiatives	Mandatory	35	58%	94	62%	134	72%
	Voluntary	25	42%	57	38%	53	28%
	Total	60		151		180	
Countries & regions		19		32		45	

Source: UNEP et al. 2012

To highlight the role of the corporate sector in overcoming the effects of the financial crisis and to emphasize the need to shift the business perspective from “short-termism” to a longer, more sustainable time horizon, Michel Barnier, European Commissioner for the Internal Market and Services said that *"[...]we need more responsible companies. Existing corporate governance principles should be more effectively implemented. Company boards should reflect gender, geographical, educational, professional and age diversity. Equally, companies should meet their obligations towards employees, consumers, local communities and public authorities. Most importantly, the way these commitments are met should be made* ***public and transparent****. That's why* ***non-financial reporting is such an important issue****"*.

In April 2013, the European Commission proposed an amendment to the existing accounting legislation which will require large companies (with more than 500 employees) to report on environmental and social matters which are material for their business sand stakeholders. More specifically, these companies will have to disclose, as part of their annual report, information on their strategy, policies and programmes aimed at tackling major environmental impacts such as climate change or water scarcity, as well as social and employee-related matters, human rights and business ethics (EC 2013). The text of the proposal further clarifies that companies will not have to publish lengthy reports, but rather focus on *"concise, solid, and useful information"*. Furthermore, companies can opt out from reporting on certain matters provided they issue an explanation, based on the "report or explain" principle (Barnier 2013). The "report or explain" approach has gathered significant support from industry practitioners because it allows for a great deal of flexibility which ultimately facilitates implementation at local levels. Companies will also have the freedom to use any reporting standard they may find suitable, such as the GRI, Global Compact, etc. Once implemented, the new legislation will lead to a tenfold increase in the number of companies disclosing ESG information, from 1,800 today to nearly 18,000 (Bertazzi 2013).

The "report or explain" principle is embedded in the G4 reporting framework: when undertaking the materiality analysis, companies are required to document the process and explain why any given aspect is deemed material or why is not. Thus, the G4 framework can constitute an adequate reporting framework for companies seeking to comply with the (future) reporting requirements.

5. Conclusions

5.1 Main findings

By shifting the focus of sustainability reporting on materiality and by laying the ground for integrated reporting the G4 guidelines have the capacity to move sustainable investment from the periphery of the investment world to mainstream.

This research clearly shows that organizations reporting according to the GRI G4 guidelines will need to step away from the "tick-box" exercise-type of reporting and embrace a holistic, strategic approach to communicating sustainability to its stakeholders. To achieve this, companies will need to engage in elaborate materiality assessments, escalate sustainability matters to board-level and strive to embrace integrated reporting.

The changes brought by the G4 guidelines have the potential to bring more investors in the sustainable investment arena by:

- Reducing the size of the reports and making them more approachable
- Prioritize quality over quantity in terms of number of indicators
- Structure information so that it is more easily quantifiable (where possible)
- Determine companies to undertake materiality analyses which can serve as a tool for stakeholder engagement
- Identifying material aspects which can pose risks across the value chain
- Identifying material aspects which can reveal opportunities across the value chain
- Determine companies to implement or further develop their policies and programmes so as to provide assurance that the company has structures in place to minimize risks
- Strengthen the cohesion of the organization by engaging multiple levels in the sustainability reporting process
- Facilitate the access of SMEs so as to increase the number of reporters

However, as we are already on the “street of last opportunity” as Mervyn King, the chairman of the GRI said, things cannot progress at the same speed as they have so far. Sustainability reporting needs to be **mandated** in order to reach its full potential. A flexible approach to regulation, such as the “report or explain” one, will motivate companies to start reporting without overburdening them. Mandating sustainability reporting will bring two major benefits for investors: first it will increase the number of reporters and thus allow access to a wider range of ESG information, and second it will increase the quality of the information as companies may become legally accountable for misstatements.

5.2 Future research

As stated in the beginning, the present thesis is probably among the first attempts to research how the G4 guidelines can contribute to improving ESG disclosure. This opens several opportunities for future research.

Once the G4 guidelines become more widespread among reporters it can be interesting to deepen the research by focusing on a certain industry sector, geographical area or type of investment. Another possible area for future research can be to investigate whether and how investors’ perception on sustainability reporting has changed following the adoption of the G4 guidelines. Further, after the G4 becomes mandatory for GRI reporters, new research can be undertaken to establish whether G4 does indeed improve the quality of ESG data.

6. References

Arbex, N. G4 Launch. *Global Conference on Sustainability and Reporting*. Amsterdam, 22 May 2013

Barnier, M. G4 Launch. *Global Conference on Sustainability and Reporting*. Amsterdam, 22 May 2013

Bertazzi, P. Sustainability reporting regulation today and tomorrow. *Global Conference on Sustainability and Reporting*. Amsterdam, 24 May 2013

BSR. 2009. *ESG In the mainstream: The role of companies and investors in environmental, social and governance integration*. URL: http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/reporting-disclosure/swedish-presidency/files/surveys_and_reports/esg_in_the_mainstream_en.pdf [consulted on 4 July 2013]

Caroll, A. B. 2008. A history of corporate social responsibility concepts and practices. In *The Oxford handbook of corporate social responsibility*, ed. A. Crane, A. McWilliams, D. Matten, J. Moon and D. S. Seigel, 19-46. New York: Oxford University Press Inc.

Cohen, E. 2012. *False claims in sustainability reports.* URL:http://sustainablebusinessforum.com/elainecohen1/71661/false-claims-sustainability-reports?goback=.gde_112720_member_186963412 [consulted on 15 June 2013]

Diplock., J. Bloomberg Businessweek Media-led debate – Drivers of change for a sustainable economy. *Global Conference on Sustainability and Reporting*. Amsterdam, 24 May 2013

The Canadian Institute of Chartered Accountants (CICA). 2010. *Environmental, Social and Governance (ESG) issues in institutional Investor Decision Making*. URL: http://www.cica.ca/publications/list-of-publications/manual/item41881.pdf [consulted on 4 July 2013]

European Commission (EC). 2013. *Directive to amend the Accounting Directives (Fourth and Seventh Accounting Directives on Annual and Consolidated Accounts, 78/660/EEC and 83/349/EEC. 16 April 2013*. URL: http://ec.europa.eu/internal_market/accounting/non-financial_reporting/

European Sustainable Investment Forum (EuroSIF). 2009. *EC 2nd workshop on Disclosure of ESG Information, the investor perspective: Overview of current practices and trend. URL*: http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/reporting-disclosure/swedish-presidency/files/workshop_2/christensen_-_eurosif_en.pdf [consulted 5 July 2013]

Favaretto, S. Financial markets: Closing the gap – Integrating ESG into investors' decision-making. *Global Conference on Sustainability and Reporting*. Amsterdam, 23 May 2013

Freeman R.E. 1984. *Stakeholder management: A strategic approach*. Marchfield, MA: Pitman Publishing

Friedman, M. 1970. The social responsibility of business is to increase its profits. *New York Times Magazine*, 13 September: 32-3, 122,126

Garcia-Manas, C. Disclosure on management approach. *Global Conference on Sustainability and Reporting. Amsterdam*, 23 May 2013

________and Friedman, R. 1962. *Capitalism and freedom*. Chicago: University of Chicago Press

Garz, H. and Volk, C., 2007. What really counts: The materiality of extra-financial factors. *WestLB Research*, February.

Glifford, J. Financial markets: Closing the gap – Integrating ESG into investors' decision-making. *Global Conference on Sustainability and Reporting.* Amsterdam, 23 May 2013

Global Reporting Initiative (GRI). 2007. *Due Process for the GRI Reporting Framework*. URL: https://www.globalreporting.org/resourcelibrary/Due-Process-for-the-GRI-Reporting-Framework.pdf [consulted on 12 June 2013]

________.2012a. *G4 Development - First Public Comment Period, 26 August – 24 November 2011. Full Survey Report*. URL: https://www.globalreporting.org/resourcelibrary/G4-PCP1-Full-Report.pdf [consulted on 12 June 2013]

________. 2012b. Exposure *draft: GRI Second G4 Public Comment Period. Overview* URL: https://www.globalreporting.org/resourcelibrary/G4-Exposure-Draft.pdf [consulted on 12 June 2013]

________.2013a. *G4 Sustainability reporting guidelines: Reporting principles and standard disclosures.* URL: https://www.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf[consulted on 18 June 2013]

________.2013b. *G4 Sustainability reporting guidelines: Implementation manual*. URL: https://www.globalreporting.org/resourcelibrary/GRIG4-Part2-Implementation-Manual.pdf [consulted on 18 June 2013]

________.2013c. *The sustainability content of integrated reports – a survey of pioneers*. URL: https://www.globalreporting.org/resourcelibrary/GRI-IR.pdfs [consulted on 20 July 2013]

________. 2013d. *Corporate website*. URL: https://www.globalreporting.org/ [consulted 20 July 2013]

Ioannou, I. and Serafeim, G. 2012. The Consequences of Mandatory Corporate Sustainability Reporting. *Harvard Business School Research*

Jensen, M. 2000. Value maximization, stakeholder theory and the corporate objective function. In *Breaking the code of change*, ed. M. Beer and N. Nohria. Boston: Harvard Business School Press.

Kiernan, M. J. 2009. *Investing in a sustainable world : why GREEN is the new color of money on Wall Street*. New York : AMACOM

King, M. G4 Launch. Global Conference on Sustainability and Reporting. Amsterdam, 22 May 2013

Koehler, D. A. and Hespenheide, E. 2012a. *Disclosure of long-term business value. What matters?* Deloitte Development LLC. URL: http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/us_scc_materialitypov_032812.pdf [consulted on 20 June 2013]

________2012b. Drivers of long-term business value. Stakeholders, stats and strategy. Deloitte Development LLC. URL: http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/IMOs/Corporate%20Responsibility%20and%20Sustainability/us_scc_Drivers%20of%20Long_Term%20Value_061312.pdf [consulted on 20 June 2013]

Laufer, W. 2003. Social accountability and corporate greenwashing. In *Journal of Business Esthics* 43: 253-261

Lewis-Beck, M. S., Bryman, A., and Liao, T. F. 2004. *The Sage encyclopedia of social science research methods* (3 vols.). Thousand Oaks, CA: Sage.

Louche, C. and Lydenberg, S. 2011. *Dilemmas in Responsible Investment*. Sheffield: Greenleaf Publishing.

Melé, D. 2008. Corporate social responsibility theories. In *The Oxford handbook of corporate social responsibility*, ed. A. Crane, A. McWilliams, D. Matten, J. Moon and D. S. Seigel, 47-82. New York: Oxford University Press Inc.

Murphy, P.E. 1978. An evolution: Corporate social responsiveness. In *University of Michigan Business review*. Nov.

Norges Bank Investment Management (NBIM) website. 2013. URL: http://www.nbim.no/en/ [consulted on 23 July 2013]

Norway Ministry of Finance (NMF). 2013. *Government Pension fund Global Responsible Investment.* URL: http://www.regjeringen.no/upload/FIN/brosjyre/2010/spu/english_2010/index.htm [consluted on 23 July 2013]

Owen, D. L. and O'Dwyer B. 2008. Corporate social responsibility: The reporting and assurance dimension. In *The Oxford handbook of corporate social responsibility*, ed. A. Crane, A. McWilliams, D. Matten, J. Moon and D. S. Seigel, 384-409. New York: Oxford University Press Inc.

Passant, F. Sustainability reporting and integrated reporting. *Global Conference on Sustainability and Reporting*. Amsterdam, 23 May 2013

Radley Yeldar. 2011. *The value of extra-financial disclosure. What investors and analysts said.* Report commissioned by Accounting for Sustainability (A4S) and Global Reporting Initiative. URL: http://www.accountingforsustainability.org/wp-content/uploads/2012/07/What-investors-and-analysts-said-The-value-of-extra-financial-disclosure.pdf

Responsible Investor. 2008. *Integrating ESG into mainstream investment portfolios*. URL: http://www.responsible-investor.com/images/uploads/reports/IntegratingESG.pdf [consulted on 4 July 2013]

Ritchie, J. and Lewis, J. 2003. *Qualitative research practice*. London: Sage Publications

Seitchik, A. 2007. *Climate Change from the Investor's Perspective*. URL: http://www.civilsocietyinstitute.org/reports/GEGWS-SeitchikChapter.pdf

Strauss, A. and Corbin, J. 1998. *Basics of qualitative research*. Thousand Oaks: Sage Publications

Sustainable Stock Exchanges (SSE) Initiative website. 2013. URL: http://www.sseinitiative.org/ [consulted on 22 July 2012]

Transparency International (TI). 2012. *Sustainability reporting of major German companies: A study of compliance with the GRI guidelines in the area of anti-corruption*. URL: http://www.transparency.de/fileadmin/pdfs/Themen/Wirtschaft/Sustainability_Reporting_of_Major_German_Companies_12-11-28.pdf [consulted on 17 June 2013]

United Nations (UN). 2012. The future we want. *Conference on sustainable development*. Rio De Janeiro, 20-22 June 2012

United Nations Environmental Programme Finance Initiative (UNEPFI). 2004. *The materiality of social, environmental and corporate governance issues to equity pricing*. URL: http://www.unepfi.org/fileadmin/documents/amwg_materiality_equity_pricing_report_2004.pdf

________. 2009. *Fiduciary responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment.* URL: http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf [consulted on 12 June 2013]

________. 2011. *Universal ownership: Why environmental externalities matter to institutional investors.* URL: http://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf

United Nations Environment Programme (UNEP), Global Reporting Initiative (GRI), Centre for Corporate Governance in Africa and KPMG. 2013. *Carrots and sticks.*

Sustainability reporting policies worldwide – today's best practices, tomorrow's trends. URL: https://www.globalreporting.org/resourcelibrary/Carrots-and-Sticks.pdf

United Nations Principles for Responsible Investment (UNPRI) and PricewaterhouseCoopers (PwC). 2012. *The integration of environmental social and governance issues in mergers and acquisitions transactions: Trade buyers survey results*. URL: http://www.pwc.com/en_GX/gx/sustainability/publications/assets/pwc-the-integration-of-environmental-social-and-governance-issues-in-mergers-and-acquisitions-transactions.pdf [consulted 24 July 2012]

Van Wensen, K., Broer, W., Klein, J., and Knopf, J. 2011. *The state of play in sustainability reporting in the European Union*. URL: http://ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=1013 [consulted on 11 July 2013]

Waygood, S. Financial markets: Closing the gap – Integrating ESG into investors' decision-making. *Global Conference on Sustainability and Reporting*. Amsterdam, 23 May 2013

Wheeler, D., Colbert, B. and Freeman R.E. 2003. Focusing on value: Reconciling corporate social responsibility, sustainability and stakeholder approach in a network world. In *Journal of General Management*, 28(3): 1-28

World Commission on Environment and Development (WCED). 1987. *Our common future*. Oxford and New York: Oxford University Press

Zeitz, J. Valuation of sustainability. *Global Conference on Sustainability and Reporting*. Amsterdam, 24 May 2013

Personal communications

Esdon, Denise. Partner with Ernst & Young LLP, member of the Board of Directors of Global Reporting Initiative and Chair of its Technical Advisory Committee, personal interview, Amsterdam, 23 May 2013

White, Allen. Vice President and Senior Fellow at Tellus Institute, co-founder and former CEO at GRI, personal interview, Amsterdam, 24 May 2013

Morrison, Kathryn. Associate Analyst and GRI certified trainer, Janzi-Sustainalytics, skype interview, 6 June 2013

Forgach, John. Chair of the Board of ForestRE Holdings Limited and International Institute for Sustainable Development (IISD) board member, skype interview 3 July 2013

Georgiev, Radoslav. Associate Analyst and GRI certified trainer, Sustainalytics, skype interview, 5 July 2013

Mnatsakanian, Narina. Senior Adviser Responsible Investment and Governance, MN, skype interview 24 July 2013

E-mail communications:

1. Representative of major investors' organizations who preferred to remain anonymous.