The arrival of mandatory corporate sustainability reporting

September 25 2023, by Steve Cohen

Credit: Pixabay/CC0 Public Domain

To paraphrase the management icon Peter Drucker, you can't manage something unless you measure it. Without measurement, you can't tell if management's actions are making things better or worse. The importance and seriousness of sustainability management requires the development of generally accepted sustainability metrics.

Just as financial accounting requires agreement on terms and reporting requirements to facilitate independent auditing, sustainability requires the same level of precision. Publicly traded and owned corporations are under pressure from investors to report environmental risks, and more and more companies are disclosing environmental and social governance (ESG) measures.

A recent Wall Street Journal survey of corporate sustainability officers indicates that while more companies are disclosing sustainability metrics, there is confusion about the measures and a demand for uniform reporting requirements. According to Journal reporter David Breg, "Public companies in the U.S. are increasingly disclosing sustainability information, but many say they find it a challenge to report fundamental climate data that many regulators around the globe likely will require under incoming mandatory reporting standards."

"Nearly two-thirds of respondents said their company was disclosing environmental, social and governance information, up from 56% in the prior year, according to the annual survey of sustainability officials that WSJ Pro conducted this spring."

The reporting challenge is due to imprecise measures and a lack of experience collecting and reporting these data. That challenge will be met by sustainability professionals trained in measuring greenhouse gases and conducting life cycle analyzes. In Columbia's MS in Sustainability Management program, we offer courses in each of those areas, and before long, hundreds of our graduates will be helping corporations meet their reporting requirements.

The U.S. Securities and Exchange Commission has been revising its proposed sustainability reporting requirements in response to a deluge of comments and has delayed issuing those requirements, once expected last spring. The political calendar of a national election next year creates extreme pressure to issue those standards this fall, and currently, they are expected in October.

There will certainly be legal challenges to whatever rule is issued, but to the extent that the rules connect environmental risk to financial risk, they are well within the SEC's enabling legislation. Additionally, the SEC is not the only body working on uniform sustainability metrics. Again, according to Breg:

"Regulators around the globe are finalizing rules that would require companies to publish standardized information after years of patchy voluntary ESG reporting based on a host of frameworks. California's governor has said he would soon sign that state's requirements into law. The U.S. Securities and Exchange Commission's rules are expected later this year. European regulations are already in place and many other countries are also working on standards. The International Sustainability Standards Board hopes its climate framework, completed this past summer, becomes the global baseline."

Assuming the SEC rules survive the ideological onslaught they will face, it is likely, just as with financial accounting, that an American rule would be highly influential and, over time, would become a global standard. If the extreme element of America's right wing dominates the debate over disclosure and overturns the rules in the conservative Supreme Court, U.S. corporations operating globally would be subject to foreign or global reporting requirements that they would have little hope of influencing.

The realpolitik of sustainability reporting requirements may convince American corporations to focus their attention on influencing rather than overturning reporting requirements. The ideological and dysfunctional side of American national politics will certainly result in court challenges to the SEC rule, but the seriousness of the effort and its impact is unknowable.

The initial SEC rule is more limited than many of the other frameworks under development and focuses narrowly on carbon disclosure. My guess is that carbon emissions from a company's supply chain will be omitted or optional in the final disclosure rule. My view is that this initial rule is a foot in the door and, like financial accounting, will evolve over time.

A growing number of publicly traded companies and even many privately owned companies are disclosing sustainability metrics. The ideologues labeling this as "woke" management fail to understand the degree to which these measures are indicators of effective and sophisticated management. ESG measures do not drive out financial indicators, they are, in fact, correlated with financial success. The principal concerns of a private firm do not change under sustainability management.

They remain profit, market share, and return on equity. But modern organizations recognize that they are operating on a more crowded, interconnected, and warming planet. These facts of organizational environments require that they manage their environmental, social, and community impacts as a part of routine organizational life.

In addition, modern organizations compete for talent, and that means that workers have influence over management behavior. Young employees care about a company's ESG performance. The post-pandemic push for hybrid work arrangements is ample evidence that top-down management is no longer possible, and organizations must respond to employee preferences.

Corporations operate in a regulated environment. That is why they have in-house counsel and engage outside law firms on a regular basis. When employees are fired or laid-off it is not unusual for them to sue their ex-employer. An American corporation operating nationally must understand state law and even local ordinances to successfully function. Companies operating globally must understand the rules of other nations.

Over 10,000 non-European companies are subject to the European Union's new ESG reporting requirements. About a third—or over 3,000—are U.S. corporations. This regulatory environment is normal and expected and fully integrated into decision-making in modern corporations. The free market is a relative and not absolute concept. There has never been and will never be a totally free market since that is akin to anarchy.

An indicator of a successful company is its ability to navigate its regulatory environment while achieving its financial goals. The widespread and growing voluntary disclosure of sustainability metrics is happening in anticipation of government regulation but also in response to investor, customer, and employee demands.

But the problem with voluntary disclosure is that the measures they use do not enable investors to compare one company's environmental risk to another, and the disclosures are not audited. Even worse, some of the NGOs that help companies measure and report sustainability are paid by the companies they report on, so these ESG reports might be fiction, and we'd never know. Uniform disclosure metrics are urgently needed.

Only the SEC, with its gatekeeper function to the public capital marketplace, has the power to develop and impose standard reporting and audit requirements.

The move to decarbonize our economy will continue to be quietly and, at times, visibly opposed by fossil fuel interests. But they are increasingly unable to counter the facts of our warming planet. They will persist and, as Mike Bloomberg's recent initiative recognizes, will shift their emphasis from burning fossil fuels for energy to utilizing them for plastics and other petrochemicals. Bloomberg is spending $85 million to block chemical plant siting as part of his effort to reduce global warming.

If petrochemical plants were required to measure and report on their air pollutants, they might well be motivated to learn how to reduce those emissions while producing what they are selling. It's easy to see why they might oppose reporting requirements, but if the alternative is to fight siting wars with local community groups, it might be in their financial interest to measure, report, and reduce emissions.

Sustainability metrics and indeed sustainability management have finally arrived. For those of us who have been working for well over a decade to develop these practices and this profession, this is welcome but not a surprise. The climate crisis modeled and predicted in the final decade of the twentieth century is now with us.

The biodiversity loss feared has also arrived. I continue to believe that we can develop a productive and growing economy without destroying our home planet. It takes brainpower, ingenuity, and technology, but most of all, our attention and concern. Carbon disclosure is a critical step in carbon management. Standardized sustainability metrics are a crucial step in realizing the vision of sustainability management.

This story is republished courtesy of Earth Institute, Columbia University http://blogs.ei.columbia.edu.

Provided by Earth Institute at Columbia University