When it comes to sustainability reporting, it depends on how serious companies are about making change

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Companies are facing pressure to become more open about how they do business. With income inequality, governance failures and the mismanagement of natural resource capital threatening both society and the environment, there are growing calls for more corporate disclosure and accountability.

Many firms now report how they are doing along economic, environmental and social lines in what is called a sustainability report. These reports give stakeholders, such as investors, customers and regulators, a comprehensive view of how businesses create value over time.

Companies may share indicators such as greenhouse gas emissions, board member composition and water usage. Benchmarks differ depending on a company's industry and location.

Recent events, such as the campaign to block Shein's proposed IPO in London due to social concerns, data breaches at Evolve Bank and the ongoing contamination of waterways, all illustrate the importance of managing the risks shown in these reports.

Some see sustainability reporting as helpful in running their business and managing key relationships outside the company. That said, not everyone is convinced they are useful. Only 24% of top executives surveyed by Ernst & Young understand how sustainability reporting will add value to their firm.

Regulated reporting

Many companies are required to produce sustainability reports. For example, the Government of Canada requires reporting of greenhouse gas emissions under the Greenhouse Gas Reporting Program.

Similarly, the Securities and Exchange Commission in the United States and the state of California have both passed greenhouse gas emissions reporting requirements.

In the European Union, comprehensive reporting on many aspects of sustainability is mandated. Canadian companies may also be affected by these regulations if they do business in European countries.

While the scope of sustainability reporting requirements is growing around the world, some companies choose to report voluntarily, using frameworks and standards set by international organizations.

Improving operations

Considerable resources have been invested by governments, standard setters and the business community to support credible sustainability reporting. Whether or not it causes business practices to become more environmentally friendly and socially conscious remains a matter of debate.

Some experts suggest including non-financial sustainability data in external reports improves corporate transparency that, in turn, increases accountability. This can help firms make progress toward the United Nations Sustainable Development Goals while supporting their profit-making activities.

For example, by reducing greenhouse gas emissions, companies are likely to produce less waste, use raw materials more efficiently and lower operating costs.

But if companies release sustainability reports just to meet the needs of external stakeholders, including regulators, it's unlikely to motivate internal changes to business operations. Through this lens, reporting may be seen as a box-checking activity.

If companies use the reporting process to determine what needs improvement internally and compare themselves to their peers, then sustainability performance is more likely to improve.

Emmanuel Faber, Chair of the International Sustainability Standards Board, wrote in 2023:

"Just as an accounting standard cannot get a company to increase its profit by 10%, a sustainability disclosure standard … cannot get it to reduce its emissions by 10%."

Faber remarks that there must be political will for business practices to change. The recent decision by United Kingdom-based energy company BP to slow down renewable energy investments in favor of oil and gas assets illustrates the uncertainty about whether many companies have this political will.

The state of play

There's a saying in business: "what gets measured, gets managed." The idea is that by collecting, analyzing and reporting sustainability information relevant to their business, companies will naturally improve their sustainability performance.

But even if this is so, will these better management practices support real improvements for society? There is still a lot to explore in this field of scholarship.

So, where does this leave us? If you are an investor, it's likely good news for you. More information can help you make better investment decisions by bringing to light risks and opportunities companies are facing.

From a capital markets perspective, it is difficult for investors to shift financial resources to more sustainable firms without the information sustainability reporting provides.

On the other hand, concerns about the trustworthiness of corporate reporting could hinder efforts to direct funds toward addressing social issues. Lululemon is currently under investigation by Canada's Competition Bureau following complaints about greenwashing.

Amendments were recently made to Canada's Competition Act to crack down on corporate greenwashing. Some companies, like Cenovus Energy, believe the changes may disrupt their ability to report environmental initiatives because of uncertainty surrounding what is now allowed.

If you are a public policymaker, seeing a firm's overall performance beyond its financial data can add valuable insights to regulatory debates. But whether sustainability reporting is likely to make a meaningful change largely depends on how serious a company is about making changes.

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