Governance Beyond Governments? The Regulation of Corporate Non-Financial Reporting

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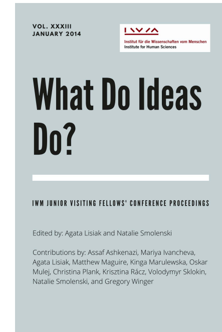

Abstract: This paper uses the case of corporate non-financial reporting to examine the relationship between private business regulation—that is, regulation by non-state actors—and public policy. Looking at developments in Europe in particular, I examine the role of organizations like the Global Reporting Initiative (GRI), the Carbon Disclosure Project (CDP), and the United Nations Global Compact (GC) in laying the groundwork for mandatory corporate non-financial reporting legislation at both the national and EU level. I argue that these (and other) organizations have commanded much of the agenda-setting and rule-making processes, resulting in new global norms with widespread legitimacy and influence. In turn, I find that public policy builds on the strengths of private regulation while simultaneously addressing its weaknesses, namely problems of implementation and enforcement. The result is a growing coalescence of support behind newly established rules and frameworks that is likely to influence the behavior of companies, governments, and other organizations far beyond the confines of Europe.

Introduction

More than 2,500 of the European Union's largest companies now disclose information related to social and environmental performance on a regular basis—up from nearly zero in the early 1990s (European Commission, *Proposal* 4) . Though critics of so-called corporate *non-financial* reporting often claim that these disclosures amount to little more than public relations 'greenwash', others argue that transparency of this kind has improved significantly over the past decade, helping companies to better understand their own impact on society and the environment and improving their long-term financial (as well as non-financial) performance. Whatever the final judgment is—and it is likely far too soon to know—the upward trend in reporting shows no sign of stopping. For while corporate non-financial reporting began largely as a voluntary enterprise—something companies did either on their own or under the guidance of private regulatory organizations like the Global Reporting Initiative (GRI), the Carbon Disclosure Project (CDP), and the United Nations Global Compact (GC)—it has now caught the eye of policymakers, most recently in Brussels, who look to extend this practice to more companies through mandatory reporting legislation. This paper uses the case of corporate non-financial reporting to examine the relationship between private business regulation—that is, regulation by non-state actors—and public policy.

Recent work in political science has called attention to the increased role of private actors at various stages of the regulatory process, including agenda-setting, rule-making, and implementation (see Büthe and Mattli; Vogel, "Private Global") . To some, the delegation of regulatory authority by government to the private sector, whether done implicitly or

explicitly, is emblematic of the declining power of the state and the further entrenchment of 'neoliberal' ideas (see Kinderman) . Others argue that private regulation 'crowds out' support for formal rules, allowing companies to ward off costly government regulation (see Werner) . Contrary to these views, the case of corporate non-financial reporting illustrates how private actors can use voluntary standards and frameworks, not to replace government, but to drag it into policy areas that have been neglected or ignored. At the same time, while private regulation has the potential to 'bring the state back in', so to speak, it also provides business interests with new opportunities to influence the development of public policy.

Although corporate non-financial reporting is already commonplace among the world's largest corporations—93 percent of the world's largest 250 companies currently report—the vast majority of companies still do not report at all (KPMG 22) . In Europe, the 2,500 companies that are currently reporting make up only about 6 percent of the approximately 42,000 large companies currently in operation. Thus, while corporate non-financial reporting has come a long way in a relatively short period of time, it still has a long way to go, especially when compared with financial reporting. Preliminary results from my research identify this as a key dynamic linking private regulation to public policy. Private regulatory organizations have created powerful incentives for companies to improve their disclosure practices above and beyond existing legal requirements. In the process, they have also established rules and frameworks with widespread legitimacy and influence in the corporate sphere, placing non-financial reporting high on the agenda of many large, high-profile companies. At the same time, they have run up against problems that state regulators are in a unique position to solve, namely problems of implementation (i.e., getting companies to report according to a common standard) and enforcement (i.e., getting more companies to report by penalizing those that do not). Although policymakers today typically refrain from imposing additional regulations on business, it appears that the work done by private regulatory organizations has provided sufficient political cover for them to intervene in this case.

From Private Regulation to Public Policy

A number of scholars have expressed concern about what they view as the dismantling of the state through deregulation, privatization, and the implementation of other neoliberal policies that began in the 1980s and continue through to the present (see Schmidt and Thatcher) . This 'hollowing out' of the state and the resulting erosion of institutionalized forms of social solidarity in Europe (and elsewhere) has also been linked to the rise of so-called 'corporate social responsibility' (CSR) as well as general anxiety about the influence and impact of large multinational corporations on social and environmental wellbeing. John Braithwaite takes a slightly different view of these developments, calling attention to recent shifts in state-society relations:

Those who believe we are in an era of neoliberalism—where this means hollowing out of the state, privatization and deregulation—are mistaken. The transitions since feudal structures of governance fell to incipient capitalist institutions have been from a police economy, to an unregulable nineteenth-century liberal economy (that oscillated between

laissez-faire, dismantling the decentralized police economy and laying the bricks and mortar of an initially week urban administrative state), to the provider state economy, to regulatory capitalism. (26-27)

Whereas the state was once looked upon to provide social services (i.e., the welfare state) and to manage industries critical to national interests, these roles have since been contracted out, to varying degrees, to private firms. While this may be a cause for concern —for example, in regard to the quality and availability of services provided by private firms—it does not mean that the state no longer plays an important role in the economy or in society. Rather, by some accounts, the transition from public to private provision merely shifted the role of the state from that of a provider to that of a regulator (see Moran) . This new 'regulatory state' aimed to control business not through direct ownership but through the administration of new regulatory regimes enforced by government agencies. That business interests often resisted such changes suggests that the state does, or can, wield significant power in its authority as a regulator (see Bardach and Kagan; Smith; Vogel, "Why Businessmen") . Still, many observers remain skeptical of the state's ability to control business through regulation. Some argue that elected officials rely on private firms (to provide jobs, to build new facilities, etc.) to such a great extent that they simply cannot oppose them (see Lindblom) . Others point to government bureaucrats, who can become 'captured' by the industries they are tasked with regulating (see Carpenter and Moss) .

Adding to the alarm of some critics, regulation by non-state actors has also been on the rise during this period. This delegation of regulatory authority to the private sector is often viewed as a continuation of neoliberal policy reforms, i.e., the outsourcing of regulation itself (see O'Rourke) . Although this label may apply in some circumstances, other perspectives on private regulation fall outside the scope of a neoliberal critique. For instance, Tim Büthe emphasizes a sharing of regulatory authority between state and non-state actors that is not necessarily combative:

Private regulation may be defined narrowly as rule-making by non-governmental actors. Private regulation in a broad sense entails private actors playing a major role—at one or more stages beyond implementation or compliance—in what might be called the 'regulatory process' or the 'governance sequence': agenda-setting, rule-making, implementation, monitoring, adjudication, and enforcement. (1)

This perspective is also reflected in David Levi-Faur's concept of 'regulatory capitalism', which describes the shift toward to regulation as part of a new political, social, and economic order in which both public and private actors play a role (15) . A prominent example is global or transnational regulation, such as in the case of financial accounting (see Büthe and Mattli) , in which no single state has the authority to act. Here, the decision to delegate authority to a single private sector (or transgovernmental) regulatory body is largely unavoidable. Another example, analyzed in this paper, is private regulation in policy domains where the state is largely absent. In these cases, institutional entrepreneurs use market-based private regulation to incentivize companies to self-

regulate in areas not yet covered by state regulation. Lacking coercive power, private regulators often appeal to firms' financial interests, offering excludable reputational benefits in exchange for self-regulation (see Prakash and Potoski) .

Despite recent advances by Levi-Faur (2005), Büthe (2010), and others, the relationship between private regulation and public policy remains undertheorized. Much of the existing literature remains divided between those who view private regulation as an institutional mirror reflecting good governance (see Campbell; Gjolberg) and those who see it as an institutional substitute filling governance deficits (see Jackson and Apostolakou; Matten and Moon) . However, neither of these positions provide a clear indication of what effect the rise of private regulation may have on future public policy. While it is important to understand why private regulation exists—that is, what causal factors explain the recent rise in private regulation—I argue that to gauge private regulation's impact on public policy we also need to examine its strengths and weaknesses. Contrary to those who view private regulation as a potential replacement for state regulation, I find in the case of corporate non-financial reporting that private regulators face significant obstacles, especially in implementation and enforcement. Although private regulators in this case have succeeded in establishing new rules and frameworks with widespread legitimacy and influence, they appear to have started a regulatory process that they are unable to finish without the help of the state.

The Case of Corporate Non-Financial Reporting

Over the past decade, demand for information related to corporate environmental, social, and governance (ESG) performance has increased dramatically across a wide range of stakeholders, including investors, consumers, business partners, employees, communities and governments (see Moon et al.) . From the stakeholder's point of view, corporate non-financial reporting provides valuable information needed to integrate social and environmental preferences into various decision-making processes—e.g., deciding which firms to invest in, work for, purchase goods from, or do business with. Similarly, from the firm's point of view, such disclosures bring with them the possibility of attracting new capital, better workers, and more business.

For most companies, the decision to go 'beyond compliance' in their non-financial reporting—that is, to exceed existing legal requirements—is an explicit part of a larger business strategy. The purpose of this strategy is often to improve *financial* performance by identifying risks and protecting brand reputation, attracting new investment, recruiting and retaining talented employees, identifying new opportunities for growth, or gaining access to new markets. As a result, many companies target their reporting at investors and 'non-financial analysts' (i.e., the gatekeepers of various indices, ratings, and rankings of 'responsible' companies), current and prospective employees, and, to a lesser extent, local communities and governments (i.e., reporting as part of the 'license to operate'). Many companies also see reporting as a way to avoid scandal. For example, many claim that the process of reporting helps to identify and address potential risks (as

is often said, ‘what gets measured gets managed’) and thus adds value regardless of whether anyone actually reads the report. Of course, some companies also say that reporting on non-financial performance is simply the right thing to do.[1]

As demand for this kind of information has continued to rise from the late 1990s through to the present (see Figure 1), so too has the demand for rules and frameworks that could be used to harmonize firms’ disclosure practices (so that information can be compared across firms and/or over time), to monitor and enforce compliance with quality assurance standards (so that disclosures are truthful and of material interest to stakeholders), and to simply increase the number of firms reporting. The development of these rules and frameworks has taken place largely within the private sector. Organizations like the GRI, the CDP, and the GC have played a large role in this rulemaking process, while simultaneously working with companies to help them figure out both *what* and *how* to report on non-financial performance. Although each organization differs in important ways (e.g., funding support, mission statement, organization, etc.), they all have succeeded in stimulating demand for corporate non-financial reporting, and they have transformed that demand into new global norms. In fact, GRI, CDP, and GC are not simply the names of organizations; they are also widely recognizable brand names that firms around the world use to signify their commitment to CSR in general, and to corporate non-financial reporting in particular. In turn, the success of these brands signifies the command these organizations hold over agenda-setting and rule-making processes.

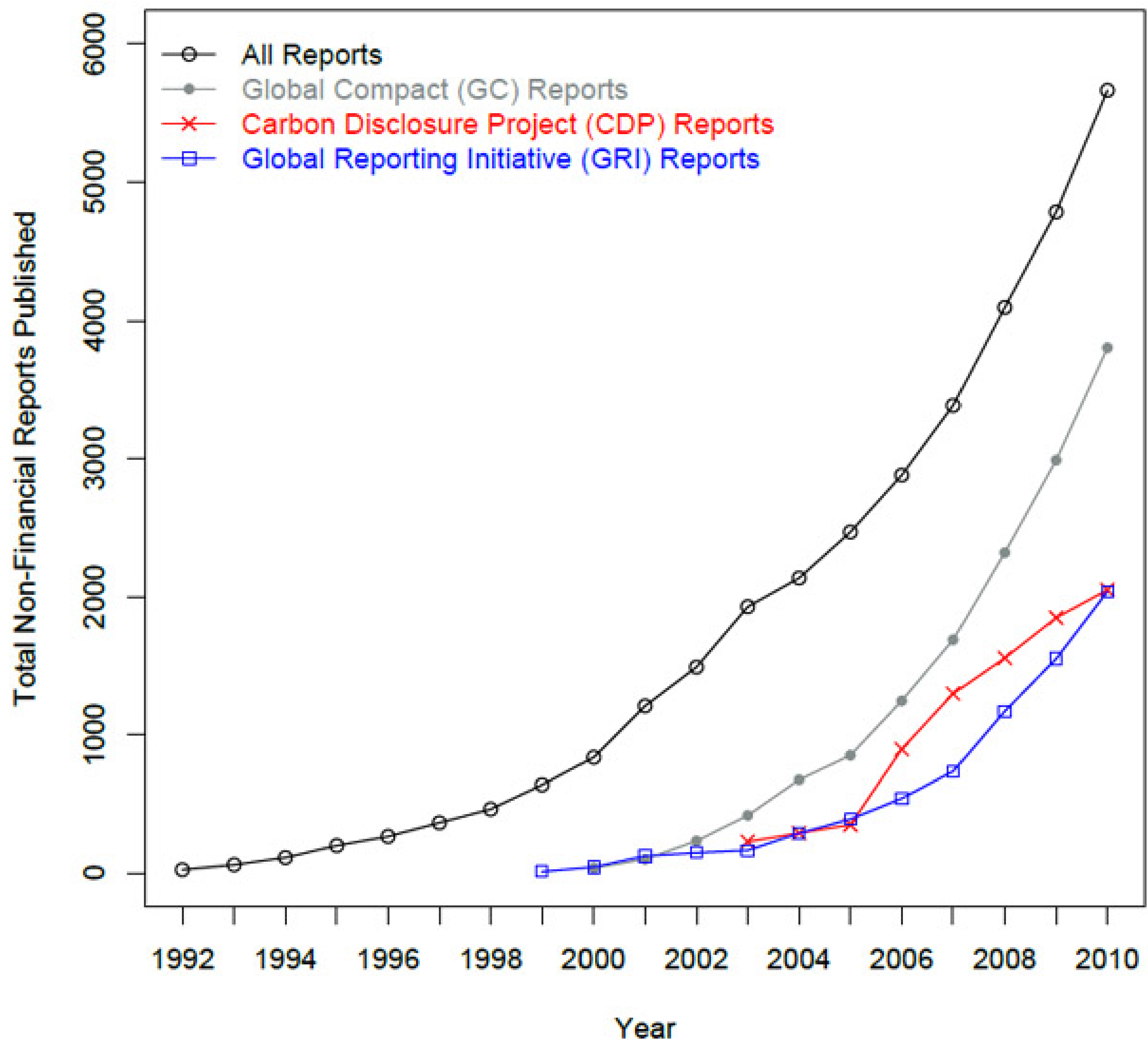

Figure 1: Total number of corporate non-financial reports published per year, worldwide.

Strengths and Weaknesses of Private Regulation

In the United States, the 1970s were the golden age of social and environmental protection, the high-water mark of so-called 'command and control' regulation, in which the state set and enforced specific targets for corporate performance through new government agencies like the Environmental Protection Agency and the Occupational Health and Safety Administration. Although the public interest movement had made significant gains though several landmark legislative victories, the decade ended in political logjam, as business interests quickly mobilized and improved their political game. Activists faced a dilemma—to push for reform within existing formal political institutions, knowing that it will be a difficult fight, or to pursue alternative strategies, perhaps working with businesses rather than against them.

The private regulation of corporate non-financial reporting emerged from this milieu. The public interest movement of the 1970s convinced much of the public that they had a 'right to know' what was happening inside corporations. At the same time, a contentious political climate encouraged activists to pursue their agenda outside formal political channels. In particular, socially responsible investing (SRI) showed how activists,

empowered with information, could successfully pressure companies without the threat of state enforcement (e.g., using divestment to help end apartheid in South Africa). The development of SRI in the 1980s and 1990s lead directly into the establishment of GRI and CDP (in 1997 and 2000, respectively) as well as other initiatives, such as the Dow Jones Sustainability Index (DJSI) and FTSE4Good. The growth of SRI boosted demand for non-financial information, which in turn drove the development of new reporting standards and frameworks.

Thus, one of the key strengths of private regulation is its ability to explore new regulatory terrain. At a time when the state was unlikely to pursue new business regulation, private actors entered the relatively unmapped policy area of non-financial disclosure and created new rules, using market incentives to drive participation. The GRI, for instance, released the first draft of its 'Sustainability Reporting Guidelines' in 2000, a framework that now includes dozens of Key Performance Indicators (KPIs), in a variety of issue areas, as well as general principles for good reporting. The CDP (along with DJSI, FTSE4Good, and many others) pursued a different approach, designing its own extensive questionnaire, sent directly to companies on behalf of investors. The GC took perhaps the most elemental approach, establishing 'Ten Principles' of corporate responsibility—relating to human rights, labor, the environment, and anti-corruption—on which its members must report each year. In addition, many other organizations—including industry associations, international organizations, and NGOs—have produced reporting standards of their own. As private rulemaking continues, new standards are developed and refined, new problems are identified and addressed, and the content and quality of disclosures improve.

In the process of designing new rules, private regulators have also built support among a broad base of key business and civil society organizations. The GRI guidelines, for example, have been used by nearly 6,000 organizations in 96 countries. On top of that, the GRI now maintains a global network of close to 600 organizational stakeholders—a vast array of companies, NGOs, government agencies, universities, and other organizations from over 60 countries—and more than 30,000 individual stakeholders from a variety of backgrounds (Global Reporting Initiative 42). The CDP collects information on more than 5,000 companies on behalf of more than 700 institutional investors, who together hold a total of US$87 trillion in assets under management (Carbon Disclosure Project 6). The GC oversees a network of more than 8,000 active business members from 140 countries, as well as more than 4,000 non-business members, including business associations, labor unions, NGOs, and public sector organizations (United Nations Global Compact 2).

While private regulation has succeeded in developing new rules and frameworks with widespread support and legitimacy, several significant shortcomings remain. In particular, private regulators have struggled in the areas of implementation and enforcement. For all the work that has been done developing new rules, there is still a great deal of variation in how companies report, due in part to the large number of standards available. While private regulators have tried to address this through enhanced

cooperation (e.g., the GRI and the GC signed a 'memorandum of understanding' in 2010), the problem is that choice is often viewed as a virtue in this market-oriented environment. Thus, getting companies to voluntarily adhere to the same standard is a problem.

Perhaps more problematic is the issue of noncompliance in private regulatory schemes. While the overall participation rate is still strikingly low (again, only 6% of large companies in Europe are currently reporting), private regulators also must deal with noncompliance within their own ranks. The GRI guidelines, for instance, included a total of 79 KPIs in 2012. Of the approximately 2,500 companies that used the guidelines that year, less than 30% made reference to all 79 indicators (either disclosing the requested information or explaining why it was omitted). At the GC, more than 4,000 companies have had their membership revoked because they failed to comply with the annual reporting requirement. Compliance is an even larger problem when it comes to the issue of third-party verification. Many argue that corporate non-financial reports ought to be checked by a third-party auditor, just as financial reports are. Companies have long been resistant to this (though more are now beginning to do so), and, partly as a result, there is still quite a lot of dissatisfaction over the quality and reliability of non-financial reporting.

The Rise of Mandatory Reporting

Governments are in a unique position to address the problems with private regulation addressed in the previous section. In addition, due to the wide base of support that private regulators have established behind the phenomena of corporate non-financial reporting in general, and their own standards and frameworks in particular, public policymakers have a better opportunity to intervene than they would have otherwise. It should come as no surprise, then, that we have seen a surge over the past decade in new state regulation governing corporate non-financial disclosure. As mentioned, in its early development, a critical feature of corporate non-financial reporting, and of CSR more generally, was that is was something that companies did *voluntarily*. This attitude was also reflected in the European Commission's (EC's) 2001 definition of CSR: "a concept whereby companies integrate social and environmental concerns in their business operations and in their interactions with their stakeholders on a voluntary basis" (*Promoting* 6) . Ten years later, the EC revised its definition significantly: "the responsibility of enterprises for their impacts on society" (*Communication* 3) . This new, more ambiguous definition is emblematic of the larger shift from private regulation to public policy underway in Europe (and elsewhere).

In May 2001, France became the first country in Europe to enact a comprehensive corporate non-financial reporting requirement. Article 116 of the New Economic Regulations required publicly listed companies to include information on 40 different indicators in their annual reports. Although problems appeared almost immediately, including the question of whether data on overseas subsidiaries was included in the mandate, many companies got the message and began to take non-financial reporting more seriously. In June 2003, the European Commission entered the fray, stating in its 'Modernisation directive' that companies should be required to disclose non-financial information "if it is necessary for an understanding of the company's development,

performance, or position" (*Directive* 2). This requirement is very broad indeed, and although it was eventually transposed in national legislation throughout the European Union, its main function seems to be as a signal that more substantial corporate non-financial reporting legislation could be on the way.

As private regulators continued to expand their networks in the mid-2000s, policymakers in several European states began ratcheting up their reporting requirements. In July 2003, the United Kingdom announced its intention to develop a more comprehensive set of regulations (far exceeding the requirements of the 2003 EC Modernisation directive), which it released to the public in draft form in May 2004. In a surprising move, especially for those businesses who supported the law and were preparing for its implementation, then-Chancellor of the Exchequer Gordon Brown announced in November 2005 that the proposed regulations would be scrapped in favor of a less burdensome requirement included in the 2006 British Companies Act. Just as the UK was scaling back its efforts, France and Denmark were plunging ahead. In 2007, a new set of negotiations called 'Grenelle for the environment' began in France, culminating in two new sets of regulations (Grenelle I in 2009 and Grenelle II in 2010), including a much revised reporting requirement extended to all large companies. Denmark passed its own reporting legislation in 2008, requiring all large companies to report on a number of specific indicators on a 'comply or explain' basis. Sweden also sent a message by requiring its 55 state-owned companies to report according to the GRI guidelines.

With interest in corporate non-financial reporting regulation continuing to rise among public policymakers, as well as those in the private sector, the EC began the process of revamping its own reporting requirement. From its perspective, the problems of implementation and enforcement that characterized the private regulation of reporting were not going to be solved if every country in the EU developed its own requirement. The power of the state was needed not only to raise the number of companies reporting but also to harmonize reporting practices across companies (and countries). Thus, in September 2009, the EC began hosting a number of multi-stakeholder workshops intended to explore possibilities of a new directive. The EC launched a public consultation on the issue of corporate non-financial reporting in November 2010; the summary report, published in April 2011, recommended that any new legislation should draw on frameworks already developed at the international level, making explicit reference to the GRI and the GC. The EC then gathered a group of experts to assess the impact of a new legislative proposal.

In April 2013, the European Commission released its proposal for a new directive, which would require all firms with more than 500 employees to disclose in their annual reports "relevant and material information on policies, results and risks concerning environmental aspects, social and employee-related matters, respect for human rights, anti-corruption and bribery issues, and diversity of the boards of directors" (*Disclosure* 1) . The Commission claims that this requirement will raise the number of firms reporting from its current level of around 2,500 firms to 18,000—a threshold private regulatory

organizations appear unlikely to reach on their own. Although many of the details remain to be seen, the Commission says it will allow firms to satisfy this reporting requirement through compliance with either national guidelines or private standards, such as the GC.

Conclusion: Governance Beyond Governments?

Although non-financial reporting is already common practice among the world's largest corporations, it is still in a relatively nascent stage of development. As a result, its precise purpose as well as the framework proposed for its implementation are constantly evolving through cooperation and contestation among public and private actors from all corners of the global economy. However, the recent movement toward mandatory reporting in Europe has hastened the process of institutionalization. As policymakers both at the national and EU level look to transnational private regulators for expertise and legitimacy in the crafting of new government regulation, collaboration between these various (and once competing) private actors has increased as well. The result is a growing coalescence of support behind newly established rules and frameworks that is likely to influence the behavior of companies, governments, and other organizations far beyond the confines of Europe.

The rise of non-financial reporting, as with CSR in general, is often associated with the rise of neoliberalism and the erosion of institutionalized forms of social solidarity in Europe. Although the absence of effective public policy is key to the rise of private regulation, this research paints a somewhat different picture by illustrating how private actors can use voluntary standards and frameworks to bring government into policy domains that have been left vacant *as a result of* neoliberalism. That said, neoliberal *rhetoric* can be a powerful tool, and it is partly though their use of this tool that private regulatory organizations have been able to secure the support not only of business but of government as well. The idea that companies can create 'shared value', benefitting both themselves and society at large, has been particularly powerful (see Porter and Kramer) . Still, while private regulation may lay the groundwork for new public policy in some cases, its reliance upon voluntary self-regulation also raises questions about corporate influence in processes and discussions that are largely hidden from public view (see Culpepper) .

For many, the most important question about corporate non-financial reporting relates not to how it is regulated but to whether it actually makes any difference. Among individual companies, many claim that the process of reporting offers an opportunity to better understand (and become accountable for) their own social and environmental performance. In turn, the availability of new information may allow investors, employees, consumers, business partners, and other stakeholders to act on their own social and environmental preferences, increasing demand for better reporting and (hopefully) better performance. At a structural or systemic level, non-financial disclosure may lead to more sustainable development, as business gradually becomes re-embedded into society. The extent to which such lofty ideas are realized in practice, of course, depends greatly on the rules and frameworks put in place to govern reporting practices. Though their work is far from complete, private actors have already played a key role in this process, exploring new regulatory terrain, building support for new standards, and, ultimately, expanding the

scope of public policy. Their efforts represent an important source of governance beyond the bounds of traditional state regulation, providing an important example of how state and non-state actors collaborate in the era of regulatory capitalism.

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1. As one can imagine, the particular reasons a company has for reporting also vary according to a number of contextual factors, including the company’s leadership, industry, size, ownership, and regulatory environment.

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