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Social Standards and CSR reporting in companies.

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Interest in corporate social responsibility and sustainability has increased significantly in recent years, especially as there is a growing awareness that every action taken by individuals and organizations has an impact. This has become particularly evident in the context of climate change: every car trip, every flight, every factory and every power plant leave an ecological footprint and contributes to climate change. This is why the call for ecological sustainability, which ensures that future generations will still have a planet and natural resources to live on, has become so loud. Even if the current debate is mainly about how to unify ecological and economic sustainability, social sustainability also plays an important role in this discourse: After all, the preservation and expansion of social systems is a basic requirement of both ecological and economic sustainability.

At the heart of this discourse is the question of how to do business in the future and how to make companies more sustainable. This includes the matter of what mechanisms ensure that companies act responsibly and are held accountable for their social and environmental impacts. In other words, under what circumstances do companies adhere to social norms and when do they break them? This naturally leads to the topic of social standards, so that is what I will talk about in the next few minutes. I will outline the current shift in the discourse from voluntary CSR standards to sustainability reporting standards and what this means for compliance with norms of responsibility. While the former only define social and environmental rules for companies, the later also oblige companies to report on certain social and ecological aspects. A lot is happening here right now, at both the European and the global level.

It all starts with the fact that today companies are increasingly expected not only to comply with laws, but also to adhere to universal ethical standards. This brings up two key questions: What exactly are companies expected to do? And how can it be achieved that companies behave accordingly - especially since it is notoriously difficult to create uniform legal regulations at the international level. Given these issues, it is not surprising that voluntary self-regulation through the adoption of international CSR standards has been discussed as an alternative to hard law. Hence, several international organizations have developed CSR standards over the past decades. Among them, the UN Global Compact is the most widespread. In fact, it is explicitly recognized and promoted by the European Union as soft law alternatives. Companies that adopt this or other CSR standards commit to complying with rules covering areas like human rights, labour, environment, and taxation.

However, why should they do this? After all, the compliance to rules restricts business freedom and causes costs. An important reason for adopting these codes is that the market is supposed to provide economic incentives for companies that demonstrate compliance with societal expectations, such as reputational benefits, lower risks for investors, and insurance-like protection against stakeholder actions such as protests and boycotts. So, does this mean that the problem of sustainability has been solved and that voluntary CSR standards create a win-win situation for business and society? Well, this would only work if such a voluntary commitment would actually make a distinction between responsible and irresponsible companies. In this case, investors and other stakeholders could make their business decisions on this basis. But unfortunately, we cannot peek into all companies, so there is information asymmetry. Irresponsible companies – the black sheep - can exploit this fact. They reap the reputational benefits of a public commitment without bearing the cost of genuine compliance by portraying themselves as more sustainable than they actually are.

So far, however, we know little about the extent to which this is a problem in the context of CSR standards. In a study of the largest German companies, a colleague of mine and I investigated this question. In essence, we wanted to know which companies are most prone to non-compliance with social norms, what is also called Corporate Social Irresponsibility or CSI. This included the question whether the commitment to voluntary CSR standards really works. If this were the case, companies that have adopted a CSR standard such as Global Compact would be less likely to engage in CSI. However, this was not the case - in fact, the opposite happened: companies that are committed to the Global Compact are even more frequently involved in CSI practices like fraud, corruption, and unethical investments. Therefore, CSR standards are indeed often used for mere symbolic reasons. This greenwashing ultimately harms both society and business, since the responsible companies no longer generate a competitive advantage through their compliance.

Actually, greenwashing is not a new issue and has been known for quite some time. That is why there have been calls for years for greater transparency in the form of reporting standards that not only cover economic but also ecological and social aspects. The most widely used international reporting standard comes from the Global Reporting Initiative (GRI), which has been around since 1997. The GRI standards are based on financial reporting, but are independent of it. They specify some basic reporting principles and indicators for selected environmental and social areas. However, they are not mandatory, and they too are based on voluntary commitments. Companies are also relatively free to decide what information they disclose. They can thus only be seen as a first step towards more transparency. There is still a lack of mandatory standards that make companies more comparable. It is therefore not surprising that in our study the adoption of GRI standards also did not lead to a reduction of CSI.

However, the demand for reporting standards is high, and not only by the public. Sustainability has become an increasingly important issue for investors and creditors. On the one hand, this is reflected in the growing demand for sustainable investments. On the other hand, issues of sustainability also have an impact on the economic success of companies. Therefore, Investors are increasingly interested in opportunities and risks in the area of ESG - environment, social and governance. For this reason, various ESG ratings have been developed in recent years. They take social and ecological criteria for enterprise value into account. To date, however, there are no international standards for sustainability indicators. For example, the International Financial Reporting Standards – the IFRS – do not yet contain any explicit references to sustainability issues. However, there have been some developments in recent months: At the end of last year, the IFRS foundation established an International Sustainability Standards Board with the aim of developing sustainability disclosure standards. Since then, the IFRS has also published a set of Prototype IFRS Sustainability Disclosure Standards: the climate sustainability prototype standard and the general requirements prototype standard. Beyond that this year, the IFRS Foundation and the GRI announced a cooperation agreement under which they will seek to coordinate their work.

In addition, a number of changes are currently taking place at the level of European legislation. In 2014, the European Parliament passed the Nonfinancial Reporting Directive. Since then, larger capital market-oriented companies have to disclose information on environmental and social sustainability. However, no concrete indicators have yet been defined, and instead it is largely up to the companies themselves what exactly they report on. This is about to change, as in 2020 the European Union decided to tighten these regulations with the aim of improving the quality and reliability of non-financial reporting. This is intended to make companies more transparent and thus make sustainable investments easier. The first step is the introduction of the EU taxonomy for sustainable activities. That is a common classification system for sustainable economic activities, on which affected companies will have to report on in the future. Companies affected will be required to report how and to what extent their activities are associated with economic activities that qualify as sustainable. This regulation is introduced gradually for six environmental goals, starting this year with the first two goals - climate change mitigation and adaptation. Now, therefore, this regulation is limited to ecological sustainability. But the directive states that the taxonomy will be further developed in the future, including the area of social sustainability. In addition, the EU is currently working on the Corporate Sustainability Reporting Directive, which aims to extend the scope of the existing reporting requirements to all companies listed on regulated markets.

In conclusion, it can be said that the CSR discourse is currently undergoing a change - towards more accountability. There is a trend is towards mandatory CSR reporting standards that make companies more transparent and comparable. This requires well-defined social and ecological Key Performance Indicators (KPIs) that companies use as a reference. The importance of such metrics was also shown in our study: companies that link their management compensation to CSR performance are significantly less likely to engage in irresponsible activities than companies that only use management compensation based on financial performance. After all, CSR is also a question of the right incentives.

So despite all the criticism, from a societal perspective, recent developments are an important next step towards more CSR compliance. This applies in particular to ecological sustainability since climate change currently dominates the discourse. But various stakeholders are currently using this as an opportunity to also include indicators for social sustainability in such standards. These include actors from the financial sector as well as unions and HR managers. Ultimately, however, it will depend on which indicators are developed and whose interests will prevail.