From Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues

A NEW WHITE PAPER FROM THE INITIATIVE FOR RESPONSIBLE INVESTMENT AT HARVARD AND ARUP MAKES THE CASE FOR MANDATORY SUSTAINABILITY REPORTING, DEMONSTRATING HOW ADDITIONAL DISCLOSURE CAN LEAD TO IMPROVED SUSTAINABILITY PERFORMANCE

Recently there has been an increase in the number of corporate stakeholders calling for greater transparency in the relation to the way organizations report on their impacts on society and the environment. Some urge government-mandated reporting, others a more voluntary approach. Both raise the question of what specific data needs to be reported and in what form it needs to be disclosed. Whatever system is ultimately adopted in the US should ensure that improved disclosure leads to improved performance on the things that really matter to stakeholders.

Currently, a lack of clear guidance – together with a disclosure system that is voluntary, time-consuming and highly complex – has resulted in a situation where the promise of sustainability reporting cannot be realized. In order to harness the power of business to address the critical sustainability challenges facing our society, clear and specific guidance must be given with respect to performance indicators. With a reasonable up-front effort by regulators to assess and prioritize the materiality of sustainability issues by sector, concise guidance can be developed for each sector as a basis for minimum, mandatory reporting.

Requiring that these KPIs be reported as part of Form 10-K disclosures will pay off handsomely: markets will be sent clear signals about what matters to stakeholders; companies will refocus their efforts from reporting to improving performance, stakeholders will be able to compare sustainability performance on a few key indicators, and the world will finally reap the benefits of improved sustainability performance by corporations: environmental stewardship, social equity, and economic vitality.

This paper sets out a new framework for mandatory reporting that enables regulators to identify a small set of indicators that are most material to a given industry sector, thereby creating a common platform through which company performance can be compared. A world is envisioned wherein companies are no longer acknowledged for the best sustainability reports, but rather for the best sustainability performance. Entire industries will move in more sustainable directions, harnessing resources to compete on the things that really matter.

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REPORT AUTHORS

Steve Lydenberg
Chief Investment Officer,
Domini Social Investments

Jean Rogers, PhD
Principal, Arup

David Wood, PhD
Director, Initiative for Responsible Investment,
Harvard University

THE HAUSER CENTER FOR NONPROFIT ORGANIZATIONS at HARVARD UNIVERSITY
INITIATIVE FOR RESPONSIBLE INVESTMENT
ARUP

ICB SubSector

Material Sustainability Issues	AUTOMOBILES	AIRLINES	PAPER	ELECTRICITY	DIVERSIFIED REIT'S	BANKING
BIODIVERSITY	0	0	5	4	4	0
BUSINESS MODEL	0	0	2	6	5	10
CHILD AND FORCED LABOR	0	0	2	0	0	0
CLIMATE CHANGE MANAGEMENT	12	13	10	15	14	15
COMPETITIVE AND ETHICAL BEHAVIOR	6	7	2	5	0	7
CORPORATE CITIZENSHIP/ PHILANTHROPY	0	4	3	0	5	6
CUSTOMER PRIVACY	0	6	0	0	0	10
CUSTOMER SATISFACTION	13	12	3	12	10	7
DIVERSITY AND EQUAL OPPORTUNITY	0	3	0	1	6	7
ENERGY	9	14	10	13	12	6
ENVIRONMENTAL MANAGEMENT	9	9	12	9	8	3
EXECUTIVE COMPENSATION POLICIES	5	0	0	0	0	5
EXTERNAL COMMUNICATION / STAKEHOLDER ENGAGEMENT	1	4	7	5	5	8
IMPACTS ON COMMUNITIES	8	12	9	10	9	15
LABOR RIGHTS AND COMPENSATION	8	7	5	0	0	1
LOBBYING & POLITICAL CONTRIBUTIONS	6	5	2	7	3	7
MARKETING AND COMMUNICATIONS	0	2	4	10	5	12
MATERIALS AND WASTE	9	6	14	6	12	6
OCCUPATIONAL HEALTH & SAFETY	5	4	9	7	3	0
POLITICAL RISK AND CONFLICT	0	0	2	0	0	7
POLLUTANTS AND EMISSIONS	9	12	14	14	4	7
PRODUCT AND OPERATIONAL EFFICIENCY	14	10	4	8	12	0
PRODUCT ENVIRONMENTAL IMPACT	15	8	5	14	14	12
PRODUCT IMPACTS ON HEALTH	6	4	0	3	13	0
PRODUCT QUALITY AND INNOVATION	13	0	12	12	10	9
PRODUCT SAFETY	15	13	0	6	7	0
RECRUITMENT AND SUCCESSION PLANNING	3	1	0	2	2	2
RESEARCH AND DEVELOPMENT	10	5	6	10	3	0
SOURCING PRACTICES	8	7	14	4	5	5
STAFF ENGAGEMENT	5	4	3	4	1	3
STANDARDS AND CODES OF CONDUCT	6	6	0	3	10	0
SUPPLY CHAIN IMPACTS	4	0	6	4	4	0
TRAINING AND DEVELOPMENT	3	3	5	1	1	2
TRANSPORT	1	0	2	0	9	3
WATER	9	5	14	11	8	3

- Top 10 issues for each sector are shaded, based on the strength of the materiality score.

Left: Material issues across the six subsectors *This figure shows a hypothetical comparison of the most material ESG issues across the 6 subsectors analyzed. Highlighted issues are those that are most material in the subsector, as determined by their total score on the materiality test. Each issue varies in its materiality from sector to sector. While some issues are highly material to all sectors (climate change), other issues are unique to certain industries (customer privacy). This highlights the importance of a sector based approach to determining materiality from a broad universe of ESG issues.*

A copy of the report can be downloaded HERE

Tested on six disparate industries, airlines, automobiles, diversified REITS, conventional electricity, paper and banks, our paper demonstrates how to assess the entire landscape of sustainability issues and evaluate them for their materiality within a specific sector. The process of prioritizing the KPIs for each sector can be done with input from stakeholders for that sector, and the outcomes can be completely transparent.

The method can be easily applied to all 120 sectors in the Standard Industrial Code (SIC) classification system, in order to arrive at a one-page guide for minimum reporting for each sector. The paper also shows how a company could respond to the guidance, incorporating the responses into the Form 10-K in a simple, comparable, and cost-effective manner. Adopting a mandatory sustainability reporting approach based on a minimum set of KPIs has the potential to:

- Provide comprehensive, cost-effective reporting on a few key issues by all companies within a sector
- Allow companies to be benchmarked based on their sustainability credentials
- Guide corporations, industry groups, and regulators to focus on the most material issues- managing risks and seizing opportunities presented by sustainability challenges
- Help investors seeking to incorporate sustainability factors into their research
- Pave the way for financial and non-financial reporting to be integrated

For further information contact:
David Wood
617-384-8322
david_wood@hks.harvard.edu
Initiative for Responsible Investment