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An integrative perspective of environmental, social and governance (ESG) reporting: A conceptual paper

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Abstract

The motivation of this study stems from the importance of protecting the environment, addressing the social issues related to internal and external stakeholders of companies and also the importance of adhering to good corporate governance. This study attempts to explore an integrative perspective for reporting environmental, social and governance (ESG) factors. The issue of ESG reporting has recently been thrust into the limelight due to increased public concern for good governance, accountability and transparency. In response, companies have to attempt to provide more disclosures encompassing environmental, social and governance factors. Integrative perspective refers to a balanced, equitable and simultaneous consideration for each ESG factor to be practiced. Hence, integrative ESG reporting would provide a means of engagement and communication between companies and multiple stakeholders with various information needs. This article allows for future research with empirical research into the integrative ESG reporting practices of companies.

Keywords: environmental, social, governance, ESG reporting, integrative, stakeholders

1. INTRODUCTION

ESG is a term that is commonly employed in socially responsible investment (SRI) (Viviers & Eccles, 2012; Eccles & Viviers, 2011) and also in corporate social responsibility (CSR) (Sparkes & Christopher, 2004; Cuesta & Valor, 2011). Eccles and Viviers (2011) suggested that SRI relates to an investment strategy that is concerned with issues of social responsibility, ethics and religious considerations, and it is very similar to ESG. Moreover, the development of SRI practices has exerted significant pressure on companies to adopt CSR (Sparkes & Christopher, 2004). Therefore, it appears that there is a link between ESG and CSR and these two terms are being used interchangeably in a number of studies. For example, in the study by Cuesta and Valor (2011), the author considered CSR reporting as similar to ESG reporting.

Studies within an ESG reporting context lag behind in the academic literature. Nevertheless, each study focusing solely or any one of the environmental, social and governance issues are not new. In fact, it is implicitly relevant to the dimensions of CSR (i.e. environment, workplace, marketplace, and community), sustainability (i.e. environmental, social and economic) and the triple bottom line (TBL) (i.e. profit, people and planet). A majority of CSR studies have examined environmental reporting (e.g. Deegan & Rankin, 1999; Sumiani, Haslinda, & Lehman, 2007). Other studies investigate both environmental and social reporting (e.g. Cormier & Gordon, 2001; Milne & Adler, 1999). Very few studies have examined corporate governance reporting (e.g. Samaha, Dahawy, Hussainey, & Stapleton, 2012).

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This paper represents an attempt to explore the concept of reporting ESG factors and to introduce a contemporary approach to evaluate ESG reporting using an integrative concept. The paper will however not be an empirical research, but instead its main objective is to first develop a conceptual approach to an integrative perspective of ESG reporting which will provide the base for future research. This paper makes an important contribution as it provides an exploration on an approach to measure ESG reporting using an integrative perspective. This integrative ESG reporting is helpful because it considers various dimensions (i.e. ESG) and accepts subjectivity as an empirical premise, and at the same time minimises arbitrariness by putting the coherent integration of all ESG dimensions in a systematic framework (Kleine & Hauff, 2009).

2. ENVIRONMENTAL, SOCIAL AND GOVERNANCE FACTORS

ESG information has traditionally been considered as non-financial, not material and not well-captured in the market mechanism relative to financial information (Boener, 2007). Nowadays, these three factors are becoming everybody's concern because of the possible long-term impact given to the investment community and also to other stakeholders at large. On the environmental aspect for example, issues of habitat destruction and deforestation not only Amazon, but everywhere have adversely affected peoples' lives, particularly in emerging markets (EIRIS, 2012). In Malaysia, there were huge public outcries over the proposed construction of a toxic refinery plant sector by Lynas corporation in Gebeng, Pahang (Boyle, 2012). In addition, climate change has been recognised as a systemic risk for investors globally in The Stern Review report (Stern, 2006). The report described the threats posed to the economy, as well as the financial costs of not disclosing the risk. For instance, environmental information could be used to determine a number of issues, for example the decision to invest, decision to lend funds, and decision to consume products (Deegan & Rankin, 1999). Some of the key areas of environmental issues relate to materials and energy consumption, biodiversity, emissions, effluents and waste, as well as compliance with environmental related rules and regulations.

Meanwhile, social issues are of varying levels of concern to different companies, depending on the industry sector, as well as other factors. For example in Malaysia, human rights is one of the corporate social issues which encompass matter such as occupational health and safety, employees beliefs, harassment, freedom of association and elimination of all forms of discrimination (Salawati, Abu Hassan, & Sheung, 2012). The major problem is that, social issues change over time and differ for different industries in different regions. It is partly for this reason that the issues approach to examine business and society relationships give way to management approaches that are more concerned with developing or specifying generalized modes of response to all social issues that become significant. For example, product safety, occupational safety and health, and business ethics were not of major interest as recently as a decade ago; similarly, preoccupation with the environment, consumerism, and employment discrimination was not as intense. Carroll (1979) suggested that, corporate social responsibility encompasses the economic, legal, ethical, and discretionary expectations that society has of companies at a given point in time. Furthermore, social factors should be given more attention because they may impact on company's risk and sustainability (Bouslah, Kryzanowski & M'Zali, 2013).

Furthermore, corporate governance has been known as one of the major contributing factors to the global financial crisis (Yeoh, 2010). Other than that, following the scandals of high profile companies such as Enron, Worldcom, Tyco and Global Crossing, the public has started to question the integrity and effectiveness of monitoring mechanism in companies (Raphaelson & Wahlen, 2004). Therefore, it is claimed that greater emphasis should be made on the internal mechanisms, which include boards, particularly to increase shareholders' insight and influence on corporate behaviour in companies (Kolk, 2008). Additionally, information related to governance can help corporate stakeholders in defining any potential risk that a company represents such as potential legitimacy threats (Kamal & Deegan, 2013).

3. ESG REPORTING

ESG reporting is a term widely applied in the investment sphere that is regarded as official corporate reporting outside the financial reports published. There has been a number of studies on ESG factors in the investment field (e.g. Kocmanova, Karpíšek, & Klímková, 2012; Bassen & Kovacs, 2008; and Boener, 2007) but most of the studies are not empirically examined except for Peiris & Evans (2010). In addition, ESG reporting is also referred to by a number of different names including, but not restricted to corporate social disclosure (CSD), corporate environmental reporting (CER), triple bottom line (TBL) reporting, corporate social responsibility disclosure (CSRD) and corporate sustainability (CS) reporting. This present study considers such reporting collectively as ESG reporting and positions itself within the corporate social and environmental reporting (CSER) literature. Moreover, this study is not intended to specifically focus on ESG as an investment strategy.

CSER is not a new phenomenon within the accounting literature and has drawn considerable attention in academic research (Adams & Evans, 2004; Solomon & Solomon, 2006). Corporate social reporting become the earliest corporate practice dating back to the 1970's (Matthews, 1997) with focuses on major social issues related to employee and employment-related information (Gray et al., 1995). Within the CSER literature, environmental reporting has been included as part of social reporting (Carroll, 1979; Wood, 1991).

In the 1980s, the focus shifted towards environmental issues such as emissions and waste generation in response to public concerns during that period. There are a number of studies which focus solely on environmental reporting globally (e.g. Deegan & Rankin, 1999; Al-Tuwaijri, Christensen, & Hughes, 2004; Clarkson, Li, Richardson, & Vasvari, 2008; Hooks & van Staden, 2011) and also in the Malaysian context (e.g. Sumiani, Haslinda, & Lehman, 2007; Ahmad, Hassan, & Mohammad, 2003). By the end of the 1990s, reporting research and practice increasingly began to consider the social and the environmental factors simultaneously in a joint report which is often published alongside traditional financial reports and in turn termed as CSER (Gao, Heravi, & Xiao, 2005; Cormier & Gordon, 2001; Milne & Adler, 1999). CSER deals with the reporting information related to products and consumers, employees, community and environmental impacts and such reporting is regarded as part of the company's responsibility to its stakeholders (Deegan, 2002; Gray et al., 1995; Mathews, 1995).

Another term related to ESG reporting is triple bottom line (TBL) reporting which was introduced by John Elkington in 1994. The TBL comprises economic, social and environmental elements and is also termed in the form of the three Ps (3Ps); planet, people and profits. It is argued, the balancing of these three elements may well move a company in more potentially sustainable directions (Elkington, 2004). A single bottom line, which is financial performance, is no longer adequate to address the sustainable development of a company. The other two bottom lines, social and environmental should be included in the consideration of a company's sustainable development. The emergence of the TBL reporting was to integrate the financial information, environmental impacts, and social activities of a company together to reflect corporate social responsibility.

Apart from that, past studies also used a single term as CSRD (e.g. Yusoff, Mohamad, & Darus, 2013; Nik Ahmad, Sulaiman, & Siswantoro, 2003; Gray, Javad, Power, & Sinclair, 2001) and/or sustainability reporting (e.g. Hahn & Kühnen, 2013; Aras & Crowther, 2008; Adams & Frost, 2008). Gray et al. (2001) argued that CSRD can typically be thought of as comprising information relating to a company's activities, aspirations, and public image with regard to environmental, community, employee, and consumer issues. Indeed many corporate reports, which used to be designated as environmental reports and subsequently as CSR reports have now been repackaged as sustainability reports. Sustainability reporting was introduced and began from the Brundtland Report, which focused on sustainable development. Sustainability reporting recognises the interdependence of economic, social and environmental factors. As can be seen, sustainability and CSR gradually converge and thus this literature review considers sustainability (reporting) and CSR (reporting) as consistent concepts. Many studies consider CSR and sustainability reporting as synonyms (Marrewijk, 2003) and/or as two sides of a coin and thus, the terms have been used interchangeably (Aras & Crowther, 2009).

Of late, there is a trend of research in CSER that merge environmental and social issues with governance factors. Carroll (2008) argued that, it is becoming more apparent that CSR is moving towards full incorporation with corporate governance (CG). Moreover, several academic studies began to examine these issues by integrating either two or three factors of environment, social and/or governance. For instance, there are studies which revealed a positive relationship between CG and CER (Cong & Freedman, 2011); between CG and CSER (Mallin, Michelon, & Raggi, 2012); and between CG and sustainability (Michelon & Parbonetti, 2010). This is consistent with Aras & Crowther (2008), who found that CG and sustainability is fundamental to the continuing operations of any company. They concluded that a company which has a more complete understanding of both, sustainability and CG, will address these issues more holistically.

Moreover, ESG reporting has become increasingly prominent in the social accounting and corporate governance literature (Rashid & Lodh, 2008). Some other studies consider sustainability practices and reporting as part of governance. For instance, Kamal and Deegan (2013) used CSR-related governance term in their study which is defined as the rules, regulations, policies or structures that a company has in place to address matters related to CSR and is considered as part of companies' broad CG practices. Similarly, Castka, Bamber, Bamber, & Sharp (2004) proposed that CG systems, whose purpose is to control, provide resources, opportunities, strategic direction of the organisation and to be held responsible for doing so, is an integral part of business, hence the CSR system. Solomon (2010) also stated that SER may be regarded as accountability mechanism within the boundaries of CG studies. Kolk and Pinkse (2010) and Kolk (2008) analysed the CSR reporting of Fortune Global 250 companies and found that more than half of the companies have a separate CG section in their CSR report and/or explicitly link CG and CSR issues. In Malaysia, the application of the Malaysian Code of Corporate Governance (MCCG) has improved corporate governance disclosure in which shows a good corporate practice (Wahab, How, & Verhoeven, 2007).

There are few studies that have used ESG reporting term, for example Cuesta and Valor (2013); Weber (2013) and Murphy (2013). Cuesta and Valor (2013) evaluated the quality of ESG reporting of Spanish companies based on the Global Reporting Initiative (GRI) guideline and concluded that GRI has resulted in some standardization of ESG reporting, particularly in terms of format. Meanwhile, Murphy (2013) argued that, part of the motivation for companies to report ESG factors was to avoid, or mitigate, the risk of class actions and associated financial penalties. Murphy proposed that in Australia the deterrence impact, and ancillary avoidance behaviour of civil litigation class action lawsuits provides a further motivation for improving ESG reporting.

From this trend, it can be concluded that ESG factors have clearly become an area on which companies have started to offer information, and thus strive to increase transparency and accountability to not only shareholders but also to other stakeholders at large. This reflects a growing awareness of the linkage between environmental, social and CG, and research on this linkage is likely to expand even more in the future. Hence, this greater attention given to these issues depicts the importance and the existence of inter and intra linkages among the three issues which are explicitly included in the ESG term. Prior researchers tended to focus on the nature and frequency of general CSR whereas this present study explores the concept of reporting practices of social and environmental information with an explicit inclusion of the CG dimension in an integrative perspective.

4. INTEGRATIVE REPORTING CONCEPT

The integrative concept refers to a balanced, equitable (Klein & Hauff, 2009) and simultaneous (Gao & Bansal, 2013) consideration for each ESG factor to be practiced. This means that companies provide simultaneous and balanced commitment towards each of the ESG factors. This commitment promotes the improvement of the overall corporate performance (Hřebíček, Soukopová, Štencl, & Trenz, 2011), impact on strategic and operational decision making (Alkaraan & Northcott, 2006) and also internal collaboration and awareness of value drivers, business risks and associated prospects (Adams & Frost, 2008; Eccles & Krzus, 2010). Moreover, companies should have in place a process to integrate social, environmental, ethical and human rights concerns into their business operations and core strategy in close relationship with their stakeholders. The relationship between company and stakeholder is essential and holds the key to an effective communication. It is argued that companies communicate their commitment and engagement in each of ESG factors as part of their stakeholders' management practices (Schaltegger & Wagner, 2006).

In the ESG literature, studies have focused on addressing an integrative concept in ESG management and performance evaluation for corporate practices (e.g. Schaltegger & Wagner, 2006; Kleine & Hauff, 2009; Gao & Bansal, 2013; Gladwin, Kennelly, & Krause, 1995). Moreover, the integrative concept is also closely related to recent global developments of integrated reporting. The International Integrated Reporting Framework defines integrated reporting as *"a concise communication about strategy, governance, performance and prospects, in the context of its external environment such as environmental, economics, societal and technology"* (IIRC, 2013:7). Integrated reporting has the potential to significantly transform companies' operations and shareholders as well as other stakeholders thinking to focus not only on short term financial aims but also on long term strategy including CSR commitments (Eccles & Krzus, 2010).

A recent study by Gao & Bansal (2013) describes the conceptual improvement of business sustainability by theorizing and demonstrating an integrative logic of decision-making that drives the simultaneous determination of the three pillars of sustainability namely; corporate financial performance (CFP), corporate social commitment (CSC), and corporate environmental commitment (CEC). It can be concluded that corporate sustainability can be successfully achieved based on the application of the integrative or simultaneous commitment towards all sustainability's dimensions. They contrasted between integrative logic and instrumental logic in managing corporate sustainability. Integrative is associated with simultaneous and concurrent determination of all sustainability elements without isolating any elements individually. Whereas, instrumental implied a causal relationship that is characteristic of managing independent factors. For instance, Al-Tuwaijri, Christensen, & Hughes (2004) applied instrumental logic and reported the existence of causal relationships among environmental reporting, environmental performance, and economic performance. However, their study did not include an analysis of social and governance factors. Gao & Bansal (2013) argued that both instrumental and integrative can be practiced, but integrative logic more closely meets the sustainability foundation and allows companies to embrace a strategic view and then generate creative solutions in decision making.

Meanwhile, Gladwin, Kennelly, & Krause, (1995) promote the use of the term “sustaincentrism”. Sustaincentrism refers to the integration of elements in a sustainable development system which is inspired by the claims of the universalism of life and embraces the full conceptualization of environmental, social, political, civil, economic, and human rights issues. This integrative paradigm is proposed for a better management practice in achieving corporate sustainability. Nevertheless, Gladwin et al. (1995) merely discussed the conceptual aspects and did not provide any systematic and objective tool for practical application.

On the other hand, from a broader corporate sustainability management perspective, Schaltegger & Wagner (2006) proposed a framework for integrative management of sustainability performance, measurement and reporting. The integrative character in the framework attempted to link the Sustainability Balanced Scorecard (SBSC) for performance; sustainability accounting for measurement; and sustainability reporting for internal and external communication. With such an approach, this present study views that companies engage in ESG practices in an integrative manner and consequently report on a company’s efforts towards ESG factors. Supporting this view, Schaltegger & Burritt (2000) argued for an integrated management of sustainability issues, in which, environmental, social, financial and risk performance indicators should not stand alone and separate from each other. Additionally, Lozano & Huisingh (2011), revealed that ESG reporting is increasingly becoming more holistic and integrative. They proposed inter-link issues and dimensions as a new ESG reporting category based on integrated and inter-link reporting such as economics and environmental dimensions (e.g. eco-efficiency) and environmental and social dimensions (e.g. environmental, health and safety). This new category can help companies to better understand their responsibilities with regard to corporate sustainability.

Another systematic ESG management tool is the Integrative Sustainability Triangle (IST) introduced by Kleine & Hauff (2009). The IST requires that balanced and equal consideration be applied to all sustainability elements. Figure 1 shows the typology of integrative sustainability dimensions; ecology, social and economy. There are four levels of integrative sustainability measured using the IST and they are; 1. Full integration which reflects all three elements similarly captured (i.e. the centre field of social, ecologic and economic dimension); 2. Strong which indicates domination of a single element (i.e. ecologic, economic or social); 3. Partial which implies that multiple elements are considered (i.e. social-ecologic, social-economic or ecologic-economic); and 4. Weak which shows only a little consideration for one particular element. This systematic approach allows issues along the three elements of sustainability to be specified, assessed and quantified simultaneously.

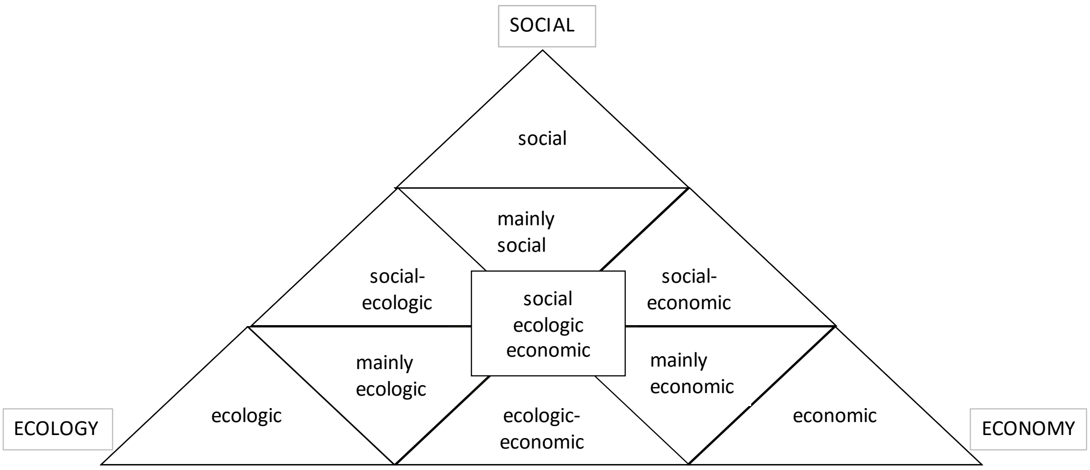

Figure 1 Integrative Sustainability Triangle (IST)
(Source: Klein and Hauff (2009)

Current ESG reporting practice is primarily on a voluntary basis and thus, companies are flexible in experimenting with the scope of reporting (Chen & Bouvain, 2009). In light of this, there are now very diverse practices of corporate reporting and different ESG reporting performance measures. Previously, studies specifically focused on reporting for a single factor or on one dimensional reports (i.e. environmental, social or governance) (Deegan & Soltys, 2007; Shrivastava, 1995) where each dimension provided an initial, inexact, and very rough classification of information. Moreover, one-dimensional reports are merely sustainability-related (Fifka, 2012) because they cover only isolated aspects of sustainability. Instead, reports that simultaneously include all three dimensions of sustainability can truly be regarded as “sustainability reporting”.

Presently, the extent of reporting tends to be measured and presented in groups or aggregate level such as low or high sustainability reporting and thus, does not accurately capture the extent to which corporate reporting adequately addresses all three dimensions of sustainability. Ballou, Casey, Grenier, & Heitger (2012) examined how accounting expertise contributes to the strategic integration of sustainability initiatives but the study did not particularly investigate the different elements of sustainability. This measure will result in reporting more or certain favourable aspects of sustainability rather than a more balanced reporting and a company may manipulate certain elements yet portray a good performance for overall corporate sustainability. Meanwhile, some other prior studies measured and reported each general sustainability or CSR dimension individually (i.e. environment, social and economic) (Sobhani, Amran, & Zainuddin, 2012; and Amran & Devi, 2007). However, past studies have not measured the integrative degree of reporting which could probably reflect the inclination of companies concerns towards all dimensions. It is only when this is undertaken that we can ensure the information communicated will cover the diverse interests of the multiple groups of stakeholders. Hence, integrative ESG reporting is considered as relevant to present corporate reporting on all three aspects of environmental, social and governance simultaneously and equitably because all are equally important (Aras & Crowther, 2009).

5. STAKEHOLDERS AND INTEGRATIVE ESG REPORTING

Stakeholders have varying information needs, and ESG matters are among the major information required (Bursa Malaysia, 2013). Companies should listen to and openly communicate with stakeholders about their respective concerns and the risks that they expect. From an accounting perspective, the primary method of communicating with stakeholders is through annual reports, which include financial statements and other information. Meanwhile, from a stakeholder perspective, the communication between companies and stakeholders can be seen from reporting of factors related to ESG (Gray, Kouhy, & Lavers, 1995) and in fact, this is a basis for companies and stakeholders' relationship (Dierkes & Antal, 1985). Moreover, prior studies have evidenced that there are perceived pressures from stakeholders for ESG information (Belal & Owen, 2007; and Islam & Deegan, 2008).

Most studies on ESG focus on the use of information by external stakeholders particularly investors (Alkaraan & Northcott, 2006; and Cormier, Ledoux, & Magnan, 2011). These findings show that investors, as the principal in the principal-agent relationship, take into account social and environmental information in investment decision making. However, there is still a lack of empirical evidence that relates ESG issues to a larger range of stakeholders. Integrative ESG reporting provides a means of communication and engagement between company and their stakeholders at large. Supporting this view, Mitchell et al. (1997) argued that management's vision of its roles and responsibilities includes the interests and claims of non-stockholding groups such as customers, suppliers, employees, communities, and the public. From the normative branch of stakeholder theory, all stakeholders have rights and should be treated equitably. This normative branch argued that companies reported information to their stakeholders due to moral obligations and corporate responsibility (Deegan, 2006). Hence, companies or in particular managers would consider to report in an integrative manner, whereby multiple issues (in particular ESG) are simultaneously balanced and equally considered in order to meet multiple interests from multiple groups of stakeholders (Rowley, 1997).

On the other hand, the managerial branch of stakeholder theory asserts the interaction and management between companies and stakeholders. In particular, corporate managers are influenced to report ESG factors when they perceived certain stakeholders' attributes of power, legitimacy and urgency as proposed by Mitchell et al. (1997). For instance, the attribute of power indicates the ability of stakeholders to influence the companies' behaviour, direction, process, or outcomes (Mitchell et al., 1997). Consequently, Agle et al. (1999) revealed that these stakeholders' attributes formed salience or priority given to certain stakeholders. Managers' perceptions of the degree of salience bring the opportunity that stakeholders' demands are given priority (Smith et al., 2005), including their needs and demands for reporting multiple information (Boesso & Kumar, 2009).

6. CONCLUSION

The integrative ESG reporting is a unique perspective whereby it considers three important issues that indicate a corporate responsibility to their large stakeholders. Practitioners and experts alike are overwhelmed by the information, interests, level of detail, and the ethical characteristics of ESG information. Thus, there is a demand for integrative concepts to provide a simple and supportive yet comprehensive and conclusive argumentation to fulfill the stakeholders' needs for ESG information. This article allows for future research with empirical data on the integrative ESG reporting practices of companies. Research can also be conducted to explore the influence of multiple stakeholders on integrative ESG reporting.

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