“We can't tell companies to be sustainable, we need to show them why it is in their interest”
How companies create value, for whom and at what cost

Over 6000 companies will be required to publish a report on their policies, risks and outcomes regarding environmental, social and human rights matters following the EU Non-Financial Reporting Directive. This new EU-wide legislation aims to lay the foundation for a new model of corporate reporting that complements financial transparency with environmental and social information necessary for understanding a company’s performance, as well as the impacts of its activities on society.

In comparison with strictly financial information, non-financial information is capable of telling a story beyond a snapshot of the position and performance of the company. However, the increased focus on the transparency of companies gives rise to some tough questions: does reporting encourage companies to integrate ESG risks and opportunities into their strategy or will it be a mere box-ticking exercise? Do investors receive the right information in the correct form? Will they act upon it and does it provide the necessary basis to move towards sustainable long-term investment strategies?

On September 19th this year, academics, businesses, civil society experts and regulators gathered in Brussels for the “Non-Financial Reporting for a Sustainable Circular Economy” conference. This event was aimed at identifying best practice and built upon the latest developments, most notably the interim recommendations of the High Level Expert Group on Sustainable Finance and the French Energy Transition for Green Growth Act. Over 20 speakers discussed the challenges and opportunities presented by the Non-Financial Reporting Directive in fostering a shift towards a sustainable circular economy (see briefing here).

Pavan Sukhdev, CEO of GIST, author of “Corporation 2020”, UN Environment Goodwill Ambassador and former Head of UNEP’s Green Economy Initiative stated in his keynote speech that “today’s corporation is, with due respect to Pope Francis, the single most important institution of our times”. He highlighted the role of corporations in the success of sustainable development since the “private sector represents two thirds of the global economy”. Pavan concluded that we are currently facing the choice to create a new kind of corporation “where goals are aligned with society”, one that acts to “conserve natural capital” and leads the shift to a stakeholder, rather than shareholder capitalism.

The ability of the Non-Financial Reporting Directive to contribute to this shift is limited as it does not clarify what specific information should be disclosed, how it should be integrated with financial information, and if or how the companies should account for non-financial capitals.

Beate Sjåfjell, Professor at the University of Oslo and head of the SMART Project, one of the organisers of the conference, emphasised the “current shareholder-centric model where maximising returns takes priority is a main impediment to relevant and reliable sustainability reporting”. Richard Howitt, CEO of the International Integrated Reporting Council, also stated in his speech that the two key misalignments at the heart of the sustainability challenge are: (a) the trap of short-termism and (b) the failure to translate environmental risks into financial ones. He called on companies to take an active interest in their sustainability policies as “we can't tell companies to be sustainable, we need to show them why it is in their interest and we need to create a culture that rewards long-termism and not just have a box ticking exercise.”

Difficulties remain in ensuring that non-financial reports include relevant information given the lack of common framework and methodology. Environmental, social and governance (ESG) information is
still being considered as an add-on to financial accounting, which is in stark contrast to the experience of some of the leading companies and investors. According to Jessica Law, Vice-President at BlackRock, the world's largest investment manager, "where ESG issues are handled well by companies, it's usually an indicator of operational excellence of the management team or the board in terms of recognising risks and opportunities". Cora Olsen, Global Lead TBL Reporting at NovoNordisk went further and challenged the concept of 'non-financial', stating that it more correctly is 'pre-financial': "if you don't take [pre-financial information] into account, you will be hit by it down the line, so it is all about the time horizons you apply (...) it's about how you make money".

In terms of standardisation, a move towards a reporting framework that comprehensively captures a company's operations means that we may need to (a) reconceive accounting principles in order to incorporate a triple bottom line approach; (b) develop guidance on how to analyse non-financial information in relation to the viability and success of the company, and (c) specify how concrete information related to systemic risks and salient ESG issues can be adequately measured and reported upon.

Producing high-quality ESG information is important for enabling responsible investment decisions and engagement. However, various speakers pointed out that more disclosure doesn’t necessarily translate into better disclosure and that materiality is key in this debate. Ladislas Smia, Co-Head of Responsible Investment Research at MIROVA, claimed there is already sufficient information, but it is not in a readily accessible form and that what is needed is "people willing to change their investment strategy and show that it's possible to link financial performance, environmental performance and social performance".

A sectoral approach to define what is material to the company, its stakeholders, the environment and society where it operates appears to be the preferred option amongst the corporate and investor community. The Directive defines it as those issues that are "most likely to bring about the materialisation of risks of severe impacts and those that have already materialised". Beyond the question of risk, there is a need to define what sustainability means in practice in order to guide corporate strategies in mitigating the negative impacts and focus on maximising the positive ones.

The High Level Expert Group on Sustainable Finance set up earlier this year by the European Commission is currently discussing potential reforms of the governance of financial institutions and public corporations and represents the next big opportunity to move forward in this debate.

**Note to editors**

The conference held on Tuesday 19 September at the Norway House was organised by:
- The SMART project studies the barriers and drivers for market actors’ contribution to the UN Sustainable Development Goals within planetary boundaries with the aim of achieving Policy Coherence for Development.
- Frank Bold is a purpose-driven law firm leading the Purpose of the Corporation Project, an open-source platform that brings together leading experts and organisations interested in promoting the long-term health and sustainability of publicly listed corporations.
- The Modern Corporation Project at Cass Business School provides the academic basis for the Purpose of the Corporation Project.

The sessions were recorded and are available at: https://www.facebook.com/UniOsloSMART/videos/

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