CORPORATE FINANCE PERFORMANCE ON SUSTAINABILITY REPORTING

Dr. Y. Nagendra Reddy*

*PDF (ICSSR), Department of Commerce, SKU, Anantapur.

ABSTRACT

Nowadays Sustainability plays most important role in an organization. Organization having the strength to effect entire organization. It influences performance and profitability. The purpose of this study is to examine the impact of “Corporate finance performance on sustainability reporting” through review of extant organization. Various researches have been conducted over the last decade for examining this organization relationship. The results are various, inconsistency and often contradictory. Ranging from positive to negative to statistically insignificance relationship depending upon the choice of measures of sustainability reporting measures of financial performance sample composition, duration and control variables. We however observed the majority of studies suggest positive relationship. This paper attempts to deeply analyze the previous researches for better and constant results. Further the rules and regulations on sustainability reporting or to become more strict and compulsory in future. Even though organization should follow considered sustainability reporting as early as possible to avoid legal complications in future. Another important issue which needs to be addressed is concern over the reliability of sustainability reports. To resolve this issue, firms should get their sustainability report externally assured from credible assurance providers to establish their image as a credible reporter in the preparation of stakeholders. The business is impossible to run, when the organization with out credibility and trust that is put by stakeholders.
INTRODUCTION

Sustainability is the most critical issue faced by corporate sector today. World Business Council for Sustainable Development (2002) defined Corporate Sustainability as - “the commitment of business to contribute to sustainable economic development, and performance” In today’s age, firms should take accountability for and disclose impacts of their operations on the overall society and environment in which they exist. Therefore, the concept of Sustainability Reporting has been assuming great importance. Sustainability Reporting Initiative (2011) defines “Sustainability Reporting” as – “The practice of measuring, disclosing, and being accountable to internal and external stakeholders for corporate sector towards the goal of sustainable development.”

The financial analysts, investors and other stakeholders are increasingly demanding information on corporate financial, i.e. Environmental, Social and Governance (ESG) performance of companies, over and above their financial information, so as to take more rational and informed investment decisions. According to Hubbard (2008), the number of investors who seek to invest in Socially Responsible Investments (SRI) has been growing rapidly; leading to the creation of various sustainability indices, such as Dow Jones Sustainability Index (DJSI), Johannesburg Stock Exchange (JSE) SRI Index, Domini Social Index (DSI), etc.

KPMG (2011) in its International Survey on Corporate Responsibility Reporting found that 90% of the 220 largest companies in the world conduct corporate responsibility reporting. About 45% companies in Asia Pacific carry out corporate responsibility reporting. The European firms are the leading ones. White (2012) stated in his report that the JSE was the first exchange to have mandated integrated reporting in a single report for listed companies from March 2010. The Integrated Reporting Framework, which is the first of its kind across expected to be published by the end of 2013.

In India, the Ministry of Corporate Affairs (MCA) issued the „National Voluntary Guidelines (NVG) on Social, Environmental and Economic Responsibilities of Business” in July 2011. These guidelines furnish principles and layout of corporate responsibility reporting for all Indian companies, including MNCs (Multi National Company) and SMEs (Small and Medium Enterprises). The Securities and Exchange Board of India (SEBI) issued a Circular on Business Responsibility Reports, dated September 30, 2012, mandating listed companies to practice NVG and to uniformly disclose their responsibility efforts in Business Responsibility Reports (BRRs) as part of Annual Reports. The provisions of circular are compulsory for top 100 listed entities based on market capitalization at BSE (Bombay Stock Exchange) and NSE (National Stock Exchange) as on March 31, 2012, and are applicable with effect from financial year ending on or after December 31, 2012 (SEBI, 2012). As per the report by John (2012, Dec 11) - number of Indian companies who report as per corporate financial developed by Global Reporting Initiative (GRI) has increased significantly from only 36 at the end of year 2011 to around 65 at the end of 2012. Among these are popular companies like TCS (Tata Consulting Company) Infosys, Wipro, M&M Sathyam Computers, ITC, etc.
It is widely believed that sustainability reporting and enhancing value of firm through various strategic benefits such as – improved stakeholder engagement or relations, better customer access, customer loyalty, good brand image, improved employee morale, retention and loyalty, risk avoidance, easier access to capital, strengthened license to operate, cost savings, productivity, etc. Various researches have been conducted over the last decade for examining the relationship between sustainability reporting and financial performance.

Finally we find out different types of results.

OBJECTIVES OF THE STUDY

This paper aims to achieve the following objectives:

► To provide an overview of the concept of Sustainability Reporting.

► To study the impact of sustainability reporting on corporate financial performance of company.

► To build theoretical performance establishing linkage between sustainability reporting and corporate financial performance.

► To provide a review of extant literature in order to throw light on the findings, conclusions and limitations of research that may facilitate future research in this area.

RESEARCH METHOD

We used qualitative and descriptive research approach in this literature review paper. We surveyed, studied, analyzed and summarized the findings and limitations of various important research papers, studies, articles, magazines and other sources pertaining to our research objectives.

CONCEPT OF SUSTAINABILITY REPORTING

According to the International Institute of Sustainable Development (IISD), the concept of Sustainability Reporting has evolved since 1980s when the first environmental report appeared. It is sometimes also referred to as - Corporate Responsibility Reporting (CRR) or Triple Bottom Line (TBL) Reporting. Elkington (1998) developed the term “triple bottom line” to emphasize on three aspects – profits, people (social), and planet (environmental). Sustainability Reports are published by firms to provide a description of their triple bottom line performance and to show the commitment of firm towards its diverse stakeholders. According to G3.1 Sustainability Reporting guidelines developed by Global Reporting Initiative (2011) - “The „environmental dimension” of sustainability concerns an organizations impacts on living and non-living natural systems, including ecosystems, land, air, and water. The „social dimension” of sustainability concerns the impacts an organization has on the social systems within which it operates.
THEORETICAL FRAMEWORK

A. LEGITIMACY THEORY

Lindblom (1993) defined legitimacy as- “a condition which exists when an entity’s value system is in harmony with the value system of society.” According to this theory, it is essential to meet the societal norms and expectations to ensure the survival of firm in long-term. The proponents of legitimacy theory (Patten, 1992; Deegan, 2000) argue that sustainability reporting tends to reduce the risk of regulatory actions and boycotts by stakeholders, and it strengthens the firm’s license to operate.

B. STAKEHOLDER THEORY

Stakeholders refer to those individuals, groups, or organizations that are likely to influence, or be influenced by the operations and decisions of firm. According to Freeman (1985), the stakeholder theory upholds that firms have accountability towards a broad range of stakeholders, apart from shareholders, i.e. creditors, customers, suppliers, employees, government, community, environment, future generations, etc. King (2002) recognized the significance of integrated sustainability reporting in strengthening the relationship between firm and society in which it operates. Ignoring the stakeholder interests may taint firm’s public image, which would unfavorably affect its financial performance.

C. AGENCY THEORY

The agency theory is based on principal agent relationship which exists between the owners and managers. This theory has gained significance in the wake of corporate governance scandals like Satyam scam. It is well known that conflict of interest and information asymmetry exists between company managers (insiders) and shareholders & other stakeholders (outsiders). In the absence of adequate public disclosure by companies, the amount of risk perceived by investors rises significantly (de Klerk & de Villiers, 2012). This causes the market to under-value the shares or demand more returns from firms which do not disclose appropriately. Sustainability Reporting reduces information asymmetry and risk perceived by investors, increases market efficiency and reduces cost of capital to firm (Dhaliwal et al., 2011; Warren & Thomsen, 2012).

LITERATURE REVIEW

A large number of research studies have been conducted in the context of sustainability reporting and its impact on financial performance during the last three decades. Prior to that emphasis was on examining the relationship between Corporate Social Performance (CSP) and Corporate Financial Performance (CFP). The first study in this regard was conducted by Narver in 1972. Margolis and Walsh (2004) evaluated 137 published studies between 1985 and 2005 to study this relationship. Out of 127 studies, 4 studies analyzed bi-directional relationship. 109 studies treated sustainability performance as independent variable, out of which 54 showed positive relationship, 7 showed negative relationship, 28 showed non-significant relationship and 20 showed mixed results. In 22 studies, corporate sustainability was taken as dependent variable, out of which 26 showed positive relationships. Orlitzky et al. (2003) performed a meta-analysis
of 52 empirical studies and concluded that, “corporate social performance is positively correlated with financial performance and the relationship tends to be bi-directional and simultaneous.” They also found that CSR performance measures were more highly correlated with accounting-based measures than with marked-based indicators.

In SAM White Paper, SAM and Robeco (2011) argued that sustainability reporting would impact corporate financial performance either through cash flows or through cost of capital. Some researchers use accounting-based measures like Return on Assets (ROA), Return on Equity (ROE), Return on Sales (ROS), Profit before Taxation (PBT), Cash Flow from Operations (CFO), etc., while others use market-based measures such as Stock Returns, Share Prices, Market Value Added (MVA), etc.

The prior researches provide no clear and precise relationship between sustainability reporting and financial performance. The results are mixed and often contradictory. Now we organize the literature review into different parts; exhibiting positive, negative, not significant, or mixed relationship, to bring more clarity and make it easier to comprehend the nature of association between sustainability reporting and corporate financial performance.

**POSITIVE RELATIONSHIP**

The majority of research studies provide evidence of a positive and significant association between sustainability disclosures and financial performance owing to various synergies and benefits. Baumunk (2009) mentioned that primary advantages of sustainability reporting are: 1) higher demand for firms offerings; and 2) increase in stock prices. The Table - 1 given below gives a description of some important studies establishing positive relationship.

**CONCLUSIONS**

So many companies who issue sustainability reports have significantly increased during the last decade. Various researches have been conducted over the last decade for examining the linkage between sustainability reporting and corporate financial performance. There also exists a strong theoretical framework in support of sustainability reporting; encompassing Legitimacy, Stakeholder and Agency Theory. Particularly, 30 studies have been analyzed in this regard. The results are mixed and range from positive, to negative, to statistically insignificant relationship, depending upon the choice of measure of sustainability reporting (may be disclosure index scores, independent sustainability ratings, dummy variables indicating issue of GRI Report or membership of popular sustainability indices); measure of financial performance (may be cost of capital, accounting-based measures, market-based measures, or mixture of these measures); sample selection (large or small sample size; from developed or developing countries); and control variables (firm size, industry, risk). Out of 40 studies, 15 exhibit positive relationship, 4 show short-term negative relationship, 9 show no significant relationship and 12 studies (most of which used disaggregated approach) provide mixed results. They show that various indicators of sustainability (environment, community, diversity, business ethics, customer relations, employees) - have varying impacts on different measures of financial performance. Thus, majority of studies suggest that sustainability reporting enhance corporate reputation and
financial performance as it results in various synergies and benefits accruing to the reporting firm.

SCOPE FOR FURTHER RESEARCH

This paper analyses and summarizes findings and conclusions of several studies in the area of sustainability reporting. There is a lot of scope for further analysis and research. Future research in this area is required to be conducted by using systematic disaggregated approach, in order to separately examine the impact of each dimension of sustainability, so as to arrive at clearer and more precise association between sustainability reporting practices and financial performance. Also most of the existing researches have been carried out in the background of developed countries like Europe, America and United Kingdom etc. Thus, there is a need to investigate this linkage in the context of developing countries like India.

REFERENCES


