Using sustainability reporting to drive behavioral change

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Introduction

It's easy to fixate on the mechanics of sustainability reporting – getting lost in the weeds of detailed metrics. This focus is both understandable and valid. But sustainability reporting is not, and never should be, viewed as an end in itself. Rather, it is a means to overcome the disconnect between ambition and action.

High quality sustainability information that is reliable, relevant, and comparable is critical, not only for the company, but also for investors, employees, contractors, communities, and other users of corporate information. This information enables them to make decisions about who to invest in, buy from, and work for. Stakeholders want insight into how companies are managing their environmental, social, and governance (ESG) risks and opportunities.

But the current reporting landscape is cluttered with data that does not always lead to better decisions. Although 92% of S&P companies were reporting ESG metrics by the end of 2020[1], there is still a "deficit of credibility and a surplus of confusion".[2] Analysts believe that 40% of companies promote better ESG credentials than their actions justify.[3]

Deloitte conducted 25 interviews with global leaders from the investment community, business world, academia, and non-profit sector to determine what it will take to overcome the current reporting challenges and drive coordinated organizational market- and system-level behavior change.

"You could get 10 different answers on why we should have ESG considerations – different people have different perspectives based on different usage. They each describe meaning in unique ways."

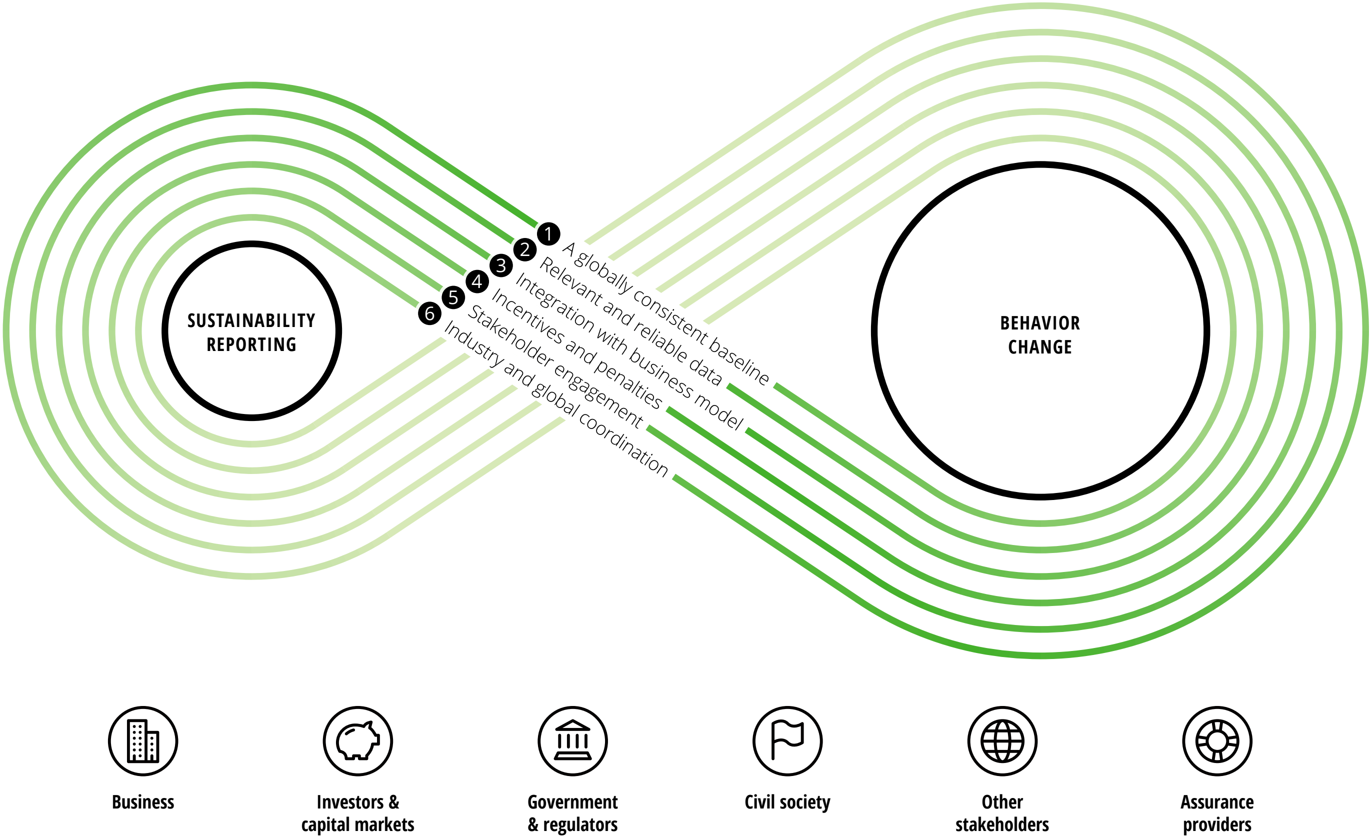
"We can get lost and forget what we are doing this for – the end goal is for companies to do their part in acting in ethical, responsible, and meaningful ways that create a future that is positive for everyone."

"To overcome ESG reporting barriers and begin the process of behavior change, there needs to be clarity of direction."

Deloitte has synthesized the feedback from these interviews to map out a potential way forward – not just for the adoption of sustainability reporting and organizational transformation, but also to create a broader operating environment conducive to widespread behavior change. Conversations identified six conditions needed to drive from the current position of inconsistent and unreliable data to a point where sustainable decision making really does catalyze demonstrable actions in the near term. This paper summarizes the views of the interviewees.

1. Governance & Accountability Institute, S&P 500 + Russell 1000 - Examining 2020 sustainability reporting trends of the largest publicly-traded companies in the U.S. as cited in Deloitte Global, Globally Consistent ESG Reporting
2. UN Secretary-General António Guterres as cited in UN News, 'We cannot afford greenwashing': Guterres highlights key role of Net-Zero experts.
3. Deloitte, 'Assessing perceptions: ESG preparedness, disclosures, and reporting, requirements'

Figure 1. The Conditions of Change



What is the purpose?

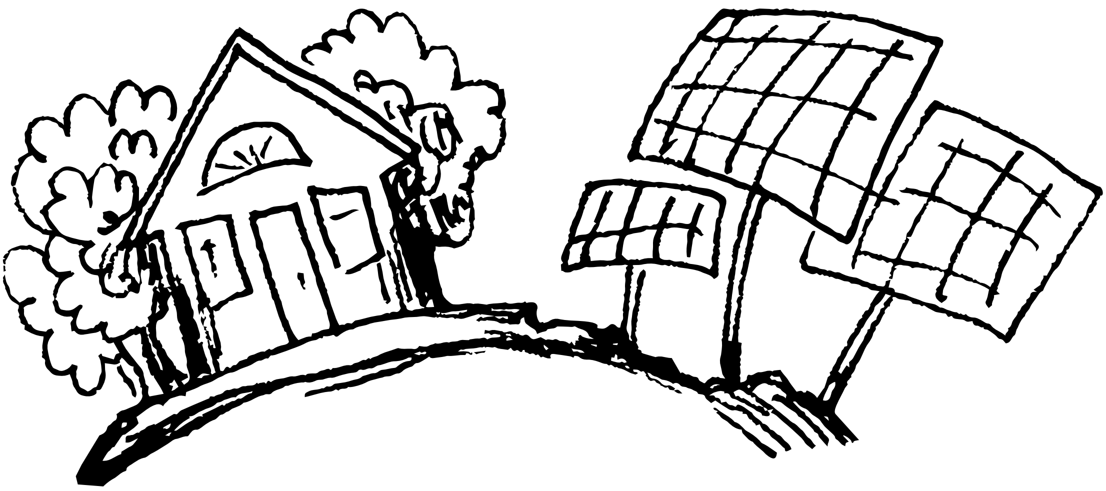
The perspectives on sustainability reporting are as varied as the stakeholders in the conversation. They are diverse and, at times, contrasting – both on the current position and the actions required to catalyze systemic change. This lack of alignment and clarity of the way forward is one of the fundamental challenges of what has largely been a voluntary system to date. It has stimulated contentious and politicized debates, and contributed to corporate fatigue as stakeholders try to navigate this shifting terrain.

Some believe that sustainability reporting should be neutral and void of an expected destination or outcome. Others see the purpose to be social, political, or part of an ethical and equitable economic framework – a tangible way to create a better future for society. Some view it as a more conventional lens to articulate corporate performance and the allocation of capital; whereas, for others, it is a mechanism to extend stewardship responsibilities and drive innovation.

Sustainability reporting serves a variety of purposes. How it is used depends largely on the priorities and lens of the stakeholder. For investors, sustainability information can offer insight into hidden material risks and corporate governance. For policy makers and regulators, disclosure can be leveraged to encourage behavior change toward stated policy goals. For consumers, employees, NGOs, and other stakeholders, transparency provides a lever to improve ethical, social, and environmental performance.

"There is an immediate need for standard-setters, the International Sustainability Standards Board (ISSB) in particular, and regulators to develop a global baseline standard on reporting of material ESG and sustainability considerations with the goal of driving better corporate governance and stewardship of business value creation. Social impact aspects are important, too, but these are likely to be viewed differently in different jurisdictions, so reporting requirements regarding them are probably better set through domestic public policy. This would be more methodologically and politically feasible than trying to mix the two."

"The purpose is to guide economic and social behaviors. To change in a way that contributes to the sustainability of the world. When we talk about economic and social behavior, it could be driven by capital allocation, consumer actions, policies, and leadership opinions... many factors and stakeholders shape social economic behavior. It goes beyond finance."



1. A globally consistent baseline

Global standards provide a common language for sustainability reporting to drive transparency and comparability of decision-useful information. Differing views on the nature of this common language have led to fragmentation, complexity, and cost.

Despite progress made by the ISSB in creating a clear set of baseline standards, and widespread support for the development of such a framework by 43 jurisdictions at the United Nations Climate Change Conference in Glasgow (COP26), there is still confusion among providers of sustainability information about which standards to follow. Even the term 'ESG' is being questioned because it is not well-defined. Global adoption is still a challenge.

What we heard

"The most important feature for all stakeholders – reporters, businesses, investors, labor representatives, unions, local communities, etc – is transparency and comparable data. This is absolutely crucial to make decisions and compare organizations. And to achieve this, we need a global baseline."

"There is danger in the proliferation of too many approaches to standard setting. Having one framework (under the leadership of ISSB) that generates a global baseline of comparability and consistency is key."

"ESG is a journey. Currently, the focus is on analyzing decarbonization and greenhouse gas emissions. We will see a move to waste and water pollution, oceans, and wildlife standards."

"ESG disclosure standards are analogous to the role that financial accounting standards played –financial accounting standards created a common language between businesses and investors for talking about financial performance. What we are trying to do with ESG disclosure by standardizing it is create a common language for business and investors to communicate about ESG performance."

"We need a certain amount of government oversight and enforcement to ensure laggards aren't disadvantaging companies that are implementing robust sustainability initiatives. We also need to provide positive incentives to drive good behavior."

Key takeaways

i. Adoption of one global baseline is critical.

ii. The goal should not be to have a complete set of standards on all sustainability topics on day one. The starting point should be a short list along with clarity as to what else will be required to be disclosed and in what timeframe. Capitalize on the consensus around climate and carbon emissions, with the understanding that other topics will be added over time.

iii. While regulation should drive compliance with baseline standards, sustainability reporting needs to be approached strategically rather than as a rigid, compliance exercise.

iv. Policy makers need to be conscious of the maturity of sustainability information provided to stakeholders and the market. They also need to encourage improvement and accommodate voluntary disclosures made in good faith. An iterative and flexible approach is required to facilitate and accelerate adoption.

2. Relevant and reliable data

Companies risk overwhelming users with too much data or too little information. While companies should be selective in what they report, cherry-picking disclosures and failing to give a fair and balanced view of a company's sustainability is likely contributing to perceptions of greenwashing. A lack of consistency in data points makes it harder for investors and other users of information to make comparisons between companies.

For many providers of information, there remain questions about data collection and processing, and how to build good governance and controls. In 2020, a Blackrock survey[4] noted 53% of respondents cited poor quality or availability of ESG data as a barrier to sustainable investing.

Companies have under-invested in systems, processes, data, and internal controls to deliver timely, quality data. Assurance that would enhance confidence in the data used for decision-making is lacking.

What we heard

"Companies are generally overwhelmed by the magnitude of disclosure and reporting requirements. As a result, it is seen as a compliance issue and there is no motivation to explore the potential business opportunities of the transformation the different sectors are in."

"Data coverage is a key question – is data needed from every office and supplier? Or do you limit the scope and focus to what will likely have the greatest impact? At a certain point, there is diminishing return. The needle moving one percent doesn't change the action required in most cases... It comes back to what is decision-useful and what's data for data sake."

"The key question is how to report. Reported data and prioritization of information is important. However, what is more integral to long-term behavior change is the ability to produce and intelligently use data. How do you source data? What do you do with this information? How will you use it?"

"Transparency is important. The company's engagements, goals and objectives over different time horizons, and how the company is progressing towards these objectives needs to be clearly communicated. Most importantly, it's not just communication that needs to occur but the actual behaviour of the company on the ground needs to be consistent and reflective of their ambitions."

"Customers and citizens want proof of the positive impact. And here, reliable data is important. Auditors have a key role here – to drive reliable positive data that consumers, government, stakeholders can trust companies and better work together with them."

"Unless you make what is important easy to measure, what is easy to measure will become very important."

Key takeaways

i. Sustainability information should ultimately be of the same quality, and be as reliable, as financial information. This is not an easy task and may require companies to invest in people, processes, and systems to effectively source, distill, and guarantee the data.

ii. To be decision-useful, and combat claims of greenwashing, companies should report a balance of quantitative metrics with a clear and honest narrative reflective of company actions and performance – good or bad. Consistent metrics, coupled with sufficient details about the company's business model, are important for stakeholders comparing companies.

iii. Stakeholder engagement is important. Companies must balance what is material to the company with what is of interest to various stakeholder groups with cost and usability. The needs of those using sustainability reporting will change over time. This will require companies to monitor and be responsive to the evolving landscape.

iv. Sustainability is not just about reporting and regulations; it should be central to a company's business model and strategy. Factors such as political engagement on sustainability issues or new sustainability innovations are data points that companies should be capturing and measuring.

4. Blackrock, 'Sustainability goes mainstream, 2020 Global Sustainable Investing Survey'.

3. Integrating sustainability into company business models

Sustainability is not fully understood across all levels of company management, including within the board and the C-suite. Sustainability reporting cannot be authentic, and address the challenge of greenwashing, until sustainability is integrated into decision-making and operations across the organization. Only approximately half (52%) of Audit committee respondents to Deloitte Global's 2021 survey[5] felt that their company had the information, capabilities, and mandate to fulfill their responsibilities in respect to climate change.

It can be hard for companies to know where to start when integrating sustainability considerations into business processes and controls, especially when reporting standards are not fully adopted and may still change. But the challenges extend beyond reporting to the creation of meaningful metrics and robust targets, and the development and implementation of strategy.

What we heard

"The area that we've not tackled is business integration and the transition. We are focusing on the directive of reporting, conditions, etc., but reporting is only one part. The next step is to improve the quality of transition plans."

"We need a management and governance system to facilitate the generation of information, enhance capabilities and competencies, establish assurable processes, and implement technology. The goal is to develop a standardized, replicable process of how to use information with rigor and consistency to achieve comparability."

"If you don't have governance, you can't talk about having environmental or social disclosure. To be transparent, you need governance. It's the foundation and the base."

"The talent gap is a threat. There is more demand for resourcing, knowledge, and ESG-related competencies than there is supply. This need will continue to grow as industries scale and shift capital in significant ways."

"We need to prioritize what's material, but if we prioritize too much, we will have a narrow view and miss opportunities to gain efficiencies and generate impact in how our operations and resource inputs interact and connect. We will miss something important from a risk perspective or miss opportunities to unlock interconnected benefits."

Key takeaways

i. The sustainability mindset should be embraced beyond specific teams; it should be fully integrated across all operations and processes. Knowledge should extend beyond the Chief Sustainability Officer to the C-suite and throughout the board. Internal capacity and competencies within the workforce should also be enhanced through training.

ii. *Integrated thinking* about sustainability risks and opportunities is fundamental to a comprehensive and connected enterprise risk management system. It makes the business and its governance more resilient and agile, unlocking opportunities and stimulating innovation.

iii. Effective *corporate governance* is critical to embedding sustainability into the company's operational model and to delivering authenticity in the company's sustainability reporting. As a starting point, the board should define its governance structure, policies, and practices that provide a framework for overseeing accountability and strategic focus on sustainability.

iv. Incentivizing directors and senior management by linking sustainability performance to remuneration may reinforce behavior change within a company. Sustainability targets should be outcome-based and directly within the control of management.

5. Deloitte Global, *'Frontier Topics for Audit Committees: Climate & Audit Committee'*

4. Incentives and penalties

Effective regulation and enforcement need to accompany the drive to comparable, consistent, reliable, and decision-useful sustainability information. Market forces alone cannot deliver the scale and magnitude of the change that is needed to move to a sustainable future; public and private sector collaboration is key to achieving a more sustainable future. Policy interventions and legislative changes in the form of incentives and penalties should be employed to accelerate this change.

What we heard

"There are four sets of tools governments can use to drive the green transformation of the economy: 1. Fiscal expenditures to drive purchasing of green products and stimulate economic demand (subsidies, purchases), 2. Taxes to disincentivize brown consumption (carbon taxes), 3. Financial policy to provide low cost funding/ financial resources of green projects (e.g., through commercial banks), and 4. Sectoral regulations (e.g., such as green building codes and regulations banning fossil fuel vehicles."

"We should also encourage "long owners" (public and private pension funds, and insurance companies) to work together and create a new paradigm of good governance in asset ownership, allocation, performance measurement, asset manager mandates, etc. If they did so, this would drive change across the financial services industry."

"Each country has the right to pick a policy mix – a toolbox. Each tool has a role and some are more focused on banking-related policy while others are focused on trading systems."

"Carbon markets can make a difference in the race towards net zero but they face challenges. There seems to be considerable skepticism about the quality of carbon offsets. ESG reporting can help allay these concerns by infusing greater transparency and accountability into the certification process and increasing investor trust in these markets."

Key takeaways

i. Standards are not a replacement for relevant laws. Regulators and other mechanisms of enforcement are critical to eliminate greenwashing and fraud. Enforcement through enhanced financial regulations and legislation and registration requirements (e.g., stock exchange registration), will be key to drive reform across the financial market and how it engages with corporates.

ii. Financial services – from banking to insurance and pension funds – can help to accelerate behavior change by funding sustainable initiatives. Access to finance is critical to accelerate organizational change. But a Bloomberg analysis of sustainability linked revolving credit lines and term loans arranged in the US since 2018 showed more than a quarter had "no penalty for falling short of stated goals and only a miniscule discount if targets are met".[6]

iii. Taxes and subsidies are influential and complementary tools for market acceleration. Taxes, including, but not limited to, carbon and consumption taxes, can disincentivize use of unsustainable or socially harmful products and services. Likewise, subsidies can catalyze positive behavior. They serve to capture the cost of negative externalities where the market fails to do so.

6. ESG Financing Comes With Few Penalties for Missing Goals - Bloomberg

5. Stakeholder engagement

Each stakeholder (investors, policymakers, customers, employees, communities, etc.) has a distinct role to play in holding companies to account. However, many do not fully understand the complexities of the sustainability reporting landscape or are not equipped with the knowledge, skills, or information to effectively engage with companies and hold them accountable. Annual reports and financial statements which contain vast amounts of data on corporate performance are often too long and complex to meet stakeholder needs.

What we heard

"Perceptions may be right or wrong but they are real. You need to involve customers, communities, employees, community leaders – they have the role of asking the right questions and engaging with companies as they change."

"It is difficult to properly communicate through an annual report on financial and extra-financial performance internally. Distinct communication is needed for internal stakeholders to help demonstrate what the company is doing across its operations. Every time you improve ESG communications within a company, it enhances internal culture, motivation and pride."

"One of the major limitations to broader system-level change is that ESG reporting is largely geared towards the investor, as opposed to other stakeholders that are both impacted by, or could impact, the corporation. This is a fundamental flaw as this perpetuates a system where finance, investment and profit are the most important."

"In some jurisdictions, the board is legally accountable to multiple stakeholders, but the question is - what is the reporting that enables those stakeholders to ensure that the board is fulfilling that responsibility? I think companies need to think about ESG disclosure in the in the same way they think about communications strategy broadly – tailoring information to the needs of the user. You don't use the same communication vehicles that you use internally with your employees with your clients. You tailor information to people's needs and companies need to think about ESG information in that same lens."

Key takeaways

i. More support, advocacy, and pressure from capital providers and the investor community could be crucial in encouraging corporate leaders and directors to prioritize sustainability programs. As suppliers of finance, they are in a stronger position to influence the company. Capital providers should also make their voice heard by regulators and policy makers across all jurisdictions.

ii. Companies need to be transparent in sharing their long-term plans and reporting progress against them. Stakeholders should recognize that change will take time. To support this, dialogue should be two-way and all channels of engagement should be leveraged to reinforce and encourage the pathway to change.

iii. Each stakeholder group should have access to educational tools and resources to navigate and understand the sustainability reporting environment as it relates to them. NGOs, philanthropists, and other civil society actors can support stakeholder mobilization and capacity building and use the information strategically and influentially.

iv. Third-party tools, such as brand certifications, and rating mechanisms are also useful although these tools must be as robust, transparent, and well-governed as formal sustainability reporting.

6. Industry and global coordination

Transformation at pace will require strategic efforts to drive coordinated implementation between sectors and industries, across peers, and throughout supply chains. A holistic *system-level approach* can unlock critical opportunities for collaboration in the transition to a sustainable economy. Lack of synchronization to date has created obstacles and complexities, disincentivized behavior change and runs the risk of leaving small to medium-sized enterprises behind.

What we heard

"System-wide engagement is key. A global baseline for ESG reporting will only be successful if there is continuous engagement between standard setters, regulators, asset managers and investors, industries and sectors from the initial stages of development all the way through to implementation."

"Thought leadership, frameworks, standards, benchmarks are critical, but we need this to be implemented. The best thing you can do as a company is share a best practice, share a template, share a product or technology, and articulate simply – people latch on to that. They need a line of sight and every industry has a few corporate models that are better able to take on this topic and show how to navigate through it."

"Small to medium-sized companies and corporates in emerging markets will experience disproportionate challenges in providing transparent information, which will impact their ability to receive capital investments and be competitive. They will experience disproportionate challenges in affording and resourcing systems and processes, they may not have the in-house guidance to navigate differing regulatory landscapes, and may not be able to benefit from professional advisory services. They will be most likely to be left behind and it's important regulators pay attention to this when crafting ESG standards."

"International economic policy coordination needs a bigger role… Setting promises, goals, and targets isn't sufficient. It's about the transition of the private sector and the economy, and for this you need to get incentives, institutions, and investments aligned. This is the stuff of the international economic policy coordination - trade, financial, and development assistance. Plurilateral cooperation among a group of influential countries that agree to align their regulations and incentives in these areas, including as they relate to ESG disclosure, would scale what needs to happen in their own jurisdictions and set an example for other economies to follow."

Key takeaways

i. Industry and sector-level peers should accelerate working together and commit to industry accountability, building on existing industry specific standards.

ii. Governments should consider collaborating with companies to facilitate what cannot be achieved by any one company. They should highlight industry exemplars that have successfully integrated sustainability within innovation, technology, and operating models.

iii. Small to medium-sized entities, especially those in emerging economies, may require coordinated support from government, large business, and civil society to help them adapt their business models and meet reporting requirements.

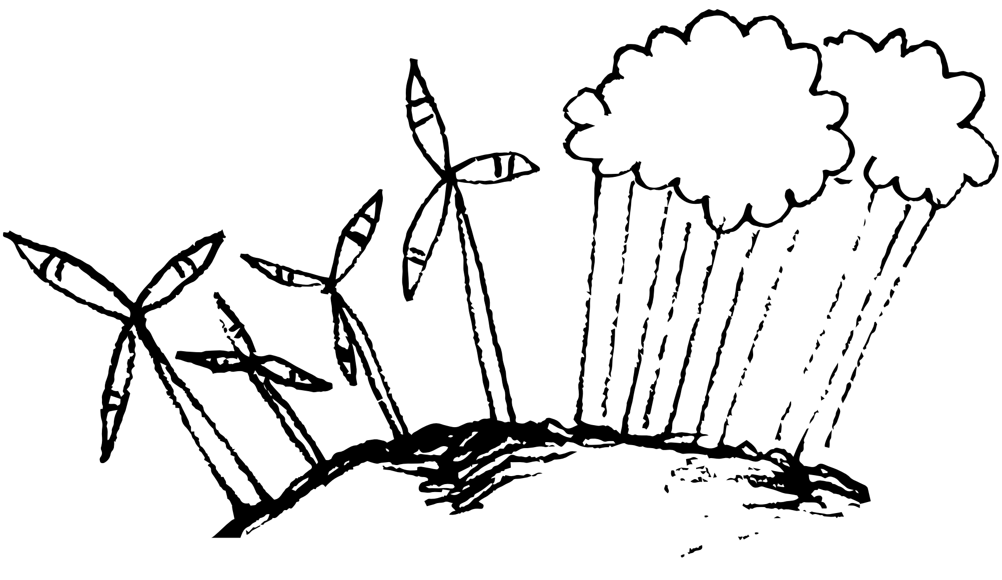
iv. An international effort is needed to incorporate sustainability reporting principles and broader economic behavior change into economic, trade, and foreign policy. Collaborating on common areas that promote the collective ability to transition will enable progress in hard-to-abate sectors, support the development of carbon markets, and scale an environment committed to sustainability and positive social impact as a fundamental part of financial and economic growth.

Conclusion

High quality, robust sustainability reporting is essential to providing stakeholders with insight into a corporation's development, profitability, position, and prospects through a more complete assessment of enterprise risk and opportunity. However, sustainability reporting is not an end in itself.

"Transparency on impact is the next big evolutionary milestone for business, investment, and capitalism. Our economic system is creating and aggravating social and environmental issues driven by a focus on profit alone. But values have changed"

To embed sustainability considerations into business decision-making and to drive behavior change within corporates and beyond, requires an environment conducive to this change. It demands clarity of direction, an unambiguous globally consistent baseline and a clear path forward to bring all stakeholders on this journey. Many stakeholders have a key part to play in creating a more sustainable future. These six conditions will serve to navigate this process.



Contributors

The interviewees represent a cross-section of stakeholder groups within the sustainability reporting landscape and in areas adjacent which influence and inform the adoption of sustainable decision-making. This includes standard-setters, regulators, policy experts, corporates, investors, academics, NGOs, and philanthropists.

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