High expectations for the new transparency

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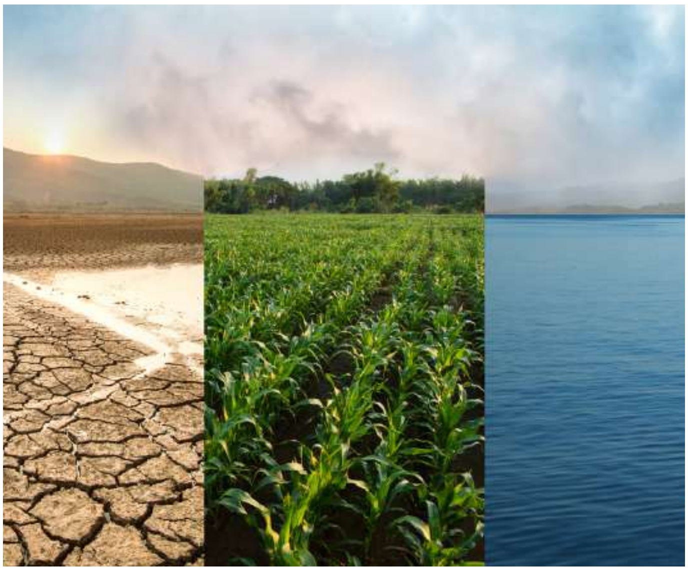
The transparency regulations in the EU and Switzerland regarding sustainability will change non-financial reporting. In the future, business reporting must be able to do more than just give an account of the past financial year and strengthen the company's image. It must ensure that companies have a "license to operate" and make the world a better place: a mammoth task.

Climate change is progressing with visible effects. The "1.5 degree target" of the Paris Climate Agreement of 2015 hardly seems realistic anymore. Business has a major role to play in combating climate change. However, the transition to more resource-efficient business models is not proceeding at the pace set by climate change. One of the reasons is certainly the lack of pressure from the capital market and consumers for a more far-reaching transition. In a classic approach, the capital market focuses primarily on specific ESG criteria and less on the broader understanding of sustainability. In ESG criteria, investors evaluate what a company is doing in the areas of environment (E), social (S) and governance (G). Based on this assessment, the capital market mainly wants to know how the environment (e.g. climate change) affects the company or an investment (outside-in perspective). This fact has already been taken up in annual report reporting for some time, as the increasing number of sustainability reports shows. In addition, the majority of ESG ratings are based on this outside-in perspective. A good ESG rating primarily shows that a company is prepared for the changing environment in terms of sustainability. A good ESG rating is mandatory today, but it also lulls you into a false sense of security.



The EU's disclosure offensive wants more, it wants to save the climate. A good rating is not enough anymore.

Sustainability is more than ESG

To effectively combat climate change, a broader stakeholder view of the issue is needed, from ESG to sustainability. Sustainability additionally looks at what impact a business model has on the environment and the world in general (inside-out perspective). Sustainability looks not only at what a company does, but how something is done, which puts the focus on the corporate strategy and the business model. Customers are already sensitized to sustainable business models, but they do not yet participate to any great extent in the transaction costs by wanting to pay more for sustainable products. Since there is a lack of major impetus from both the capital and consumer markets, the transition is not yet being driven forward quickly enough. This circumstance calls politicians to the scene, who try to accelerate the transition of the economy with regulation. If the terms ESG and sustainability continue to be equated, trust will not be created in the long term because they have different effects.

Transparency should improve the world

In 2018, the EU Action Plan on Financing Sustainable Growth was launched. Originally intended as measures to achieve the Paris climate targets, it was the start of an actual wave of regulation that has not subsided to this day. The goal is nothing other than the restructuring of the economy and its decarbonization. For this reason, the expectations for regulation and the transparency that comes with it are very high, probably too high. With the disclosure regulations, policymakers have stoked an expectation that is difficult to live up to. In particular, the new regulations on non-financial reporting are challenging the reporting of companies.

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The importance of the reporting process increases significantly and the departments responsible for business reporting suddenly gain a lot of attention. With non-financial reporting, a product is created that establishes new processes that will have a direct impact on corporate strategy. However, transparency alone will not change business models. But it will show the impact of previously launched initiatives and promises made by companies. Thanks to the new transparency, investors and consumers should know which companies are sustainable and adjust their own behavior accordingly, according to the legislator's idea. If this happens, it will accelerate the transition that is urgently needed due to climate change.

Building trust is a long road

However, companies will first be confronted with major additional efforts in order to be "compliant" at all. Non-financial reporting requires new skills, which companies must first acquire in order to meet the expectations. In the future, non-financial corporate data will have to be disclosed, which in most companies has not been collected so far or has been collected in very different ways. The non-financial information must also be appropriately plausibilized and consolidated. This requires new processes to be set up, an additional expense without any direct or short-term economic benefit. It will take time until the non-financial reporting has been established, and the new corporate reporting process is in place. Time in which the transition of business models threatens to stall. Time, too, in which it becomes difficult to build trust with stakeholders due to the abundance of new information: because transparency alone does not create trust.

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This in turn can lead to frustration due to the lack of impact of regulation among politicians and the public. If this happens, legislators will do what they do best: Draft new laws that directly intervene in companies' business models. Instead of banning technologies and business models, externalities must have a price so that the market starts to play. But policymakers are having a hard time with this.

Companies would therefore do well to see the new disclosure regulations as an opportunity. Even companies that have not yet addressed the issue of sustainability or do not have any major ambitions must implement the regulations and, in doing so, also comment on the opportunities in connection with sustainability aspects. The new transparency should be an incentive to think about how future-oriented one's own business model is. After all, as a company, you will always be more successful in the long term if you manage the change yourself.

About the Author

Dominik Marbet has been Head of Public Affairs & Sustainability at the Baloise Group since 2015. He has been involved in business reporting for 20 years and has over 20 years of experience in corporate communications, including in the IT, chemical and insurance industries. He established Baloise's sustainability strategy and is responsible for non-financial reporting in addition to sustainability strategy and management.