Business Ethics Briefing

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Business Ethics in Corporate Reporting

Corporate reporting is "*not what it used to be*".[1] The growth of Narrative, Sustainability and Integrated Reporting have created a space in which business ethics is being reported in external company reports. This Briefing looks at how the three initiatives listed above have facilitated the reporting of business ethics, what organisations are saying about how they conduct their business, and areas in which more information could be reported.

Changes in Corporate Reporting

Traditionally, corporate reporting has been a focused account of an organisation's financial performance for the preceding year. The 'flag bearer' was the Annual Report which was considered to be the "*primary source of authoritative information about a company*".[2]

However, it is agreed that financially focused reports do not provide a sufficient depth of insight into a company's true performance. The issue is captured by one respondent in research conducted by Tomorrow's Company: "*given the complexity of the economy, the focus of our corporate reporting is too narrow. It is too financially focused.*"[3] Recent thinking suggests that the changes in corporate reporting have not kept up with the changes in corporate activity. Research conducted by intellectual property bank Ocean Tomo shows that 30 years ago around 80% of the market value of a company was recorded on its balance sheet, by 2010 that figure was approximately 20%[4]. This increases the necessity for a compelling narrative to complete the picture.

Over the last decade, this issue has moved into the mainstream as shareholders, and also a wider range of stakeholders, have called for greater transparency on all areas of business performance. Consequently, a number of initiatives aimed at developing corporate reporting have emerged.[5] All large listed companies in the UK are required, as part of their Annual Report, to include a Strategic Report (covering the business model, strategy, objectives and principal risks, a review of the year and future outlook)[6], as well as report on emissions and human rights and follow new remuneration regulations. With effect from 30 September 2013 year ends onwards the UK Corporate Governance Code requires boards of premium listed companies to make the following statement in the annual reports: "*The board confirms that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the performance, strategy and business model of the company*". Companies therefore need to tell their 'story' to shareholders differently to how they have done in the past, with a clearer expression of the business model and the risks faced.

Within this reporting landscape there are a number of initiatives aimed at developing guidance and structure for all or part of the corporate information which needs reporting. In particular, **Narrative** and **Integrated Reporting** are both aimed at improving the quality and consistency of the 'story' that is told in reports, ensuring it matches the numbers. **Sustainability Reporting** is a further initiative aimed at providing relevant information to a wider range of stakeholders. All are gaining momentum internationally; a description of each is given in Box 1.

These developments have presented the opportunity and necessity for companies to report on non-financial issues, including business ethics.

1. **Professor Mervyn E. King (2011)** in *Tomorrow's Corporate Reporting – a critical system at risk*. See fn[3]
2. **Investor Relations Society (IRS) (2014)** – Best Practice Guidelines for Annual Reports.
3. **Tomorrow's Company (2011)** – Tomorrow's Corporate Reporting: a critical system at risk.
4. **Ocean Tomo (2013)** – The data, article in Financial Management Magazine, July/August 2013, accessed 23/05/14.
5. ibid fn [3].
6. **Deloitte (2013)** – The Strategic Report: a practical guide to the new regulations.

Box 1 *Narrative, Sustainability and Integrated Reporting*

Narrative Reporting. Narrative reporting is the term given to all non-financial information included in annual reports. It includes the directors' report, the chairman's statement, the directors' remuneration report and corporate governance disclosures, and is intended to provide a broader and more meaningful snapshot of an organisation.[7] There are a variety of public and private initiatives aimed at developing and improving narrative reporting, including the Integrated Reporting Framework; the United Nations Global Compact; and the Global Reporting Initiative (GRI).

Sustainability Reporting. According to the GRI[8], "*Sustainability reporting helps organisations to set goals, measure performance, and manage change in order to make their operations more sustainable. A sustainability report conveys disclosures on an organisation's impacts – be they positive or negative – on the environment, society and the economy. In doing so, sustainability reporting makes abstract issues tangible and concrete, thereby assisting in understanding and managing the effects of sustainability developments on the organisation's activities and strategy.*"

Integrated Reporting. Integrated reporting is a movement towards creating a report which is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term.[9] It aims to: improve the quality of information available to providers of financial capital; promote a more cohesive and efficient approach to corporate reporting, communicating the full range of factors that materially affect the ability of an organisation to create value over time; enhance accountability and stewardship for a broad base of capitals and promote understanding of their interdependencies; and support integrated thinking, decision-making and actions.[10]

Ethics in Reports

As interest in the organisation behind the numbers grows, how businesses create and sustain value has become more important and additional focus is being given to business ethics as well as issues of governance, corporate values and culture. The use of materiality analyses, whereby an organisation identifies the issues which are most salient to the business and are of concern to wider stakeholders, highlights this. For example, **G4S** report that its biennial Corporate Social Responsibility materiality exercise highlighted '*business ethics and anti-corruption'* as one of three core priority areas for 2014.[11] The **Ericsson** materiality analysis matrix identifies '*anti-corruption'* and '*human rights'* as two of the most important issues which require addressing and active engagement.[12] Materiality assessments are increasingly created as a result of stakeholder consultations suggesting a more collaborative approach to reporting, based on two-way communication.

Reflecting these shifts, metrics linked to business ethics are now becoming more commonplace in external company reporting. These include areas such as: the number of reports to the Speak Up (whistleblowing) line; online training metrics – especially in the area of bribery/corruption and human rights; staff engagement results; staff turnover rates; health and safety records; diversity reporting (the percentage of women on the board, in senior management and across the company as a whole); and greenhouse gas emissions.

Despite this move towards more rounded corporate reporting, many of the metrics used focus on outputs which management believe are consistent with ethical behaviour rather than explaining the actions and processes in place to ensure high standards of business conduct are achieved. The IBE defines business ethics as "*the application of ethical values to business behaviour*". Reporting on how these values are applied in the day to day running of the business is not, as yet, routine although some notable examples can be found. For example, the 'tone from the top' is outlined well in a number of current reports (see Box 2).

7. ibid fn [6].
8. **GRI** – G4 Sustainability Reporting Guidelines: reporting principles and standard disclosures, accessed 01/05/14.
9. **IIRC (2014)** – What is Integrated Reporting? accessed 17/04/14.
10. **IIRC (2013)** – The International <IR> Framework, accessed 01/05/14.
11. **G4S (2014)** – Corporate Social Responsibility Report 2013.
12. The Ericsson Materiality assessment can be viewed at http://www.ericsson.com/thecompany/sustainability-corporateresponsibility/materiality, accessed 01/05/14.

Box 2 *The 'tone at the top' in reports*

BAE Systems, Sir Roger Carr, Chairman's Letter, Annual Report 2013
"*In addition to improved performance, there is no doubt that under Sir Richard [Olver's] Chairmanship, the Board established a culture of good governance and high business ethics. These have been adopted across the business and are respected throughout the industry.... Its culture and ethos have been established to achieve the highest standards: honesty and openness in all business dealings, respect for those that work for the Company, appreciation for those that trade with the Company and recognition and reward for those that own the Company*".

Sainsburys, David Tyler, Chairman's Letter, Annual Report and Financial Accounts 2013
"*Our unique values and strong culture are at the heart of our success, and this remains as true today as it was when we were founded 144 years ago*".

L'Oreal, Board of Directors, Annual Report 2013
"*The Board places great importance on the respect of L'Oréal's Ethical Principles – Integrity, Respect, Courage and Transparency – and more generally of the Code of Business Ethics. These commitments are the foundation notably of the group's policies on responsible innovation, environmental stewardship, social and societal responsibility and philanthropy*".

Such statements are to be considered good practice, however they are currently not universally adopted. The Grant Thornton Corporate Governance review of 2013 observed that "*efforts by chairmen to emphasise culture and values as the cornerstone of good governance has stalled*", with only 57% of chairmen using their statement to promote their importance.[13]

Developing effective metrics for ethics is beginning, but much more is needed to be done. Three organisations which do explicitly address ethics in their Corporate Responsibility Reports are **WPP**, **Northrop Grumman** and **GSK**. Each of these companies provide an overview of their company ethics programme, list and apply the organisation's core values and address misconduct.

Addressing Misconduct

Some reports go beyond listing good achievements and communicate their organisational commitment to doing business ethically by addressing how the company is actually doing and reporting openly on such information. They report on how they have addressed ethical challenges over the preceding year in a way that builds and maintains confidence in the organisation. **WPP** do this well, acknowledging in their Sustainability Report that despite the "highest of intentions" mistakes still happen:

> "*Recently, for example, 'scam' ads produced purely for advertising festival awards and never actually run, were produced in India for one of our most important clients. These were offensive and unforgiveable. Appropriate action was taken in respect of those immediately responsible but it is felt by senior management and the Board that a more comprehensive and independent cultural review needs to be taken to ensure that this does not happen again*".[14]

The area where this is seen most frequently is in public disclosures of reports to corporate Speak Up lines. The majority of organisations reporting these figures provide the basic metric of total number of reports received. Some organisations give more in-depth information about the reports, including a breakdown by geography, their type, the number which turn out to be substantiated and an overview of the different outcomes. For example, **Northrop Grumman** reported in its Corporate Responsibility Report that:

> "*We had a total of 2,379 OpenLine contacts in 2012, including 1,148 questions on policies and procedures. The 2012 contacts included 684 workplace allegations and 547 business allegations, many of which required substantial investigation. In these investigations, we took various disciplinary actions including termination of 76 employees for their ethics and business conduct violations*".[15]

And **Diageo**, in its Sustainability and Responsibility Report, stated:

> "*There were 743 suspected breaches reported this year, compared with 601 in 2012, of which 376 were*

13. **Grant Thornton (2013)** – Corporate Governance Review 2013, accessed 23/04/14.
14. **WPP (2013)** – Sustainability Report 2012/2013.
15. **Northrop Grumman (2013)** – Corporate Responsibility Report 2012.

subsequently substantiated compared with 388 last year".[16]

The **BP** Sustainability Review 2012 provides an extra level of detail. In addition to reporting on which section of the code reports refer to, it also includes information related to the termination of supplier contracts for failing to meet expected ethical standards:

"*In 2012, our businesses reported 424 dismissals for non-compliance or unethical behaviour.... In 2012, our businesses reported that six suppliers' contracts were either terminated or not renewed*".[17]

Another organisation which reports transparently on these issues is **Adidas**. In its 2013 Sustainability Progress Report – Fair Play, the company report contract terminations with suppliers by geography. In 2013, contracts were terminated with six suppliers from Asia, two from the Americas and one in EMEA due to non-compliance issues.[18]

Future Developments

Adopting such a transparent approach to corporate reporting increases the validity of the report and mitigates accusations of 'greenwashing' or the paying of 'lip service' to issues that really matter. However, reporting on business ethics need not be limited to addressing issues of misconduct. In addition to the tone at the top, performance metrics on issues such as customer complaints, staff turnover rates, results of staff surveys – especially responses related to employee perception of the values and culture of their workplace, staff morale and stakeholder engagement could be recorded. These elements must be presented in an integrated manner which reinforces how the business is run and how they impact the overall picture of the business, its strategy, performance and future prospects.

About the IBE

The IBE was established in 1986 to encourage high standards of business behaviour based on ethical values.

Our vision is to lead the dissemination of knowledge and good practice in business ethics.

We raise public awareness of the importance of doing business ethically, and collaborate with other UK and international organisations with interests and expertise in business ethics.

We help organisations to strengthen their ethics culture through effective and relevant ethics programmes.

The IBE is a registered charity, supported by subscriptions from businesses and other organisations, as well as individuals.

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16. **Diageo (2013)** – Sustainability & Responsibility Report 2013.
17. **BP (2013)** – Sustainability Review 2012.
18. **Adidas (2014)** – Sustainability Performance Report 2013 Fair Play.