Regulatory and Policy Coherence on Sustainability Reporting in Africa's Corporate Governance Framework: Lessons from Home and Abroad

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Theme:

Dissecting the Legal and Regulatory Framework for Doing Business in Africa

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Outline

- Introduction
- Theoretical Framework
- Sustainability Reporting
- Regulatory and Policy Frameworks
- Conclusion and Recommendations

Introduction

- Sustainability Reporting (SR) or Non-Financial Reporting (NFR) requires companies to give account of their Environmental (E), Social (S) and Governance (G) activities.
- Financial account as only measure of performance is changing
- Almost 400 regulations on SR across 64 countries (Carrot & Stick Report, 2016) - 180 instruments across 44 countries in 2013.
- Driving factor in regulatory reforms – regulatory growth in Europe, Latin America and Asia Pacific with 'comply or explain' approach
- Africa slow in responding to transparency and accountability for corporations with regards to SR except for few countries
- Duplication and overlaps in SR frameworks – need for coherence, coordination and harmonization

Introduction II

Aim: to explore regulatory and policy coherence on SR in Africa.

Question: to what extent can the African region develop its own corporate governance and legal framework on SR for companies operating in the region.

Significance

- honing corporate strategy;
- improving competitiveness;
- driving efficiency;
- mitigating risks; and
- ensuring a stable financial system for Africa.

Theoretical Frameworks

- **Theory of the Firm -** profit maximization as basis for company's existence
- Influenced by writings of Adam Smith and advanced by work of Coase (1939) on transactions costs
- In relation to SR – companies have no business with SR
- **Stakeholder theory –** purpose of a company is to serve as a vehicle for the coordination of the interests of stakeholders
- Originates from the work of Freeman (1984) who defined stakeholders as:

  "Persons that may affect the achievement of the organization's goals or that is affected by the process of searching for these objectives"

Theoretical Frameworks II

- Primary and secondary stakeholders (Clarkson, 1995)
- Companies should give greater importance to primary stakeholders – those essential to the survival of the company
- Normative or ethical and positive or managerial elements
- Ethical – treat all stakeholders fairly irrespective of power relations.
- Managerial: companies are more interested in their primary stakeholders
- Information a tool to 'manage' stakeholders aimed at getting their support
- In relation to SR – companies to disclose ESG activities to stakeholders
- But to what end?

Theoretical Frameworks III

- **Legitimacy Theory** – "generalized perception that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995)
- Companies are bound by societal norms – social contract
- Norms evolve and companies must adapt to change
- Institutional legitimacy and Strategic Legitimacy
- The assumptions of institutional legitimacy?
- Strategic legitimacy the focus within context of discourse
- Low and high legitimacy – societal sanctions with former
- In relation to SR – companies voluntarily engage in ESG disclosures to prevent society's sanctions.

Sustainability Reporting

- Company performance measured from monetary value utilising financial information.
- SR – disclosures made by companies on the positive and/or negative impacts of their activities on the environment, society and the economy (Hassaan, 2016)
- SR –integration of financial and non-financial information, providing stakeholders with enhanced information for more informed decisions – bigger or comprehensive picture
- SR – enables firms to set goals, measure performance, and manage change aimed at making operations more sustainable (KPMG, 2013; GRI, 2013).
- Companies are increasingly considering sustainability reporting to be a business imperative (Jones *et al.*, 2014)

Sustainability Reporting II

- The CSR-CFP link investigated – positive, negative, and neutral relationships
- For South Africa, Savage (1994); For Nigeria, Amaeshi et.al, 2006; Ngwakwe, 2009; Guobadia, 2000; Worgu, 2000)
- Financial reporting often mandatory while SR has been voluntary
- But access to SR as a 'right to know' hence mandatory trend
- The extent of corporate disclosures in annual reports is lower in DCs than in the developed countries (Okoye, 2009)

Sustainability Reporting III

Standards and Frameworks

- International Standards of Accounting and Reporting (ISAR)
- International Financial Reporting Standards (IFRS)
- AccountAbility 's AA1000 AccountAbility Framework Standard
- UN Global Compact
- ISO 26000
- Global Reporting Initiative

Regulatory and Policy Frameworks

EU Framework

- Directive 2014/95/EU (EU NFR Directive) amending Directive 2013/34/EU
- Applies to large undertakings that are Public Interest Entities (PIEs) with an average of 500 employees over its financial year and that:
- issues transferable securities that are admitted to trading on a regulated market in the EU;
- is a credit institution (a bank or building society, not a credit union);
- is an insurance undertaking; or,
- is designated by a MS as a PIE (for instance because of its business, size, or the number of its employees).

Regulatory and Policy Frameworks II

- Requires disclosure by companies and groups in scope of their activities on environmental, social, employee, human rights, and anti-corruption matters, including a brief description of :

i. their business model;

ii. information on their policies;

iii. outcome of these policies;

iv. principal risks related to these matters; and

v. any relevant non-financial key performance indicators

- Unquoted companies falling within definition will comply
- Applies to EU companies regardless of domicile

Regulatory and Policy Frameworks III

- May extend to supply and subcontracting chains
- No specific framework suggested but companies may employ international, European or national guidelines for developing report
- Member States may require third party or independent verification of the submitted NFR.
- Provides consistency and conformity across Europe in relation to disclosure requirements

India

- Companies Act in 2013 - legally mandates sustainability reporting
- Companies (Corporate Social Responsibility) Rules
- Circular No. 21/2014 in June 2014

Regulatory and Policy Frameworks IV

- Companies to spend percentage of profits on CSR activities in India
- Financial criteria: 1. companies with net worth of INR 5,000 million or more (US $ 160 million); 2. companies with turnover of INR 10,000 million or more (US $ 83 million); and 3. companies with net profit of INR 50 million or more (US $830,000).
- Applies to all Indian companies – public, private and foreign
- Failure to meet financial criteria for 3 consecutive years
- Projects that satisfy obligations – hunger, poverty and malnutrition eradication, making available safe drinking water; promoting education, employment and health care; and ensuring environmental sustainability; contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government; and rural development projects.

Regulatory and Policy Frameworks V

- Circular No. 21/2014 – activities listed in the Companies Act are not necessarily exclusive
- Contributions or donations to political parties excluded
- Obligation to fund CSR activities coupled with mandatory reporting in Annual Reports or websites showing compliance with Companies Act

South Africa

- SA Companies Act (71 of 2008) introduced CSR unlike CA (61 of 1973)
- S. 7(k) requires companies to balance the rights and interests of all relevant stakeholders
- S. 7(a)(iii) encourages (not oblige) companies to be transparent and to adopt high standards of governance.
- S. 7(d) confirms CSR's role by alluding to government's objective of using companies to achieve economic and social benefits.

Regulatory and Policy Frameworks VI

- Investors to meet requirements of the Socially Responsible Index (SRI) of the Johannesburg Stock Exchange (JSE) or the Principles for Responsible Investment (PRI) based on King III
- Despite King III being voluntary governance code, section 7.F.5 of the JSE regulations makes it mandatory for all JSE-listed companies to apply the King III principles, on an "apply or explain basis".
- Other examples of mandatory SA sustainability disclosures include those relating to safety, health and environmental legislation, employment equity and broad-based black economic empowerment (BBBEE)
- Growth of PRI signatories since launch in 2005 – 1, 200 signatory organisations by 2014
- Signatories commit to act in the interests of their beneficiaries, and accept that ESG issues can affect the performance of their investment portfolio.

Conclusion and Recommendations

- Private sector's ESG activities veritable tool to advance the development of society – innovative and efficient
- However corporations cannot fill the role of, or substitute the State
- African region to play role in its development – not uninterested regulator
- AU to set the framework for SR utilising lessons from home (SA) and abroad (EU, India, China, etc) – coherence in framework
- However, SR standards needs to be harmonised to allow for coherence in reporting
- African leaders to exercise political will in ensuring that corporations operating on the continent observe best practices