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The idea of introduction of a fully regulated CSR reporting system

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Abstract: This article discusses the concept of Corporate Social Responsibility (CSR) and explores the potential benefits and drawbacks of implementing a regulated system for reporting CSR activities. It highlights the existing soft law arrangements and voluntary self-regulation systems, such as international accountability standards and reporting standards like the Global Reporting Initiative (GRI). The document argues that a regulated CSR reporting system could provide defined legal limits, increase transparency, and improve overall corporate governance practices. The potential benefits of CSR regulation include improved financial performance, employee welfare, product quality, and responsible innovation. However, there are also drawbacks such as increased monitoring and administrative costs, the challenge of choosing a global regulator, and the trade-off between CSR and profit-related activities. Ultimately, the document suggests that a well-regulated CSR reporting system could lead to a balance between CSR and profit, benefiting both society and businesses.

Keywords: Corporate Social Responsibility, stakeholder theory, transparent reporting system, management, reporting standards

Introduction

In today's world Corporate Social Responsibility (CSR) plays an increasingly important role in operations of multinational corporations and society in general. Managers of such corporations pay more and more attention on the ways to report on corporate sustainability and social aspects, thus, adhering to the needs and requests of key stakeholders, which comprise shareholders, management, workers and other economic agents such as suppliers, customers and financial institutions.

So, what is Corporate Social Responsibility? Corporate Social Responsibility has several key definitions. It was defined as 'a strategic decision whereby an organization undertakes an obligation to society,for example in the form of sponsorship, commitment to local communities, attention to environmental issues, andresponsible advertising' (Ness, 1992: p.1). Also, another definitionwas provided by Banerjee as 'the commitment of business to contribute to sustainable economicdevelopment working with employees, their families, the local community and society atlarge to improve their quality of life' (2008, cited in World Business Council, 2005: p.15).

Furthermore, Banerjee (2008: pp.18-19) argued that 'the primary relationship between business and society has and continues to be an economic one, rising public concern about the social and environmental impacts of economic growth and increased legislation in areas of social welfare and environmental protection led many corporations to assess the social and environmental impacts of their business activity'. The main ideas behind implementation of CSR by corporations are taking care of social and environmental issues, behaving in ethical manner and, ultimately, engaging society to provide support and increase social welfare.

Many corporations acknowledge that they need to provide regular reporting on their CSR activities so that investors and the public can observe what actions were taken to support their sustainability efforts. It was noted that 'over the last two decades there has been a proliferation of international accountability standards (IAS) intended to encourage and guide corporate responsibility, and to provide multinational corporations (MNCs) with ways to systematically assess, measure and communicate their social and environmental performance' (Gilbert, Rasche, and Waddock, 2011: p.23).

Unlike financial reporting, where there are strict reporting guidelines (e.g. International Financial Reporting Standards, US Generally Accepted Accounting Principles) and legal requirements from authorities, CSR reporting is not regulated by law. Thus, it is so-called soft law arrangementsand not enforceable through binding regulations in terms of legal compliance.

Introduction of regulation and reporting requirements for CSR practices of corporations have become a vital topic all over the world. This article will evaluate the potential benefits of creating a strict and well developed system for reporting CSR activities and why it is important to have a transparent reporting system.Benefits and drawbacks of such system will be identified and explained. Also, a potential conflict between CSR and profit related activities of corporations will be analysed including suggestions on how this conflict might be resolved.

Benefits of CSR regulation

One of the benefits of CSR regulation is defined legal limits in business-society relations. Caroll (1979, cited in Banerjee, 2008: p.16) discussed further the legitimacy principle, which is focused on imposing sanctions and obligations for non-compliance. Thus, the key stakeholders would know what to expect from the organisations in terms of compliance with the predefined rules and regulations for CSR activities. Regulators will know when the companies are compliant or non-compliant and there would not be any subjective treatment towards such companies. Reporting requirements will be strictly set and legally need to be abiding with and therefore, an increase in quality of CSR disclosure could be expected.

A transparent reporting system of CSR practices is another theme that will be positively affected by the regulated reporting system. Due to the factors described above it would bring transparency to a higher level, improving overall corporate governance practices, satisfying needs of key stakeholders and the general public, and ultimately, enhancing business environment and delivering inputs to the global sustainability. Increased transparency in its turn will make comparison between globally operating companies easier, so that investors may decide and objectively choose where to invest in. Comparability will be improved between industries, geographical areas and companies themselves, which positively affects an investment climate. Transparent track records of compliance with CSR standards by different companies will be kept for further analysis and history.

It is reasonable to expect that quantity of corporations that will select to obey all the laws will be increased. Thus, it will have positive impact on pollution, waste management and environmental issues in general. Labor equality will be promoted with more emphasis. It is obvious that objectives of sustainability will be fulfilled quicker and with a greater impact.

Another benefit of CSR regulation is potential positive impact on financial performance of organisations. Banerjee (2008, p.17) referred to

‘127 empirical studies conducted during 1972-2002 measuring the relationship between corporate social performance and corporate financial performance found that about half the studies found a positive relationship’. Also, it was pointed out that there was no evidence to conclude that CSR practices may negatively affect the profit generation activities of corporations.Thus, according to the conducted studies by investing in CSR practices corporations may eventually improve their financial performance and increase profits.

Additionally, increased endeavors in CSR will positively affect employee welfare and product quality.

‘Undertaking an extended responsibility for employee welfare may increaseloyalty, improve industrial relations and reduce training costs through lower labour turnover. Similarly, improvingproduct quality and service may provide benefits associated with increases in loyalty and repeat purchasing’ (Ness, 1992: p.3). So, if the organisation invests in its human capital and products or services, subsequently it may reap rewards in terms of increased sales and avoidance of searching for new staff.

Finally, if the CSR system is well regulated, there will be more controls over the internal functions within organisations. It will lead to more responsible attitude from the management towards any undertaken actions including innovative activities. Thus, so called ‘responsible innovation’ (Voegtlin and Scherer, 2015, p.4) will be promoted and monitored to a greater extent.

‘…Organizations need to make sure that innovations are responsibly developed and implemented; that is, that new products or services avoid harming people and the planet… In order to improve living conditions and safeguard the Earth’s life-support system, organizations should be provided with incentives to develop innovations that alleviate or reverse environmental depletion and social misery… It is necessary to put in place global governance structures that facilitate the first and the second dimension of responsible innovation’ (Voegtlin and Scherer, 2015, p.4).Obviously, with more responsibility from organisations due to an established legal framework for CSR, there will be more input for global sustainable development with more resources left for future generations.

Drawbacks of CSR regulation

We have discussed above benefits from creating well regulated CSR reporting system and how it could affect all key stakeholders. But, what about any drawbacks of such regulation? Or are there any whatsoever? What could be the arguments against such regulation?

Primarily, we need to state the current soft law arrangements that are effective and the most popular globally. These are international accountability standards and they include the UN Global Compact, OECD Guidelines for Multinational Enterprises, The Clarkson Principles of Stakeholder Management, all of which are related to the principle based standards.There are certification standards such as SA8000, the Fair Labor Association, the Marine Stewardship Council, ISO 14001. There are reporting standards, and the most recognised is the Global Reporting Initiative (GRI), which focuses on disclosure of non-financial metrics. Finally, there are the AA1000 standards, which represent process standards (Gilbert, Rasche, and Waddock, 2011: pp.26-29). It is worth mentioning that all of the above standards are well known globally, but perhaps the most widespread and recognisable are GRI standards. Even in developing countries and countries with weak corporate governance systems, GRI standards found its application. For instance, in Kazakhstan there are an increasing number of companies that choose to apply GRI voluntarily to compliment annual reports with non-financial parameters. Usually, these are large state companies and companies listed on the local stock exchange. However, there is an upward trend in GRI application by smaller and private companies as well.

So, what are the possible drawbacks of regulation of CSR reporting system?

Already existing softlaws and self-regulation system for corporations

Main soft laws arrangements were discussed above.

'Soft law relies on businesses to apply voluntary self-regulation, particularly in cases where governments are unable or unwilling to provide sufficient regulations' (Voegtlin, Shrerer, 2015: p.19).

So why do we need to spend time and create something new that is already working and in place? Accountability standards are not completely optional though (Gilbert, Rasche, and Waddock, 2011: p.24). It means that there should be reasons for implementation of such standards. First,

'Soft law can "harden" over time. ISO environmental standards, for instance, are referred to by government regulation for the definition of key terms' (Gilbert, Rasche, and Waddock, 2011: p.24). There are standards like ISO 14001 and OHSAS 18001 both of which are directed at implementing best practices of environmental protection, labor health and safety. So, regulators in different countries do not need to create new standards if they want to tighten environmental and labor practices. They just need to enforce and legally adopt applicable ISO standards. In addition, other reasons for implementation of soft law standards are requirements from business partners or clients to comply with the stated standards like ISO or GRI. Thus, adherence to the standards could be an "entrance ticket" for doing business or entering the industry. Moreover,

'…Deliberately ignoring standards as a way to account for a firm's social and environmental impacts can weaken existing stakeholder relations. Many firms have adopted standards because of pressure from stakeholder groups such as NGOs, consumers, and unions' (Gilbert, Rasche, and Waddock, 2011: p.24).Companiesin order to set strong relations with stakeholders choose to account for CSR while doing business.

Actually, the issue of self-regulation of CSR and transition to soft law arrangements is not uncommon in the modern world.

'These new forms of governance do notonly establish a new institutional context with private actors in a regulatory role,they also rely on a different form of regulation, the so-called soft law that operateswithout a governmental power to enforce rules and to sanction deviant behavior (Shelton 2000, cited in Scherer and Palazzo, 2011: p.907). Currently, this issue is a popular topic for discussions in corporate society. There are arguments for self-regulation of CSR practices, thus monitoring for compliance could have beenperformed without government intervention.

Increased transaction and administration costs to monitor compliance

'Monitoring compliance in a command and controlsystem can be an expensive process involving high transaction costs. Moreover, it is naïve tothink that laws governing the behavior of corporations are made in isolation and not withoutactive involvement from industry. Political lobbying as a corporate strategy has more than a200 year history' (Banerjee, 2008: p.13). For the regulated CSR system to be effective it will require additional resources invested in monitoring for compliance with the new regulations. It includes additional human costs to perform compliance job, additional costs associated with each operational change in the regulating system. Obviously, such actions will lead to the increased level of administrative costs arising from monitoring for compliance.

Difficulty to choosea global regulator

Even if new regulation for CSR reporting is introduced, the question is who will create, support and regulate all the compliance system? In case of financial reporting there are International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) as major regulating bodies. In case of CSR reporting there will be a need to establish a global institute, which will promote and monitor activities related to CSR. This can be problematic considering different approaches of countries, their mentality, cultural and legal peculiarities.

Different legal systems of the countries

It is obvious that in case of implementation of fully regulated CSR reporting system, each country will need to pass all stages in the legal system in order to adopt proposed new regulations. Considering specifics and different economic and political stage of development of each country it could be cumbersome and time consuming as well.

Resources required for establishing new regulations

Setting up the new regulating system for CSR that is legally enforceable will require additional resources in terms of financial disbursements and time dedication. Usually, creating something new or making existing regulations legitimate require time and money spending. This could be difficult or hardly possible to implement for some countries.

Trade-off between CSR and profit related activities

Another important aspect of the CSR is a trade-off between resources dedicated to the CSR related activities and financial performance of organisations. Below we will explore an idea of mutual beneficial existence of CSR and profit related activities or if there is a constant conflict between them.

The view that CSR related costs are not significant and the companies may even capitalise from socially responsible actions like loyalty and productivity of employees is supported by the arguments below.

'The emergence of managerial capitalism with increasing industrial concentration has meant that managementdoes not have to adopt profit maximization as their only objective. Managerial autonomy, which features in manyof the managerial theories of the firm means that management are free to impose objectives upon the firm whichreflect their own values' (Ness, 1992: p2). Moreover, it was argued that some companies tend to rely more on 'moral and religious beliefs of the founders' (Ness, 1992: p2). An ideal situation is that adherence to CSR practices should be embedded within the organisation culture from the top to the bottom. Thus, the top management will lead by example and satisfy needs of all stakeholders. So, it is up to organisations and their management to bolster CSR activities.

As per this view CSR should be considered as a compliment to a corporate strategy of organisations and profit generation activities, thus providing mutual beneficial coexistence between them. Additionally, it was argued that

'In order to make CSR really worthwhile, it must bring benefits in both directions – to thesociety it operates within but also to the business it comes from. This is entirely possible ifCSR is managed at the very top and is thought about strategically, being treated as part ofthe core business rather than as a tangential project' (Strategic Direction, 2007: p.2). Today, with a high level of globalisation process in the world along with quick information dissemination, organisations are forced to account for the interests of other parties, besides shareholders. Organisations do not want to be associated with the ones who are not caring about environmental and social issues in order to avoid adverse publicity.

'An increasing number of managers and executives are now coming to realise theadvantages of practicing CSR. Businesses are feeling the pressure to operate in an ethicalway, and know that philanthropy improves reputations among employees, shareholders and customers' (Strategic Direction, 2007: p.1).

Furthermore, there are pressures from social, governmental sides along with non-government organisations (NGOs) and society in general, so that CSR can no longer be ignored. The main goal is to cooperate strategically so that CSR will bring benefits to all parties (Strategic Direction, 2007: p.3).These parties are usually considered as mainstakeholders of the organisations. Organisations assess advantages of following CSR practices comparing to risk of ignoring these practices. In case of strategic cooperation there will be benefits for everyone engaged, providing evidence that value from CSR implementation prevail. Such benefits can include lower labor turnover and associated costs of replacing employees as well increased quality of products and services.

Companies that choose to invest in their CSR practices find themselves in advantageous position in terms of relationship with bankers, investors, government officials. Thus, economic benefits may arise from improved relationships with these parties. Social aspects of corporations have been reported as a factor in investment decision making process. Therefore, strong CSR practices improve companies' access to sources of capital (McGuire, Sundgren and Schneeweis, 1988: p.856).It will be advantageous for the companies to have strong and trustworthy relationship with financial institutions and investors as it in may provide additional sources of capital when required. Also, it may lower the cost of capital for such firms.

'A high degree of CSR may permit a firm to have relatively low financial risk as the result of more stable relations with the government and the financial community… It may also havea low percentage of total debt to total assets. A low total debt ensures that a firm can easily continue to satisfy implicit claims. Thus, compared to other firms, firms with high social responsibility may have lower market- and accounting-based total risk because they are less sensitive to certain external events, like governmental actions, and have a lower debt' (McGuire, Sundgren and Schneeweis, 1988: p.856). Executing CSR best practices allow firms to have good relationships with the government and bankers, which in its turn lowers financial risk and risk of governmental interference. Furthermore, there were studies that revealed that CSR compliant firms had reduction of the firm risk overall (McGuire, Sundgren and Schneeweis, 1988: p.869).

Different research papers have been conducted in the area of relationship between CSR and financial performance of the companies. Some results revealed proponents of negative relationship between CSR and profit related activities because of the high additional costs comparing to the other firms, which are less socially responsible. Such costs could be

'Making charitable contributions, promoting community development plans, maintaining plants in economically depressed locations, and establishing environmental protection procedures. In addition, concern for social responsibility may limit a firm's strategic alternatives' (McGuire, Sundgren and Schneeweis, 1988: p.855). Indeed, such explicit costs may bring additional burden to the organisations' budgets in terms of unnecessary investments or simple cash disbursements foractivities with low importance. For instance, an unprofitable factory that could have been shut down will continue to operate because of undesirable labor consequences in terms of possible boost of unemployment in the region.

Proponents of famous Friedman's quote 'the business of business is business' consider two main arguments against CSR activities. First, they judge issues of morality, ethics and responsibility from a legal point of view. Ness (1992: p.5) brought ideas of Friedman that

'Corporations are given legal status quite distinct from that of the individuals who control them: they can ownproperty, undertake legal action and so on'. It was argued that only individuals have responsibilities, not legal entities. Moreover, Ness (1992: p.5) pointed out that

'Friedman's view of therelationship of the firm with its environment is constrained to the shareholder as opposed to the stakeholderconcept. He considers management to be the employees of the owners of the firm, the shareholders, and thatmanagerial responsibility is to this particular group rather than to society as a whole. Such responsibility wouldrequire managers to pursue the objectives of shareholders, which, in Friedman's view, requires them to make asmuch profit as possible within the basic rules of law and the custom of society'. Thus, it was implied that management should be accountable only to the shareholders without considering interests of other stakeholders as long as it is legally compliant. Also, such practice of doing business is completely directed at revenue generating activities and does not account for interests of other stakeholders as long as it is in compliance with the law.

Second, role of the government and business have been considered so that organisations with high CSR values act as the government representatives imposing taxes on shareholders by donating other social groups. It was argued that only the government may perform such activities as taxing someone else (Ness, 1992: p.5).Thus, by considering interests of those who are not just shareholders, organisations may indirectly impose taxes on such shareholders by ways of not directing all profits to them as well as sacrificing benefits to the needs of other stakeholders.

Conclusion

We have listed and explored the idea of introduction of fully regulated CSR reporting system. We elaborated on advantages and drawbacks of this system. Clearly, there are arguments for and against it. However, as the businesses are functioning under current conditions, assuming that there will be continuation of improvement in the global corporate governance practices, the current system of CSR reporting may represent the best scenario. Moreover, in case of leaving the current system, which is not fully regulated without changes there would be economy of resourcesand time otherwise spent on creating of and complying with the new regulated system. Emphasizing the fact that the current system is not completely optional and is regulated in certain areasand alsoassuming that there are requirements from stakeholders about CSR reporting, corporations would have no other choice, but to comply with current CSR reporting best practices.

Different arguments have been discussed concerning the trade-off between CSR and financial performance of the organisations. As it happens in most cases, there would be those who support this trade-off and its negative relationship; however, there would be other ones who fully admit and promote the fact that CSR and financial related activities could and need to coexist in order to bring benefits from such synergy to all stakeholders. In this paper we have studied that benefits of CSR may easily outweigh costs of such activities if the organisation and its management work actively with the stakeholders taking into account ethical and social issues as well as maintaining sustainability.

Friedman's thoughts might be relevant several decades ago, when actually his work on CSR has been written. But, today with all the globalisation processes and fast information proliferation around the world that original approach about taking care of only shareholders might seem outdated and "old-fashioned". In the modern world, organisations try to listen to society, thus supporting stakeholder theory about accountability to other stakeholders like employees, government, proponents of environmental and social protection, and public in general.

It may seem reasonable that the only goal of the business is to provide values to its shareholders. Perhaps it is correct by form, but by substance there are not only shareholders who the organisations need to account for, but other stakeholders as well. And as we all know from the basic accounting principles, substance should always prevail over the form.

‘There are two common approaches to CSR: the outward-looking one, which concentrates on the expectations of stakeholders and the inward-looking alternative, which focuses on internal issues, aligning philanthropic activities with core competencies. Neither on its own is enough to be sustainable’ (Strategic Direction, 2007: p.2). By addressing expectations of all stakeholders, organisations can find a balance between CSR and profit related activities. Thus, it would be realistic to achieve their objectives including financial and operational parameters, and ultimately, providing input to global sustainability with CSR related activities.

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