

Chapter 31

Sustainability Reporting in Transitional Economies

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ABSTRACT

This chapter provides insights on some issues associated with the development of sustainability reporting in Egypt as a transitional economy that recently developed the S&P/EGX ESG index. In a dynamic world, and faced with a scientific proof that relates dangerous climatic changes to corporate activity, corporate financial reporting needs to be placed in perspective. Hence, as a social science, accounting should play a vital role in integrating corporate financial and non-financial measures. Semi-structured interviews were employed to investigate the extent to which sustainability reporting is appreciated in the Egyptian market by both business enterprises and the investors. Results indicate that sustainability information is of limited interest to markets except when it is identified as relevant in terms of risk or governance. On the investors' side, returns were seen as the main driver of portfolio selection. However, sustainability issues would be seriously considered when comparing among alternatives with similar returns.

INTRODUCTION

Sustainability reporting is a broad term that describes the disclosures to be made by firms on the positive or/and negative impacts of their activities on the environment, society and the economy. Hence, this mechanism has the potential to enable firms to set goals, measure performance, and manage change in order to make their operations more sustainable (KPMG, 2013: 10; GRI, 2013: 3). Globally, sustainability reporting enables the integration between financial and nonfinancial information, providing stakeholders with enhanced information to make more informed decisions.

Recently, there is an increasing trend among many organizations around the world to make their operations sustainable. Furthermore, the idea that long-term profitability should go hand in hand with social justice and environment protection is gaining ground. Hence, the quest to move to a truly sustainable economy is understood by organizations' financiers, customers and other stakeholders. This suggestion is supported by the findings of a recent KPMG's global reporting survey which highlights that more

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than 50% of reporting companies worldwide include sustainability related information in their annual reports compared to 20% in 2011 (KPMG, 2013: 11).

As a promising exchange, recently the Egyptian market has taken a pivotal step towards fulfilling the innovation in international best practices. In this context, the S&P/EGX ESG index was planned and developed as the principal index in Egypt to address the investors' concern about environmental, social and governance issues. The S&P/EGX ESG raises the profile of listed companies that are the best performing in terms of three parameters; environmental, social, and corporate governance responsibility (ESG). The index employs a unique and innovative methodology that quantifies a company's ESG practices, and then uses a scoring system to rank listed companies based on the established criteria. Unlike previous indices of this kind that measure ESG parameters on a committee and internal consensus basis, the quantitative scoring system of the S&P/EGX ESG is very informative as it provides investors with sustainability related information in addition to financial information. In other words, recognizing the need for an investable index, the selection process requires that eligible companies not only have high ESG scores, but also meet a market capitalization and liquidity threshold.

Legitimacy theory highlights the extent to which corporate social and environmental disclosures are influenced by the boundaries established by the society in order to be appreciated and avoid being penalized by the community in which the company operates. However, this theory does not take into consideration that legitimacy is interpreted differently from one society to another according to societal values, political system and government ideology. On the Other hand, signaling theory suggests that markets react to good and bad signals, most likely these signals are perceived as indicators of potential returns.

Building on this, sustainability reporting that is a voluntary disclosure that releases negative impacts of company's activities on the environment, society and the economy may not be supported. Hence, markets particularly transitional ones may discourage sustainability reporting initiatives that is fundamental if sustainability agenda is to be a meaningful practice. Stemming from this viewpoint, financial accounting researchers should investigate the extent to which capital markets can contribute to sustainable development. As sustainability relating information is voluntary, companies may be selective in releasing such information. This viewpoint is supported by the fact that wealth maximization is the main goal for companies as well as for current and potential investors, even corporate governance codes continue to place shareholders as the main stakeholder.

Drawing from the contextual interplay among accounting, capital markets and sustainable development, qualitative approach has been chosen to best address the research question. To the best of the researcher's knowledge this study is the first to investigate how the Egyptian market perceives sustainability reporting.

SUSTAINABILITY REPORTING: AN OVERVIEW

Sustainability Development

In broad terms, sustainable development is defined as the “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (UNWCED, 1987: 8). From the researcher's point of view, this definition highlights a key theme of sustainable development that is ‘needs’, which reflects the issue of scarce resources and how current generations should consider the welfare of the future generations. This depicts the interactive relationship between

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