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THE IMPORTANCE OF ESG DISCLOSURE IN ENSURING THE SUSTAINABLE DEVELOPMENT OF COMPANIES

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Abstract. In today's business era, transparency and effective communication with stakeholders are essential to a company's success and sustainability. With the rise of global sustainability concerns, ESG (Environmental, Social and Governance) disclosure and adherence to the SDGs (Sustainable Development Goals) are key directions in any firm's strategies. Due to the new nature of sustainable reporting, companies are facing an increasing number of questions about the content and the way of reporting, with integrated reporting becoming an increasingly used and valued tool for assessing corporate performance. These reports go beyond the presentation of financial data and integrate financial and non-financial information to provide a complete picture of the business and its social, environmental and corporate governance impact on its operating environment. Thus, the main objective of the paper proposed by the authors is to examine the importance of ESG information in the framework of sustainable development. From the literature review, it can be appreciated that the quality of ESG information presented in sustainability reports becomes crucial for the proper understanding and assessment of a firm's performance.

Keywords: Sustainable Development, Non-Financial Information, Sustainable Reporting, Integrated Reporting, ESG - Environmental, Social and Governance

JEL Classification: M41, M48

Introduction

A company's performance cannot be assessed solely on the basis of balance sheet and profit and loss figures, but requires an approach that also includes social and environmental impact and corporate governance. In this paper, the authors aim to explore the importance of ESG information and how it influences company performance. Therefore, this analysis aims to highlight the key role that the quality of information plays in strategic guidance and decision making within the business environment, highlighting the importance of a comprehensive and transparent approach to corporate reporting.

Non-financial information has emerged in financial reporting to address the need for more complete information on corporate performance, being a label with which to work and gather a continuum of new information on corporate social responsibility issues, with this in mind the Non-Financial Reporting Directive 2014/95/EU [1] was designed to unify European reporting practices under a common banner [2]. Firms should focus on providing information with a breadth and level of detail that allows stakeholders to understand the evolution, results, position and impact of their activities. Non-financial statements include key performance indicators, qualitative information that facilitates the understanding of non-financial statements and quantitative information that can be effectively reported on non-financial issues. Stakeholders tend to value quantitative information the most because it allows them to assess progress and progress towards long-term objectives, to check consistency over time and to make various comparisons [3].

Environmental, social, human rights, anti-corruption and anti-bribery and corporate governance information published by entities enhances transparency, credibility and stakeholder attention, and moreover, together with financial statements develops an environment for sound decisions and investments [4]. Today's sustainability debate often centres around corporations because of their impact on the environment and society [5]. Corporations are facing increasing demands on the sustainability of their activities from multiple stakeholders [6]. These stakeholder needs are also reflected in the regulatory environment in which companies operate. Regulators in the United States and the European Union are working to increase the importance and standardization of non-financial reporting [7]. In the United States, the Securities and Exchange Commission will require disclosure of sustainability impacts and policies beyond the level of direct GHG emissions (greenhouse gas emissions), even for small reporting companies, by 2025 [8]. The European Union goes even further with its Corporate Sustainability Reporting Directive (CSRD), which will be implemented in 2024, by making reporting on target setting mandatory [9].

In recent years there has been an increased focus on environmental issues and social responsibility, which has led to changes in the accounting profession as the actions of accounting professionals have moved in line with current trends. Sustainable development implies a series of changes at the accounting level in order to meet the needs of users of financial and accounting information, with accounting professionals playing a key role in the business environment as they measure, communicate and control all information relating to organisations, leading them to embrace the notion of sustainable development [10].

Social reporting is defined as the reporting of significant and definable areas of a business enterprise's activities that have social impact, such reporting involves measuring and disclosing, internally or externally, information about the impact of a business enterprise and its activities on society [11]. Integrated reporting can be seen as the latest development in corporate reporting. It is defined as a reporting mechanism that aims to address the shortcomings of current accounting systems namely the retrospective nature, short-term orientation and failure and to capture the intangible factors that are the main drivers of organizational performance [12]. Such reporting aims to overcome other problems in financial reporting, such as information overload resulting from producing numerous and disconnected reports that increase in length and complexity and the need to incorporate more information on sustainability issues that can support the transition to sustainable economic models [13].

Contemporary society faces various challenges in terms of social and economic development, business expansion and national economic growth. In particular, significant transformations can be observed in the financial landscape, highlighting a growing awareness of the impact of sustainable and responsible business practices, which not only influence long-term financial performance but also contribute to a more equitable and environmentally aware society [14]. In this context, investors are increasingly turning their attention to ESG issues to guide their investment decisions, assessing the impact of businesses on the planet, society and their internal governance structures [15].

By the end of 2023, at the European level, sustainability (or non-financial) reporting, also known as the CSRD Directive, is the piece of legislation that introduced legal sustainability reporting obligations for certain large companies in the European Union [16]. At the same time, the aim of the reporting directive, as defined by the European Commission, is to achieve the Green Deal objective of transforming the European Union into a modern, competitive and resource-efficient economy, ensuring that: by 2050, there will be no greenhouse gas emissions; economic growth will be achieved that is not dependent on resource use; and no person and no place will be left behind [17].

1. Theoretical background and literature review

To meet the information needs of stakeholders, companies have increasingly published non-financial reporting, including the social, environmental and economic impacts of their business, not only as a form of accountability but also as a way of shaping company strategy.

In recent years, due to the increasing complexity of the international business environment, new reporting requirements have been added through laws, regulations, standards, codes, guidelines or listing requirements [18]. This has led to an increase in the volume of information submitted by companies, resulting in long and complex financial reports with many technical details that require a high level of expertise to understand [19].

The number of companies producing integrated reports is still small due to the voluntary nature in many countries, South Africa being an exception to this rule, where integrated reporting has been mandatory for companies with securities listed on the stock exchange since 2010 [20]. Companies tend to present management rather than performance issues, and the information presented is easily manipulated and has a marginal position to the essence of the business, with the aim that the items presented should positively influence the economic situation or demonstrate good practices in the application of regulations in the sector, providing useful information for the company [21].

The integrated report being a concept that incorporates financial, social, environmental and sustainability reporting principles provides information on corporate governance, strategy and performance in an organised, compact and coherent manner, reflecting the commercial, social and environmental context in which the company operates [22], such a report should contain relevant aspects of the company's business, both positive and negative [23].

The highest degree of integrated reporting is practiced in Brazil, Germany, South Africa, Sweden and the UK, and companies in these countries are advised to continue to exercise leadership to help create a more sustainable global society [24].

The main objective of the IIRC Conceptual Framework (2013) [25] is to provide a common reporting basis by defining the fundamental concepts of integrated reporting and establishing guiding principles and content elements that should be present in an integrated report, and the definition provided by the IIRC Conceptual Framework has thus become the main underpinning for the process of integrating financial and non-financial elements. An integrated report is a concise communication of 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 [25]. Integrated reporting encompasses financial and non-financial information in a single document, thus showing a more comprehensive picture of the reporting entity, all in terms of business transparency and social accountability [26], thus enhancing transparency and accountability, which are key to building trust and resilience, by disclosing how the legitimate needs and interests of key stakeholders are understood, considered and responded to through decisions, actions and performance, as well as ongoing communication [27], with such reporting containing qualitative and quantitative performance information.

Assurance mechanisms and other tools are necessary to ensure the credibility and reliability of corporate reporting, especially considering that integrated reporting is primarily intended for investors, according to the International Integrated Reporting Framework [28].

The year 2021 has brought to the landscape of integrated corporate reporting a novel element that will be rapidly adopted, namely integrated digital reporting. This involves taking into account GRI standards, International Business Council (IBC) recommendations as well as sector indicators imposed by the Sustainability Accounting Standards Board (SASB). The pathways defined by the relevant domains allow for interconnected and personalised content navigation based on specific areas of interest and in-depth analysis to uncover each company's sustainable business model, strategy, value creation process and commitment to combat climate change [29].

There is awareness of the need to reform corporate reporting and the need to adapt the process of reporting financial and non-financial information to the new economic environment by incorporating an optimal volume of information so that the resulting reports bring balance and stability and transparency to cover and harmonise economic, social and environmental aspects: ESG (environmental, social and governance). The term "ESG" can be seen as an evolution of the older concept of "SRI" (Socially Responsible Investment) which aligns with ideas such as corporate social responsibility (CSR) and philanthropy, and is also an indicator showing standards for the management of corporate governance, environmental and social issues within companies and is increasingly used when investors choose the companies they want to invest in. The indicator is also used by lending institutions when granting financing.

Sustainable development has become and remains a ubiquitous paradigm for long-term development and a core concept in the global development policy and agenda [30], and the Sustainable Development Goals are a key benchmark in the struggle for a sustainable global future. However, in order to translate these aspirations into reality and promote a responsible and holistic approach, ESG factors come into play, which will be an appropriate tool to involve civil society and the private sector in the global agenda of sustainable development [31].

In April 2021, the European Commission presented a legislative proposal for the CSRD (Corporate Sustainability Reporting Directive) by imposing additional reporting requirements, with the long-term aim of ensuring comparability between sustainability and financial reporting [32]. Thus, from 2025, for the previous financial year, the legal framework changes and the Corporate Sustainability Reporting Directive (EU) 2464/2022 (CSRD) comes into force, which aims to standardise non-financial reporting at the level of large public and private entities [33], as well as at the level of public SMEs, by complementing a set of regulatory efforts [34], including the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy.

ESG has become a topic of major interest on the global economic scene, and Romanian companies cannot remain outside this concept [35]. In this regard, the Parliament has transposed the relevant European rules into national legislation, while the Bucharest Stock Exchange has published a Guide on ESG Reporting, which includes relevant parameters from the reports of listed companies.

2. Benefits of disclosing ESG information

The first appearance of the term "ESG" occurred in the report "Who Cares Wins: Connecting Financial Markets to a Changing World", published by the United Nations (UN) and the Global Compact in 2004 [36], aimed at developing standards and recommendations on effective ways to address systemic environmental, social and governance issues in asset management, equity brokerage services and research functions [37].

ESG criteria are presented by 3 factors, environmental, reflected by the letter "E" (Environment), denoting an entity's impact on the environment, such as pollution and greenhouse gas emissions; social, referred to by the letter "S", reflecting the entity's relationship with its employees, customers and other stakeholders, and factor 3 is represented by the letter "G", corresponding to governance factors [38], reflecting how an entity organizes, conducts and oversees its operations to ensure ethical and responsible conduct.

Prior to 2001, companies did not regularly provide this type of information and the data disclosed lacked structure, guidance or consistency [39], gradually investors and stakeholders began to pay more attention to ESG issues and information. ESG reporting is issued to maintain positive relationships with stakeholders, to comply with regulations and to avoid problems [40], the number of ESG topics reported is increasing and becoming more detailed, subsequently influenced by the international framework, indices and initiatives such as the Paris Agreement and the UN 2030 Agenda. The demand for transparency and corporate responsibility has led companies to highlight their efforts and progress by implementing sustainable and socially responsible policies, accompanied by reporting, in order to maintain competitiveness in the industry [41]. Thus, ESG reporting is an effective communication tool through which a company informs its stakeholders, integrating all information related to the environment, society, governance, ethics and human rights [42], the company also aims to take responsibility for the well-being of its stakeholders. By prioritising sustainable and socially responsible initiatives, a company can improve its reputation and possibly attract more investors in the future [43], and if it achieves its ESG goals it will be more likely to survive and be more robust.

While the Sustainable Development Goals provide an overarching set of goals and directions for sustainable development, ESG information provides the methods and processes to achieve them [16], focusing on the behaviour and practices of individual entities [44].

In order to meet CSR reporting, the European Financial Reporting Advisory Group (EFRAG) created the first set of European Sustainability Reporting Standards (ESRS), which received EU-wide endorsement in July, 2023. They are guidelines to ensure that companies operating in the EU report transparently on their sustainability practices, providing a clear picture of their overall performance by disclosing sustainability information that could affect business practices and decisions [45].

By requiring firms to disclose quality financial information about their ESG performance in their annual reports, the CSRD aims to improve the clarity, credibility and comparability of this data, supporting investors and other stakeholders in making informed decisions about working with particular companies, directing more capital to sustainable businesses and investments [46].

An important detail regarding CRSD is that all reports must be available in a structured, digital, single European electronic format with sustainability information digitally tagged, facilitating more efficient access and processing of information for both software tools and stakeholders. Companies should also audit their sustainability information through a certified auditor before submitting it to the competent authority [16] and develop plans, actions and measures to manage risks and capitalise on opportunities arising from the transition to sustainable business [47].

Adopting and disclosing ESG information also has important benefits for investors [48], allowing companies to communicate effectively with all their stakeholders, thus gaining their trust and support, especially as they become increasingly selective in their choice of investments [49], with companies being more likely to obtain financing on better terms from investors as their sustainable practices are seen as offering long-term growth potential and greater financial stability [50]. Investors attribute long-term value to entities that disclose ESG data because they see the green economy as an opportunity and tend to protect their investments against risks associated with environmental, social and governance issues [51]. ESG performance and non-financial disclosure can play a key role in enhancing company value and facilitating sustainable development by adopting green innovations in production processes that can reduce resource consumption and waste, while increasing energy efficiency and improving overall efficiency and laying the groundwork for future sustainable development, in such situations firms can attract more attention from socially responsible investors [52].

Different aspects at the firm, country, industry and time level influence the decision to make ESG disclosures, with factors such as company size, reputation, board composition, and the existence of a CSR committee potentially positively influencing the decision to make such disclosures [53], while dimensions such as social performance may negatively influence it.

By reporting sustainability, a company can convince potential investors that it is a less risky investment than other companies [54], with investors claiming that ESG disclosures inspire greater trust among managers and stakeholders, providing more accurate forecasts and reducing information asymmetry [55]. Firms with high sustainability scores are also better able to manage downside risks and are more resilient in times of crisis [56]; portfolios with high ESG scores generally performed better than those with low ESG scores during the recent COVID-19 crisis in China [57].

Conclusions

Companies that choose to adopt and implement the SDGs can simultaneously integrate ESG factors into their practices, thereby better addressing the sustainability requirements of investors and communities while contributing to the achievement of global goals. Implementing sustainable practices can help strengthen company management by identifying and managing risks more effectively, and reduce operational costs by adopting efficient resource use and waste management measures, leading to significant cost savings. Companies falling under the scope of the SRSD will need to follow certain defining directions: assess the importance of relevant factors to their business; report on the double materiality of each factor; explain the resilience of their business model and strategies in the face of sustainability risks, covering different time horizons; provide detailed information on how they manage risks, internal controls, risk monitoring processes and the values they support; and reflect in their reporting the opportunities arising from sustainability concerns.

The concept of ESG and sustainability goals are bringing about a transformation in the way a company's role and purpose is perceived and understood.

Adherence to and achievement of global objectives is effectively supported by the implementation of ESG factors, which provide concrete ways of addressing the sustainability requirements of investors and communities. The adoption and implementation of the SDGs and ESG factors offers companies numerous opportunities for sustainable growth and development. ESG is thus the standard indicator for the management of corporate governance, environmental and social issues within companies and is increasingly used when investors choose which companies to invest in, and is also used by lending institutions when providing finance.

Sustainability reporting standards are on an upward trend and are based on and built on most existing financial reporting standards. ESG is becoming a critical part of the business model of companies of the future, which, based on the reporting behaviour adopted, fall into two categories: those that have voluntarily adopted sustainability reporting, adopted a sustainable business model and reduced the pressure of their own activities on ecosystems and natural resources; and those that have not turned their attention to sustainable conduct, putting their existence at risk either as a natural consequence of climate risks or due to pressure from direct competitors.

In this context, there is awareness of the need to reform corporate reporting and the need to adapt the process of reporting financial and non-financial information to the new economic environment by incorporating an optimal volume of information so that the resulting reports bring balance and stability and transparency to cover and harmonise economic, social and environmental aspects: ESG (environmental, social and governance).

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