Corporate Social Responsibility Disclosure Credibility

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Executive Summary

The purpose of this white paper is to highlight for business leaders some key insights from academic research on corporate social responsibility disclosures (CSRD) and their perceived credibility. In the United States, CSRD from public corporations remain largely voluntary and thus heterogeneous. The heterogeneity may in part be due to the various CSRD information quality preferences of key stakeholders. Investors are skeptical of greenwashing, consumers are suspicious of virtue signaling, and employees are leery about performative or optical allyship. Public corporations are thus challenged with a complex balancing act—how to satisfy the CSRD preferences of key stakeholders while maintaining control over their environmental, social, and governance (ESG) commitments, but without being perceived as potentially disingenuous and self-serving.

One way to frame this challenge is through the lens of credibility, which is a *judgment* that a perceiver makes, with regard to a given message, based on the perceiver's assessment of the messenger's relevant knowledge, veracity, and intent. Applied to the context of CSRD, the stakeholder would therefore look for credibility cues to inform her assessment of the messenger, and ultimately, the credibility of the CSRD. With regard to relevant knowledge, it is the choice of the CSRD assurance provider and the perceived reliability of that provider that may influence the stakeholder's perception of CSRD credibility. With regard to veracity, it is the choice of measurement framework and obeisance to that framework that may influence the stakeholder's perception of CSRD credibility. With regard to intent, it is the choice of affiliations and alignment between a public corporation's social and environmental conduct that may drive the stakeholder's perception of CSRD credibility.

Said another way, stakeholders judge as more credible CSRD that is assured by their preferred third party; mapped to their preferred measurement framework; and that is followed by corporate actions that reflect an authentic commitment to corporate social responsibility.

Corporate Social Responsibility Disclosure

The question of what and how to report their firm's CSR activities and risks is of significant importance for public corporations - the Fortune Global 500 spends over $ 20 billion a year in CSR activities (Meier and Cassar 2018). Yet corporate social responsibility (CSR) reporting is notoriously multidimensional. As a case in point, the World Business Council for Sustainable Development (WBSCD) describes corporate social responsibility (CSR) as the call for business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large. This, among many other definitions of CSR, leaves much latitude for public corporations to choose what they disclose about their CSR activities and risks. Further, there remains no common or mandated set of CSR reporting standards. As a result, corporate social responsibility disclosure (CSRD) provided by public corporations remains largely voluntary and heterogeneous in the United States (Christiansen, Hail, and Leuz 2021).

Contributing to this heterogeneity is the seeming lack of consensus among key stakeholders in terms of their CSRD preferences, which ultimately inform their economic decisions. As of 2019, one-third of the $51.4 trillion in assets under professional management is now dedicated to positive environmental, social, and governance (ESG) investing (Carlson 2020). In his 2021 letter to public corporation CEOs, the CEO of BlackRock, Larry Fink, discusses the value-relevance of CSRD in the context of ESG investing. ESG investing is a social responsible investment (SRI) approach that specifically targets purposeful companies with better environmental, social, and governance (ESG) profiles; with 'better' being broadly defined as consistent, high-quality, and material public CSR information (Fink 2021). This view generally aligns with survey research findings on professional investors' preferences for non-financial information (Cohen, Holder-Webb, and Zamora 2015); and the view that investors use ESG disclosure quality as a proxy for management quality (Eccles, Serafeim, and Krzus 2011). Indeed, investors have referred to questionable CSRD as greenwashing (Lyon and Maxwell 2011).

Consumer demand and purchase decisions are also influenced by CSRD. In 2018, a Nielsen survey found that 48% of consumer said that they would definitely or probably change their consumption habits to reduce their impact on the environment. This view is borne out in actual consumer spending of $ 128.5 billion on sustainable fast-moving consumer goods (FMCG) in 2018 (Thygesen 2019). For consumers, the value-relevance of CSRD is also influenced by information characteristics. For example, luxury brands that frame their CSR activities as self-enhancing (versus prosocial) experience a decline in consumer evaluations; except when the brand concepts (i.e., openness and conservation) do not conflict with what consumers deem relatable with what they deem as CSR (Torelli, Monga, and Kaikati 2012). Consumers also value transparency but also due diligence. Corporate charitable giving, even outside of the firm's core business, enhances product perceptions (Cherven and Blair 2015); yet intentional green enhancements (versus greening as a product or service side effect) negatively impact consumers' evaluations if the CSR activity is perceived as diverting resources away from customer considerations such as product quality (Newman, Gorlin and Dhar 2014). Consumers have called such superficial CSRD as "virtue signaling" (Bartholomew 2015).

Employees are likewise responding to their firm's CSRD. In a survey of 2,285 U.S. professionals across 26 industries, 9 out of 10 said there were willing to trade a percentage of their lifetime earnings for greater meaning at work (Thygesen 2019). Research suggests that employees seem to value CSRD that they deem as forthright, substantive, and reliable. Employees exposed to their firm's commitment to CSR reduce their participation in counterproductive behavior such as cynicism (Archimi, Reynaud, Yasin, and Bhatti 2018). Reported prosocial activities and employee engagement incentives increase employees' task productivity and retention while lowering wage demands. However, prosocial activities may reduce employee productivity if the firm's CSR goal is perceived mainly as an instrument to increase productivity or profits (Meier and Cassar 2018). Further, it is only employees' positive attribution that reported CSR activities are substantive (versus symbolic) that is associated with employees' attitudinal and behavioral outcomes such as affective commitment to the organization and person-organization identity fit (Donia, Tetrault Sirsly and Ronen 2017). Employees have recently used the term performative or optical allyship to describe otherwise symbolic CSRD (Thomas 2020).

Taken together, the increasing skepticism of the value-relevance of CSRD is shared among key stakeholders, even as they are labeled differently. As a result, public corporations are challenged with a complex balancing act - how to satisfy the CSRD preferences of key stakeholders while maintaining control over their environmental, social, and governance (ESG) narrative, but without being perceived as potentially disingenuous and self-serving.

CSRD Credibility and Cues

One way to reframe the seemingly different CSRD preferences of stakeholders is from the lens of credibility and credibility cues. Credibility is commonly assumed to be an *attribute* of the messenger. However, scholars have long examined credibility a *judgment* that a perceiver makes, with regards to a given message, based on the perceiver's assessment of the messenger's relevant knowledge, veracity, and intent to do good (McCroskey and Young 1981).

Two subtle but important assumptions are worth nothing. First, the perceiver is less likely to believe the message if the messenger has more (versus less) incentives to be misleading or untruthful (Mercer 2004). An example of such situational CSRD incentives is tying executive compensation to reported CSR performance, as this provides greater motivation for executives to overinvest in CSR (Kolk and Perego 2014). Second, the perceiver would incur prohibitive search costs to uncover the truth about the message (Hartzell and Starks 2003). A recent meta-analysis study suggests that there is significant information overload in CSRD in part as an effort by public corporations to boost their reputation as being transparent (Velte 2021). The ESG ratings from external aggregators that collect CSR information through a variety of means beyond CSRD also do not appear to reduce users' information search costs. A 2019 study finds only a 30 percent correlation among leading ESG rating providers – including MSCI (which acquired KLD), Sustainalytics, Bloomberg, and RobecoSAM (Berg, Kölbel, and Rigobon 2020). As a result, the perceiver may reduce their search costs by looking to credibility cues to inform their assessment of the messenger, and by extension, the value-relevance of the message (Aguilera, Rupp, Williams and Ganapathi 2007).

Relevant Knowledge

Relevant knowledge has been called source credibility in studies of attitudes and attitude changes (Birnbaum and Stegner 1979). Source credibility can be interpreted as the messenger's observable professional credentials (e.g., CPA) and prior expertise as evidenced by prior and current employment (e.g., CFO). However, in the presence of situational incentives and information search costs as described above, perceivers must look to other credibility cues such as independent assurance. Kinney (2000) notes that "An independent party with a reputation for competence in measurement and trustworthiness in reporting can improve an outsider's perception of information reliability by investigating the assertions, and attesting to the care and lack of bias in information display. The information assurer can [thus] add credibility by increasing the perceived reliability of management's information claims and assertions."

As such, once a firm chooses to obtain CSRD assurance, then it is the assurance provider's knowledge that becomes relevant. Investors may favor financial auditors who bring to bear audit technology, global network of assurance teams, and experience in meeting measurement and reporting standards to the CSRD audit engagement (Cohen and Simnett 2015). This choice may also be efficient and cost-effective. Studies find that when financial and CSR assurance are provided by the same auditor, there is a positive correlation between measures of financial information quality and CSRD quality (Francis, Nanda, and Olsson 2008; Gao, Dong, Ni, and Fu 2016) but without significant increases in audit or total fees (Dal Maso, Lobo, Mazzi, and Paugam 2020). Further, financial auditors may have a professional advantage in understanding the concept of materiality and applying this largely financial accounting concept to the CSRD audit. One study finds that when financial auditors provide CSRD assurance, qualitative factors have a greater impact on sustainability materiality assessments than on financial statement materiality assessments when the matter at issue is a difference between five and ten percent of a relevant base (Moroney and Trotman 2016).

In contrast, consumers may favor internal auditors who provide the firm-specific expertise and risk and compliance understanding to the CSRD assurance scope. Research suggests that consumers tend to value an assurer's immersion in the field more so than their independence (Power 2011). Two novel examples of this different conception of "assurance" to reduce information asymmetry between public corporations and consumers come from the grades and rankings from buyers and sellers of collectible baseball cards in North America (Jamal and Sunder 2011) and prior consumers' reviews and ratings of leisure products and services in TripAdvisor (Jeacle and Carter 2011). Further, survey-based research suggests that risk and compliance are dimensions of interest to customers, as well as social justice as a new dimension (Bradford, Earp, Scott Showalter, and Williams 2017). Internal auditors are thus well-positioned to contribute their first-hand knowledge about the firm's CSR activities and their expertise in internal controls to mitigate business and reporting risks, thereby increasing the reliability and validity of the CSRD (Trotman and Trotman 2015).

Also in contrast, employees may favor specialist auditors with prior CRSD experience with peer firms since specialist auditors are not financial auditors from professional accounting firms but instead are national or city level industry leaders and have subject matter expertise (Huggins, Green, and Simnett 2011). One study finds that firms with higher CSR ratings are more likely to hire specialist auditors (Sun, Huang, Dao, and Young 2017). Also, the Shell Company notes, in its

2003 CSRD, that "environmental and social data and assertions are subject to more inherent limitations than financial data, given both their nature and the methods used for determining, calculating or estimating such data" (Ballou, Heitger, and Landes 2006). As a result, financial accounting fundamentals (e.g., assets equal liabilities plus equity) may not be readily transferable to the CSR context. The same limitation applies to the auditor's statement that typically accompanies the CSRD. Unlike the financial statement auditor's opinion, which is informed by interactions between the auditors, management, and the audit committee, the specialist auditor's CSRD statement co-evolves largely based on the legitimizing input from stakeholders other than investors, specifically employees. Said another way, the direct involvement of employees in the CSRD assurance process that specialist auditors engage in ultimately helps legitimize the resulting CSRD audit statement (O'Dwyer, Owen, and Unerman 2011).

Veracity

Veracity relates to the extent to which a messenger is deemed truthful (Mayer, Davis, and Schoorman 1995). Accounting studies have examined this in the context of managers building a reputation for truth-telling for financial information that is ex-post verifiable. A noteworthy assumption here is that in the context of voluntary financial disclosures, there is still a common framework and a set of accounting standards that are used as a basis for managers to formulate their forecasts and for users to rely on. For example, one study shows that financial analysts respond more (by revising their own financial forecasts) to more (versus less) reputable managers based on the manager's prior financial forecast accuracy (Williams 1996). In the CSRD context, there is no common set of CSR reporting standards, but rather, a number of alternative CSDR frameworks, so it is an open question how CSRD framework choice impacts stakeholder perceptions of CSRD credibility. Abernathy, Stefaniak, Wilkins, and Olson (2017) note that "opportunities exist for researchers to examine how the choice of measurement framework and varying levels of obeisance to those frameworks influences the credibility and completeness of CSR reporting." For example, one study finds that explicit over-referencing of a firm's adherence to the Global Reporting Initiative (GRI) framework, which provides a universal language for multi-stakeholder CSR reporting and sector-specific standards, reduces credibility perceptions of the CSRD (Baier, Göttsche, Hellmann and Schiemann 2021).

As such, once a firm selects a CSRD framework, then that framework's emphasis becomes the basis against which perceivers judge the extent of the messenger's veracity. For example, investors may favor the use of the Sustainability Accounting Standards Board (SASB) framework because it adheres to the federal security laws' definition of what is material to reasonable investors, particularly the SASB's Materiality Map. The SASB's industry-specific standards for CSR reporting aims to provide decision-relevant, transparent, and complete CSRD along five themes: climate change, safety, access, resource management, and responsible financing (Rogers 2016). The SASB framework thus provides investors a common basis to set their expectations. For instance, one study finds that firms that voluntarily disclose their climate-change-risks (CCR) in their financial reports using the SASB framework have lower imputed cost of equity; and the market penalty for firms not disclosing CCR when the market expects CCR to be material is significantly larger than the reward for disclosure when the market does not expect CCR to be material (Matsumara, Prakash, and Vera-Muñoz 2020).

Another CSRD framework comes from the International Integrated Reporting Council (IIRC), which offers an integrated reporting framework aimed at efficiently linking seemingly disconnected financial and CSR information into a more cohesive picture of a firm's financial and CSR performance. Consumers may favor this CSRD framework choice because it elevates stakeholder considerations over stakeholder primacy. For example, a study of 954 firm-years in the Johannesburg Stock Exchange, which mandates adoption an integrated reporting approach, finds a reduction in market valuation of net assets after mandatory adoption. These authors interpret their results as suggesting that integrated reporting makes salient the relative importance of the other, nonfinancial 'capitals' – human, social, and natural (Baboukardos and Rimmel 2016). Other studies suggest that integrated reporting provides value-relevant information to stakeholders (Zhou, Simnett, and Green 2017); perhaps because the process of integration encourages firms to more clearly articulate their value creation process (Adams, Potter, Singh, and York 2016). Accordingly, Vitolla, Raimo, Rubino, and Garzoni (2019) find that integrated reporting quality increases with pressures from stakeholders, including customers, environmental protection organizations, employees, shareholders, and governments.

Yet another framework used by public corporations is the United Nation's 17 Sustainable Development Goals (SDG), which makes a public corporation's ESG efforts tangible for employees (Thygesen 2019). For example, one study finds that employee perceptions of sustainable social initiatives as part of the SDG framework are more positive when employees identify with the initiatives, especially in emerging markets where the employees volunteer their time to implement these initiatives (Munro and Arli 2020). It is not surprising then that many public corporations take a selective approach to incorporating the SDGs into their business strategy, with the most frequently referenced being those more closely related to employee concerns, such as SDG 8 (Decent work and Economic Growth), SDG 13 (Climate Action), SDG 12 (Responsible Consumption and Production); and the last frequently referenced being SDG 2 (Zero Hunger), SDG 14 (Life Below Water), SDG 1 (No Poverty), SDG 15 (Life on Land), and SDG 10 (Reduced Inequities) (PwC 2019).

Intent

The intent to do good has been examined as an antecedent of trust (Mayer, Davis, and Schoorman 1995). This research has focused on psychological contracts, that is, the explicit and implicit promise made by the messenger to the perceiver to do good (Simons 2002). In an organizational context, employees perceive the violation of a psychological contract when there is a misalignment between a messenger's words and his or her deeds; and this misalignment in turn undermines the perceiver's belief in the messenger's overall intention to do good (Robinson 1996). One study indirectly applies the idea of word-deed misalignment to the CSRD context and finds that for 92 firms in environmentally sensitive industries, membership in the Dow Jones Sustainability Index (DJSI) is positively associated with higher levels of CSRD and higher perceptions of reporting reputation; but negatively associated with environmental performance measured using Trucost environmental scores. In effect, DJSI membership is influenced more by what and how much firms say than what they do (Cho, Guidry, Hageman, and Patten 2012).

As such, what and how much firms say with regards to CSRD is influenced by the issues that they make salient and therefore more visible to their stakeholders (Dawkins and Fraas 2011). An example of this is a firm's choice to join the Carbon Disclosure Project (CDP), which is an initiative sponsored by the Coalition for Environmentally Responsible Economies (Ceres). Such affiliations may reveal the firm's authentic commitment to sustainability because voluntarily sharing GHG emissions data via the CDP enhances the traceability of the CSRD, particularly for investors who will look to reconcile the information submitted to the CDP and that provided in the firm's CSRD.

One study finds that firms disclose lower but more detailed GHG emissions data in their CSRD compared to that submitted to the CDP. The authors reason that while CPD data is aimed at primarily institutional investors, CSRD has a broader set of stakeholders as the targeted readership. As a result, the more robust the CSRD, the more credible the firms' commitment to sustainability (Depoers, Jeanjean, and Jérôme 2016). In contrast, there is little evidence that firms joining the Business Roundtable (BRT) as signatories engage in stakeholder-centric activities compared to within-industry peer firms. Signatory firms had more environmental- and labor-related compliance violations, pay more in compliance penalties, have higher carbon emissions, rely more on government subsidies, and are more likely to disagree with proxy recommendations on shareholder proposals (Raghunandan and Rajgopal 2021).

Compared to research on how CDP participation and BRT membership may impact investor perceptions of CSRD credibility, there is little research on how consumer perceptions of CSRD credibility may be influenced by such affiliations and affirmations. For example, some firms set ambitious climate neutrality or net-zero targets but focus on carbon emissions rather than all greenhouse gas emissions, even though net-zero means that the company removes all of the carbon emissions it generates through its value chain, and ideally, without relying on carbon offsets, but rather, by reducing its carbon footprints (Mandel 2020). These firms stand in contrast to those who have disclosed their membership in the Science Based Targets Initiatives (SBTI), which moves firms beyond climate action pledges to CSR resource sharing and advocacy. The same can be said for those firms joining Transform to Net Zero.

Further, what may matter to consumers and employees are affiliations that continue despite a firm's climate change pledge. For example, continued membership in the U.S. Chamber of Commerce and the American Legislature Exchange Council (ALEC) undermines CSRD credibility, since these organizations are known to undermine climate action (Mandel 2020). Similarly, affirmations are nothing without consistent action. One example is Visa, who joined 300 other companies to call on Congress to adopt green recovery plans post-pandemic. However, Visa also donated over $150,000 to politicians who routinely oppose climate action policy (Schupak 2020).

Practical Implications

The above discussion suggests that there is no single CSR credibility cue that will fully satisfy the various information quality needs of key stakeholders. Hence, for those making CSRD choices within their firms—sustainability directors, risk or compliance officers, investor relation managers, legal professionals, and so on—the next question becomes which of the CSR information characteristics are most controllable *and* most likely to have the desired stakeholder perception impact?

This approach to inform CSRD credibility cue choices is related to, but separate from, the fundamental question of what CSR activities to pursue in the first place. Indeed, a recent article in the *Wall Street Journal* suggests that management should systematically prioritize CSR activities that aim to address the most significant concerns of stakeholders that are particularly influential *and* informed (Taylor 2021). This would be more feasible for firms that either have not engaged in CSR activities yet or are agile in their CSR systems such that they can readily pivot as the stakeholder analysis suggested. However, for firms that are already and deeply engaged in CSR activities, there may be more potential in making CSRD choices as a way to satisfy the CSRD preferences of key stakeholders. To maintain control over their environmental, social, and governance (ESG) commitments, firms emersed in CSR can begin by obtaining CSRD assurance, using a CSRD framework, and perhaps most importantly, authentically aligning CSRD affirmations with their CSR activities.

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