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Sustainability reporting by publicly listed companies in Sri Lanka

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ABSTRACT

While many studies have investigated sustainability reporting in developed countries there is a dearth of research in developing countries. This is of particular concern, as the majority of the world's population lives in these countries, which experience their own social, political and environmental issues. One of these countries, Sri Lanka, has a population of 20.3 million and is presently experiencing post-conflict economic growth. Sri Lanka faces a number of environmental problems including land degradation, pollution, poor management of water resources, loss of bio-diversity, coastal erosion and poor industrial waste management. This study empirically examines sustainability reporting in publicly listed companies in Sri Lanka, its extent, nature and possible drivers, specifically considering the use of key performance indicators. Results indicate that there is a major focus on social indicators, despite the poor environmental record in the country. The economic context therefore appears to be a significant factor influencing how sustainability reporting develops in Sri Lanka. The findings have implications for policy makers in Sri Lanka as the trend towards foreign investment is likely to increase pressure on firms to comply with global environmental standards and guidelines.

1. Introduction

Debate persists around the negative environmental and social impacts from the disproportionate and unwise use of resources by business organisations (Dilling, 2010; Kolk, 2003). As business organisations engage in both intermediate and final assembly of products and services, it is argued that sustainable manufacturing and utilisation of resources by companies would result in an improvement in the environment and society (Hubbard, 2009; Dilling, 2010; Elijido-Ten, 2011). Organisations are also increasingly held accountable for their effect on society and the environment as reflected by the growing number of laws, regulations and penalties in this area (Henri and Journeault, 2008). Investors look for evidence of sound business strategy and effective management of risk, some customers are concerned with product origins and the conditions under which they are manufactured, and employees want to work for organisations that visibly account for their responsibilities to society and the environment (Belal and Owen, 2007). These have all led to an increased prevalence in corporate sustainability reporting (Lee, 2008).

While many studies have investigated sustainability reporting in developed countries (Patten, 2002; Frost et al., 2005; Gray, 2006b; Othman and Ameer, 2009; Burritt and Schaltegger, 2010; Gurvitsh and Sidorova, 2012), there is a dearth of research in developing countries (Sahay, 2004; Sumiani et al., 2007; Md. Habib-Uz-Zaman et al., 2011). This is of particular concern, as the majority of the world's population lives in developing countries, which experience their own social, political and environmental issues (United Nations, 2013). Many of these countries are characterised by unstable governments, high levels of unemployment, limited technological capacity, unequal distribution of income, unreliable water supplies and under-utilised factors of production. A common strategy in achieving faster economic development is rapid industrialisation. Industrial development policies are pursued with the aim of attracting greater foreign investments to these countries. Foreign investors are keen to start businesses to benefit from fiscal incentives, export processing zones and cheap labour. While these strategies have economic merit, they can have other, adverse, social and environmental effects. These include the use of child labour, unpaid wages, inequitable career opportunities, workplace safely matters, increased waste and environmental pollution.

As an emerging economy in the South Asian region, Sri Lanka was selected as the research focus for this study. Sri Lanka is a

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country with a population of 20.3 million presently experiencing post-conflict economic growth. The Sri Lankan economy has been growing significantly since the end of a thirty-year war (World Bank, 2013). As a result, foreign companies have increased their investments in Sri Lanka with US$ 933 million US dollars in direct foreign investments in 2013 alone Board of Investment of Sri Lanka (2013). While Sri Lanka is classified as a middle income developing country, the challenge for Sri Lanka is to achieve high economic growth without causing irreversible damage to the environment and while eliminating social issues such as poverty, malnutrition and poor workplace ethics. At present, Sri Lanka faces a number of environmental problems including land degradation, pollution, poor management of water resources, loss of bio-diversity, coastal erosion and poor industrial waste management (Goger, 2013). However, Sri Lanka also has a long history of corporate philanthropy towards society and the environment, largely led by individual values and actions and cultivated from religious and cultural views (Beddewela and Herzig, 2013). Nevertheless, the topic of sustainability reporting in Sri Lanka receives relatively less attention in research compared to other parts of the world. Sustainability reporting is not mandatory in Sri Lanka, as with many other countries in the world, thus it is likely that voluntary sustainability reporting by Sri Lankan companies may show structural diversity and disclosures may vary from low to high levels.

In addition, a key aspect of sustainability reporting – sustainability-related key performance indicators (KPIs) is significantly under-researched. According to Adams and Frost (2008), if sustainability reporting is to lead to improvements in sustainable performance, organisations must integrate KPIs from the economic, social and environmental dimensions into the overall management system. If KPIs are not presented in sustainability reports, different stakeholder groups will have difficulty in analysing and understanding the sustainability efforts of the company (Perrini and Tencati, 2006). Even though organisations have adopted sustainability practices over the years, outcomes from economic, social and environmental activities are often viewed in isolation or distinct from each other. By contrast, sustainability reporting aims to view these facets together in combined sustainability KPIs (Figge et al., 2002). Sustainability KPIs are a framework of performance indicators reflecting the economic, social and environmental aspects of organisational activity. Sustainability KPIs allow better connections to be made between sustainability efforts and outcomes. They identify causal relationships between financial and non-financial performance. Furthermore, KPIs enhance the transparency of the internal processes that enable the stakeholders to better understand the sustainability approach and resulting value addition. Therefore, sustainability KPIs are an inherent component of sustainability reporting. Even so, the extent and nature of sustainability KPI reporting has not been distinctly addressed by existing research to a large extent, in either developed or developing economies. Similarly, given the importance placed on the use of KPIs, their relationship with financial performance has also not been considered.

This study provides preliminary evidence on sustainability reporting by publicly listed companies in a developing country, Sri Lanka. Specifically, it examines the extent, nature and possible drivers of reporting on a sample of larger, listed companies. The nature and extent of sustainability reporting, and specifically considering the reporting of key performance indicators (KPIs) for sustainability, are described and measured using a Sustainability Reporting Scoring Model. Using scores derived from this model, the study also tests the relationships between the extent and nature of sustainability reporting and certain company characteristics, including size, age, industry and financial performance.

The next sections present background information on sustainability reporting and a review of relevant prior research. This is followed by the development of the research questions and hypotheses, and a discussion of the research method employed, including the sample selection and the Sustainability Reporting Scoring Model developed. Finally, the results and conclusions of the study are presented including the study's limitations and recommendations for further research.

2. Sustainability

There is no single definition for sustainability, or sustainability reporting, and as a concept it continues to evolve. It is associated with numerous contemporary business and reporting practices including corporate social responsibility (CSR), corporate sustainability, corporate citizenship, integrated reporting, and sustainable entrepreneurship (Reddy and Gordon, 2010). The most structured definition of sustainability reporting is derived from the concept of sustainable development, which is built on the three pillars of economic propensity, social equity and environmental protection. That is, sustainable development is defined by the World Commission on Environment and Development as "development which meets the needs of the present generation without compromising the ability of future generations to meet their own needs" (Brundtland et al., 1987). Therefore, from a business perspective, sustainable development can be accordingly defined as an organisation meeting the needs of a its present direct and indirect stakeholders (shareholders, employees, clients, pressure groups, regulatory bodies, government, local community) without compromising its ability to meet the needs of future direct and indirect stakeholders (Dyllick and Hockerts, 2002).

2.1. Sustainability key performance indicators (KPIs) and reporting

The introduction of sustainability reporting has coincided with an increased demand from stakeholders for non-financial performance measures due to the shortcomings of traditional control and performance measurement practices (Figge et al., 2002; Elijido-Ten, 2011). These include failure to relate performance measurement to the strategic objectives of organisations, and highlighting financial measures which are lagging rather than leading indicators of performance.

KPIs usually provide information about the causes or drivers of business outcomes and are usually linked to the firm's competitive strategies. KPIs are typically non-financial in nature and are said to assist managers in achieving better financial performance, by focussing on lead indicators rather than lag indicators, where lead indicators guide the organisation on how to achieve improvements to outcomes (Braam and Nijssen, 2004). Leading indicators of performance, for instance the number of new products introduced by a company (non-financial), are contrasted against lagging indicators such as profit margin (financial), which reflect the outcomes of past events (Davis and Albright, 2004).

Sustainability KPI reporting involves reporting on specific indicators developed for corporate information requirements (Perrini and Tencati, 2006) and assist business entities to quantify information which is usually viewed as non-measurable (Roca and Searcy, 2012). In other words, sustainability KPIs represent a 'control panel' for sustainability reporting. This helps to continually monitor an organisation's sustainability performance trends.

KPIs are an essential component of sustainability reporting as they focus on the financial stability, eco-efficiency and socio-efficiency of the organisation (Cohen et al., 2012). Sustainability KPIs can also be used as a fundamental tool to communicate information to the different direct and indirect stakeholder groups,

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