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Does the Egyptian Market Value Sustainability Reporting?

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ABSTRACT

This paper aims to provide insights on some issues associated with the development of sustainability reporting in Egypt. In the context of a dynamic world, and faced with a scientific proof that relates climatic changes to corporate activity and highlights how such non controlled activities has the potential to threat mankind, corporate financial reporting needs to be placed in perspective. Hence, as a social science, accounting, in terms of the rules that govern corporate activity and the financial reporting process, is an essential link in this chain. For decades, corporate financial disclosure decisions and investors' decisions were totally influenced by corporate's profitability regardless of the environmental, social and economic impact of its activity to generate such profits. However, recent years have witnessed an increasing awareness of the need to integrate financial and nonfinancial information to gain an overview about corporate sustainability which mirrors its long-term operation and financial stability. In this context the S&P/EGX ESG index was planned and developed as the premier index in Egypt to address the investors' concern about environmental, social and governance issues. As the EGX is a promising exchange, this raises the need to investigate the extent to which sustainability reporting is appreciated in the Egyptian market by both business enterprises and the investors. In order to achieve study objectives semi-structured interviews were employed. Results indicated that although the importance of sustainability reporting is not quite clear to all participants, business enterprises consider sustainability information 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 behind portfolio selection. However, sustainability issues would be seriously considered when comparing among alternatives with similar returns.

Keywords: S&P/EGX ESG index, Egypt, Sustainability reporting.

1. 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 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.

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 maximisation is the main goal for companies as well as for current and potential investors, and 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.

To achieve this study objective the remaining part of this paper is organized as follows. A literature review is provided in Section 2. Section 3 describes research methodology. Results are presented in Section 4. Finally, Section 5 concludes.

2. Literature Review

The modern concern with human-environment interactions was highlighted since 1972 in Stockholm conference on human development. The following three decades have witnessed a widening of the debate concerning the relationship between human development and the environment and emerges against a background of concern about the environmental crisis, the under development of the majority of the world's population and social responsibility (e.g., Pirages, 1990; Bartelus, 1994; Esteva, 1992; Tolba & El-Kholy, 1992; Gray et al., 1995; Sachs, 1995; Gray, 2002; O'Donovan, 2002; Patten, 2002; Parker, 2005; Campbell, 2007; Pulver, 2007; Crane et al., 2008; Rockstrom et al., 2009; Chen & Roberts, 2010). Further, this literature formed the basis for the recognition of sustainability as a policy issue and also forms the starting point for many of the more recent research papers on sustainability and sustainable reporting (e.g., Adams, 2004; Ballou et al., 2006; Aras & Crowther, 2008; Jackson, 2009; Milne, et al., 2009; Gray, 2010; Bansal & Hoffman, 2012; Bebbington & Larrinaga, 2014; Bebbington, et al., 2014; Unerman & Chapman, 2014; Cho et al., 2015).

Increasing organizational interest in sustainability reporting and accountability, along with increased academic investigation of these accounting issues, have resulted in greater evidence and public awareness of sustainability. The recognition of social and environmental issues by corporate board of directors is most likely reflected via corporate sustainability reporting practices, which have in recent years spread swiftly and perceived as a component of the information stream produced by business organizations. Moreover, currently many organizations are developing a growing array of accounting, accountability and assurance practices to enable identification and handling of sustainability related risks and opportunities (O'Dwyer et al., 2011; Malsch, 2013; Cho et al., 2015). Besides, the development of such practices have emerged critiques and debates, supported with insights from academic research, regarding the degree to which such practices might be considered as applicable (Gray, 2010; Cho et al., 2015). The issue of corporate sustainability related assertions and practice has been investigated by many researchers who produced inconsistent results (e.g., Archel et al., 2011; Dhaliwal et al., 2012; Malsch, 2013; Milne & Gray, 2013; Unerman & Chapman, 2014). Opponents of sustainability reporting argue that voluntary sustainability reporting scope is limited (O'Dwyer et al., 2005) and that it is employed as a means to gain legitimacy and serve their own interests rather than signaling rational plans and commitments (Adams, 2004; Milne & Gray, 2007; Cho et al., 2012; Patten, 2012; Milne & Gray,2013). Hence, company reputation will be the main factor that governs company decision regarding what type of sustainability relating information to release, with corporate management being most concerned with bending, obscuring, or rationalizing their poor social and environmental performance (Cho et al., 2010; Cho et al., 2015). On the other side, proponents of sustainability reporting argue that it improves corporate accountability and transparency regarding social and environmental impacts of its activities (Bebbington, et al., 2014). Additionally, sustainability related assertions are to some extent considered as signals to the market that the company is proactively managing its social and environmental risks (Malsch, 2013).

The review of the prior research that investigates sustainability reporting reveals the lack of consensus among prior researchers regarding the issue of sustainability reporting. Hence, there is a need for further research particularly in transitional economies whereas sustainability reporting is considered as a newly imported practice.

3. Research Methodology

Given the complex nature of sustainable development, and the relative lack of knowledge about the mechanisms by which business undertake sustainability reporting, semi-structured interviews were undertaken. Building on the review of prior research and the S&P/EGX ESG index a relatively standardised set of questions were created. The following themes were developed within the interviews:

1. The clarity of 'sustainable development' concept
2. How sustainability reporting is perceived by the interviewees

3.1. Sample Selection

The researcher planned to conduct 20 interviews; ten persons from each group (board of directors of companies listed on the EGX whether their companies are listed on the S&P/EGX ESG index or not and securities brokers as sustainability reporting users). However, despite the original intention, the researcher could only complete 15 interviews (75%), six from the first group (two of them are members in the Board of Directors of companies listed on the S&P/EGX ESG index, particularly participants 5 and 6) and eight from the second group.

Before conducting any of the interviews, the researcher contacted the potential interviewees to explain the purpose of the study and to obtain their permission to participate. People who agreed to be interviewed were asked to determine the suitable time and were informed of the themes to be covered during the interview to allow them to consider the information being requested.

3.2. Interview Questions and Ethical Considerations

The interviews were semi-structured and lasted between 30 and 40 minutes and were conducted between November 2014 and January 2015. The interview questions were open-ended to encourage free expression of participants' views, ideas, and perceptions. Firstly, Interviewees were asked if the concept 'sustainable development' is known by them. Then discussions moved to questions directly relating to sustainability reporting with respect to how it is valued by them.

Measures to ensure the trustworthiness of the study were also incorporated in the interviews. Each began by emphasizing that complete anonymity would be provided to interviewees. Notes were taken during the interviews, as the interviewees were not prepared to be tape-recorded. Interviewees were encouraged to speak freely, and for verification purposes, they were asked to read the notes taken by the researcher during the interview to make sure that their views were accurately reported. The questions were translated into Arabic, as this was the language used. The researcher then translated the transcripts from Arabic to English, and to further guarantee the validity of the texts, the researcher asked a linguistic specialist to review her translation.

In constructing the interview questions the researcher followed the recommendations of Collis & Hussey (2003) to keep questions simple, avoid using unnecessary jargon or specialist language, phrase questions to keep the meaning clear, avoid asking negative questions because they are easy to misinterpret and avoid leading or value-laden questions. The researcher decided to use a manual method as the number of interviews and the interview material were manageable. Also, as qualitative data analysis depends mainly on deep understanding of data by the researcher and as software programs do not analyze qualitative data in depth, it was decided that the use of software was inappropriate.

4. Research Results

4.1. The Clarity of 'Sustainable Development' Concept

The interview data indicates that all participants are aware about the concept of sustainability. However, it is more recognized in relation to the environmental impact of organizational activities as reported by 11 interviewees. *" ...it is a newly developed concept that is concerned with how to carry out your economic activity without polluting the environment or harming its natural balance" Interviewee 3 (first group)."...it is an emerging culture among businesses worldwide that requires them to be environmentally responsible" Interviewee 10 (second group)*. The association between sustainability and economic, environmental and social endeavors is recognized by only four participants; three from the first group and 1 from the second group.*"...it is to achieve the economic, environmental and social objectives to improve the welfare of the current population without preventing the coming generations from that right" Interviewee 5 (first group). "...it is to be environmentally and socially accountable while achieving economic objectives" Interviewee 15 (second group).*

4.2. How Sustainability Reporting is Valued

The interview data collected from the first group is contradictory with respect to the importance of sustainability reporting. Members of the board of directors of companies listed on the S&P/EGX ESG index believe in the importance of sustainability reporting and perceive it as part of transparency and accountability *" ...we used to support any recommended practice so we decided to take the initiative and release sustainability reports…our reputation and our image in the eyes of the community means a lot… we used to provide a role model in transparency and accountability to our competitors and to other businesses" Interviewee 6(first group).* However members of the Board of Directors of companies not listed on the index consider releasing sustainability reports as unreasonable cost. *"...we believe in social and environmental responsibility of business organizations…we are already working on decreasing the harmful impacts of our activity on the environment and that costs us a lot of money… but we think releasing sustainability reports is an extra unneeded cost as the majority of people if not all donot consider such reports and it is not a mandatory requirement" Interviewee 4(first group).*

With respect to the perception of the first group participants regarding whether releasing negative impacts of their activities throughout sustainability reports may affect their financial performance, all interviewees agree that investors are initially looking for investment opportunities that provide them with the highest return regardless of the economic, social and environmental impacts of investee activities as long as the company is not violating laws that increase their risk. *" ...our main responsibility is to achieve the highest return on capital invested… investors put their money in the company that provides them with the highest return…they do not think about the impact of its activity as long as it is not subject to governmental regulations that may increase the company risk" Interviewee 2(first group).*

With respect to the perceptions of the second group participants regarding the importance of sustainability reports, they all argue that it is a good practice that reflects company's accountability. However, they all mentioned that returns on investment is the main factor to be considered in deciding which company to invest in. *"sustainability reporting is an appreciated practice that reflects social and environmental responsibility of business organizations and improved transparency…when deciding which company to invest in, the returns on investment is the main aspect" Interviewee 8(second group)."...of course sustainability reporting is a good thing but when we talk about investment decisions the best investment opportunity is the one that provides the highest return" Interviewee 13(second group).* Four interviewees mentioned that sustainability related information is most likely to be considered when comparing investment opportunities with similar returns.*"...to be honest sustainability related information most likely to be considered when you choose among investment opportunities of similar returns" Interviewee 12(second group)."...when comparing between two investment opportunities with similar returns, the optimum choice will be the one which is more socially and environmentally responsible" Interviewee 15(second group).*One participant argued that when the company reputation is affected due to its harmful activities it is better to avoid investing in such company even if it is the best available investment opportunity*"...if the company reputation is affected due to irresponsible activities that harm the environment and the community it will not be a good decision to invest in this company* *even if it is currently paying the highest return because at any time its value will be at stake…it is a risky investment that you should avoid'' Interviewee 9(second group).*

5. Summary and Conclusions

Based on the interview data, the following generalizations could be concluded:

1. All participants are aware about the concept of sustainability. However, it is more recognized in relation to the environmental impact of organizational activities.
2. The interview data collected from the first group is contradictory with respect to the importance of sustainability reporting. Members of the board of directors of companies listed on the S&P/EGX ESG index believe in the importance of sustainability reporting and perceive it as part of transparency and accountability. However, members of the Board of Directors of companies not listed on the index consider releasing sustainability reports as unreasonable cost.
3. With respect to the perception of first group participants regarding whether releasing negative impacts of their activities throughout sustainability reports may affect their financial performance, all interviewees agree that investors are initially looking for investment opportunities that provide them with the highest return regardless of the economic, social and environmental impacts of investee activities as long as the company is not violating laws that increase their risk.
4. With respect to the perceptions of the second group participants regarding the importance of sustainability reports, they all argue that it is a good practice that reflects company's accountability. However, they all mentioned that returns on investment is the main factor to be considered in deciding which company to invest in.
5. Half of the interviewees from the second group mentioned that sustainability related information is most likely to be considered when comparing investment opportunities with similar returns and one participant argued that when the company reputation is affected due to its harmful activities it is better to avoid investing in such company even if it is currently the best available investment opportunity because at any time its value will be at stake.

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