HOLDING MULTINATIONAL CORPORATIONS ACCOUNTABLE: IS NON-FINANCIAL DISCLOSURE THE ANSWER?

Allison M. Snyder*

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* J.D. Candidate 2008, Columbia University School of Law; B.S. Business Administration 2003, Georgetown University. The author wishes to thank Professor Katharina Pistor for her guidance, Sylvie Goursaud for her support, and the staff of the *Columbia Business Law Review* for their editing assistance.

I. INTRODUCTION

Holding Multinational Corporations (MNCs) accountable for business activities in foreign countries is an ongoing concern as the world continues to shrink. There are currently over 70,000 transnational firms with approximately 700,000 subsidiaries and millions of suppliers around the world.[1] This accumulation of power and global reach has brought increased attention to the corporate community.[2] Since 1990, the world has seen the establishment of more than 10,000 new citizens' groups.[3] From poor working conditions to complicity in human rights violations, there has been no shortage of newsworthy corporate activities provoking public outcry.

Despite a lively debate about corporate accountability and numerous proposals to ameliorate the situation, a solution has yet to surface. Some commentators argue that non-financial or corporate social responsibility (CSR) reporting

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[1] *See* John Ruggie, Special Representative of the Secretary-General, *Interim Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises*, U.N. Doc. E/CN.4/2006/97 (Feb. 22, 2006).

[2] *Id.* (noting that the accumulation of power by one social actor will induce efforts by others to organize countervailing power, that businesses have made themselves targets because of various abuses, and that MNCs have a global reach unmatched by government).

[3] Sheila M.J. Bonini et al., *When Social Issues Become Strategic*, MCKINSEY Q., Oct. 23, 2006. Additionally, this article notes that while trust in non-governmental organizations has risen, trust in companies has declined. The blame paradigm has shifted, with people blaming societal problems on the "environment."

provides such a solution.[4] Proponents claim that non-financial reporting by companies will improve not only corporate actions, but also enable shareholders and stakeholders to make better and more informed choices. One commentator maintains that disclosure provides a way for governments to assure control of corporate abuse and promote the public interest.[5] Others propose that stock exchanges should mandate non-financial disclosure and enforce attendant standards.[6] Some commentators argue the business case for disclosure, pointing to the importance of long term corporate sustainability.[7] Non-governmental organizations (NGOs) are an active voice encouraging increased transparency.[8] In addition, investors have called on companies to voluntarily disclose social and environmental information.[9]

This note evaluates the use of non-financial disclosure as a way to improve corporate activities that impact our society

[4] This note uses non-financial, CSR, sustainability, and social reporting interchangeably throughout the text.

[5] STEVEN LYDENBERG, CORPORATIONS AND THE PUBLIC INTEREST: GUIDING THE INVISIBLE HAND (2005) (outlining a method for using disclosure and pointing out the need for data to be processed for dissemination and a changed dialogue in the marketplace).

[6] *See* Duncan McLaren, *Global Stakeholders: Corporate Accountability and Investor Engagement*, 12 CORP. GOVERNANCE 2, 191-201 (Apr. 2004) (arguing that stock exchanges should enforce standards for disclosure).

[7] *See* Dan Anderson, *The Critical Importance of Sustainability Risk Management*, 53 RISK MGMT. 4, 66 (Apr. 2006) (arguing that sustainability risks are crucial consideration for fiduciaries and that reporting serves as a way to promote sustainability).

[8] *See, e.g.*, KPMG'S GLOBAL SUSTAINABILITY SERVICES AND UNITED NATIONS ENVIRONMENT PROGRAMME (UNEP), CARROTS AND STICKS FOR STARTERS: CURRENT TRENDS AND APPROACHES IN VOLUNTARY AND MANDATORY STANDARDS FOR SUSTAINABILITY REPORTING (2006), *available at* http://www.unep.org [hereinafter UNEP AND KPMG REPORT] (providing an overview of current state of reporting and recommendations for the next steps).

[9] *See Investors Press S&P 500 Companies for Better Disclosure on Environmental and Social Challenges*, PR NEWSWIRE, Oct. 5, 2006 (explaining recent proposals for disclosure by institutional investors) [hereinafter *Investors Press*].

and the environment. The subsequent evaluation illustrates that corporate disclosure of social performance has limited impact on improving how companies conduct business abroad. Ultimately, recognizing the limits of non-financial disclosure is a step toward developing a meaningful way to hold companies responsible for activities on foreign soil.

Part II outlines the evolution of social disclosure from early suggestions to today's efforts. Part III describes the theoretical underpinnings of disclosure and highlights some practical concerns about the usefulness of these theories in the non-financial context. The section also provides insight about the benefits of financial disclosure regulations in the United States as a point of contrast. Part IV addresses some initial hesitations about the viability of non-financial disclosure. These hesitations include practical concerns, hurdles to measuring social data, an examination of value-driven corporate models, and experience with monitoring systems. Part V evaluates current voluntary disclosure initiatives and illustrates their shortcomings, particularly focusing on the ability of companies to control the CSR discussion. Lastly, Part VI assesses the potential of mandatory disclosure as a remedy for the failings of voluntary disclosure. The section addresses the policy arguments for mandated social disclosure and empirical evidence about its effectiveness thus far.

II. BACKGROUND

A. History

Social reporting has gained momentum in recent years, but it is not a new idea. During the 1960s and 1970s, an awareness of external responsibilities ignited debates about reporting in both the United States and Europe.[10] Commen-

[10] UNEP AND KPMG REPORT, *supra* note 8, at 6. *See also* A.W. Clausen, *Voluntary Disclosure: An Idea Whose Time Has Come*, *in* CORPORATIONS AND THEIR CRITICS: ISSUES AND ANSWERS TO THE PROBLEMS OF CORPORATE SOCIAL RESPONSIBILITY 63 (Thornton Bradshaw & David Vogel eds., 1981) (noting that in 1976, AT&T Chairman John DeButts stated that the best way to demonstrate accountability was for businesses

tators noted that the corporation "is now being required to assume responsibility toward the society in which it operates."[11] One early recommendation for social auditing was to encourage businesses to voluntarily disclose a calculation of their expenditures designed to improve the welfare of employees, public or product safety, or environmental conditions.[12] In addition to the policy debate about social reporting, there was some reporting by the mid-20th century in the business community. A 1974 report by a public accounting firm assessed social disclosures in Fortune 500 companies' annual reports.[13] The study found that the number of reports containing social measurements increased from 239 in 1971 to 298 in 1973.[14] Much of the early disclosure in this period focused on human resource issues.[15]

During the 1980s, ethical investment funds emerged.[16] These funds screened companies for their social and ethical performance. The dialogue about reporting continued. One member of the business community noted that public pressures for more information reflected the enlarged power and responsibility of businesses.[17] Several years later, the 1989 Exxon Valdez disaster sparked an increased drive for social reporting and the development of environmental

to adopt "a sufficient openness to public inquiry—and a sufficient readiness to respond to public challenge—to make it clear that we recognize what once we might have been disposed to call 'our' business is in fact the public's business and that the public, having a stake in our decision, should have a voice in them as well").

[11] David F. Linowes, *The Corporate Social Audit*, *in* SOCIAL RESPONSIBILITY AND ACCOUNTABILITY 95 (Jules Backman ed., 1975) (noting that the private and public sectors have become "all mixed up," recognizing the need for social audits, and providing a framework for companies to implement audit programs).

[12] *Id.* at 102.

[13] *Id.* at 97.

[14] *Id.*

[15] UNEP AND KPMG REPORT, *supra* note 8, at 6.

[16] *Id.*

[17] Clausen, *supra* note 10, at 63 (arguing that in response to public pressure, companies should respond with voluntary disclosure programs; additionally citing public support, improved internal operations, and enabling the market to function more efficiently as reasons to disclose).

reporting guidelines by the Coalition for Environmentally Responsible Economies (CERES).[18] The 1990s saw expanding coverage of CSR topics. Companies such as Body Shop International issued Values Reports discussing environmental, animal protection, and social issues.[19] In 1997, CERES and UNEP launched the Global Reporting Initiative (GRI) to create guidelines for companies to report economic, environmental, and social performance.[20]

The focus of social reporting has evolved and expanded over the years, but the underlying idea has been a force in the business community since the 1960s. Today, voluntary social reporting has reached a new peak. The Corporate Register, a database of social reports, contained approximately 1900 social reports by global companies in 2005, a significant increase from fifty reports in 1992.[21] A recent survey of Fortune 500 Global companies suggests that nearly nine out of ten internally report in connection with their human rights policies, and about seven out of ten periodically release public reports.[22] Another survey suggests that 45% of the world's largest firms produced some form of a non-financial report in 2004, up from 35% in 1999.[23] There has also been an increase in independent auditors that verify the social data.[24] While only 13% of companies reporting had

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[18] UNEP AND KPMG REPORT, *supra* note 8, at 6.

[19] *Id.*

[20] *Id.*

[21] *Id.* at 7; *see also* CorporateRegister.com Report Statistics, http://www.corporateregister.com/charts/charts.pl (last visited Mar. 17, 2007) (database of non-financial reports published by companies).

[22] Ruggie, *supra* note 1, at 37-38 (noting that preliminary results of UN study suggest that more firms have at least instituted a rudimentary internal and external reporting system on human rights policies).

[23] Dara O'Rourke, *Opportunities and Obstacles for Corporate Social Responsibility Reporting in Developing Countries* vi (Corporate Social Responsibility Practice, Washington, D.C.: The World Bank Group, Working Paper, 2004), *available at* http://nature.berkeley.edu/orourke/PDF/CSR-Reporting.pdf.

[24] *Id.* at vii.

third party verification in 1996, independent auditors verified 27% of the reports by 2002.[25]

Further, the suggested parameters for reporting continue to develop. In 2006, GRI released updated guidelines, entitled G3.[26] These added an "entry level" option enabling businesses to choose to report on a limited number of issues instead of all sustainability aspects.[27] By lessening the complexity of the reporting, companies can now take incremental steps toward full disclosure.[28] G3 added sections on strategy and management approaches, in addition to an economic indicator that translates climate risks into financial risks.[29] GRI released G3 with enthusiasm, explaining that "companies will now see a clear business case for reporting on their sustainability practices, because being accountable reduces risk and capital cost, attracts and retains customers and staff, supports stakeholder engagement, and creates new business opportunities."[30]

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[25] *Id.*

[26] *Guidelines on Corporate Social Responsibility Simplified*, FIN. TIMES, Oct. 6, 2006 [hereinafter *Guidelines Simplified*]. Although GRI is often at the forefront of disclosure discussions, there are other international guidelines as well. Some of these include AA1000 published by AcountAbility which provides a model for stakeholder engagement, International Standards Organization (ISO) with over 15,000 standards currently focusing on quality and environmental management with social responsibility standards on the way, the Association of Chartered Certified Accountants (ACCA) which outlines sustainability reporting best practices, OECD guidelines which include a section on disclosure, and the UN Global Compact which requires participating companies to report on their progress in internalizing ten principles on human rights, labor, environment, and anti-corruption. *See* UNEP AND KPMG REPORT, *supra* note 8, at 16-17.

[27] *Guidelines Simplified, supra* note 26.

[28] *Id.*

[29] *Ceres, Others Call for Use of New Environmental Reporting Guidelines*, FOSTER ELEC. REP. (Foster Associates, Bethesda, M.D.), Oct. 11, 2006, at 20 [hereinafter *Ceres and Others*].

[30] *Id.* Some commentators are enthusiastically optimistic about the increasing use of disclosure guidelines, noting that "global companies are finding value in reporting far *more* information than GRI currently demands." *See* John Elkington & Mark Lee, *Third Time's the Charm: Will the Latest Corporate Sustainability Reporting Guidelines Herald a*

B. Recent Push

While the 21st century has seen an increase in voluntary reporting by companies, some investors are asking for more. In October 2006, nine major investors called on S&P 500 companies to follow the lead of their European counterparts and issue reports in accordance with GRI guidelines.[31] Investors included the California Public Employees Retirement System and the New York City Pension Funds, which have combined investments of $300 billion.[32] The letter sent by New York City Comptroller William C. Thompson explained, "Given that our assets are invested primarily in public companies, a fiduciary's ability to assess a company's long-term sustainability is critical."[33] Thompson went on to emphasize the importance of a universal protocol for disclosing social, environmental, and economic performance.[34]

This is not the first time that the New York City Pension Fund has made such requests. In recent years, the Comptroller's Office has filed shareholder resolutions seeking reports on the potential impact of environmental issues, like climate change, with various corporations.[35] Many of these companies, including American Power and Ford, responded with the requested publications.[36] Further,

Brave New World?, GRIST, Oct. 24, 2006, http://www.grist.org/biz/fd/2006/10/24/guidelines/. Commentators cite recent reports from BP, Gape, GE, and Nike as "really exciting, all linking sustainability reporting to their mainstream business." *Id.* For example, BP recently committed over $5 billion to research alternative energy and pledged that this investment will grow over the next 10 years.

[31] *Ceres and Others, supra* note 29, at 20.

[32] *Investors Press, supra* note 9.

[33] *Id.*

[34] *Id. See also* Thomas M. Kostigen, *Globalization for Reporting Guidelines?*, CFO.COM, Jan. 25, 2006, http://www.cfo.com/article.cfm/5434145/c_2984351/?f=archives (noting that the UN "reached out to several pension funds and research firms representing some $6 trillion in assets to develop environmental, social, and governance ESG guidelines" in hopes that, by getting institutional investors to move, the market will move, too).

[35] *Investors Press, supra* note 9.

[36] *Id.*

the Social Investment Forum indicated that sustainability reporting is one of the key issues gaining support through shareholder resolutions.[37]

Other investors have also voiced concern about the transparency of business operations abroad. In a letter to John Ruggie, UN Special Representative on the issue of business and human rights, the Interfaith Center on Corporate Responsibility requested increased use of disclosure in monitoring activity that impacts human rights.[38] The letter explained that as "investors, [they] stand in a unique position to achieve this goal [of encouraging responsible corporate behavior], but [they] cannot do so without reliable data to allow [them] to assess corporate performance in this area."[39] The group explained that they used information on human rights performance to engage management, guide proxy votes, and select investments.[40] In addition to suggesting increased uniformity in reporting, the investors also maintained that mandating reporting was necessary so that corporations would tell the "whole story."[41]

NGOs have also demanded increased disclosure by companies. For example, Amnesty International USA, AFL-CIO, and several other NGOs joined forces to promote International Right to Know (IRTK) legislation in the United States.[42] In 1986, the U.S. Congress passed a law requiring companies to disclose chemicals that they use, store, and release from their facilities, but the legislation only applied

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[37] Riva Froymovich, *Socially Conscious Investors See Their Power Growing*, INV. NEWS, Oct. 23, 2006, at 24; *see also More Shareholders Back Green Schemes,* CFO MAG., Sept. 13, 2006, at 6.

[38] Letter from Interfaith Center on Corporate Responsibility to John Ruggie, United Nations Secretary General's Special Report on Human Rights and Business (Oct. 10, 2006), *available at* http://www.iccr.org/news/press_releases/pdf%20files/ruggieltr10-10-06.pdf [hereinafter *Interfaith Letter*].

[39] *Id.*

[40] *Id.*

[41] *Id.* at 9.

[42] INT'L RIGHT TO KNOW CAMPAIGN, INTERNATIONAL RIGHT TO KNOW: EMPOWERING COMMUNITIES THROUGH CORPORATE TRANSPARENCY (2003), *available at* http://www.amnestyusa.org/justearth/irtk.pdf.

to operations within the United States.[43] IRTK is an effort to hold companies based in the U.S. or traded on a U.S. stock exchange and their foreign subsidiaries to the same disclosure requirements as their domestic counterparts.[44] IRTK legislation takes the domestic regulation a step further by requiring disclosure of human and labor rights issues.[45] IRTK legislation explains that such disclosure is necessary because there have been too many incidences of companies being complicit in human rights abuses, forcing relocations, using child labor or forced labor, and allowing a wide range of unsafe operating practices.[46]

Other voices outside the business community have called for more disclosure. GRI, discussed above, continues to lead the pack in encouraging reporting with its evolving guidelines. In 2002, South Africa's *Kings Report* encouraged every South African company to report annually on its social, ethical, safety, health, and environmental policies and practices.[47] Third party verification groups have also expressed concern. For example, the European Federation of Accountants issued a report encouraging development of an international standard for sustainability assurance that would enable auditors to evaluate the effectiveness of company reports.[48]

Finally, other commentators suggest that disclosure will help to achieve socially responsible corporate activity. Steven Lydenberg describes today's CSR dilemma as the need to find a way for government to "assure control of corporate abuse and promote the public interest without

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[43] *Id.* at 5-6.

[44] *Id.* at 6.

[45] *Id.*

[46] *Id.*

[47] Carol Adams, Geoff Frost & Wendy Weber, *Triple Bottom Line: A Review of the Literature*, *in* THE TRIPLE BOTTOM LINE: DOES IT ALL ADD UP? 19 (Adrian Henriques & Julie Richardson eds., 2004).

[48] Press Release, The European Federation of Accountants, European Accountants Call for Specific International Standard on Sustainability Assurance (June 13, 2006), *available at* http://www.fee.be/news/default.asp?library_ref=2.

returning to the heavy hand of ownership and regulation that it has so recently turned away from."[49] Lydenberg explains that corporations can best serve the public interest through long-term wealth creation.[50] This wealth will continue to benefit members of society even after the corporation disappears.[51] Achieving long-term wealth requires that corporations do not externalize costs on society, deplete natural resources irretrievably, or impoverish stakeholders.[52] Lydenberg argues that making data available is the first step in creating a marketplace where the corporation's ability to generate long-term wealth can be assessed.[53] Following disclosure, Lydenberg explains two additional steps to ensure effectiveness. First, the data must be processed, analyzed, compared, disseminated, and debated.[54] Second, there must be consequences in the

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[49] LYDENBERG, *supra* note 5, at 9.

[50] *Id.* at 19.

[51] *Id.* Lydenberg outlines a calculation to assess long-term wealth. This requires adding four components: (1) the value of contribution to society through productivity gains less costs imposed by anti-competitive practices; (2) the value of company's internalization of the costs less externalized costs; (3) the value of sustainable management of environmental resources less cost of environmental harms; and (4) the value created through investment in stakeholder relations less costs created by mismanagement. Focusing on long-term wealth maximization, a corporation would do things like develop the community's capacity to provide child care not just for employees, but for all community members. Although not achieving short-term interests, such initiatives "create lasting societal value." *Id.* at 22.

[52] *Id.* at 19.

[53] *Id.* at 57. Lydenberg sets forth four requirements for "adequate" disclosure: (1) a global system of voluntary disclosure (such as GRI) to provide a baseline for comparing data; (2) national legislation mandating the disclosure of key data; (3) additional mandate at national level for disclosure of key data in disaggregate format such as specific records of local corporate operations; and (4) encouragement to companies to tell their own stories in their own words. *Id.* at 57-58.

[54] *Id.* at 79. Lydenberg explains that in order for meaningful dissemination, intermediaries need to assemble the data so that consumers can digest the information. These bodies can include rating agencies that provide compilations and comparisons. In addition, there will need to be a changed debate culture with the focus on the corporation as citizen. "In

marketplace to steer corporations toward the public interest.[55] Thus, disclosing data in combination with other mechanisms will serve as a way to hold corporations accountable for their activities that impact social welfare.

In sum, there has been a growing voice of parties in favor of non-financial disclosure as a way to hold MNCs accountable for their activities. Institutional investors, NGOs, and other commentators are asking for or encouraging the use of social reporting to improve corporate accountability. The question remains as to whether these voices are focusing on a meaningful mechanism to seek their desired ends.

III. ECONOMIC THEORY

Economic theory provides an important background for assessing the ability of social disclosure to deliver on its promises. This section begins by outlining basic economic theory, followed by a brief review of microeconomic theory as a way to justify financial disclosure through cost-benefit analysis. Noting some practical considerations undermining traditional economic theory, the final portion of this section explores the use of disclosure to create an efficient marketplace by protecting and facilitating information trading.

order for investors, consumers, and other stakeholders to send messages to the corporate community about social and environmental initiatives, they must be well-informed and able to reflect on the true values of their society." This will require activity similar to the works of community development, financial institutions, employee-owned corporations, and transparent large businesses that work to educate consumers and involve employees. *Id.* at 88-96.

[55] *Id.* at 107. Mechanisms to ensure that the "invisible hand" (the marketplace) guides corporations correctly include: (1) targeted engagement involving dialogue between shareholders and management; (2) asset relocation that will redirect investments from today's mainstream entities to those doing a better job with achieving long term wealth; and (3) increased public discourse about social issues. *Id.* at 107-38.

A. An Introduction to Economic Theory

Traditional economic theory supports the use of disclosure and holds that the self-motivated actions of individuals and corporations will result in efficient production and consumption in a perfectly competitive economy.[56] Economic theory further recognizes that there are exceptions to the underlying assumptions, coined as "market failures."[57] Externalities and information asymmetry are key reasons for such failures.[58]

First, information asymmetry between parties reduces market efficiency. One central assumption in market economics is that in order to function efficiently, participants must have full information.[59] When information is not complete and accurate, stakeholders and shareholders alike are unable to make decisions that are in their best interests.[60] Individuals have significantly fewer resources to gather information about a company's activities and their impact than the corporation. This results in information asymmetry[61] and undermines the ideals of a free market.[62] Proponents of increased environmental disclosure often point to this market failure. Such commentators argue that

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[56] Nicholas Franco, *Corporate Environmental Disclosure: Opportunities to Harness Market Forces to Improve Corporate Environmental Performance*, American Bar Association Conference on Environmental Law in Keystone, Colorado 3 (2001), *available at* http://www.rosefdn.org/images/EPA.Disclosure.Study.pdf.

[57] *Id.*

[58] *See also* Ronie Garcia-Johnson, *Beyond Corporate Culture: Reputation, Rules and The Role of Social and Environmental Certification Institutions* 1-2 (Duke Project on Environmental and Social Certification, Working Paper No. 1, 2001) (noting first that Adam Smith's theory on reputation mechanism provides that people will not do business with people who are cheats, which is particularly true when the market contains many alternative players—reputation will hold players accountable; however, in large, heterogeneous societies reputation often fails to follow firms long distances).

[59] O'Rourke, *supra* note 23, at 7.

[60] *Id.*

[61] *Id.* at 8.

[62] *Id.* at 7-8.

insufficient information to consumers about the environmental impact of a product creates a market failure because consumers cannot account for these externalities in their purchasing decisions.[63] Thus, markets usually "underprovide" information to consumers and investors.[64] Reducing information asymmetry will better inform choices and negotiations by investors, consumers, and stakeholders.[65]

Second, a tendency to externalize costs further reduces market efficiency. Coasean bargaining, which involves parties internalizing externalities, provides another traditional justification for disclosure.[66] An example of a polluting firm and an affected community illustrates how Coasean bargaining works in practice. Assuming that there are no transaction costs and that the bargaining parties possess complete information, the polluting firm and an affected local community suffering environmental damages will bargain to an outcome that makes one party better off without making any individual worse off.[67] The distributional result (who has to pay) will depend on the initial allocation of rights.[68] The basic premise of correcting this market failure is to shift the cost of an externality, such as pollution, from the non-consenting party (the community) to the party generating the costs (the corporation).[69]

However, the assumptions underlying Coasean bargaining, that parties will possess complete information and that transaction costs will be minimal, are very rarely satisfied.[70] In reality, information asymmetry between the bargaining parties increases transaction costs.[71] Thus, application of

[63] David W. Case, *Corporate Environmental Reporting as Informational Regulation: A Law and Economics Perspective*, 76 U. COLO. L. REV. 379, 415-16 (2005).

[64] *Id.* at 416.

[65] O'Rourke, *supra* note 23, at 7-8.

[66] Case, *supra* note 63, at 419.

[67] *Id.*

[68] *Id.*

[69] Franco, *supra* note 56, at 4.

[70] Case, *supra* note 63, at 419, 422.

[71] *Id.* at 419.

this theory in its pure form is more or less impracticable. Regardless, these Coasean assumptions provide an ideal that regulatory mechanisms often aim to emulate.[72] Thus, when corporations disclose information about externalities to affected parties, efficient allocation of the costs and benefits of that activity will be more likely.[73]

B. Cost-Benefit Analysis

Disclosure is a primary tool used in federal law to protect investors. Scholarship on the economics of firm disclosure identifies several benefits "including reduced agency costs, a lower cost of capital, improved liquidity for the firm's shares, and a number of benefits that a company making a disclosure may not fully capture."[74] Microeconomic analysis provides additional support for federal disclosure requirements.[75] Costs and benefits of disclosure are realized in three ways: (1) by a company whether or not a company has publicly traded securities; (2) by a publicly traded company; and (3) by others (externalities).[76] There are numerous tradeoffs when companies disclose information. For private and public firms, the disclosure of more information reduces agency costs by providing ownership with more information about management and improving shareholders' ability to monitor.[77] However, the firm incurs direct costs of preparing and disseminating information.[78] For public firms, increased disclosure will also improve liquidity and increase accuracy of share prices, but may create a competitive disadvantage.[79] Finally, for third parties, more information will improve

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[72] *Id.* at 423 ("Although the Coase Theorem's assumption that transactions costs in private bargaining are zero is unrealistic, it is nonetheless a desirable objective that is worthy of pursuing in a free market society.").

[73] O'Rourke, *supra* note 23, at 7-8.

[74] Michael D. Guttentag, *An Argument for Imposing Disclosure Requirements on Public Companies*, 32 FLA. ST. U. L. REV. 123, 133 (2004).

[75] *Id.* at 132.

[76] *Id.*

[77] *Id.* at 142.

[78] *Id.*

[79] *Id.*

asset allocation and create consumer surplus gains, but may create a disincentive to invest in innovation.[80] Corporate concerns about the potential competitive harm of disclosure "cause a significant market failure in the disclosure practices of public companies" and informational regulation should correct this market failure because the benefits outweigh the costs.[81] Thus, regulators should intervene with informational requirements when there is a significant market failure and the benefits of disclosure outweigh its costs.[82]

Thus far, the economic theories discussed support the use of non-financial disclosure. First, correcting market failures such as information asymmetry and externalities requires distribution of more information to the market. Second, from a microeconomic perspective, a cost-benefit analysis justifies much of today's federal financial disclosure requirements, and this analysis can also be applied to non-financial reporting. These theories suggest that disclosing more information will improve marketplace efficiency, but how disclosure will work in practice depends on how the information impacts the behavior of market participants.

C. Federal Securities Regulation in Practice

A recent article explores disclosure from a more practical perspective. Zohar Goshen and Gideon Parchomovsky argue that "securities regulation is not a consumer protection law," but instead serves as a measure to attain efficient financial markets, and to thereby improve the allocation of resources in the economy.[83] Further, they argue that this is and should be achieved through information traders.[84] The observations of Goshen and Parchomovsky, particularly those relating to disclosure, illuminate key differences between how social reporting and financial reporting work in practice.

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[80] *Id.*

[81] *Id.* at 147, 190.

[82] *Id.* at 146.

[83] Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 713 (2006).

[84] *Id.* at 714.

First, Goshen and Parchomovsky explain that efficient markets are the result of accurate pricing and high liquidity.[85] Accurate pricing requires that information be incorporated into the price of securities, which entails three tasks: (1) information production; (2) verification of accuracy; and (3) pricing the information based on analysis.[86] Liquidity requires sufficient trading to enable quick transactions between buyers and sellers.[87] Capital markets consist of five main groups, the actions of which determine the market price:[88] insiders, information traders, liquidity traders, noise traders, and market makers.[89]

Information traders earn profit by detecting discrepancies between the corporation's value and its market price.[90] The authors suggest that instead of efficiency, it is more fitting to categorize markets as "effective" or "ineffective."[91] A market will be most effective when there is a mechanism in place to cause prices to revert to the corporation's value.[92] The effectiveness of such mechanisms turns on the costs and risks of information trading.[93]

U.S. securities law reduces the costs and risks to information traders, thus reducing discrepancies between price and value. Three broad categories of securities law achieve this end. First, restrictions on insider trading protect information traders from competition that would undermine and

[85] *Id.* at 720.

[86] *Id.* at 721.

[87] *Id.* at 722.

[88] *Id.* at 729.

[89] Insiders are proximate to the corporation and can access inside information. Information traders invest in gathering and analyzing information to inform investment decisions. Liquidity traders allocate their investment resources between saving and consumption without gathering or analyzing information. Noise traders are irrational actors that follow differing methods of investment. Market makers offer to buy or sell on a regular basis, facilitating trading and maintaining a market for securities. *Id.* at 722-26.

[90] *Id.* at 726.

[91] *Id.* at 730.

[92] *Id.*

[93] *Id.* at 731.

prevent recovery of their investment.[94] Second, the duty to disclose reduces the costs of searching and gathering information.[95] Further, mandatory disclosure reduces the risks in accurately discovering deviations between price and value.[96] Third, the restrictions on fraud and manipulation significantly reduce the need for information traders to invest in costly verification.[97]

Current informational regulation in the financial sector benefits financial analysts by reducing the costs and risks of the services that they provide. Creating a competitive information trading market results in disclosure beyond what is demanded by regulations and provides investors with this information free of cost.[98] Thus, the analyst community serves as a crucial intermediary between the secondary market buyer or seller and the corporation.

Applying this analysis to social reporting illustrates two significant points of departure from financial data. First, underlying Goshen and Parchomovsky's argument is an assumption that information traders can compare data across industries. Given the variety of CSR issues, such non-financial data is difficult, if not impossible, to standardize.[99] Second, there is no party to fill the role of information

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[94] *Id.* at 733.

[95] *Id.* at 738.

[96] *Id.* at 738-39 ("[T]he net effect of mandatory disclosure duties is to support a competitive information traders' market."). In addition, a more competitive information trader marketplace will increase liquidity. It will be less likely that market makers must trade against more informed participants, thus lowering the difference between the bid and ask prices. *Id.* at 740.

[97] *Id.* at 741-42 ("Improved deterrence reduces the incentive to lie, which, in turn, further reduces precaution cost.").

[98] *Id.* at 739-40. This additional information comes from two places. First, "a competitive information market generates increased demand for firm specific information, which in turn provides managers with incentives to make timely and elaborate disclosures beyond what is mandated by the law, in an attempt to capture the benefits of increased coverage by information traders." *Id.* And second, "in a competitive market, strong marketing and other pressures will ensure that analytical products that would otherwise be confidential are revealed to the market."

[99] See *infra* Part IV.B for further discussion.

traders in the realm of CSR. Unlike financial information and analysis, little profit can be made on social data.[100] In addition, NGOs willing to play this role lack the resources necessary to process and verify social or environmental data.

In sum, economic justifications for disclosure provide an important background to evaluate non-financial disclosure's potential to deliver on its promise. Further, analysis of how current securities regulations work in the United States provides important insight into the differences between financial and non-financial data.

IV. INITIAL CONCERNS ABOUT THE USEFULNESS OF DISCLOSURE

With the current state of disclosure and its theoretical underpinnings in mind, the next step is to begin assessing disclosure's viability as a solution for holding companies accountable. There are four initial concerns to highlight. First, current investment and purchasing trends suggest that increased information on the market alone will not solve market failures. Second, an assessment of some initiatives used to measure non-financial social data illustrates how such data departs from financial data and is difficult to measure. Third, companies that successfully focus on sustainable development are unique in the marketplace. Finally, experience with monitoring systems and corporate codes suggest that mechanisms similar to disclosure have failed in the past.

A. Practical Considerations

On paper, economic theory justifies and encourages the use of disclosure in holding corporations accountable, but in practice, its viability is less certain. Disclosure improves market efficiency only if it impacts the behavior of market

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[100] *See* LYDENBERG, *supra* note 5, at 86-87 (noting that the need for a research specialist in processing CSR data is clear, but that it is less clear how to fund such a specialist. Lydenberg further explains that until clientele can be established for intermediaries, "these organizations will remain understaffed and underfunded.").

participants. This is not necessarily the case when it comes to social issues. As noted in Part III, non-financial reporting differs from financial reporting because of the absence of information intermediaries. There are two additional departures to highlight: shareholder activity illustrates the limited importance of social issues for most investor decisions and most consumers are still unwilling to pay premiums for "ethical consumption."[101]

There has been a mounting call for disclosure by investors and a growing body of socially responsible investors, but statistics paint a less than encouraging picture. During the first two quarters of 2006, only 27% of shareholder resolutions on social and environmental issues came up for a vote.[102] These proposals received at least 15% of shareholder votes.[103] Some point to the growth of socially responsible investment funds as an indication that ethical concerns do matter to the investment community. However, such investments constitute only a small portion of total investments. In 2005, only 9.4% of the $24.4 trillion assets under professional management in the United States used socially responsible investing strategies.[104] These strategies include social screening, shareholder advocacy, and community investing.[105]

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[101] O'Rourke, *supra* note 23, at 22.

[102] Froymovich, *supra* note 37, at 24. Proxy Governance's study of 179 social policy resolutions filed in 2006 found that 38% had more than 10% shareholder support, up from 29% with 10% support in 2005. *Shareholders Press Social Accountability*, CHI. TRIB., Sept. 29, 2006, Business Section, at 2.

[103] *Shareholders Press Social Accountability*, CHI. TRIB., Sept. 29, 2006, Business Section, at 2.

[104] SOCIAL INVESTMENT FORUM, 2005 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES, at iv (Jan. 24, 2006), http://www.socialinvest.org/areas/research/trends/SRI_Trends_Report_2005.pdf (identifying $2.29 trillion in total assets managed using one or more of three socially responsible investing strategies).

[105] *Id.* Screening is the practice of evaluating investment portfolios. Shareholder advocacy involves socially aware shareholders taking on their role as "owners of corporate America." Community investing directs capital from investors or lenders to communities traditionally underserved by financial services. *Id.* at 3.

Studies on consumer behavior provide further concern about the power of information to correct market failures. For example, consumers purport a willingness to pay more for "good" products in order to avoid "bad" products.[106] However, data on "ethical consumption" indicates that only a small percentage of consumers implement such concerns in their purchasing.[107] For example, The Co-Operative Bank, the new economics foundation (nef), and The Future Foundation track ethical consumerism in the United Kingdom. Their 2005 study found that while the market for ethical products and services has increased, such purchasing accounts for less than 2% of total sales in the United Kingdom.[108] It is important to note that a shortage of information or an unwillingness to pay more—or both—may be causing these results.[109]

Experience with environmentally safe products provides further illustration of consumer impact. Approximately twenty years of "green consumer" campaigns demonstrates that people "do think and care about ethical, social, environmental, and health concerns."[110] But once again, while most consumers consider themselves "environmentalists," only 10-12% of consumers ensure that they purchase only environmentally safe products.[111] If companies incurred no cost when disclosing information and taking socially sound or environmentally friendly actions, then many would do so in hopes of attracting these consumers. However, the

[106] O'Rourke, *supra* note 23, at 22.

[107] *Id.* Consumers have effectively harnessed market forces in the past through boycotts targeting MNC activity. However, this activity is usually only targeted at a very small percentage of firms that are in the public spotlight, such as Nike, and arguably has a limited impact on the entire market.

[108] THE CO-OPERATIVE BANK, THE ETHICAL CONSUMERISM REPORT 2005, at 6 (Dec. 12, 2005), *available at* http://www.co-operativebank.co.uk/images/pdf/coopEthicalConsumerismReport2005.pdf. Other studies have found that ethical concerns guide about 5% of the public when purchasing products. *See* O'Rourke, *supra* note 23, at 22.

[109] O'Rourke, *supra* note 23, at 22.

[110] *Id.* at 23.

[111] *Id.*

data illustrates that the costs outweigh the consumers to be gained. In sum, current investment and purchasing trends further suggest that social disclosure will have a limited impact on corporate behavior.

B. Measurements

The variety and nature of CSR issues make measuring the impact of corporate behavior difficult, if not impossible. This will potentially prevent meaningful dissemination and illustrates another way in which social data differs from financial data. There have been recent efforts to quantify social impact. Examination of such efforts affirms initial intuitions and illustrates that given the nature of the issues, the reports are inherently ambiguous. First, GRI released the G3 guidelines in an effort to improve the structure of prior guidelines and to increase transparency.[112] Trade unions, NGOs, and companies suggested 4000 improvements that GRI accounted for in revising the guidelines.[113] Second, Vermont-based Center for Sustainable Innovation (CSI) launched the first non-financial reporting method able to mathematically calculate the bottom-line impact of corporations on society.[114]

1. GRI Guidelines

Two components make up the G3 guidelines: a set of outlined principles that guide companies on how to report data and a set of standard disclosures that provide companies with a list of factors to report. This section outlines these two aspects with attendant tables to better illustrate the guideline's content.

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[112] *Guidelines Simplified, supra* note 26, at 1.

[113] *Id. See also* Case, *supra* note 63, at 398-99 (outlining the initial GRI development process. GRI issued revised guidelines in both 2000 and 2002 based on an "exposure draft" issued in 1999 for public comment).

[114] *Social Footprint: Measuring Corporate Sustainability Performance*, BUS. CREDIT, June 1, 2006, at 38 [hereinafter *Social Footprint*]; *see also* http://www.sustainableinnovation.org.

The G3 guidelines outline principles, guidance, and protocols that dictate how a company reports a set of standard disclosures.[115] Principles of materiality, stakeholder inclusiveness, sustainability context, and completeness help direct what to include.[116] Principles of accuracy, balance, comparability, timeliness, reliability, and clarity guide the report's quality of information.[117] The guidelines provide tests or checklists for companies to ensure that corporate reporting reflects these principles in both type and quality.[118] For example, when evaluating if the information is material and should be included, G3 provides both external factors, such as sustainability topics raised by stakeholders, and internal factors, such as "[c]ritical factors for enabling organizational success."[119] When assessing if the report is balanced to ensure quality, one indicator is whether the information is formatted in a way that allows users to see performance trends, both positive and negative, on a yearly basis.[120] Table 1 outlines the principles guiding both report content and quality, with a sample of an attendant test for each principle.[121]

[115] GLOBAL REPORTING INITIATIVE, SUSTAINABILITY REPORTING GUIDELINES 3 (2006), http://www.globalreporting.org/NR/rdonlyres/A1FB 5501-B0DE-4B69-A900-27DD8A4C2839/0/G3_GuidelinesENG.pdf.

[116] *Id.* at 4.

[117] *Id.*

[118] *Id.*

[119] *Id.* at 9-10.

[120] *Id.* at 13.

[121] *Id.* at 7-18. While this table lists all principles, it does not include all tests or checklist items. The table is meant to provide a general illustration.

Table 1: How to Report

	Principles and Tests
Defining Report Content	• Materiality ▪ External Factor: Main sustainability interests and indicators raised by stakeholders ▪ Internal Factor: Critical factors enabling organizational success • Stakeholder Inclusiveness ▪ The organization can describe the stakeholders to whom it considers itself accountable • Sustainability Context ▪ Describes how sustainability topics relate to long-term strategy, risks, and opportunity • Completeness ▪ Includes all entities that meet criteria of being subject to control/influence of organization
Ensuring Report Quality	• Balance ▪ Discloses both favorable and unfavorable topics • Clarity ▪ Contains the level of information required by stakeholders but avoids unnecessary detail • Accuracy ▪ Data measurement techniques and bases for calculations are adequately described • Timeliness ▪ Information in the report has been disclosed while it is recent and relative • Comparability ▪ The report and information can be compared on a year-to-year basis • Reliability ▪ The scope and extent of external assurance is identified

The next portion of G3 addresses what to report by providing companies with a set of listed standard disclosures.[122] These include: (1) strategy, profile, and governance of the organization; (2) management approach; and (3) indicators on environmental, economic, and social performance.[123] The strategy and profile section should provide a

[122] *Id.* at 5.
[123] *Id.*

high-level, strategic analysis of the corporation's relationship to sustainability.[124] This furnishes context for subsequent and more detailed reporting with other sections of the guidelines.[125] This portion should include a statement by the organization's senior decision maker about the overall vision for economic, environmental, and social performance.[126] It should also include a narrative on key impacts (such as the effect on stakeholders' rights as defined by national law), risks, and opportunities.[127] Finally, tables should provide targets, organizational performance measured against the targets, and "lessons learned" during the reporting period.[128] The next portion of the section should outline the corporate profile and the parameters of the report.[129] The final portion of this section should detail the governance structure of the corporation.[130] This includes commitments to external initiatives, the processes for using shareholder proposals or other mechanisms for minority involvement, and a list of stakeholders engaged by the corporation.[131]

The next section combines the final two standard disclosures (management approach and performance indicators).[132] The report should discuss management's goals, policies and other information that adds context while discussing its performance.[133] This section consists of three categories: economic, environmental, and social.[134] For each category, there are core indicators, which are generally applicable to all, and additional indicators which are relevant for emerging practices or to specific sectors.[135] In addition, social

[124] *Id.* at 20.
[125] *Id.*
[126] *Id.*
[127] *Id.*
[128] *Id.* at 21.
[129] *Id.*
[130] *Id.* at 22.
[131] *Id.* at 22-24.
[132] *Id.* at 24.
[133] *Id.* at 25.
[134] *Id.* at 26-37.
[135] *Id.*

indicators are divided into four subcategories.[136] Table 2 provides a sampling of these performance indicators.[137]

Table 2: Performance Indicators

Performance Indicators	**Core Indicators**	**Additional Indicators**
Economic	• Direct economic value generated and distributed • Financial implications and opportunities due to climate change • Significant financial assistance received from government • Description of significant indirect economic impacts	• Range of ratios of standard entry level wage compared to minimum wage at significant locations of operation
Environmental (this indicator is divided into nine aspects)	• Material: Materials used by weight • Energy: Direct energy consumption by primary energy source • Water: Total water withdrawal by source • Emissions, Effluents, and Waste: Total weight of waste by type and weight	• Biodiversity: Habitats protected and restored • Overall: Total environmental protection expenditures and investment by type
Social: Labor Practices	• Workforce by type, contract, and location • Employees covered by collective bargaining • Salary ratio of men to women by employment type	• Employees receiving regular performance and career development reviews • Health and safety topics covered in formal agreements with trade unions

[136] *Id.*

[137] *Id.* at 27-36. This is not a comprehensive list of factors, but only a sampling meant to demonstrate what GRI asks companies to report.

Social: Human Rights	• Significant investment agreements with human rights clauses • Reported incidents of discrimination • Operations with significant risks of child labor	• Incidents of violations involving rights of indigenous people and actions taken
Social: Product Responsibility	• Product Development stages in which health and safety impacts are assessed for improvement • Number of products assessed	• Number of substantial complaints about breaches of customer privacy or lost data
Social: Society	• Actions taken in response to corruption • Public policy position and policy development	• Legal actions for anti-competitive behavior

GRI's latest guidelines provide numerous factors for consideration with forty-nine core indicators and thirty additional indicators.[138] Many of the indicators, particularly those relating to social performance, use broad qualitative language. This results in data that is difficult to aggregate into a user-friendly and easily comparable format. Even the quantitative indicators leave room for corporate discretion. Further, ambiguous principles inform companies about how and what to report. These measurements stem from the nature of the issues at play. Unlike objective calculations, prose is required to communicate information about the social impact of corporate activity.

[138] *Id.* at 27-36. In addition to concerns about the ability to meaningfully measure social performance, there is also concern about information overload. Corporate codes of conduct and monitoring systems fall victim to this problem. The Lawyers Committee for Human Rights reported that over 2000 indicators on labor standards were used in codes. O'Rourke, *supra* note 23, at 25.

2. The Social Footprint

CSI's *Social Footprint* provides an alternative way to measure non-financial performance. CSI attempted to reduce the ambiguity with its development of the *Social Footprint*. This mathematical calculation compares top-line impacts with actual human conditions in society to compute the social bottom-line of an organization.[139] This fraction determines the sustainability of an activity.[140] CSI first applied this type of calculation to determine ecological sustainability. If a region produces ten million gallons of fresh water and humans in the region consume fifteen million, then the quotient is 15/10 or 1.5; since any quotient greater than 1.0 is unsustainable, such an activity would not be ecologically sustainable.[141] Using the same type of calculation, the *Social Footprint* compares the number of people involved in an activity to the social or environmental impacts that it creates.[142] Instead of natural capital, this quotient deals with "anthro capital" or social, human, and constructed capital.[143] Thus the fraction measures the gap between what a community needs and what a community has decided to produce or make available.[144] The key principle is that each individual is responsible for "the behaviors of their leaders, their employers, and their organizations," in addition to their own actions.[145] For example, if a community needs $10 million per year to provide education (necessary anthro stock or denominator) and the residents are only providing $8 million per year (social imprint or numerator), then the

[139] *Social Footprint, supra* note 114.

[140] *Id.*

[141] *Id.*

[142] *Id.*

[143] CENTER FOR SUSTAINABLE INNOVATION, THE SOCIAL FOOTPRINT: PROOF OF CONCEPT 23 (2006), www.sustainableinnovation.org/Social_Footprint.pdf [hereinafter SUSTAINABLE INNOVATION REPORT].

[144] *Id.*

[145] *Leaving Social Footprints*, 17 BUS. & ENV'T. 6 (June 2006).

fraction is 8/10 or 0.8.[146] Thus, anything *under* 1.0 is also unsustainable.[147]

These examples provide clean calculations for both ecological and social footprints. However, reality is not so simple. The G3 indicators illustrate that fitting activities impacting society into the *Social Footprint*'s calculation is not easy. While the quotient provides a standardized way to disseminate information about performance, it is unable to capture the depth of what GRI's guidelines describe. In fact many of GRI's reporting requirements could not translate into the social footprint model.

In sum, the *Social Footprint* cannot cover a broad range of CSR issues, while the GRI guidelines cannot provide clear calculations that are easy to aggregate. The impact of corporate activities on society are difficult to measure, and while there have been significant innovations in this area, examination of these innovations illustrates a significant difference between non-financial and financial data. Social disclosure requires qualitative measurements because of the nature of CSR issues.

C. Value Driven Corporate Model

Some companies are able to successfully incorporate sustainable development into their business models. However, such examples illustrate their uniqueness in the business world. This suggests that while these models can be successful, they are the exception and not the norm. Further, these companies must pay a premium, which is passed on to consumers.

Patagonia, Inc. is a corporation that found a way to be financially successful while committing itself to sustainable environmental practices. Founded in 1970, Patagonia is an outdoor apparel company that was willing to gamble its financial viability on a company-wide commitment to protect

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[146] SUSTAINABLE INNOVATION REPORT, *supra* note 143, at 11.

[147] *Id.*

the environment.[148] In 1996, founder Yvon Chouinard recognized that the firm's use of conventionally grown cotton, a chemically dependent crop, undermined Patagonia's commitment to the environment and converted the company's entire cotton line to organic materials.[149] This move forced the company to significantly reduce its sportswear line, costing $20 million in lost sales.[150] Patagonia also makes organic T-shirts available to other members of the industry through its Beneficial T's program, which produced about 500,000 pounds of organic cotton in 2004.[151] This was not Patagonia's only initiative aimed at protecting the environment. For example, in 1993, Patagonia worked with a supplier to develop technology to produce fleece fabric from recycled plastic soda bottles.[152] In addition, employees that have worked with the company for two years can take eight weeks paid time off to work for an environmental organization.[153] This was a company built on and driven by a commitment to the environment.

Other firms follow similar models, using sustainable endeavors to inform the company's identity.[154] However, a cursory glance at these companies illustrates that they are very different from the large public corporations that dominate the marketplace. There is a significant difference in

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[148] LYDENBERG, *supra* note 5, at 25. *See also* Patagonia Company History, http://www.patagonia.com/web/us/contribution/patagonia.go?asset id=3351 (last visited Mar. 16, 2007).

[149] Patagonia Company History, http://www.patagonia.com/web/us/contribution/patagonia.go?assetid=3351 (last visited Mar. 16, 2007).

[150] *Id.*

[151] *Id.*

[152] *Id.*

[153] *Id.*

[154] For example, Organic Valley Family of Farms promotes adoption of small scale organic farming techniques to prevent the environmental harm attendant to large farms utilizing economies of scale to sell lower-cost products. *See* Organic Valley Family of Farms, http://organicvalley.coop/ (last visited Mar. 7, 2007). Ben and Jerry's is another commonly cited firm founded on a commitment to forward-thinking corporate responsibility initiatives. *See* Ben and Jerry's Mission Statement, http://www.benjerry.com/our_company/our_mission/ (last visited Mar. 7, 2007).

approaches to costs. Most firms would be unwilling, or unable because of the targeted consumer, to incur a $20 million loss for shifting to an environmentally or socially friendly product. While these value-driven companies serve as an ideal for corporate activity, it is important to recognize their uniqueness when evaluating ways to increase corporate accountability. Companies like Patagonia were founded on social values and are open about their practices because of this commitment. Public discourse about their activities is not what drives this commitment. In such cases, corporate introspection comes before disclosure and not *because* of disclosure.

D. Experience with Corporate Codes and Monitoring

Empirical evidence about the impact of corporate codes and monitoring systems illustrates that mechanisms similar to disclosure fail to address the underlying issues of corporate social responsibility. Two studies examining working conditions in Nike factories abroad provide good examples. The first study compared social audits of over 800 factories in fifty-one countries.[155] The second study compared two almost identical Nike plants in the same area of Mexico.[156]

1. Nike Study One: Analysis of Conditions at 800 Factories

The first study looks at over 800 factories and assesses the effectiveness of monitoring systems as a way to improve working conditions.[157] The evidence found that despite Nike's efforts and investments, monitoring alone did not im-

[155] Richard Locke et. al., *Does Monitoring Improve Labor Standards?: Lessons from Nike* (MIT Sloan Working Paper No. 4612-06, July 2006) [hereinafter *Nike Study One*].

[156] Richard Locke & Monica Romis, *Beyond Corporate Codes of Conduct: Work Organizations and Labor Standards in Two Mexican Garment Factories* (MIT Sloan Working Paper No. 26, Aug. 2006) [hereinafter *Nike Study Two*].

[157] *Nike Study One*, *supra* note 155, at 2.

prove working conditions among its suppliers.[158] There are a couple of initial hurdles to overcome for monitoring to be effective. First, while internal auditing fails to ensure unbiased and accurate information, it is unclear that NGOs have the time or resources to properly verify the information, and independent auditors are not always reliable.[159] Next, there are varying codes at factories for different purchasers, thus putting factories in "compliance limbo."[160]

Nike factories experience three types of audits: (1) Safety, Health, Attitudes of Management, People Investment, and Environment Program (SHAPE); (2) M-Audit (Management); and (3) Fair Labor Association (FLA). Nike grades each supplier based on these three audits on an A to D scale.[161] Nike launched SHAPE in 1997 to provide a "general picture" of labor, environment, safety, and health standards compliance.[162] Field-based production staff generally conducts this audit, taking about one day and occurring one to two times per year.[163] The M-Audit assesses the labor-management practices and working conditions of factories.[164] Internal compliance specialists always conduct this audit and it takes about forty-eight hours over several days.[165] Factories receive a numerical score from 1 to 100, with 100 equaling full compliance.[166] Finally, FLA conducts unannounced audits on a sample of 5% of Nike suppliers yearly.[167]

The study compared various factors with the M-audit scores. First, there is a positive correlation between the strength of the country's regulations or institutions and the factory's audit score.[168] Second, the performance of larger

[158] *Id.*
[159] *Id.*
[160] *Id.* at 6.
[161] *Id.* at 13.
[162] *Id.*
[163] *Id.*
[164] *Id.*
[165] *Id.*
[166] *Id.* at 15.
[167] *Id.* at 13.
[168] *Id.* at 24.

factories, measured by total employees, was significantly lower than performance of smaller factories.[169] Third, there was no significant relationship between scores and foreign versus national ownership.[170] Fourth, there was a negative correlation between the length of Nike's relationship and the percentage of supplier's resources dedicated to Nike.[171] Finally, the amount of visits by Nike personnel and whether a factory was a strategic partner were positively related to M-Audit scores.[172] The study separated the types of personnel in analyzing the frequency of visits by Nike staff and found that there were still positive results after removing compliance staff from the analysis.[173] This suggests that the correlation was not the result of compliance audits, but the strategic relationship.[174] One explanation for this is that plants with a close relationship to Nike have more personal contact with sourcing and production teams that work to improve factory efficiency.[175]

This Nike case study suggests that combining external pressures of monitoring with internal management systems aimed at the root problems of quality management will do what monitoring alone cannot achieve. "The more systematic approach is precisely how previous issues (i.e., improving product quality, promoting occupational health and safety, redressing problems of equal opportunity in employment and promotion decisions) were tackled."[176]

2. Nike Study Two: Comparison of Two Similarly Situated Suppliers

The second study comparing two Mexican suppliers further supports these findings. The two factories, Plant A

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[169] *Id.*

[170] *Id.*

[171] *Id.* at 26.

[172] *Id.* at 25.

[173] *Id.*

[174] *Id.*

[175] *Id.*

[176] *Id.* at 39.

and Plant B, interfaced with the same regional office and had similar compliance scores, but the realities at each factory were significantly different.[177] Plant A employees received more bonuses, reported higher levels of satisfaction in part due to the plan's rotation instead of routine production system, participated in decisions, worked forty-eight hours per week instead of forced overtime, and attended mandatory meetings with the union.[178] The explanation for these differences boils down to the management's approach. In the mid-twentieth century, Douglas McGregor observed how organizations managed employees and noted that workers could be viewed as a variable cost to be reduced or an asset to be valued and developed.[179] The management choices at each plant align with this hypothesis. Whereas Plant A empowered employees to work as independent problem solvers and provide input, Plant B aimed to control the "cost" of employees.[180] These different approaches connect to Nike's relationship with each plant. While Nike's local staff had an open, collaborative relationship with Plant A, the staff had a "formal and distant" relationship with Plant B.[181]

A study on supplier-buyer relations in China reached similar conclusions. The report argued that "brands develop two distinct types of compliance relationships with their suppliers: a hands-on cooperative relationship with some suppliers and an arms-length, more distrustful 'compliance' relationship with others."[182] Further, the difference in such relationships shapes not only the manner of interaction but also the substance of the supplier's compliance.[183]

In sum, this group of studies illustrates that monitoring compliance with labor codes has limited impact on improving the working conditions at supplier plants. Disclosure is a

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[177] *Nike Study Two, supra* note 156, at 12.

[178] *Id.* at 13-19.

[179] *Id.* at 35.

[180] *Id.* at 36.

[181] *Id.* at 37.

[182] *Id.*

[183] *Id.* at 37-38.

similar mechanism that encourages activity to evaluate conditions and circumstances without addressing the root substantive issues that will actually improve supplier activity.

Thus, disclosure's usefulness will turn on its ability to overcome some initial hurdles. First, there is the current reality of the marketplace, both in terms of consumers and investors. Second, social data differs from financial data because of its ambiguous nature. Third, disclosure does not necessarily force introspection and internal change. Finally, failed monitoring approaches and disclosure share much in common.

V. EVALUATION OF VOLUNTARY DISCLOSURE INITIATIVES

A. Growth of Reporting

The new millennium has seen a growth in voluntary CSR reporting. Approximately 1900 global companies published non-financial reports in 2005.[184] Further, 2004 statistics indicate that 45% of the world's largest global firms are voluntarily disclosing non-financial data.[185] The type and amount of reporting varies by country and sector, with large branded companies being the most likely to report because of their public position.[186] Some companies issuing recent reports in accordance with the GRI guidelines include Coca-Cola Enterprises, Hewlett-Packard, and McDonald's.[187]

B. Limits of the Use of Voluntary Disclosure

Despite the growing use of voluntary disclosure by corporations, there are some significant limits to its ultimate impact. First, report language tends to be ambiguous and in

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[184] UNEP AND KPMG REPORT, *supra* note 8, at 7.

[185] O'Rourke, *supra* note 23, at vi.

[186] *Id.*

[187] *See* CorporateRegister.com–The world's largest directory of corporate non-financial reports, www.corporateregister.com (last visited Mar. 17, 2007).

the company's control. Second, improving public image and increasing "social credibility" motivate most CSR reports. Finally, empirical evidence suggests that these concerns do in fact lead to disappointing results.

1. Report Language

Currently, corporations are able to control the dialogue about social issues and often do so through graceful rhetoric. The rhetoric of corporate social responsibility reports often overlaps with the rhetoric of corporate codes of conduct.[188] For example, Coca-Cola's Report explains that operating "ethically, lawfully, and with sensitivity toward the public good has always been fundamental to who [they] are and what [they] are about."[189] This eighty page report begins with a letter from the CEO followed by an outline of Coca-Cola's corporate profile and concludes with sections on issues such as employment, environment, health, and community.[190] In explaining its approach to energy, the report states that Coca-Cola "recognizes the serious threat posed by global climate change, and [they] are committed to improving [their] energy efficiency and reducing [their] emissions of CO_2."[191] This is the type of language used in most social responsibility reports.

[188] Joshua A. Newberg, *Corporate Codes of Ethics, Mandatory Disclosure, and the Market for Ethical Conduct*, 29 VT. L. REV. 253, 293 (2005).

[189] COCA-COLA ENTERPRISES, CORPORATE RESPONSIBILITY AND SUSTAINABILITY REVIEW 2005 15 (2005), *available at* http://www.cokecce.com/abrochures/corporate_responsibility/index.html.

[190] *Id.*

[191] *Id.* at 65. *See also* Jamie Snider et al., *Corporate Social Responsibility in the 21st Century: A View From the World's Most Successful Firms*, 41 J. OF BUS. ETHICS 175, 180-84 (Dec. 2001) (reviewing corporate discussion on websites and other publications about corporate social responsibility). This article found that most talk includes: (1) general value statements; (2) explanation of environmental policies; (3) reference to customers as "valuable goods"; (4) reference to employees in terms of diversity, skill development, and career enhancement; (5) little reference to competitors as stakeholders; and (6) division of society into three categories: local communities, nation states, and the world. The

A critical linguistic analysis conducted by Sharon Livesey further illuminates the concerns about CSR language. Livesey reviewed Royal Dutch/Shell's 1998 Corporate Social Responsibility Report.[192] She found that Shell was able to present "itself as sensitive and scientific, caring without being sentimental, and equally attentive to the straightforward financial demands of shareholders and the inchoate desires of the loosely defined stakeholder class."[193] Shell further focused on creating the "human feeling of trust" while recognizing the value of objective standards.[194] Thus, through Shell's choice of language, the company was able to portray itself in a certain way.

A review of 2003 reports published by ExxonMobil and British American Tobacco (BAT) further illuminates the influential power of language and the corporations' ability to choose how to use this power. The ExxonMobil report is filled with bright illustrations and blends the social with the economic or the "rhetoric of care and the rhetoric of analysis."[195] The report emphasizes ExxonMobil's systematic management and financial contributions and ambiguously discusses greenhouse gases and climate change.[196] BAT's report looks different. The 158 page report contains few illustrations and a detailed twelve page discussion of their internal CSR process.[197] By preempting mandatory reporting with voluntary reporting, corporations have gained the power to define and frame.[198] "By choosing a hard discourse of economics . . . ExxonMobil rules out many forms of criti-

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article concluded that most MNCs disseminate similar CSR messages focusing on the same stakeholder groups and issuing often interchangeable statements. *Id.*

[192] John Conley & Cynthia Williams, *Engage, Embed and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 J. CORP. L. 1, 24 (Fall 2005).

[193] *Id.* at 25.

[194] *Id.*

[195] *Id.* at 25-26.

[196] *Id.* at 26-27.

[197] *Id.* at 29.

[198] *Id.* at 30.

cism, but still sets itself up for fact-based attack."[199] In contrast, BAT can reply to criticism with more communications and while this open-ended discourse may invite criticism, "it binds the company to nothing more than listening."[200] In the end, empirical reviews of CSR reports cast doubts on its ability to succeed and the attractiveness of such success given the skepticism about corporate motives.[201]

The language choice is further amplified by strong incentives not to report negative information. While demands for increasing trust put pressure on companies to disclose "key information," firms remain reluctant to disclose bad information for fear of losing customer good will.[202] In addition, the complexity of global supply chains makes it extremely difficult for third parties to track facility conditions.[203] Costs to the end-user that must gather the information and check its credibility prevent many from using the reports that are available.[204]

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[199] *Id.* at 31.

[200] *Id.*

[201] *Id.* at 37. The "rhetoric of care" is similarly echoed by various CEO public discussions. *See generally* Robert Bruce, *Sustainability: Revolution as Companies Look at How to Survive in the Longer Term*, FIN. TIMES, Sept. 15, 2006 (Tony Trahar, CEO of Anglo-American mining Company, states that the company needs "to engage with and understand stakeholder groups."); *Sustainability Enhances Competitiveness: Dialogue with Dow Corning CEO Dr. Stephanie Burns and Professor/Lecturer Sun Liping*, CHEMICAL WK., Vol. 167, Issue 42, Dec. 14, 2005 (Dr. Burns states that Dow Corning "believe[s] we 'wear' three hats simultaneously in terms of sustainability. These represent our social, economic, and environmental responsibilities.").

[202] O'Rourke, *supra* note 23, at 27 (finding that businesses incur additional risks when they report negative information and costs than when they give more detailed reports). *See also Interfaith Letter, supra* note 38, at 9 (noting that voluntary disclosure fails because companies focus on isolated projects instead of telling the "whole story").

[203] O'Rourke *supra* note 23, at 27 (noting that outside organizations have a difficult time even determining where production sites are located).

[204] *Id.* at 28. *See also* McLaren, *supra* note 6, at 194 (noting that active monitoring and engagement are costly endeavors for investors and "rational ignorance is the most logical path").

By allowing MNCs to define and frame the issues, voluntary disclosure puts control of the discussion in the hands of the company. Instead of "redressing the power imbalance between corporations and civil society, these processes may be reinforcing it in subtle but effective ways."[205]

2. Public Image

These concerns are reinforced by the underlying motivations for voluntary disclosure. As one commentator notes, CSR reporting is a "method of self-presentation and impression management conducted by companies to insure various stakeholders are satisfied with their public behaviors."[206] A recent survey of Fortune 500 CEOs evaluated the future impact that sustainability issues are likely to have on the reputation of MNCs.[207] This survey found that CEOs believed environmental and social credibility would play an important role in preserving a positive corporate

[205] Conley & Williams, *supra* note 192, at 37. *See also* CORPORATE WATCH, CORPORATE WATCH CSR REPORT 2006, *available at* http://www.corporatewatch.org.uk/?lid=2670 ("CSR is an effective strategy for: bolstering a company's public image; avoiding regulation; gaining legitimacy and access to markets and decision makers; and shifting the ground towards privatization of public functions.").

[206] Snider et al., *supra* note 191, at 176. *See also* O'Rourke, *supra* note 23, at 27 (noting the problem of CSR reporting "being captured" by firm's marketing and public relations departments); *Two Views of Virtue*, CFO MAG. FOR FIN. EXECUTIVES, Dec. 15, 2005, at 6 [hereinafter *Two Views*] (noting one commentator's view that companies respond to financial pressure first and corporate responsibility issues only rank as a top business risk when a company's brand or reputation is on the line). That reports are often issued following public outcry is an additional illustration of the underlying motivation. *See Wal-Mart Stores Inc. First Report Anticipated After Kudos*, WASTE NEWS, Aug.14, 2006, at 12 (stating that after criticism from socially responsible investment groups, Wal-Mart announced plans to publish a sustainability report in Spring 2007).

[207] Arlo Kristjan O. Brady, THE SUSTAINABILITY EFFECT: RETHINKING CORPORATE REPUTATION IN THE 21ST CENTURY 102 (2005). This book incorporates a survey that used scenario planning techniques to garner insight into the perceived future reputational impact that sustainable development will have on MNCs through Fortune 500 CEOs.

image in the near future.[208] On average, CEOs thought that social credibility would be equally as important as financial credibility.[209] This aligned with the World Economic Forum's 2002 finding that business leaders worldwide face growing pressure to prove outstanding performance in their corporate governance and citizenship activities, in addition to financial competitiveness and market growth.[210]

The survey illustrates how CSR matters in terms of reputation. It is the reputational capital that CEOs are concerned about when it comes to sustainability factors.[211] For many Fortune 500 companies in the public eye, reputation is a financial concern. Thus, increasing concern by companies about social and environmental credibility motivates voluntary disclosure and the substance of the dialogue. It is important to note that there is potential for corporate reputation concerns to serve as a way to hold companies accountable. This is exactly what NGOs use when attacking brands such as Nike and Coca-Cola to influence their behavior. If there was an organization in the world of social data that served the same function that Moody's or Standard & Poor's does with financial data, then reputation could serve as a meaningful mechanism.[212] Thus, reputational capital has potential to be an accountability mechanism, but that is not the reality of today. Instead, reports are an endeavor driven by public relations. [213]

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[208] *Id.*

[209] *Id.* at 103.

[210] *Id.*

[211] *See* McLaren, *supra* note 6, at 198 (noting that ten years after "the Rio Earth Summit, despite a massive upsurge in voluntary CSR initiatives, there are less primary forests and more sweatshops in the world").

[212] *See generally* LYDENBERG, *supra* note 5, at 88-96 (noting that there have been some efforts in the CSR community to develop credible and varied rating systems, but that it is still unclear how these efforts will be funded in the future).

[213] Consider also the recent case against Nike in which a consumer sued over a misleading public relations campaign. The amicus brief submitted by prominent MNCs such as ExxonMobil, Microsoft, and Pfizer contended that if a company's claims on human rights, social, and

3. Empirical Evidence

Finally, disappointments with the use of disclosure further amplify the discussed shortcomings. Empirical evidence illustrates that corporations do, in fact, use reports as a form of public relations and often fail to take social concerns seriously. This shows that disclosure does not necessarily result in introspection or corporate initiatives to improve behavior.

The Global Mining Industry provides one such example.[214] The International Council on Mining and Metals (ICMM) enumerated ten principles for members of the industry to follow.[215] The principles included sustainability reports.[216] Following ICMM's framework, four mining companies issued disappointing reports.[217] Much of the report content was "pictorial and descriptive."[218] The companies hand-picked information they wanted the public to know rather than picking information the public actually wanted companies to provide.[219]

In addition to disappointment by observers and interested parties, awards provide another platform to evaluate the

environmental issues were legally required to be true then "corporate speakers will find it difficult to address issues of public concern implicating their products, services or business operations." Brief of ExxonMobil et. al. as Amici Curiae in Support of Petitioners at 2, Kasky v. Nike, Inc., 45 P.3d 243 (Cal. 2002), *cert. granted*, 537 U.S. 1099 (2003), *and cert. dismissed*, 123 S. Ct. 2554 (2003) (No. 02-575).

[214] *See also Shell Breaks Environmental Standards . . . Again*, US FED. NEWS, May 21, 2006 (reporting that independent assessors discovered numerous breaches of European Bank of Reconstruction and Development standards despite Shell's sustainability report stating that the company had reported "in full" on river crossings).

[215] S. Prakash Sethi & Olga Emelianova, *A Failed Strategy of Using Voluntary Codes of Conduct by the Global Mining Industry*, 6 CORP. GOVERNANCE 226, 232 (2006).

[216] *Id.*

[217] *Id.* at 234.

[218] *Id.*

[219] *Id.* ("It emphasized process rather than output, and provided information, which the companies would like the public to know rather than the information that public would want the companies to provide.").

value of using disclosure. The Association of Chartered Certified Accountants (ACCA) holds an annual ceremony to recognize excellence in sustainability reporting.[220] The ACCA judges have noticed that many of the companies entering the competition fail to follow recommendations from previous years.[221] This indicates that corporations look at awards as a way to receive public recognition or social and environmental credibility, and not as a way to make valuable improvements to their activities.

In sum, despite the growing voluntary initiatives by corporations, such disclosure falls short. Today, corporations are able to choose and frame the issues that they report on by using rhetoric. Further, the main driver for such disclosure is to preserve social credibility and not to force introspection or alter corporate approaches to activities that impact society.

VI. MANDATORY DISCLOSURE'S POTENTIAL

A. Policy Argument for Mandatory Disclosure

In the face of concerns about voluntary disclosure's viability, some have suggested mandatory disclosure. Some commentators argue, and the previous section suggests, that voluntary initiatives are incapable of solving problems that result from under-priced externalities and geographically-displaced impacts.[222] These failures undermine the traditional justifications for disclosure—correcting information asymmetry and internalizing externalities—and suggest that another alternative, such as mandatory disclosure, is necessary to achieve the desired results. Further, the recent history of Enron illustrates that self-regulation fails to work where strong financial pressures encourage relaxed standards.[223] While corporations retain control of disclosure

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[220] *Special Report – Sustainability: Devil is in the Detail*, ACCT., Mar. 31, 2006, at 6.

[221] *Id.*

[222] *See* McLaren, *supra* note 6, at 198.

[223] *Id.*

through voluntary initiatives, this control stops where the business case for disclosure stops, not where society's moral and economic case stops.[224] Thus, retaining legal sanctions as a last resort is needed for effective disclosure.[225] In addition to legal certainty, other commonly cited reasons for mandatory disclosure include increasing credibility, fostering transparency, standardizing data for comparison, forcing disclosure of negative events, saving costs by gathering information at a central location, and increasing equality of investors since all will be privy to information.[226]

Considering the structure of a corporation provides additional support for mandatory initiatives. One model of the corporate entity outlines three rings constraining corporate purpose.[227] In the inner circle are the corporation's legal rights to protections and privileges.[228] The second ring, which exerts less influence on corporate behavior, contains securities regulations, corporate law, corporate governance, and capital ownership.[229] The third ring, most removed from core detriments of purpose, include company leadership, voluntary initiatives, corporate codes, and international norms.[230] The majority of CSR practice, including voluntary disclosure, focuses on the outer ring, whereas the inner rings are the most powerful levers for change.[231] Thus, according to this business model, mandatory disclosure, as part of the second ring, will constrain corporate activity.

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[224] *Id.* at 192, 197 ("The driving forces of competition and shareholder value make it well-nigh impossible for corporate executives to act voluntarily even where the moral case is clear.").

[225] *Id.* at 198.

[226] UNEP AND KPMG REPORT, *supra* note 8, at 12-15.

[227] Allen L. White, *Lost in Transition? The Future of Corporate Social Responsibility*, 16 J. CORP. CITIZENSHIP 19, 22 (2004) (exploring the evolution of the CSR movement and its future viability).

[228] *Id.*

[229] *Id.*

[230] *Id.*

[231] *Id.*

B. Empirical Evidence of Mandatory Disclosure's Effectiveness

Unfortunately, looking to corporate practices and empirical evidence suggests that mandatory disclosure will not solve the problems attendant to voluntary initiatives. First, while still new, French regulation requiring disclosure has had disappointing results.[232] Second, mandatory environmental disclosure in the U.S. provides an analogy for the potential effectiveness of similar disclosure requirements for social impacts.

In 2001, France became the first country to mandate systematic disclosure by passing the New Economic Regulations Act.[233] The regulation spelled out social and environmental indicators, the reporting for which began in 2003.[234] Utopies, a French consulting firm, evaluated the first year of reporting and although 69% of major firms reported, the overall results were mixed.[235] Out of 120 firms, twenty "effectively" did not report; of those reporting, two-thirds reported on less than 40% of the required indicators.[236] Thus far, there is limited evidence that this reporting initiative is actually improving accountability.[237]

The United States has experimented with non-financial disclosure requirements relating to environmental impacts of corporate behavior. Comparison of the success of both the impact and use of such data illustrates the difficulties in the ability of qualitative data to hold companies accountable. Since the 1970s, the Securities and Exchange Commission (SEC) has required U.S. companies to disclose certain kinds of environmental data.[238] Such disclosures include the estimated future costs to clean up hazardous waste sites and potential costs resulting from any lawsuits brought by

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[232] LYDENBERG, *supra* note 5, at 66.

[233] *Id.*

[234] *Id.*

[235] *Id.*

[236] *Id.* at 66-67.

[237] UNEP AND KPMG REPORT, *supra* note 8, at 8.

[238] LYDENBERG, *supra* note 5, at 68.

federal agencies that are likely to result in fines or penalties greater than $100,000.[239] A July 2004 study by the General Accountability Office assessed the adequacy of SEC enforcement of environmental disclosure requirements.[240] The report found that "little is known about the extent to which companies are disclosing" and that without more "definitive information" on the extent of environmental reporting, the adequacy of SEC enforcement could not be determined.[241]

In comparison, disaggregate data made available through Toxic Release Inventory (TRI) has made a documented impact on both corporate behavior and the ability of the public to make more informed choices. The Environmental Protection Agency (EPA) maintains the TRI database, which stores the figures of those companies required to disclose the quantities of toxic chemicals stored and released at the plant level.[242] TRI has become an international model for such reporting.[243] The first publication in the late-1980s provoked significant public reaction and pressure immediately mounted to require that companies reduce their emissions.[244] This public pressure resulted in action by the EPA that

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[239] *Id.* The SEC requires disclosure of all "material" information, which includes any information that a reasonable investor would consider "significant in the total mix of information available" to assess a company's assets. The benefit of the materiality approach is that it connects environmental and social disclosure to the already accepted principle that information helping shareholders assess firms should be disclosed. The downside is that "materiality" is subjective and enables firms to sporadically disclose based on their own judgments. *Id.* at 68-69.

[240] *Id.*

[241] *Id.*

[242] *Id.* at 71. The legislation was passed in 1986 and by 1998, seven industries were required to report, including electric utilities, metals mining, and coal mining. By 2004, companies had to report on approximately 650 chemicals. *Id.* at 71-72.

[243] *Id.* at 72.

[244] *Id.* Publication by newspapers listed the top emitters of toxic chemicals at the national level while local papers listed the specific figures of the region's largest polluters. *Id.*

ultimately led to reduced emissions.[245] Assisting in the dissemination of this data, the non-profit organization Right-to-Know Network (RTK NET) made the data available in a user-friendly format.[246]

A brief look at the outcomes of these two environmental disclosure initiatives illustrates the difficulty in using qualitative information to hold corporations accountable for their actions. While it is unclear if the SEC disclosure provisions have had any impact, the TRI database resulted in documented corporate action. Much of this has to do with the nature of the information and the ability to verify its accuracy. Studies have been inconclusive on enforcement of SEC environmental disclosure, and unverifiable data is of little use to investors and the public. In contrast, TRI's data is easy to verify, aggregate, and compare across the board. Unfortunately, information on social issues is more like the former than the latter. As discussed earlier, GRI's guidelines contain endless qualitative data as a result of the nature of CSR issues.

There are two additional impediments to the usefulness of mandatory disclosure. First, governments are generally unwilling to prioritize an increase in the accountability of corporate activity abroad. Most governments remain "somewhat ambivalent about accepting corporate duties," particularly duties toward citizens in states where corporations do business.[247] Additionally, "[i]n great part, fears of inroads on national sovereignty block the creation

[245] *Id.* In 1988, the EPA launched a voluntary program calling for fifty percent reductions in corporate releases and transfers of particularly toxic chemicals. By 1995, the EPA reported that such releases and transfers dropped fifty percent nationally.

[246] *See* RTK NET Home Page, http://www.rtknet.org/. RTK NET is a service that provides free access to environmental databases such as the TRI.

[247] Steven R. Ratner, *Corporations and Human Rights: A Theory of Legal Responsibility*, 111 YALE L.J. 443, 488 (2001) (noting that discussion about rights and enforcement at an international level have thus far shown an inconsistent posture among decision makers who are willing to recognize rights in many areas, but prescribe enforceable duties in limited areas).

and implementation of effective international enforcement measures."[248] Second, to the extent that companies can comply with standards at a modest cost or get around the standards all together, they will do just that.[249] Regulation creates an incentive to abide by requirements in the least costly manner, often missing the purpose of the regulation.

In sum, mandatory disclosure fails to cure the problems attendant to voluntary initiatives. Thus far, France's attempt at such regulation has had limited impact. In addition, a comparison of SEC environmental disclosure requirements and TRI further illustrates the limits of disclosing qualitative data.

VII. CONCLUSION

The evidence suggests that disclosure alone, voluntary or mandatory, will not compel corporations to change internal mechanisms forcing responsible behavior and will not improve the ability of the public to make better choices. However, this is not the end of the discussion. While it is important to recognize the limits of disclosure, as enumerated above, recognizing these shortcomings can help guide an alternative.

The use of non-financial disclosure has two significant shortcomings. First, disclosure fails as a market mechanism. Given the information's qualitative nature, the ability of companies to control the dialogue, the lack of intermediaries to translate the data, and the limited responsiveness of consumers and investors alike, non-financial disclosure alone does not create movement in the market. Second, disclosure focuses on the surface, enabling companies to implement what is effectively a public relations tool without causing a change in their underlying behavior. These shortcomings must be addressed before non-financial disclosure can serve as a way to hold corporations accountable for their activities abroad.

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[248] WORKERS' RIGHTS AS HUMAN RIGHTS 16 (James A. Gross ed., 2003).

[249] *Two Views, supra* note 206, at 6.

For social or environmental data to have a noticeable market impact, a significant overhaul of the traditional business model and the marketplace is required. As discussed in Part II, Lydenberg encourages disclosure in addition to mechanisms that would make such structural changes.[250] However, while the suggested mechanisms look good on paper, their ability to stand up in reality is less certain. Lydenberg recommends that the data be processed and analyzed to enable comparisons.[251] In order for the information to be useful, it must be in a readily understandable format; however, getting there is a challenging endeavor. Earlier discussion illustrated that there is not yet a way to reduce much of the necessarily qualitative data about social and environmental issues to a mathematical calculation or raw data format. This is a key difference between social and financial data, which is further compounded by the lack of intermediaries able to translate and disseminate the information. Unlike the financial marketplace, there are no information traders to provide CSR data to consumers and investors in a user-friendly format. In sum, because social data departs from financial data in significant ways, it is unclear that disclosure of social data can ever operate as effectively as the disclosure of financial data.

Given today's hurdles for using the market as a regulator to encourage socially responsible behavior, the focus should turn to correcting the second shortcoming. Social disclosure focuses on the corporation's external, public image and not its internal operations. Disclosure must find a way to break through the surface or be used in connection with mechanisms that do, if it is to be useful. The Nike case studies, discussed in Part IV, provide valuable insight to this problem. The studies suggest that combining the external pressures of monitoring with the internal management systems aimed at the root problems of quality management can do what monitoring alone cannot achieve. Ultimately,

[250] LYDENBERG, *supra* note 5, at 108-38.

[251] *Id.* at 79.

disclosure falls victim to the same pitfalls of monitoring systems. The studies concluded that some level of monitoring was needed, but that the emphasis should turn toward providing suppliers with technical and organizational assistance to tackle root problems that drive poor working conditions.[252] Likewise, disclosure can serve important goals, but there needs to be an increased emphasis on addressing the underlying problems that drive irresponsible corporate behavior.

NGOs, investors, and stakeholders alike should focus their attention not on disclosure as an end, but on disclosure as a part of the bigger picture. In addition to disclosure, there needs to be a greater focus on ways to increase the quality of internal management activities and on ways to implement a meaningful feedback mechanism in areas where the market fails to force any response. Until these are in place, the shortcomings discussed above will prevent disclosure from having an impact on most corporate behavior. Recognizing the limits of non-financial disclosure is a first step in moving toward a meaningful way to hold MNCs accountable for business activities in foreign countries.

[252] *Nike Study One*, *supra* note 155, at 39.