

# **CSR, transparency and the role of intermediate organizations.**

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## *Summary*

Transparency is a crucial condition to implement a CSR policy based on the reputation mechanism. The central question of this contribution is how a transparency policy ought to be organised in order to enhance the CSR behaviour of companies. Governments endorsing CSR as a new means of governance have different strategies to foster CSR transparency. In this paper we discuss the advantages and disadvantages of two conventional policy strategies: the facilitation policy and the command and control strategy. Using three criteria (efficiency, freedom and virtue) we conclude that both strategies are defective. Most attention is paid to the facilitation strategy since governments nowadays mainly use this. In evaluating this strategy we analyze the Dutch case. As an alternative we introduce a third government policy: the development of a self-regulating sub-system. By construing an analogy with the historical development of corporate financial disclosure, we point out that the vital step in the creation of a self-regulating subsystem is the creation of strong informational intermediate organizations.

*Key-words:* self-regulation, self-governance, system approach, social reporting, command and control, strategic and moral assessment of transparency, transparency policy, CSR, infomediaries

## 1 Introduction

The main question of this article is how to design a transparency policy in our latter day market society in order for it to foster the development of corporate social responsibility (CSR). CSR is thereby interpreted as an alternative mechanism to solve public problems. The core of it is that companies take responsibility and consider themselves accountable for the economic, social and ecological consequences of their operations.

Our main question is fostered by a problem of contemporary society in general and its system of governance in particular. This problem is commonly referred to as the problem of “the limits of state action” (Keane, 1988). Today the world faces a complex set of ecological and social issues that need resolve. Governmental institutions, located at both the nationally and international level, face serious and structural difficulties in addressing these issues (Weale, 1992; Yeager, 1991; Dubbink, 2003; Scherer, Palazzo and Bauman, 2006).

The recognition of “the limits of state action” has raised an interest in alternative mechanisms for realizing public goals (i.e. in mechanisms of governance). Corporate Social Responsibility (CSR) is often conceived of as one of these alternative mechanisms. From a governmental perspective CSR is closely linked to transparency. A transparent organization provides information in such a way that the stakeholders involved can obtain a proper insight into the issues that are relevant for them (Kaptein, 2003). Transparency is a necessary condition for CSR. CSR will remain marginal as a mechanism of governance as long as stakeholders cannot closely keep their eye on them. This is not to deny that some managers will be inherently motivated for CSR. But for it to become a significant mechanism of governance,

stakeholders must be able to see the difference between CSR and window-dressing. Besides, all possibilities to make it pay off must be used. This requires that society must ensure that corporations are sufficiently transparent. Thus, if there is an effective need for CSR in contemporary society, there is also a need for "CSR transparency" - as we call it.

The need for CSR-transparency contrasts sharply with the present level of transparency in contemporary markets. Empirical evidence sufficiently shows that the present level of transparency still is largely insufficient. Walden and Schwarz (1997) for example, question whether companies will voluntarily report substantive environmental information that will adversely affect their future earnings. Most disclosures of firms they studied were 'time and event'-specific. This indicates that firms use disclosure mainly to respond to public pressure after incidents. In the same vein Owen et al (2000) argue that social audits are monopolized by corporate management, which uses this instrument as a means to control public relations. Social and environmental disclosures are to a large extent self-laudatory (Hooghiemstra, 2000). What is more, various studies show that voluntary environmental disclosure is not a reliable indicator of a firm's environmental performance (Berthelot et al, 2003; See also Gray, 2001; Walden and Schwarz, 1997; Deegan and Rankin, 1996). Too often, companies attempt to change perceptions without changing facts (Hess, 2007; see also: Hess and Dunfee, 2007).

This paper looks for the best policy to enhance the CSR-transparency of market actors, given the limits of state action. The set-up of the paper is as follows. In the next section we discuss the advantages and disadvantages of transparency in relation to CSR enhancement. We distil three criteria for assessing a transparency policy.

Section three and four describe two public policies with respect to transparency: command and control<sup>1</sup> and a facilitation policy. We accept the conventional criticism as to the former and evaluate the latter by describing and analysing a European forerunner in this regard: the Dutch case. Thereupon we introduce the basic components of yet another policy, labelled *self-regulating sub-system* and discuss two instantiations of this policy. One of these clearly seems superior because it tries to employ the newly evolving infomediaries. Again, the Dutch case is important in this respect. On the one hand it shows that the idea of self-governing subsystems is not just some theoretical whim. On the other hand, it also suggests the importance of infomediaries in organizing self-governing subsystems.

Our paper conceptually contributes to the existing body of knowledge on transparency theory by (1) showing that the common duality between "self-regulation" and "command and control" policies must be rejected, as the common association with "voluntary" versus "enforced" policies that goes with it. Self-regulation can refer to self-regulating *actors* and self-regulating *subsystems*. From a governmental point of view, this distinction is crucial. We will show that it changes the assessment of (the nature) of various governmental policies and their potential success. Interestingly, we are able to make this contribution by relating work done on environmental policy assessment in administrative science in the 1990s to contemporary theory on transparency. (2) Another conceptual contribution is our attempt to assess transparency policies on multi-dimensional criteria. In a liberal society efficiency cannot be the only relevant criterion. The moral point of view also counts and as we see it, the moral point of view changes our assessment of particular policies. (3) Our third contribution relates to the recently evolving literature stressing the importance of

infomediaries. In the light of our analysis we are able to back up and elaborate on both the importance of this new development and the ways in which this policy can be stimulated.

## 2 Three criteria to evaluate transparency policies

In this section we define three key criteria for evaluating transparency policies by means of a discussion of the advantages and disadvantages of transparency in relation to CSR.

### *Advantages of transparency*

The literature provides several economic and moral arguments why transparency is important in relation to CSR. First, transparency enhances *allocative efficiency*, at least if consumers attach value to the social and ecological consequences of the products that they buy. Transparency may also enhance *dynamic efficiency* and *innovation*. Without transparency, companies performing well in CSR cannot distinguish themselves from companies that perform badly. This will limit the incentive to and necessity of process and product innovation to increase value creation in the social and ecological dimension (see Kaptein, 2003 and Graafland et. al., 2004 and 2006).

Transparency can also be defended from the moral point of view. First, consumer freedom increases when more information about the characteristics of various products is available. This information should also include the CSR relevant information of these products. Ethically speaking, informing transaction partners is an

important aspect of showing respect to others. Stakeholders have a reasonable right to information concerning the reporting company when its activities impinge on their interests (Deegan and Rankin, 1996; Gray, 2001).

Transparency is also morally important because it enhances an attitude of honesty, openness and a commitment to truth that is implicit in thinking on CSR. Thus, it has been argued that transparency enhances a sense of accountability and responsibility (Kaptein, 2003), again virtues relevant for CSR. The argument here is that transparency makes it much easier for stakeholders to confront a company with its actions, thereby stimulating a sense of responsibility in the company. Moreover, more and better information could have a stimulating effect on the attitude of consumers vis-à-vis CSR. Currently consumers often are too passive in this respect. More transparency, for example by labelling products, will confront consumers directly with the moral consequences of their choice and thus increase their willingness to pay for CSR products (Auger et al, 2003; see also Curlo, 1999).

#### *Disadvantages of transparency*

All these advantages, however, do not imply that pushing transparency to its limits is necessarily a good thing. There are disadvantages attached to striving at *full* transparency. From an economic point of view complete transparency may be costly to society. Although communication technology has diminished information costs, the stakeholders' right to information can be very costly to individual firms.<sup>ii</sup> This is further complicated by the fact that many aspects of CSR cannot be measured very accurately. Another problem is the bounded rationality of stakeholders. Because of the limited cognitive powers and restricted time for absorbing information, an

overload of information may cause the user to overlook the most important information or even to refrain from inspecting the information (Conlisk, 1996; Rabin, 1998; Fung et al, 2004). KPMG finds that stakeholders do not derive a direct measurable value from the voluminous environmental reports of large companies.<sup>iii</sup> As a result, its effectiveness in realizing either allocative efficiency or long run dynamic efficiency through innovation may be limited.

A moral consideration against full transparency concerns company freedom. Although entrepreneurs and managers should inform their stakeholders, complete transparency and the resulting burden of compiling the necessary information may come into conflict with company freedom. Full transparency may come into conflict with other moral principles, such as the right to privacy of workers or other parties. Transparency must also not disproportionately endanger the interests of the company that provides the information (Council for the Annual Reports, 2003). This actually involves more than company secrets. If many companies in a sector conceal information that is sensitive and harmful for them, the fully transparent firm may suffer a disproportionate amount of damage.

Yet another consideration is that full transparency may in fact turn companies against taking moral responsibility and thus CSR. Demanding full transparency may hinder the enhancement of virtues like honesty, openness and integrity. Although modest external pressure certainly can stimulate the internalisation of these virtues, beyond a certain level external pressure may also have a negative effect. It may feed an attitude of minimal compliance and distrust. This negative effect is particularly strong when companies are not able to deliver reliable information or lack the best practices of CSR (KPMG, 2006).

*Three criteria for the evaluation of transparency*

On the basis of the above discussion we distil three criteria for evaluating transparency policies: efficiency, freedom and virtue. With regard to the first criterion, any transparency policy should raise the quality of information at an affordable cost level. Transparency will only be efficient if the quality of the information is good and if the information can be provided at low costs. In the literature several procedural standards for transparency in social audits and social reports have been developed to secure the quality of information (Zadek et al, 1997; Wartick and Wood, 1999; Graafland, 2002). Table 1 presents an overview of procedural standards with respect to CSR information (Kaptein, 2003).

Table 1 Procedural standards for transparency in social reports

|                             |      |                                   |    |
|-----------------------------|------|-----------------------------------|----|
| Completeness                | ABCD | External verification             | AD |
| Inclusivity                 | ABC  | Impartiality                      | AD |
| Relevance / evolution       | ABD  | Attention for Sustainability      | A  |
| Comparability               | ABC  | Process governance                | B  |
| Comprehensibility / clarity | ACD  | Organizational embedment          | C  |
| Timeliness / Evolution      | AB   | Consistency                       | C  |
| Public disclosure           | AC   | Continuous improvement            | C  |
| Verifiability               | AC   | Information quality / reliability | D  |

<sup>a</sup> A: Global Reporting Initiative; B: Accountability 1000; C: Institute for Social and Ethical AccountAbility; D: Guideline Insurance 100 IFAC. Source: Kaptein (2003).

The second and third criterion—freedom and virtue—are moral in nature. Any transparency policy should ideally respect the freedom of both companies and stakeholders. It should also be conducive to the development of virtues like openness, awareness and honesty. The three criteria are closely connected. For instance, in the

procedural standards reported in Table 1 the development of a virtuous organisation is implicit.

### 3 Command and control versus facilitation policy

Experts in social reporting have recently explored the various ways in which government may enhance CSR transparency (see: Hess, 2007). Customary, these experts distinguish between two government policies: *command and control policy* with mandatory disclosure and *self-regulatory, new governance or facilitating policy* based on voluntary disclosure (Rhunka and Boerstler, 1998; Berthelot et al, 2003; KPMG, 2006; Hess, 2007).<sup>iv</sup> These two strategies correspond quite well with a standard typology of possible governmental strategies as developed within administrative science over the last decades. Here academics usually distinguish between "command and control policy" and "facilitation policy" (Van Vliet, 1992).

‘Command and control’ is a standard term for making policy by means of legislating, implementing and maintaining coercive laws. Command and control is often considered to be the traditional way in which government can attempt to steer societal processes (Stone, 1975; Van Vliet, 1992). Geared to transparency politics, command and control policy means that the government regulates the transparency of companies by forcing companies to provide certain types of information (Kolk et al, 2001)<sup>v</sup>. For example, the government can force companies to publish information about environmental and labour issues in their annual report. Such a command and control transparency policy has to consist of three elements. There must be a set of rules disciplining companies to come up with CSR data on a regular basis. But the necessary control, inspection and prosecution processes must also be in place

(KPMG, 2006). This relates to both the data and the process of their deliverance. Lastly, the information must be rightly interpreted and disseminated to relevant audiences.

The core of the facilitation strategy is that government conceives of companies as 'self-governing *actors*' or 'cooperative citizens' (Hafkamp and Molenkamp, 1990: 240), not unwilling to participate in the process of government. Given this policy the cardinal task of the government is to stimulate the societal actors to assume that role and to shape the conditions for it. This can be done by providing information, subsidies etc.. Applied to the issue of transparency a facilitation policy can employ various instruments (See Table 2).

Table 2 Examples of instruments belonging to a facilitating strategy

|   |
|---|
| Subsidies   |
| Awards for best practices   |
| Research to model code of conduct   |
| Labelling and harmonizing existing labels and certifications  |
| Research to transparency benchmark, CSR reputation index, transparency scan etc.                              |
| Other   |
| Establishment of an information centre providing public information about social labels and specific subjects |
| Labels or certification as condition for licences   |
| Publicly expressed support of codes of conduct  |

An option is subsidizing or granting awards for best practices in transparency. The government can also subsidize labelling organizations and investigate the desirability and feasibility of harmonizing existing labels (Lange and Winkler, 2000). By helping companies or sectors to set up a reliable product or process label, the government contributes to the reliability of the information about CSR. A final example of

financial facilitation is subsidizing research on reputation indices, or, as in the Netherlands, benchmarking of transparency (Ministry of Economic Affairs, 2004).<sup>vi</sup>

Facilitation is not just about financial instruments. At its core it consists of "communicative instruments". An example of a communicative instrument is the establishment of a CSR information centre. This centre must provide and disseminate independent and reliable information on CSR. This may involve information on socially responsible best business practice, (the establishment of) model codes of conduct or information on social labels (Lange and Winkler, 2000). Another instrument is the creation of websites on specific subjects. The government can also importantly influence a company's CSR transparency by rewarding the establishment of information systems and certification policies by companies. It can for example relieve certain conditions of licences or lower punishments, in relation to particular violations. Third, the government can promote transparency by symbolic actions, such as publicly expressed support.

Interestingly, many academics involved in transparency policy today, stand favourably to the idea of self-governing actors. Ruhnka and Boerstler (1998), for example, argue that in the past the shift of US policy from negative incentives to positive incentives coincided with a substantial rise in corporate codes. This may also work for CSR reporting (See also Hess, 2007). What is more, currently governments have also put their hopes on the facilitation policy with respect to CSR transparency. The Dutch government provides an interesting example. Clearly a frontrunner in Europe, this government explicitly casts its CSR transparency policy in terms of command and control versus facilitation and has opted for the latter.

#### 4 The limits of both policies (The Dutch case 1)

Will either the command and control policy or the facilitation policy be effective in enhancing CSR-transparency? In the 1980s and 1990s a rather broad consensus evolved both inside politics and in academic circles that command and control politics is structurally deficient. It cannot solve any complex problem in modern society (Van Vliet, 1992; Weale, 1992). Many problems related to the command and control policy are related to the "limits of law" (Keane, 1988; Stone, 1975; Yeager, 1991). We will not challenge this consensus and leave aside command and control as a way of enhancing CSR policy. Since it is ineffective, we maintain that at least it fails on the criterion of efficiency.

What about the facilitation policy? We will use the remainder of this section to describe and analyze the Dutch case in order to assess the facilitation policy. Facilitation is the dominant government policy with regard to CSR transparency in the Netherlands (Ministry of Economic Affairs, 2007). The Dutch government uses the entire range of transparency policies introduced in table 2. It awards best practices, develops CSR toolkits, master classes in sustainability etc. The Dutch government disseminates information about CSR through a national organisation (NCP) and several websites.<sup>vii</sup> The Dutch government has also defined minimum CSR requirements for companies eligible to make use of various governmental export and investment facilities. Companies must declare to be acquainted with the OECD guidelines and make the greatest possible effort to apply these. Moreover, government support in exporting is only available for companies that meet some concrete requirements related to the environment, corruption and social aspects. Finally, the

Dutch government has issued research aimed at developing a conceptual framework for social reporting. This has resulted in the publication of the Guideline 400 of the Council for the Annual Reports (2003, see footnote 17).

How does Dutch facilitation policy fare in relation to our three criteria? We maintain that the Dutch case makes it abundantly clear that the facilitation policy fails in terms of its efficiency. Despite the employment of all the mentioned instruments, CSR transparency of Dutch companies has still remained low. Many of the procedural standards reported in Table 1 are currently not met by Dutch companies. Public disclosure often is very limited. Several indicators point at this. For example, according to the transparency benchmark of the Dutch Ministry of Economic Affairs (2004) only 5 % of the large companies meet all criteria of the benchmark.<sup>viii</sup> While trying to construct a benchmark for CSR, Graafland and Eijffinger (2004) found that the amount of publicly available information on CSR is too limited for this goal.

Information is also incomplete and not very relevant for several types of stakeholders. The principle of completeness means that no area can be systematically excluded from the social report. This principle is important to ensure that the company does not deliberately hide areas of its activities that will show – on inspection – negative social or ecological performance (De Laat, 2001). Still, the CSR platform in the Netherlands<sup>ix</sup>, which represents NGO's industry and government, insists that too many companies provide too little and too fragmented information about the supply chain of their products and the labour conditions under which they are made.

Furthermore, the information provided in social reports also lacks comparability. The principle of comparability means that the information presented in the CSR report

can be compared to information about the performances in different periods or to information presented by other relevant organizations. Comparability makes it possible to assess the evolution of the CRS performance of a company. This enables stakeholders to compare the various companies and to choose with which company they will involve themselves. It also enables companies to identify bottlenecks with respect to CSR. Still, in practice comparability is low. Private initiatives have led to a high number of hallmarks, thus complicating the use of information for both buyers and others users of information. An example is wood. There are many wood related hallmarks present in the Netherlands, confusing the consumer. Large companies often acknowledge the importance of standardisation (which is, for example, supported by the guidelines of Global Reporting Initiative (GRI, 2002)). But even so, in practice there still are substantial differences in how these are applied by companies (Lamoen and Tulder, 2001).

All this corroborates the conclusion that the facilitation policy fails on the efficiency criterion. Even if a few large companies have realised substantial progress in opening up the societal aspects of their business, the majority of companies has not. Since any successful policy must be efficient, we can ignore the assessment of the facilitation policy in terms of freedom and virtue.

## 5 A third policy: self-regulating sub-systems

Administrative science of the past decades has stressed time and again that we tend to conceive of the process of governing by means of a mental model in which the government is the central – if not the only – actor responsible for and capable of changing societal processes (Van Vliet, 1992; Hafkamp and Molenkamp, 1990; Kooiman, 1993). When thinking along the lines of this ‘government centred model’

one tends to conceive of the rest of society as passive with regard to the governmental issues. Consequently, one tends to overlook the many ways in which complex societal forces present in society may contribute or hamper the process of governing. Both the command and control policy and the facilitation policy are entrenched in this government centred model and hampered by it. In attempting to organize society both policies concentrate on the ways in which *the government* can influence actors at the micro-level.

Another way of conceiving of the process of governing is by means of a governance or system approach (See: Teubner and Willke, 1984; Kooiman, 1993; see also: Luhmann, 1988). In the system approach society is conceived of as a complex body of interrelated subsystems. Each contains forces of many kinds and all of them together form one complex system. The government is one of these subsystems. Still, it holds a unique position as it has the power to influence the structure of other subsystems. If we look at the process of governing from the system approach it becomes natural to strive towards *self-regulating subsystems*. In this context self-regulation of a subsystem can be defined as a situation in which the balance of forces within the subsystem results in the attainment of a state of affairs that coincides with the ultimate governmental goal of a well organized society, under the condition that there are minimal governmental maintenance costs involved. The definition implies that a fully self-regulating system is an ideal. It is important to notice that striving for self-regulation within the system does not necessarily mean that no laws are issued or that no force whatsoever is used. A self-regulating system is not necessarily grounded in voluntarism or self-governance at micro level (See: Hess, 2007: 453). The process is geared at constituting self-regulating *systems*, not self-governing *actors*. Coercive laws thus may be involved. The core of the approach is to find ways to minimize

governing costs by the maximum employment of societal forces. It is also important to stress that the systems approach does not necessarily imply cooperation between government and all societal actors and/or cooperation between all societal actors (See: Hess: 455). Quite the contrary, the systems approach may very well be described as a policy that tries to employ *countervailing powers*. The government must try to employ and exploit the existing antagonistic forces within society in its strive towards self-regulating sub-systems (See: Dubbink, 2003).

An exemplary policy suggestion that is in accordance with the system approach relates to the goal of ensuring that all motor bikers wear their helmets. Governments can try to attain this goal by issuing a law that the police must implement by supervision and punishing. It would be in line with the system approach to allow health insurance companies to reimburse motor bikers injured in traffic under the condition that they wore a helmet at the time. In this way motor bikers are given a strong motive to wear a helmet apart from the possibility of being fined. Thus maintenance costs are lowered and partly transferred to other parties.

## 6 A first instantiation of self-regulating subsystems (Dutch case II)

The idea of self-regulating subsystems is very inviting, governmentally speaking. It holds the promise of organizing society at low governing costs, since the interplay of societal institutions is effectively structured. In fact, the idea of the capitalist free market itself bore out of the idea of self-regulating sub-systems. After all, the market is legitimized as a sphere of action in which private interest is transformed into public benefit by means of the working of a ingenious set of institutions, sometimes metaphorically referred to as "the invisible hand" (Baumol, 1975 and 1991; Pigou,

1920; Schultze, 1977; see also: Smith, 1776). It thus should come as no surprise that proposals have been drawn up to employ the idea of self-regulating systems in relation to CSR transparency. An interesting proposal was suggested in the Dutch context by the Dutch Consumer Federation (Consumentenbond, 2002). We will discuss and evaluate this proposal in some detail. It gives us insight into the conditions a policy geared to enhancing self-regulating systems must fulfill.

The basic idea of the Consumer Federation proposal is that companies have a legal duty to provide information about the societal aspects of its products, production processes and the complete product chain.<sup>x</sup> Any consumer or societal organization has a legal right to demand information from the final suppliers of a product or service. This holds true even if the information concerns aspects of the supply chain that the final supplier does not directly control. In that case, the supplier's suppliers should deliver the information. The proposal also states that companies have a legal duty to develop product manuals. These should contain information on the societal aspects of both the product and production processes throughout the chain. Since the proposal does not prescribe given formats, it allows the consumer much flexibility. He is able to ask any information that he considers relevant in the societal debate. The Consumer Federation expects that branch organisations will develop self-regulatory rules to work out the need for information on sector level. Still, the company itself is obliged to meet the request of the consumer. The company can only deny a request if it can show that the requested information does not serve any societal interest or generates disproportional advantages or disadvantages to a involved party, violates the right to privacy or harms state security interests.

Interesting about the proposal of the Consumer Federation is that it is clearly inspired by the idea of self-regulating systems. An attempt is made to enhance CSR transparency by employing the power of the consumer i.e. consumer sovereignty. The power of the consumer is thereby enhanced by a set of governmental measures. Still, this latter aspect does not convert the proposal into an instance of command and control policy. The proposal suggests using governmental measures to change the institutional structure. It is not used directly to put pressure on companies.

How must we assess this instantiation of the self-regulating systems? We believe it must be rejected, even if it has some advantages. The proposal has a tendency to convert transparency into an absolute. Thus it neglects the moral limits of transparency policies discussed earlier. First, although communication technology has diminished information costs, the consumer's right to demand information can still be very costly to individual firms. According to the Consumer Federation, information costs do not constitute a legitimate ground for limiting the consumers' right to information. However, these costs can be considerable. This is especially so if companies cannot focus on a limited set of core parameters and if companies are obliged to provide information on their complete supply chain.

Another problem is the bounded rationality of consumers. Most consumers have limited knowledge of the complex production processes within the production chain. This will not only reduce the effectiveness of the transmission of knowledge of companies to consumers. It may also cause irrelevant information being requested. Although companies have a right to dismiss this type of questions, the costs involved in convincing consumers (or courts) that this particular request is irrelevant may be substantial. Related to this is the problem that it is often very hard and costly to

determine the right level of detail. Too many details only confuse ordinary consumers; a shortage on details runs the danger of becoming meaningless.<sup>xi</sup>

A moral consideration forcing limits on a transparency policy concerns company freedom. A law that requires companies to gather and supply information about all kinds of possible societal effects of their operations as well of the operations of their (indirect) suppliers in the chain represents a substantial limitation of the sphere of freedom for doing business. What is more, the high costs involved in absolute transparency are likely to reduce the willingness of companies to cooperate. According to KPMG (2006), this will obstruct the development of excellence exactly at those companies which are currently in the process of developing it. More generally speaking, it must be feared that the proposal may have an adverse effect on the company with regard to morality. If companies have to dig up so much information on any person's request, they may subsequently deny any further caring responsibility (Kaptein, 2003).

Our analysis of the law proposal by the Dutch Consumer Federation makes clear that organizing self-regulating systems is no sine cure. Simply enhancing consumer power can in the end be contra-productive. Thus, if we want to employ self-regulating systems in relation to enhancing CSR transparency we have to develop more nuanced proposals. In the last part of this paper we will try to improve the idea of self-regulating systems; basically by elaborating on one mechanism that we think is crucial. This is geared towards strengthening the position and role of the newly evolving intermediary information processing organizations.

7      A second instantiation of self-regulating subsystems: using infomediaries

In order to work out our proposal we must take a second look at the societal actors relevant in thinking on CSR transparency. Despite all the differences between the policies discussed so far, (command and control policy, facilitation policy and self-regulating systems as elaborated on by the consumer federation) they all employ a framework in which basically three types of actors participate. These are: (1) the individual companies or their representative organisations, (2) individual stakeholders in their role as consumer, worker, investor and citizen as well as their representative organisations, (3) government. Given this framework, policy is then constantly geared at manipulating companies in such a way that they produce information that is *directly* relevant for the various stakeholders.

Here Figure 1

However, as we see it, there is a fourth type of actor present in the contemporary social world whose importance seems to increase rapidly. This actor is the informational intermediate organisation, the so-called infomediary (see Figure 1). An infomediary is a broker in information. It *disseminates* information to all the different parties involved, but especially to the consumer and the interest groups. But that is not its only task, perhaps not even its most important task. It also *controls*, *verifies* and *translates* information produced by companies. The direct political influence of the informational intermediary on companies is and must be limited. Its function is to mediate informational contacts between the other types of actors. Still, an important sign of the maturity of the infomediary in a given system is the point where the companies start using the information provided by the infomediary in its own decision

making processes as a means of anticipating to the reactions of the other actors involved.

During the past decade informational intermediaries have popped up in the field of CSR. Consultancy firms, large as well as small, discovered the CSR field and often play a double role: they help companies to set up a CSR policy, while at the same time performing auditing functions with respect to CSR aspects of company policies.<sup>xii</sup> NGO driven informational organisations not only launch ethical labels but also take care of third party control of the label. Ethical screening organisations like the London based EIRIS or Paris based VIGEO collect all kinds of CSR information, company and non-company based, to deliver a CSR profile of a company and sell this information to anyone interested in applying ethical screens to his or her investment policy. Many of these screening organisations started out as NGO based initiatives and were very small at the beginning. Now they have professionalized in regard to their organisational aspects. The same goes for the methodology used to collect and screen all publicly available information. Lately, they have organised themselves into professional bodies. These are developing their own quality standards with respect to the research they do and the quality of the information that is send through.<sup>xiii</sup> It is not only in the gathering and control of CSR information that intermediaries play an increasing part. They also have an important role to play in the way information is communicated to the public. Purely web based player like "CSRwire" and "Kauri" as well as new journals like "P3" in the Netherlands or "Get Up" in Belgium popularise recent CSR evolutions very much in the same way as the specialised business or investment press does for the financial side of the economy.

*Analyzing the structural importance of infomediaries*

So far the rise of infomediaries has been a purely market driven phenomenon. Governments have done little to support it. Still, infomediaries seem to be structurally functional from a governance perspective. They solve all kinds of problems in the interaction between producers and customers, thus enhancing CSR transparency. This can be clarified with the concept of information *embeddedness*. Fung et al. (2006, 157) has analysed the conditions under which a transparency policy is efficient and effective. They maintain that the usefulness of information for users as well as disclosers is determined by its incorporation into ordinary decision making processes. The more information is thus embedded into the daily decision making of users and disclosers, the more successful a transparency policy will be. Fung et al. define a series of conditions that determine the embedment of information for users and disclosers. We briefly summarize them:

*User:*

- The information should be relevant for the user
- Compatible with user decision-making processes, this implies that the information should be provided in a useful format, in a timely manner and easy to find and to interpret and not too costly to collect.

*Discloser:*

- The information must have impact on the decisions of users and change their conduct in such a way that it affects core goals of the discloser
- The discloser should be able to perceive this impact on the user and collecting this information should not be too costly

Fung et al describe several places where transparency is used as a means to regulate the behaviour of actors. They conclude that at this moment the system of corporate financial disclosure is probably the most successful example of information streams that lead to self-regulation by market participants. Interestingly, this is exactly an institutional field where infomediaries play a crucial part.

In the field of financial disclosure information is produced by the company. This disclosure itself and the format in which it takes place, is to a high extent assured by governments. Still, highly sophisticated infomediaries (securities analysts, brokers, financial advisors etc.) are a crucial factor. They control, verify and disseminate information. They also translate quarterly or annual financial reports by disclosers into user friendly data for investors. Rating organisations like Moody's or Standard and Poors for instance transform financial information into a clear indicator that is widely used in evaluation policies. Independent accountants verify the correctness of the figures provided by the company, while international accounting organisations are constantly reviewing the appropriate accounting format in order to make sure that financial reports remain comparable over different states and jurisdictions. These professionals are themselves regulated through a mixture of self-regulatory bodies and stringent legal requirements. After the processing of this complex information, the financial information is popularised and disseminated among a broader audience of interested stakeholders through many different channels, all directed towards a certain type of public, some more demanding with respect to the content of the information while others are only interested in a final score. Interestingly, the companies themselves closely track the reactions of investors to their financial reporting. Intermediaries are again very helpful in passing on this information in a suitable format.

### *Evaluating self-regulating systems with infomediaries*

We believe that CSR transparency must be enhanced by means of a policy that puts self-regulating systems into action. We also hold that in the field of CSR transparency any such system must employ infomediaries. In the following we will substantiate our position by evaluating this proposal in terms of our three criteria (efficiency, freedom and virtue). Since the development of infomediaries is still in its infancy in relation to CSR transparency, we will also refer to the field of financial disclosure to make our argument.

A system of CSR transparency is efficient when it can produce information that fulfils certain procedural criteria at affordable costs. Let us first look at the latter aspect. Cost efficiency is crucial for a process of enhancing CSR transparency. One of the difficulties with the proposal by the consumer federation discussed above were the excessive costs it generated. Every consumer could ask any CSR information from a company. If intermediaries collect the information a company only needs to communicate with a limited number of organisations. Thus the cost-benefit ratio connected to disclosure is improved.

Enhancing the *procedural quality of the CSR information* is another challenge in relation to enhancing CSR transparency (see table 1). Again, infomediaries can make a difference. First, third party intermediaries can assure the objectivity of the information produced. *Completeness* is another procedural standard for CSR reporting that is not met today. In the end all companies are selective in their reporting, even those acknowledging that transparency pays off in terms of stakeholder relationships and reputation management. Intermediary organisations are expected to deliver all

publicly available information and in general have no interest in withholding part of that information. This will secure the completeness of the CSR information.

*Comprehensibility* and *comparability* are yet other procedural standard not met by companies. Current social reporting is designed to serve a non-professional audience. It contains smooth texts illustrated by attractive pictures, but with little controllable details. What is more, given the various marketing styles, there is a little standardization. This makes it difficult to compare between companies, let alone between sectors. As Hess and Dunfee (2007) note, today we find promising standards in the GRI guidelines, a typical pioneering infomediary. But application is voluntary. Thus not all firms are using this standard or comply with all aspects of it. Although companies are undoubtedly interested in knowing where they stand with respect to their direct counterparts, they will have little incentive to publish this information (especially not if it turns out that they are not on top of their sector). Once the information passes through the filter of infomediaries, standardization of the information is far easier to attain. Benchmarking and translation into comprehensible parameters is typically a task of intermediaries.<sup>xiv</sup> Improving comparability and comprehensibility will raise the benefits of CSR information for the users. The more significant groups of both users and disclosers benefit from releasing information under a mandated disclosure policy, the more improvement one can expect in the system and the more this information will be embedded in everyday decision making routines of users and disclosers (Fung et al, 2004).

Of course, infomediaries will undoubtedly provide *external verification*. But *reliability* and *adequacy of data* also stand to gain. Professionals understand better what type of information a company can provide and what type is difficult if not impossible to provide. Furthermore, the intermediaries will contribute to unbiased

presentation of information (impartiality). This will not only objectively benefit consumers. It turns out that most stakeholders prefer information about CSR to be handed over by news media or certified third parties (See: Hess and Dunfee, 2007).

Next to the efficiency criterion we also identified two moral criteria—freedom and autonomous development of moral virtues—in order to judge a transparency policy. As we see it, the autonomous development of the virtues will not be negatively affected by strengthening the role of infomediaries. After all, the procedural standards are closely connected to the development of moral virtues within the firm, such as truthfulness and integrity (see section 2.). If infomediaries strengthen these procedural standards (as we argued above), it seems reasonable to assume that they will enhance the development of informational virtues also. It is interesting to look back at the history of corporate financial reporting in this respect. In the 1920s corporate financial information was very diverse in scope and reliability (Van Overfelt 2007). Lies were as common as the truth. All this changed considerably as the quality and amount of information grew. The early infomediaries collected more and better information. Consequently, it became much harder for the individual firm to bluff its way through financial statements. The improvement of the procedural quality of the information set new standards and more and more companies felt the pressure to deliver truthful statements. Practice turned into a habit that was later endorsed by legal requirements. Of course, the importance of legal pressure must never be underestimated. At the same time, however, much of the standardisation and procedural enhancement of corporate financial information took place outside the legal framework and was only later on confirmed by it.

Finally we have to consider freedom. We indicated that the proposal of the consumer federation increases the informational load on the company in such a way that it seriously limited company freedom to act. It also could jeopardise the privacy of workers and other parties involved. Are these arguments also relevant if the role of infomediaries is strengthened? Again the analogy with financial information streams can be helpful. Accountants usually are restricted by a privacy agreement prescribing that they cannot just hand over data to any third party. Likewise in the CSR world professional intermediaries can be bound by privacy guidelines. These can enhance the provision of more and better information without infringing on the rights of other stakeholders.

## 8 The prospects of infomediaries in CSR transparency.

Corporate financial disclosure is a complex, differentiated, high level information system. CSR information streams are nowhere near this highly sophisticated, world encompassing information system. The contrast may seem insurmountable. In that context it is inspiring to take a closer look at the situation of corporate financial disclosure at the beginning of the previous century (See e.g. Barton and Waymire, 2004 and Van Overfelt et al. 2007). The financial infomediaries did not come all at once. In the early days they were marginal players, developing slowly. The system was in many respects defective. Initially, they developed mainly through market forces, indicating that the information was embedded. There was something in it for the user as well as the discloser. Still, their development was a crucial phase in the development of proper financial reporting.

It is encouraging to see that CSR reporting likewise developed purely driven by market forces, again indicating the embedment of the information. Market forces also gave rise to early forms of CSR infomediaries. Especially interesting are players like Vigeo or Innovest. These intermediaries have specialised in collecting CSR information and have developed their own measurement tools. These players can be compared to the Standards and Poors of the financial counterpart, even if they are still in their infancy. The development of voluntary guidelines for CSR research for Europe (see footnote 17) is an indication of maturing taking place. There is no doubt that the quality of methodology used to collect and check CSR information has clearly improved over the past ten years.

How can the development of CSR transparency be promoted? In relation to this it is important to note that the rise of the financial reporting system was not a fully autonomous process. A crucial boost to the development of financial reporting systems was given by the American government when it set up a basic reporting framework in 1933-4. After that, it took at least 40 years of fine-tuning before a more or less smooth system developed.<sup>xv</sup> That is to say: market forces alone could not do the job. Government regulation was needed to force companies to come up with a certain type of information in a certain format. This extended the scope and reliability of the information collected by infomediaries considerably and consolidated their position as a vital player in corporate financial reporting.

If we accept the conclusion that the development of infomediaries is also necessary in relation to CSR reporting, this suggests that a basic legal framework is also needed here. This should lay down certain CSR information requirements and quality standards. Interestingly, it seems that the first steps of this legal development are taken in practice with respect to CSR reporting. In the Netherlands large public

companies are now legally obliged to report on environmental and social issues.<sup>xvi</sup> They have to publish this kind of information in order to provide a good understanding of the development, results and position of the company with respect to CSR. This requirement is based on European law (guideline 2003/51/EG; <http://www.ez.nl/content.jsp?objectid=36790>).<sup>xvii</sup> We perceive this as an indication of changing political forces. Even if Hess (2007) is right to point out that these initiatives are often weak. In the Dutch situation companies retain a lot of freedom in applying the guideline. In 2005 only 15% presented indicators about sustainability performance in their annual reports (Bartels, 2006).<sup>xviii</sup> Still, the financial reporting system also did not develop overnight. It was not until the financial crisis of the 1930's that the momentum came about in American politics that created the legal frame for corporate financial reporting. It took decades for the system to develop and disseminate to all industrial countries.

## 9 Conclusion

The central question of this contribution is how a transparency policy ought to be organised in order to enhance the CSR behaviour of companies. The contribution is prompted by practical conflict over this issue. Currently, transparency policies of governments with respect to CSR are often based on self-governance of companies supported by governmental facilitation. NGOs complain that self-governance by companies is insufficient, if only because the information produced is far too limited to be valuable to consumer and interest groups. Accordingly, NGO's have come up with proposals for more stringent transparency policies. All these involve a governmental role that reaches beyond facilitation.

In this paper we evaluated these proposals, using a framework taken over from administrative science. We distinguished three categories of policies: command and control, facilitation (or self-governing actors) and self-regulating subsystems. We also worked out three key criteria to evaluate these three types of policies: efficiency, freedom and virtue. Much attention has been paid to the facilitation policy, since that is currently used by most governments. By analyzing the Dutch situation we concluded that self-governance of actors fails, at least on the efficiency criterion. We then turned to the possibilities of using the idea of self-regulating systems. From an administrative theory point of view this policy differs fundamentally from command and control or facilitation. The last two aim directly at the micro-behaviour of actors. The self-regulating system policy aims at organizing the balance of power in a subsystem, such that the government objective is attained at a minimal cost.

A first attempt to instantiate this type of policy in CSR reporting by the Dutch Consumer Federation is rejected. It fails on the criteria of freedom and virtue. The costs involved would also be too high. Accordingly, we developed another instantiation of the self-regulating sub-systems policy. In this proposal infomediaries take centre stage. Infomediaries take care of many of the problems related to direct interaction between disclosers and users of information.

In the last part of the paper we developed an analogy between the early days of corporate financial reporting and CSR reporting today. It is promising to see that in both cases market forces pushed the various actors in the direction of more transparency. A crucial development in financial reporting was the rise of infomediaries. This development now seems under way in CSR reporting. Pushing the analogy between CSR reporting and financial reporting, however, means that governmental regulation is needed to consolidate the position of the infomediaries.

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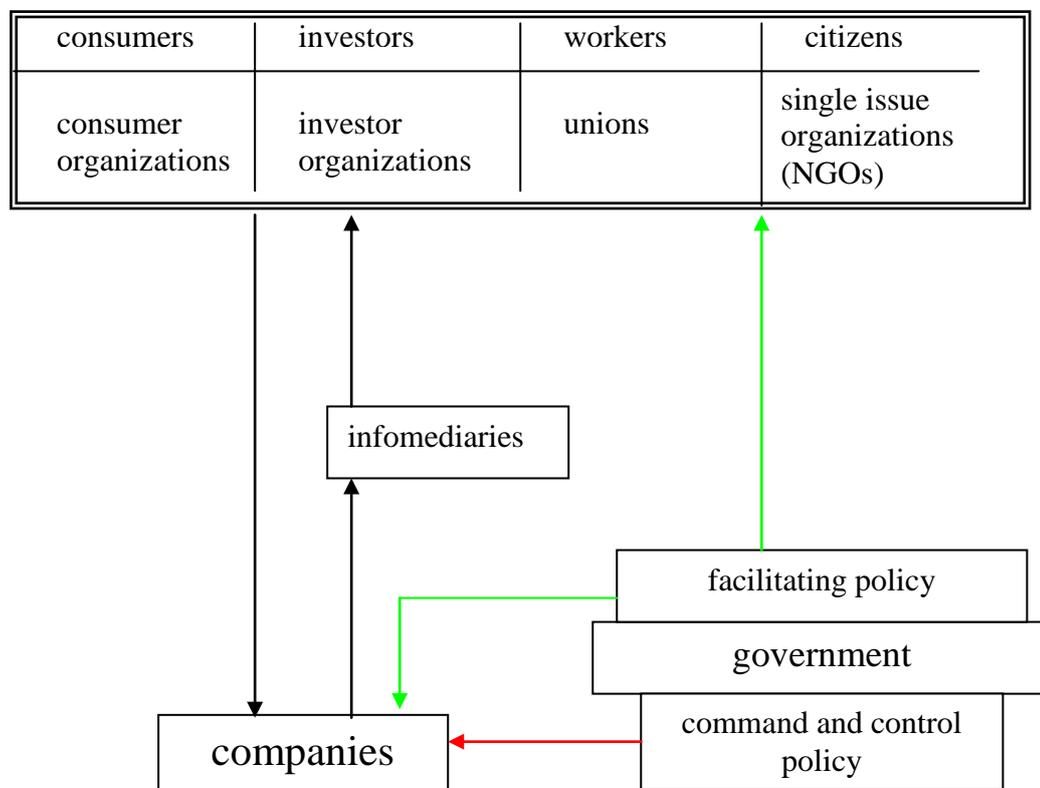
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**Figure 1: Transparency policy of government: an institutional framework**



<sup>i</sup> This approach is, among others defended by NGOs. In an official response to the final report of the 2004 EU Multi-Stakeholder Forum, some of the leading and most influential NGOs state that ‘Ensuring corporations are legally accountable to their stakeholders is essential. Only binding legal measures will establish a general incentive for responsible corporate behaviour that matches their general incentive to be profitable (<http://www.foeeurope.org>).

<sup>ii</sup> Hess and Dunfee (2007) refer to a British telecommunications company reporting that it has one employee spending two or three days a week responding to demands of various parties – investors, community groups and consultancies – to fill in questionnaires about social responsibility practices.

<sup>iii</sup> Cited in Ministry of Economic Affairs (2007), page 51

<sup>iv</sup> Berthelot et al (2003) distinguish an additional reporting mechanism, namely external sources of disclosure, such as newspapers or other media or research by third parties. In our framework, this category belongs to the self-regulation strategy, since this strategy includes the possibility that third parties provide CSR information about companies.

<sup>v</sup> Merely threatening to regulate might also be effective, because companies often fear the high administration costs caused by legal requirements and try to prevent this by pro-actively meeting the stakeholders’ needs to transparency in CSR.

<sup>vi</sup> Another example is the employability index developed by the council of Social Affairs and Employment in the Netherlands, which informs employees about the possibilities to develop their own employability in various sectors of industry (De Grip et al, 1999).

<sup>vii</sup> Examples are: [www.mvo.ez.nl](http://www.mvo.ez.nl); <http://appz.ez.nl/transparantiebenchmark>; [www.internationaalondernemen.nl](http://www.internationaalondernemen.nl); [www.ncp.nl](http://www.ncp.nl); [www.duurzaamheidsscan.nl](http://www.duurzaamheidsscan.nl); [www.senternovem.nl/duurzaamondernemen](http://www.senternovem.nl/duurzaamondernemen); [www.senternovem.nl/duurzaaminkopen](http://www.senternovem.nl/duurzaaminkopen);

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www.duurzaamheid.kennisnet.nl.

<sup>viii</sup> NGOs even doubt the level of CSR of companies that belong to the top 5% of most transparent companies. For example, ABN Amro was judged the most transparent company in the Netherlands according to the transparency benchmark subsidized by the Dutch government. However, the NGO Milieudefensie awarded ABN Amro with the 2005 'Deceptive Image prize' because of its financial involvement with the construction of oil pipe lines without any consideration of the high environmental risks (Milieudefensie, 2005). This illustrates that transparency is merely a necessary condition and not a sufficient condition for a high level of CSR. The benchmark is solely based on some formal criteria with respect to the format of the social report of the companies.

<sup>ix</sup> MVOplatform (2006). Among the NGO's participating in this platform are Amnesty International, Consumentenbond, FairFood, Fair Trade Original, Fair Wair Foundation, FNV, Mondiaal, Greenpeace NL, Milieudefensie, Oxfam Novib, Pax Christi, SOMO, Stichting Max Havelaar, Stichting Natuur en Milieu and VBDO.

<sup>x</sup> Some companies already meet this condition. For example, Eosta, a Dutch fruit retail company, provides every piece of fruit with a sticker with a code. Through the internet, the consumer can trace the origin of the product as well the score in terms of product quality, environment and social responsibility (People Planet Profit, 2006, Vol. 5 (Sept.), pp. 5).

<sup>xi</sup> A nice illustration of this problem is the financial instruction leaflet for banking products that the Dutch Authority Financial Markets made obligatory for the provision of complex financial products such as mortgages, single premium assurance policies, and investment funds. The instruction leaflet was intended to improve the transparency and the comparability of these products, and to protect the financial consumer. However, only seven percent of the consumers happened to read the leaflet. It was estimated to be both too vague and too complex (NRC, 2-7-2004).

<sup>xii</sup> It is clear that the combination of control and advice by the same party is inherently problematic, as was made sufficiently clear by the unfortunate Arthur Anderson case, but one should realise that the market for CSR auditing is at present so small that forbidding the combination of both targets would probably end the life of CSR consultancy in the first place. If the role of infomediaries increases, standards for social auditor independence should be developed.

<sup>xiii</sup> See CSRR-QS European voluntary guidelines for SRI research. More information on <http://www.csrr-qs.org/>

<sup>xiv</sup> Sector studies by SRI screening institutions provide at this moment the first examples of benchmarking in CSR. This information in general does not reach the public, but it does reach the companies themselves and is taken on with great interest.

<sup>xv</sup> And as the series of corporate scandals at the beginning of this century indicates, the system is even now far from flawless.

<sup>xvi</sup> Several European countries are also experimenting with legal requirements for CSR reporting including Denmark, Sweden, Norway, the UK and France (KPMG, 2005; Hess and Dunfee, 2007). Hess (2007) concludes that the laws in the UK and France are not more than weak compromises that do not appear to be much stronger than voluntary reporting initiatives.

<sup>xvii</sup> Guideline 400 of the Council for the Annual Report (2003) provides recommendations for information about CSR in the financial report. Still, these guidelines are not obligatory. Small and medium companies do not have an obligation to present non-financial information in their annual report (VNO-NCW, 2006).

<sup>xviii</sup> KPMG (2006) notes that in France firms also do not fully comply with the legal requirement to report on environmental and social impacts. Hess (2007) suggests that this is due to limited penalties for non-compliance and a lack of specific standard and guidelines.