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The Challenge of TBL: A Responsibility to Whom?

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BACKGROUND

The triple bottom line (TBL) theory claims to be a reporting mechanism designed to encourage businesses to give closer attention to the *whole* impact of their commercial activities, rather than just their financial performance. It is probably the best known among a number of nonfinancial reporting formats to have been given serious attention over recent years. It is defined by the McGraw-Hill book publishing organization as "a calculation of corporate economic, environmental, and social performance." The TBL implies that business should give parity of treatment to these three dimensions of business impact, *without* giving unique weight to their financial results. It focuses on more than just the economic value of business activities, by adding two more balance sheets covering the social impacts and environmental impacts of the business. This framework is intended to capture the whole set of values, issues, and processes that companies *should* address in order to minimize any harm that results from their activities and to ensure creation of positive economic, social, and environmental value (Elkington, 1997). TBL reporting aims to extend decision making and disclosure so that business decisions explicitly take into consideration the impacts on society and the environment, as well as on profit.

Enthusiasts would claim that TBL reporting requires the company to take into consideration the needs of *all* its "stakeholders."

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These, obviously enough, begin with shareholders and include employees, customers, and suppliers, with all of whom the company is in a contractual relationship. Less obviously, there is another, secondary group of "stakeholders," which includes governments, local communities, and the general public. This broader concept of "stakeholder" embraces all who might, in some way, be affected by a company's actions and, thereby, have a "stake" in the outcomes. TBL thinking embraces two basic assumptions that are not always explicit. The first is that the company fully abides by the law and meets all the obligations imposed upon it by legislation. The second is that companies that are socially and environmentally responsible accept a higher level of obligation and moral responsibility than that demanded by mere compliance with the law.

This framework does have some major weaknesses. One is that it offers business no means of prioritizing among the requirements of different stakeholder groups. Another is that it does not help the company manager to trade off the wishes of one group against those of another when the needs of different stakeholder groups are in conflict. Most centrally, it provides no standard of account, that is, of measurement; either within one single dimension of account, or across all three bottom lines. It provides no means of summing a series of different outcomes within either of the two noneconomic "lines." Nor does it provide a unit of account for summing across all three bottom lines. So realistically, this central weakness casts doubt on whether the TBL really is a "bottom line" at all.

It is not sufficient to argue that all line items could be furnished with an imputed dollar value and the problem thereby resolved. Any imputed dollar value would, ultimately, rest on individual judgment and consequently, be open to legitimate challenge. It follows that the absence of a credible unit of account is a colossal limitation on the value of TBL reporting. Indeed, two academics, after subjecting the concept to rigorous scrutiny, effectively demolished its intellectual credibility (Norman and MacDonald, 2004). Nonetheless, we are still left with the reality of the concept's appeal and growing contemporary influence. For whatever reasons, the world's larger corporations are fast finding a place for the TBL. Academic researchers in Australia (Rice, 2004) make two informed observations. One is that size and political visibility is a strong

motivating factor for companies to produce TBL reports. The other is that public scrutiny is by far the biggest driver and that TBL reporting is used as a device for reputation management. With so many more retail investors today than in the past and with the heightened media interest in corporate affairs, this should cause little surprise.

ORIGIN AND POPULARIZATION

The origin of the TBL concept is somewhat cloudy but certainly recent. It first appeared in the 1990s. In the business community at least, it seems to have been unknown until popularized by John Elkington of the SustainAbility consultancy, with publication of his book about it in 1997. Since that time, awareness of TBL and corporate efforts to make use of it have grown rapidly. Whether TBL is a concept that is simply in tune with contemporary thinking and right for its time, or just another management fad, is not yet certain. Either way, it is undoubtedly having a very considerable influence on contemporary international business.

"Sustainable development," or simply "sustainability" is commonly given as one of the goals of TBL reporting. Unfortunately there are said to be well over 100 definitions of sustainability in current use. Anyhow, the term is frequently encountered in the TBL context. There is also John Elkington's well-known business consultancy, with strong corporate social responsibility leanings, called SustainAbility.

The idea of sustainable development, which is inherently desirable and appealing, raises the issue of whether business should be required to report on more than just its financial performance. This question, in turn, challenges the capacity of conventional accounting to provide desirable information about the nonfinancial consequences of business activities. Unlike financial reporting, the TBL is intended to provide such information.

Widespread usage of the term sustainability dates from publication of *Our Common Future* (Brundtland, 1987), the Brundtland Commission report of the World Commission on Environment and Development. This defined sustainability as "Development which meets the needs of the present without compromising the ability of future generations to meet their own needs" (Elkington, 2004).

Those companies that acknowledge this objective and that aim to operate "sustainably" and with "social responsibility" usually adopt TBL reporting. Indeed, the TBL framework is promoted to encourage business to migrate from a one-dimensional, "Friedmanite" fixation on profit, to a more holistic and socially acceptable posture in which social responsibility standards are higher and in which sustainability is successfully achieved (Elkington, 1997). In its 2002 Reporting Guidelines, the Global Reporting Initiative (GRI, 2002) emphasized the need to develop techniques that enhance the ability of business to report more consistently and more comprehensively on the economic, environmental, and social dimensions of their activities, products, and services. The GRI's objective is to enhance the quality, rigor, and utility of sustainability reporting. To date, the TBL is the format most commonly chosen by business for this purpose.

ADOPTION AND DIFFUSION

The speed with which TBL has been adopted by the business community is quite remarkable; all the more so given the fuzzy nature of the concept. Its geographical spread is equally impressive. Business support, however, does rest on at least one de facto proviso. This is that TBL should *not* be interpreted as to mean that companies are expected to *maximize* returns across the three dimensions of performance but, rather, that financial performance is recognized as the primary consideration in assessing business success (G100, 2003). Obviously enough, this makes a lot of practical sense, but is seldom explicit.

The number and variety of organizations adopting and supporting TBL reporting, or something very close to it, have been growing steadily over the past few years. That this is so must tell us something. Either companies want to report this information for their own sake in order to influence potential investors or potential buyers, or they feel under social or governmental pressure to do so. Either way, the growing numbers send a message.

According to PricewaterhouseCoopers' (PwC) "Management Barometer" survey of 14 different advanced economies, 68 percent of large corporations in Western Europe and 41 percent in the

United States were reporting on TBL in the second quarter of 2002 (PricewaterhouseCoopers, 2002). At that time, PwC commented:

> With the current breakdown of confidence in financial reporting, large companies are facing increasing demands and expectations from stakeholders and are being held more accountable for their performance and actions. The TBL approach is a proactive step in providing shareholders with increased transparency and a broader framework for decision making . . . it's a great way for companies to disclose meaningful nonfinancial results.

This comment is illuminating in two ways. First, it explicitly acknowledges that increasing public pressure is one of the factors driving the adoption of TBL. Second, it emphasizes straightforward disclosure rather than accounting or audit. In both, the assessment is realistic. In addition, it alerts us to the fact that the business service industry, with the Big Four international auditors in the lead, are finding sustainability, or "corporate social responsibility," including TBL, a valuable new revenue stream.

KPMG conducts an international survey of what they call "corporate sustainability reporting" every three years. Although sustainability reports are not quite the same as TBL, they always include an environmental component, which is one of the triple bottom lines. For the KPMG survey of 2002, the most recent available, we learn that environmental, social, or sustainability reports from 2000 companies were assessed; these included the top half of the *Fortune 500* group and the top 100 companies in 19 countries. According to KPMG, the results of the survey demonstrate that this kind of reporting "is becoming mainstream business [and] no longer restricted to sectors with a high environmental impact in Western countries, but also in nonindustrial sectors and other regions" (KPMG, 2002). The report documents a 29 percent increase in the number of companies from the *Fortune 500* sample publishing reports in 2002, compared with 1999. It goes on to state that the survey of top companies across 19 countries showed that Japanese companies reported most (72 percent) followed by the UK (49 percent) and that within the United States and Western Europe as a whole, 30–40 percent of companies report. These numbers represent a huge corporate commitment to TBL.

In addition, there is no doubt that the spate of corporate scandal experienced around the world from 2001 has raised interest in TBL reporting. The likes of Enron in the United States, the Health International Holdings (HIH) in Australia, and Parmalat in Europe have greatly raised the level of interest in every aspect of corporate behavior and governance, not the least corporate reporting. Nowhere is this more obvious than in South Africa, where the second report on governance standards by Justice Mervyn King, in 2002, has given a direct boost to TBL. The King report explicitly stated that corporate citizenship was becoming an established fact in business life and that there was a need for companies to report on their continuing sustainability in terms of environmental responsibilities, including their interpretation of, and response to, social responsibilities. On a note of realism, however, it recognized that if reporting on TBL issues becomes a standard requirement in practice, firms will face a problem when "they find that the standards for compliance are not defined" (Temkin, 2004).

DEVELOPMENT AND METRICS

As awareness and interest in the TBL has spread, an increasing effort has gone into the development of reporting standards and codes across the three lines of account. As already noted, these remain rudimentary and limited as yet but it is notable that the attempt is being made at all. Best known is probably the work of the Global Reporting Initiative (GRI), which aims at ensuring a common approach to indicators, measurement, accounting, auditing, reporting, and verification. There is also significant interest in the development of appropriate metrics among business service providers, including Standard & Poor's which, in collaboration with the United Nations, publishes an annual survey of corporate sustainability reporting. Another group working seriously at the task is the Business in the Community Organisation (www.bitc.org.uk). This group has gilt-edged corporate participation and support from companies like Halifax and Bank of Scotland, Nestle, and Marks & Spencer. Moreover, the European Union is supporting the development of environmental management systems such as the ISO 14,000 series and the EU Eco-Management and Audit Scheme (EMAS).

RESPONSIBILITY TO SHAREHOLDERS

At this point, it is desirable to make a fundamental observation about the legal foundation of modern business and its responsibilities. A company is owned and paid for by its shareholders; it is conventionally regarded as a “legal person.” It comes into being under the laws of the land in which it is incorporated and must always operate within those laws. Subject to compliance with the law, it is responsible to its shareholders. The wishes of shareholders, in a formal sense at least, are imposed on executive managers through the decisions of the board. The operating assumption of economic theory is that the purpose of the enterprise and the common wish of shareholders are to maximize profit. This does not necessarily mean that the enterprise will always take the best decisions and succeed in maximizing profit. Nor does it exclude deliberate decisions by the board to devote resources to nonprofit maximizing activities such as charitable donations or other “good works” of whatever kind. Profit maximization does, however, offer the only credible, *generalized* description of the business objective. It also guarantees the primacy of the shareholder interest, the interest of the owners of the business, over any other—at least in theory.

The introduction of the TBL into this framework, again in theory, is to introduce risk and potential confusion. TBL substitutes three bottom lines for a single account of financial performance. The single objective of profit is replaced by three different objectives. Worse, there exists no universally appropriate unit of account by which to trade off across the three different objectives. Theoretically, this has the potential to cause business to lose focus and pursue plural and possibly inconsistent objectives. In this event, the outcome is likely to be inefficiency.

As is often said, he who serves two masters is responsible to neither. In other words, conceptually, TBL removes the primacy of shareholders and, thereby, the primacy of profit.

RESPONSIBILITY TO STAKEHOLDERS

TBL replaces responsibility to shareholders with responsibility to stakeholders, whoever they may be. Conceptually, it brings to an

end the unique place of the shareholder as the driver of business policy. Instead, TBL gives us the pantheon of so-called stakeholders, all of whose interests businesses must now somehow strive to meet. Some stakeholders are in a contractual relationship with the firm and some are not. Consequently, some stakeholders have reciprocal obligations and responsibilities to the firm, while others do not. In the context of TBL, the firm has an "obligation" to respect and, possibly, further *all* these interests. Where the stakeholder has *no* contractual relationship with the firm, this inevitably extends beyond legal responsibility. There is also a sense in which this is generally the case, given that the law can never adequately anticipate emerging community standards. Conceptually, there may well be a solid case to be made in favor of extending business responsibility to embrace "stakeholder" interests, save only that it can be operationalized. Despite the fact that the firm is already obliged to meet whatever environmental, planning, and other legal and regulatory requirements are in place, TBL in effect asks that business go beyond this. Moreover, most larger corporations possess sufficient resources to able to do so. So it can be done, though, it is sensible to emphasize the likely resource implications of any such decision because there are major implications. One is that TBL offers business no guide to action when hard choices are faced, or, guide to priorities when objectives are in conflict. Another problem is that TBL, alone, without the addition of independent assessment and audit, may not necessarily give a "true and fair" statement of activities in a way that is truly informative. This brings us back to the basic weakness of TBL. Although independent "assessment" of TBL reports is possible and mechanisms are under development to facilitate this, without a common unit of account, human "judgment" is inescapable. While *independent* judgment *can* be assured, it will remain subjective judgment with which there will always be room for legitimate disagreement. For example, suppose a company reduces the quantity of four out of five pollutants resulting from its process. That looks good. However, if the fifth pollutant is arsenic and the quantity of waste arsenic increases, whereas the four pollutants that are reduced are all much less harmful to the environment than arsenic, how should we judge progress? Who is to make that judgment? Provided the company fully meets its legal requirements, who is to judge whether this change, on balance, is for better or worse? The government may

come to one judgment and the local community to another. Whose judgment should prevail? TBL does not provide answers.

HUMAN RIGHTS AND ENVIRONMENT

Although TBL adherents would claim, quite correctly, that TBL's social dimension embraces human rights issues, it is relevant here to mention also the Global Compact of the United Nations. This is a parallel corporate social responsibility mechanism that makes explicit reference to human rights concerns. The Compact is designed to ensure that company activities conform to basic human rights, labor, and environmental standards, thereby overlapping considerably with TBL. Leaving aside problems with monitoring and measuring Compact standards, it is relevant to examine this initiative, as its voluntary corporate membership has grown rapidly from 50 charter members in 2000 to more than 1,700 today. Private nongovernmental organizations and labor groups have also joined. The business membership is also interesting in that it includes companies like Gap Inc. and Newmont Mining, which have been the subject of strong public criticism, plus several companies from countries like China, which have poor human rights records. There are also 20 financial institutions, including Goldman Sachs & Co., which has fallen foul of recently upgraded U.S. corporate governance standards. However, many of the more respected human rights and environmental activist groups like Amnesty International and Friends of the Earth are disillusioned and critical of the Compact. They claim, probably correctly, that the UN has been more concerned about increasing membership than ensuring that member companies honor their Compact commitments. It is certainly the case that four years after its establishment, the Compact lacks clear reporting and compliance standards (Engardio, 2004). So, one may fairly question its value. This is directly relevant to the TBL reporting. In particular, it raises the question of whether TBL is of any real help to firms, and to others, in monitoring corporate social and environmental performance. Does it *really* offer the community an opportunity to monitor business performance more effectively than in the past, or, is it simply being used by business as a public relations tool? Without effective assessment or auditing of TBL reports, the question cannot be answered.

CURRENT STATUS OF TBL

Despite its imprecise meaning and flawed pretensions as an accounting mechanism, the TBL does seem to reach into society's deep concerns. This is suggested by the both speed of its spread and the geographical spread of its adoption. While it may yet prove just a fad, for the moment it is proving a resilient and increasingly influential force. Not only does it influence the thinking and aspirations of individuals and private groups, but it is praised by governments and adopted by large numbers of our biggest corporations. Most importantly, it is the subject of widespread and serious discussion by corporate boards. It could fairly be said that the TBL shows every sign of having acquired a life and momentum of its own. It has become a familiar part of our contemporary corporate scene; at least, at the big end of town.

The only obvious explanation for this burgeoning support for TBL is that it indeed is a reflection of something deep in contemporary society. Little else can explain why the TBL has not been held back by its intellectual weakness. In this view, conceptual fuzziness is less significant than the wide degree of practical support it attracts, especially in the business community. This widespread support seems to rest on a widely shared belief among the general public that business *should* act with much greater social and environmental responsibility than it is seen to do, with some demanding that business somehow be made to do so. Considered in this nontechnical way, the strength of the TBL movement begins to make sense.

In our increasingly densely populated and integrated world, with an ever growing number of corporate giants spreading their activities across the globe, we can understand how heightened concern with corporate responsibility may well be growing in parallel with corporate globalization. Perhaps we should not be surprised. There is anecdotal evidence in support of the judgment that public opinion is evolving in a direction that is going to increase the demands on business to adopt much broader social perspectives. For example, Leon Davis, who is chairman of Westpac and deputy chairman of Rio Tinto, has recently commented to this effect publicly. At a national conference on the future of employment, in Sydney in 2004, he said

> There is no question that our society has become less paternalistic and more individualistic. Individual good seems to be taking precedence over the common good. With this . . . frustration is growing and people are saying to companies: look at it through our eyes; add empathy to your corporate strategies. (Buffini, 2004)

Few would disagree with the first part of this statement and there is further anecdotal evidence in support of the latter part of the statement. For example, a group of Europe's biggest investors, controlling US$900 billion in assets, have written to 20 of the world's top pharmaceutical companies outlining the steps they believe need to be taken to reduce the risks to the industry's reputation from crises (Scheiwiller, n.d.).

REAL INFLUENCE AND MEANING?

In determining the reality of nonfinancial reporting in contemporary business, TBL or other, it is sensible to start by assessing the validity of the information that companies choose to include in their TBL statements. Conveniently, PwC collected historical data to examine the nature, extent, and quality of TBL performance reporting by 40 of Australia's largest listed companies in 2002. There is no reason to suppose these findings are not internationally representative. PwC utilized the data to analyze how each company used its concise annual report, produced as part of the GRI program, to communicate TBL information. The *quantity* of reporting suggested that TBL was indeed very important to certain companies. Furthermore, large companies were six times more inclined to report against the *social* bottom line than the environment or economic bottom lines. More interestingly, the *quality* of TBL reporting was examined in terms of both its *neutrality* or absence of bias, and its *alignment* with society's most important expectations of corporate behavior. On this test, as might be expected, PwC found most reported information to be favorable to the company and are self-serving. Only 34 percent of reporting was judged neutral, with some companies reporting up to 96 percent in a manner obviously favorable to themselves. At the same time, an average of only 15 percent of the information was related to what PwC regarded as society's most important expectations (Newson,

2002). Overall, it might be said that the larger part of the information reported was biased and a very large part of it irrelevant to the matters of greatest community concern. This is a poor score sheet for TBL reporting.

Another indicative source of information is the Business in the Environment organization. They conducted a survey of attitudes toward TBL reporting in the city of London in early 2001. This showed that although a growing proportion of financial analysts and institutional investors believed environmental and social issues to be "important," the survey found this had *not* impacted on the criteria used in the financial sector to judge companies. In fact, the principal of URS Corporation, Andy Hughes, is quoted as saying he did not believe the TBL agenda had then had any substantial effect on the small amount of environmental comment made by analysts. "No one seems to be communicating in such a way as to capture the attention of the financial sector," he said (2002). Once again, a poor score card for TBL.

It is also worth remembering that at the time of that survey, Enron numbered among the companies issuing a TBL report and in 2000 the company had received no less than six environmental awards. It also had, on the public record, praiseworthy policies on climate change, human rights, and even anticorruption. Its CEO gave speeches at ethics conferences and put together a statement of values emphasizing "communication, respect, and integrity." Moreover, Enron shares were held by many "ethical funds" at the time of its collapse (Anonymous, 2004). It follows that neither TBL nor other public demonstrations of corporate social responsibility can be taken too seriously unless and until they are subject to thorough and independent audit. Indeed, auditing of a higher standard than that applied to Enron's financial accounts would be required.

Despite its lack of theoretical rigor and effective audit assurance, as the earlier part of this paper has shown, there is much to suggest that TBL *is* nonetheless with us, perhaps to stay. Its effect is to bring into the public domain certain corporate information that, for the most part, might otherwise remain private. The apparent success of TBL so far strongly indicates that this enhanced flow of corporate information is in public demand. Common sense suggests that this is a response, at least in part, to the fact that business now faces informed and active pressure from a range of new stakeholder groups who have not been very visible in the past.

These include organized community groups of the general public, NGOs, the media, and branches of government. TBL reporting takes them into account and goes at least some way toward satisfying a real need on the part of this wider public. It follows that to whatever extent this is so, TBL is serving a useful purpose, but *not* quite the same purpose as that for which it was first proposed.

In other words, the real value of TBL is being found to lie outside the concept itself. The public demand is for more information, broader information, and for greater corporate transparency across the board; all of which could be achieved by other means. So the conclusion of this observer is that TBL is *not* what it purports to be but that it is nonetheless valuable. It is valuable because it boosts corporate disclosure of a kind, which traditionally, has not been made. Today, with bigger and more powerful companies impacting ever more widely, the rise of nonfinancial reporting and closer corporate attention to that information is increasingly demanded and even more widely thought desirable. It follows that so long as the cost of providing it is not excessive, TBL reporting performs a positive social function and is all to the good. In the post-Enron world, higher levels of disclosure and transparency are generally judged desirable in themselves. Less obviously, this is also in the self-interest of business. For the global corporation, other things being equal, greater disclosure and transparency serves to reduce the suspicions of the cynical, and diminish popular distrust in general.

In the end then, TBL may really mean little more than more disclosure; but that in itself is good. However, disclosure *alone* does not create a transparent company. Monitoring of that disclosure, indeed auditing where possible, is also desirable. This makes TBL reporting a corporate choice, not a corporate responsibility. The true responsibility of business, as ever, is to behave ethically. The TBL movement is a reflection of heightened concern in society that it should do so.

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