

Letters From the Square

Transparency + Monitoring = Increased Competitive Advantage

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Over the past few years, the global movement for information disclosure and transparency has increasingly penetrated China, affecting many aspects of Chinese society and economic life. The most obvious and well-known example is the Chinese government's recent installation of PM2.5 air quality monitors in major Chinese cities, allowing netizens across the globe to track Chinese pollution levels – a major step forward for environmental governance in China. As former US Supreme Court Justice Louis Brandies famously noted, “sunshine is the best disinfectant.” But while information availability is important, also necessary is the ability to act on information and use it to enforce higher standards. In the PM2.5 example, it is not the information per se that is important, but new and effective means, such as Weibo, that allows the information to be spread and the polluters brought under public scrutiny.

A lesser known, but perhaps even farther-reaching and profound example of increasing information and transparency standards, is the movement among Chinese companies to issue sustainability and social responsibility reports documenting their environmental and social impacts. In recent years, there has been a global trend of stakeholders, including investors, consumers, employees and governments, increasingly advocating that companies be evaluated not only on their financial performance, but also on their social and environmental results, (also known as the “triple bottom line”). With this movement, major international organizations, such as the UN Global Compact (UNGC) and Global Reporting Initiative (GRI) have developed internationally accepted frameworks for companies to follow when measuring and reporting on their environmental and social performance. Yet, significant questions remain on whether this reporting is truly an indication of increased transparency or just an elaborate form of “window-dressing,” or “greenwashing,” whereby companies issue reports to appear transparent (and therefore socially responsible), yet in reality do not communicate any substantive information.

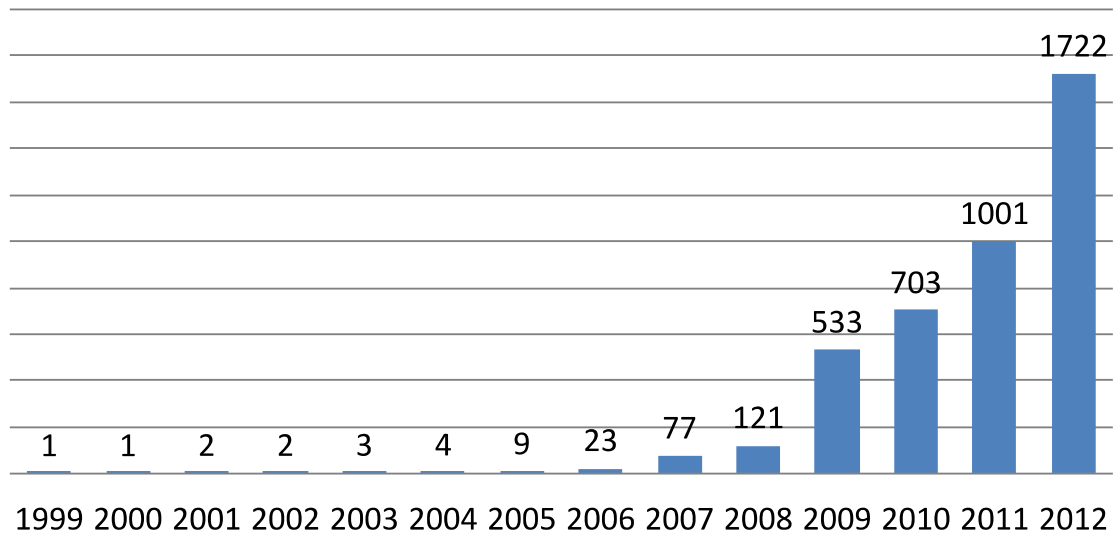
Recent studies of environmental issues in China and Chinese firms' sustainability activities highlight the importance of not only increasing transparency standards, but also of creating new monitoring processes to ensure that what is being reported is both relevant and actionable. In other words, mechanisms that ensure that greater information disclosure actually reflects more transparency, and then leads to better behavior. Information disclosure is but one step in the process of

converting corporations into global citizens. Following global transparency standards can and should make Chinese companies more competitive in global markets, but to truly be effective, there also needs to be more attention to fostering ways by which civil society can monitor companies and hold them accountable to higher standards of sustainability.

Growth in Corporate Transparency: Sustainability Reporting of Chinese Companies

Recent research coauthored by Marquis investigates the extent to which sustainability reporting has spread to China, and further, whether increased reporting actually means increased transparency.¹ Since 2006, the Chinese Central Government has been actively encouraging Chinese firms to issue sustainability reports, and by 2012, over 1700 Chinese companies had done so, a dramatic increase from just 23 in 2006². But aside from these raw numbers, the substantive content of these reports is rarely examined.

Growth in Sustainability Reporting Among Chinese Companies



In the study, the authors first created a detailed database on Chinese companies' sustainability reporting history and used numerous ways, including measuring different characteristics of the reports and third party evaluations, to try to uncover

¹ Marquis, Christopher and Cuili Qian. 2013 (forthcoming) "Corporate Social Responsibility Reporting in China: Symbol or Substance?" *Organization Science*.

² Syntao Thinktank, "商道智汇第一期-封面链接版." 2013; page 26. Available at: <http://www.syntao.com/Uploads/file/商道智汇第一期-封面链接版.pdf>. Accessed July 13, 2013.

the extent to which the reports contained substantive data on firms social and environmental responsibility, or were mainly empty marketing statements. The findings revealed that Chinese companies were more likely to initiate sustainability reporting to the extent they were dependent on the government, for example as a result of ownership or their financial independence. As issuing these reports has been a priority of the government, this set of findings is not terribly surprising.

The more interesting findings concern which companies issued *meaningful* reports that have detailed, measurable and replicable data, in some cases even audited by international firms. Here, findings revealed that firms issue these higher quality reports only when their reports are more likely to be monitored, either because the leaders are more closely connected to government via interpersonal networks, or are located in regions where there are more developed enforcement bureaucracies. Thus, the conclusion from this study is that if the company is not subject to monitoring, they are more likely to issue empty reports with fewer actionable details. The deeper implications are clear: the spread of sustainability reporting is not enough to truly foster transparency; unless the firm is subject to monitoring, the results are mainly symbolic.

Benefits of Increased Transparency and Monitoring

More detailed and measurable reporting indicate that a company is socially and environmentally responsible, but are there further implications or benefits for China's economic competitiveness? The research also shows that increasing transparency can improve the global competitiveness of Chinese companies and China itself, both through increasing the confidence of international governments and providing enhanced investment opportunities

Regarding transparency affecting companies international government relations, Marquis and coauthors also wrote a detailed HBS case study on Chinese shipping giant COSCO³ focusing on how the organization was a pioneer among Chinese companies in following international transparency and reporting standards. The case study outlined how such a strategy can aid Chinese companies' globalization strategies. As the Chinese government has continued to push Chinese companies to be more global, it has been met with significant resistance from countries such as the United States and Australia, in large part because of the lack of transparency. For instance, the US government places an unusual level of scrutiny on many Chinese companies entering US markets, for example, the distribution of Huawei's telecommunications equipment and meat processor Shineway's acquisition of Smithfield Foods. Over the past two decades, COSCO's commitment to transparency has served its business and global reputation well. The company has built a proprietary sustainability management process and system that it now sells as a

³ Chris Marquis, Lynn Yin, and Dongning Yang. "COSCO: Implementing Sustainability." (Harvard Business School Case 412081)

product to other Chinese firms, and international organizations, (such as the UNGC and GRI), have publicly recognized COSCO's pioneering work in sustainability reporting. At a time when many Chinese firms have struggled to enter the US market, COSCO has built up significant relationships and presence in many US ports. It has won environmental awards from the Long Beach Port Authority a number of times, which resulted in significant reduction in port entrance fees. The company has also been lauded by trade unions and the city government in Boston for its responsible business practices there.

The Chinese investment community is also starting to recognize, like other global investors, that increased transparency aids firms in managing long term risks and is an indicator of management quality. For example, Beijing based Tsing Capital has positioned itself as one of the world's premier cleantech venture capital firms, in part because its social and environmental compliance program is seen as an asset to potential portfolio firms.⁴ Potential investee companies with many investor options choose Tsing Capital because of its track record in using sustainability management systems and processes to foster long term company growth. The Shenzhen Stock Exchange has also implemented information disclosure and reporting guidelines and training for listed companies with the explicit goal of increasing the management quality of newly listed firms. These examples, coupled with the Chinese government's attention to the matter show that within China the benefits of corporate transparency are being noticed and the practice is beginning to take hold.

A Call for Increased Monitoring Mechanisms in China

As transparency practices have been increasing, there have also been many examples of the increasing importance of grassroots monitoring. From human flesh searches on Weibo that shine light on government officials' often murky sources of income; to examples like the food safety database Throw It Out the Window, built by Fudan University student Wu Heng, there are many examples how ordinary citizens have harnessed diffuse information on the internet to enable more effective monitoring of powerful groups in China. And such efforts are pushing the government toward greater willingness to communicate with the public. A survey by the Chinese Academy of Governance found that by year-end 2012, government bodies and individual officials had opened a combined 176,700 Weibo accounts, a 249% increase from the previous year.⁵ Often an outlet of last resort, internet-driven monitoring efforts can be crude, but there is no doubt that the web's panoptic gaze is making bad behavior increasingly harder to hide.

While there has been a rise in grassroots activism through on-line channels, in many cases it is not enough. For example, in May, citizens in Kunming took to the streets

⁴ Chris Marquis and Nancy Dai. "China Environment Fund: Doing Well by Doing Good" (Harvard Business School Case 410142)

⁵ Li Yongchun. 2013. "Number of Gov't Weibo Accounts Soars." Caixin Online, <http://english.caixin.com/2013-03-28/100507640.html>. Accessed July 13, 2013.

in protest of a new CNPC oil refinery and paraxylene (PX) project. As much as the potential pollution itself, citizens were protesting the lack of transparency in the project's approval process. As a result of the outcry, Mayor Li Wenrong released the environmental assessment report (EIA),⁶ yet as it turns out the EIA omitted the PX component of the project and evidence of public participation, which is required for such projects.⁷ The case echoes Marquis' findings on CSR reports: high quality reports correlate with a high level of monitoring. If EIAs are kept secret, then existing rules, such as public participation, receive little enforcement, and whatever ad hoc public monitoring occurs can only yield piecemeal results. Transparency and good behavior go hand in hand, only to the extent that monitoring mechanisms exist.

Furthermore, while Weibo has proven to be an effective way to spread information and check misbehavior on an ad hoc basis, the research discussed above also indicates that more systematic checks and balances need to be designed into the Chinese economic system to cope with the dramatic expansion of corporate power over the past two decades. Throughout Chinese history, the most powerful institutions in society have been the centralized state and the family. Unlike Western countries, until recently, large corporations have not existed in China. In the West, throughout the twentieth century, as large companies grew in size and power, so too did an effective third sector filled with activist non-governmental groups to aid in the monitoring and supervising of those corporations.

In China, the development of more organized civil society actors has not kept pace. NGOs and other grassroots advocacy organizations should be seen as key allies in helping the Chinese government monitor and manage the increasingly powerful private sector. The recent changes to NGO registration rules, which allow industrial associations, charities, community services, and technological organizations to register directly with the Bureau of Civil Affairs, is an important first step, as 85% of 490,000 registered NGOs at the end of 2012 belonged to one of these four groups.⁸ However, the path should also be cleared for NGOs focused on monitoring and other types of advocacy work. The Institute of Public and Environmental Affairs and National Resource Defense Council's Pollution Information Transparency Index is one such project. The index ranks cities on their compliance with disclosure requests on environmental incidents, responses to citizen petitions, and public records of environmental violations.⁹ Working under and leveraging the Ministry of Environmental Protection's landmark 2008 transparency law, "Measures on Open

⁶ Zhang Tao. 2013. "CNPC Report Says Kunming Chemical Project Not Harmful." Caixin Online, <http://english.caixin.com/2013-06-28/100548594.html>. Accessed July 13, 2013

⁷ Luna Lin. 2013. "Kunming Oil Refinery Environmental Report "Invalid" Say NGOs." Chinadialogue 博客 Blog <http://www.chinadialogue.net/blog/6181-Kunming-oil-refinery-environmental-report-invalid-say-NGOs/en>. Accessed July 13, 2013.

⁸ He Dan. 2013. "New Rules for NGOs to Improve Operations." CHINADAILY.com.cn, http://www.chinadaily.com.cn/china/2013-04/17/content_16413055.htm. Accessed July 13, 2013.

⁹ Ben Block. 2009. "China Gradually Improves Environmental Transparency." Eye on Earth, Worldwatch Institute's online news service, <http://www.worldwatch.org/node/6247>. Accessed July 13, 2013.

Environment Information,”¹⁰ the Index is a powerful example of how NGOs can enhance government regulatory power, not detract from it.

The move in China to greater information disclosure and transparency has been an important trend, yet our conclusion from this research is that it is not enough, and that greater emphasis needs to be put on establishing civil society monitoring mechanisms to ensure that what is being disclosed is relevant and leads to increased environmental and social standards. As has been shown in the US and other countries, NGOs and related groups don't destabilize society, but rather contribute to a nation's competitive advantage by keeping corporations honest. For China to continue on its path and achieve a greater role in the global economy, our conclusion is that such mechanisms are necessary to better not only the standing of Chinese companies, but China itself.

¹⁰ Ma Jun. 2008. "Your Right to Know: A Historic Moment." Chinadialogue 文章 Articles, <http://www.chinadialogue.net/article/show/single/en/1962-Your-right-to-know-a-historic-moment>. Accessed July 13, 2013.