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Sustainability and its Integration into Corporate Governance Focusing on Corporate Performance Management and Reporting

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Abstract

This paper discusses corporate governance and its necessary change with regard to trends in society, especially in view of the concept of sustainability. Corporate sustainability is understood as the ability of companies to positively influence environmental, social and economic development through their governance practices and market presence. The approach of enterprises to sustainability and the level of integration of sustainability into corporate governance were examined by the author's empirical research conducted among enterprises in the Czech Republic in 2012. It was found that enterprises are aware of the importance of the concept of sustainability to achieve corporate performance in the long term. However, sustainability is not integrated into individual business processes (especially by small and medium-sized enterprises), as research results demonstrated. Focus on the company's financial results is prevalent. Many enterprises do not work with sustainability within corporate strategy and management, and neither do they include sustainability in performance measurement and management. Reporting of sustainable corporate activities is very simple, especially for SMEs. A prerequisite for fully functioning corporate governance with regard to sustainability is a reflection of sustainability through the whole process of business management. Sustainability should become an integral part of strategic management and corporate planning.

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Keywords: Sustainability; corporate governance; corporate performance; non-financial reporting

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1. Introduction - Corporate governance and recent trends

The role of corporate governance is indispensable; every business needs a governing body that ensures that the enterprise is running in the right direction and running well. The importance of corporate governance dramatically increased at the beginning of the twenty-first century after a series of corporate fraud, managerial misconduct and negligence cases that caused a massive loss of shareholder wealth [1].

Corporate governance is usually defined as “procedures and processes according to which an organization is directed and controlled [2, 3]. Corporate governance includes the activities of the Board and its relationship with the shareholders, managers, but also with external parties such as auditors, regulators and other corporate stakeholders [4]. The corporate governance structure specifies the distribution of rights and responsibilities among these different participants in the organization (such as boards, managers, shareholders and other stakeholders) and lays down the rules and procedures for decision-making [5, 6]. Generally speaking, the Board has the power to decide what direction a company will take and how. Therefore, it is a factor that significantly affects business performance. OECD claims “it is one key element in improving economic efficiency and growth as well as enhancing investor confidence” [5]. So, corporate governance should be dealt with in ways to assure investors about the return on their investment [7]. Corporate systems and procedures should ensure accountability and ethics behavior too. Corporate governance covers many areas including reporting to owners, managers and other stakeholders.

There are many various definitions of corporate governance that have been produced during recent years. Definitions usually solve the behavioral patterns that are the actual behavior of corporations, in terms of performance, efficiency, growth, financial structure and treatment of shareholders and other stakeholders. On the other side, we can meet with another category of definitions that concerns with the normative framework that are rules under which firms are operating (rules coming from such sources as the legal system, the judicial system, the financial markets, and the factor (labour) markets) [8, 9]. We can also observe how the various definitions vary along with development in society and with response of the corporate theory and practice to this development.

There are changes in society, the thinking and behavior of people is changing, business environment is changing, with new trends and concepts being developed to which enterprises should react if they want to be successful. The process of internationalization, changes of technology and others are offering the possibility of creating higher values for the stakeholders [10]. In a global business environment, we are seeing different opinions calling for change of approaches to corporate governance and to control and manage companies in a way that will continue to achieve both effective performance and appropriate social accountability and responsibility, for example [11], or Kontes [12] states “traditional governance model is not appropriate for maximizing the company value in the long-term”. Sustainability has become one of the world trends and a challenge for enterprises in recent years. The question is how businesses will respond to this challenge and how they can integrate this concept in corporate governance in order to obtain benefits.

2. Sustainability and its integration into corporate governance

Sustainable development was first defined by World Commission on Environment and Development as development that meets “the needs of the present without compromising the ability of future generations to meet their own need” in 1987 [13]. It refers to building a society in which an appropriate balance between economic, social and environmental goals is developed [14]. In order to achieve this goal, all three dimensions of sustainable development have to be satisfied, i.e. economic, environmental and social dimensions (the well-known approach called triple bottom line introduced by Elkington and others [15]). Integration of all three dimensions of sustainable development should be a condition for achieving long-term corporate sustainability. However, some authors emphasize economic dimension of sustainability as the most desirable because it provides financial strength and avoids conditions leading to an early demise of the business due to financial reasons, see [16, 17].

Sustainability could be also defined as a strategy of the process of sustainable development [18]. Corporate sustainability is understood as the ability of a company, through its governance practices and market presence, to positively influence ecosystems (improving natural resources, reducing pollution levels, etc.), society (supporting local populations, creating employment etc.) and economic development (distributing wealth through dividends, paying fair salaries, respecting supplier payment obligations etc.) [19]. Sustainability can also be perceived as a way

when a firm creates value for its shareholders by maximizing positive and minimizing negative effects of environmental, social or economic issues [20].

Enterprises should understand how corporate sustainability is constructed in a specific context and how the concept of sustainable development can be applied to the business level and what enterprises should do when they want to become sustainable [21]. For example efficient use of the organization's resources, managing the expectations of all stakeholders, making its long term profitability goals compatible with the principles of the sustainable development of society and so on should become parts of corporate governance activities [19].

When integrating the concept of sustainability, the company should develop management models and strategies that will lead to the creation of social, environmental and economic values. It is necessary to set up corporate governance which incorporates a positive response to the company's social, economic and environmental risks and opportunities that have the potential to influence the performance of the organization [19]. Individual levels of sustainability should be defined and the enterprises should know which activities are specific for individual levels. The questions of how to correctly perceive the concept of sustainability and how to implement it in corporate management in accordance with corporate strategy are widely dealt with; see [22, 23].

It requires [20, 24]:

- Integrate sustainability into the business process management (sustainability must become an integral part of strategic management and business planning).
- Integrate sustainability into the measurement and performance management (quantify the effects of sustainable activities in the financial performance and its impact on the growth of shareholder value).
- Identify appropriate business performance metrics (identification of social, environmental and economic indicators that influence the success of an organization).

Research questions were formulated in order to determine the level of integration of sustainability into corporate governance in the Czech Republic:

What is the approach of Czech enterprises to corporate sustainability and its integration into corporate governance?

What is the state of corporate performance management and non-financial reporting of Czech enterprises due to sustainability?

3. Research method

The approach to corporate responsibility and sustainability and the level of integration of sustainability into corporate governance in Czech enterprises was examined by the author's following empirical research entitled "The business approach to sustainable development and its impact on financial management and accounting". This research was done in 2012. For this research, a questionnaire method was used among Czech small, medium-sized and large enterprises in various branches of business.

The questionnaire contained three groups of questions, namely demographic questions, introductory questions and main questions. The demographic questions were included to gather information about respondents such as legal form of business, branches and region in which a company operates, and size by number of employees and turnover. Introductory questions were designed in order to assess attitudes to sustainability and how it is significant for enterprises in terms of achieving corporate goals. The main questions were focused, for example, on integration of sustainability into corporate performance measurement and management and used performance indicators or state and methods of sustainable activities reporting in Czech enterprises.

3.1. Research sample

300 Czech enterprises were contacted and 193 respondents participated in the research. Most of the companies were from the Pilsen Region, Karlovy Vary Region and South Bohemian Region, but companies from all regions of the Czech Republic were represented. Because different results depending on the size of the company were expected, respondents were categorized into small, medium-sized and large enterprises. The categorization was

made based on the Directive of European Commission No. 70/2001. There were 41% medium-sized enterprises, 34% small enterprises and 25% large enterprises in the research sample.

As regards the representation of enterprises in sectors, 68.2% of respondents were from the industry sector, 16.6% from the service sector and 15.2% from the trade sector.

4. Results and discussion

4.1. Sustainability and Czech enterprises

Most Czech enterprises have already met with the concept of sustainability. Knowledge of this concept increases according to the companies' size, but nevertheless this knowledge was confirmed by 63% of small enterprises.

Looking at corporate goals (Fig. 1), the most important goals are the financial stability of a company and profit maximization. Focus on the company's financial results is prevalent. A positive finding is the position of sustainable business in third place. It shows that businesses perceive and realize importance of the concept of sustainability for their future performance, and perhaps even survival. They monitor the development of the business environment and global trends and these trends are not indifferent for them. But what is the corporate governance approach to the introduction of sustainability into business?

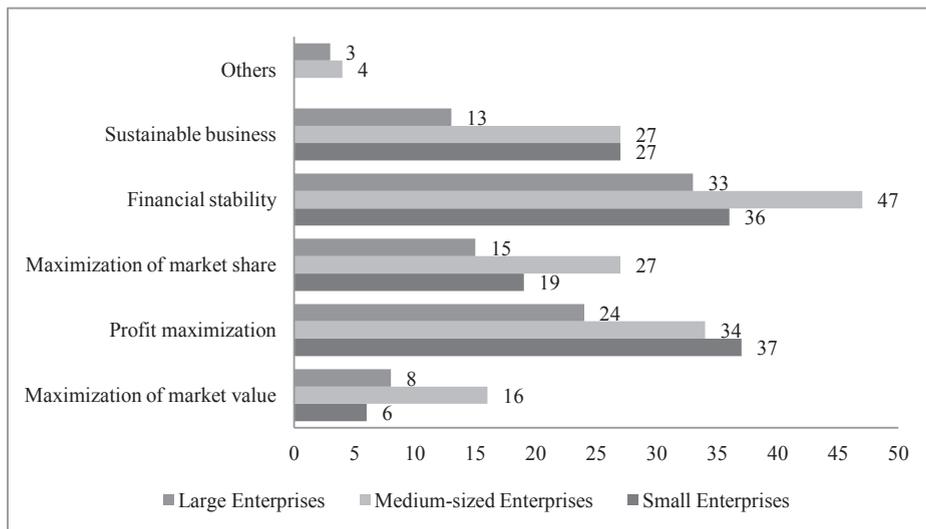


Fig. 1. Corporate goals of respondents in 2012 (in absolute numbers), Source: own, 2013.

4.2. Corporate strategy and management

Although most Czech enterprises consider the concept of sustainable development as a prerequisite for the economic success of their company, more than half of small and medium-sized enterprises do not work with the concept of sustainability in corporate strategy and management (see Table 1).

It was also tested whether the integration of sustainability into corporate management and strategy depends on the size of the enterprise:

H0: The integration of sustainability into corporate management and strategy does *not* depend on the size of the enterprise.

H1: The integration of sustainability into corporate management and strategy *does* depend on the size of the enterprise.

A Chi-squared test (χ^2 test) was used as it establishes whether or not an observed frequency distribution differs

from a theoretical distribution. The following contingency table (Table 1) shows the observed frequency (n_{ij}) and the expected frequency (m_{ij}).

The expected frequency was calculated as follows:

$$m_{ij} = \frac{n_{i.} \times n_{.j}}{n} \quad (1)$$

Where $n_{i.}$ and $n_{.j}$ are marginal lines and columns totals, n is the number of elements on the n scope.

Table 1. Integration of sustainability into corporate strategy and management.

Do you work with sustainability within corporate strategy and management?	Small enterprises		Medium-sized enterprises		Large enterprises		Total ($n_{i.}, m_{i.}$)
	n_{ij}	m_{ij}	n_{ij}	m_{ij}	n_{ij}	m_{ij}	
Yes	26	33.005	38	40.622	34	24.373	98
No	39	31.995	42	39.378	14	23.627	95
Total ($n_{.j}, m_{.j}$)	65	65	80	80	48	48	193

Source: own, 2013

Calculating the test-statistic [25]:

$$\chi^2 = \sum_{i=1}^r \sum_{j=1}^s \frac{(n_{ij} - m_{ij})^2}{m_{ij}} \quad (2)$$

The value of χ^2 (test statistic) was compared with the critical value of χ^2 - distribution of degrees of freedom $(r-1) \times (s-1)$ on the chosen level of significance ($\alpha = 5\%$), where r is the number of lines and s the number of columns. The calculated χ^2 is higher (11.0894) than critical value of χ^2 - distribution (5.9918).

The null hypothesis was rejected and the relationship between the two variables was proved. Furthermore, it is possible to measure the intensity of the relationship in the contingency table using the Cramer coefficient (V) [26]:

$$V = \sqrt{\frac{\chi^2}{n(q-1)}} \quad (3)$$

Where $q = \min \{r, s\}$.

The Cramer coefficient is 0.2397, which proves the weaker dependency. Whether Czech enterprises integrate sustainability into formulation of corporate strategy and corporate management or not is dependent on the size of the enterprise, but this dependence is weak.

4.3. Performance management

Companies around the world are trying to improve their performance and optimize resource utilization, pay attention to cost control and efficiency of economic and business processes. Performance measurement systems are tools commonly used in management and decision-making processes to assess the level of achievement of corporate

goals, including different types of indicators [27]. Thus accurate, consistent, complete and relevant data are required to support financial and strategic corporate decisions regardless of company size.

Czech enterprises have made significant progress in performance measurement and management (almost all large enterprises, more than three-quarters of medium-sized enterprises and more than sixty percent of small enterprises have already established a system of performance management), but they still have a classical approach to assessment of corporate performance. They focus only on economic performance, for which traditional indicators of financial analysis (e.g. return on equity, return on assets, return on sales etc.) are most often used in its measurement. Using indicators of financial analysis for performance measurement were stated by 89% small enterprises, 82% medium-sized enterprises and 96% large enterprises [24, 28]).

None of the enterprises that participated in the research include the concept of sustainability in performance measurement and management.

4.4. Non-financial reporting

Pressure from stakeholders on non-financial reporting of sustainable activities is growing in Czech enterprises regardless of company size or business focus. This fact was confirmed by 37% of small and medium-sized enterprises and 45% of large enterprises. Table 2 shows the state of processing of non-financial reports by respondent enterprises.

Table 2. Processing of non-financial reports.

Does your enterprise process non-financial report?	Small enterprises		Medium-sized enterprises		Large enterprises		Total ($n_{i\cdot}, m_{i\cdot}$)
	n_{ij}	m_{ij}	n_{ij}	m_{ij}	n_{ij}	m_{ij}	
Yes	12	25.259	22	31.088	41	18.653	75
No	53	39.741	58	48.912	7	29.347	118
Total($n_{\cdot j}, m_{\cdot j}$)	65	65	80	80	48	48	193

Source: own, 2013

Dependence of non-financial report processing according to enterprise size was again examined: H0: The processing of a non-financial report does *not* depend on the size of the enterprise; H1: The processing of a non-financial report *does* depend on the size of the enterprise.

The calculated χ^2 is higher (59.519) than critical value of χ^2 - distribution (5.9918). The null hypothesis was rejected and dependence was found. The intensity of the relationship in the contingency table using the Cramer coefficient is 0.5553.

Thus, we can see that enterprises undertake activities in accordance with the concept of sustainability, but on the other hand these activities are not reported consistently. Whether enterprises process non-financial reporting or not is influenced by enterprise size. Small and medium-sized enterprises usually report classical financial data in contrast to large enterprises. If small enterprises report some non-financial data, is it as a part of the annual report (usually one or two paragraphs), not as a separate report. We can find non-financial reports by large enterprises, most often in the form of environmental reports and sustainable reports in CSR reports.

5. Conclusion

Recent trends within society support the development of the corporate sustainability concept and its implications in business management. This requires adapting corporate governance. Corporate governance should first identify with sustainability if the company has to fulfill the principles of sustainability. Corporate governing bodies should behave socially responsibly and sustainably, and in this regard manage and control their companies. Sustainability should permeate the entire organization for successful integration. If sustainability is not included into the

formulation of corporate goals, corporate strategies, policies and processes (from the top), the pursuit of sustainability is unnecessary.

Approach to sustainability and its integration into business management were examined using a sample of enterprises in the Czech Republic. Although most Czech enterprises understand sustainability as a way to improve competitive advantage, more than half of enterprises do not work with sustainability within corporate strategy or corporate management. They carry out some sustainable activities, but it is mostly in isolation from other activities, so it is not included in the business planning and management processes.

In connection with the concept of sustainability, enterprises are facing increasing pressure to measure, monitor and report sustainability performance. But there is a large discrepancy in what and how enterprises measure and report their sustainability performance [16]. It was found that Czech enterprises do not include the effects of sustainable activities into corporate performance measurement and management regardless of the enterprise's size. Prerequisite for a fully functioning performance management system with regard to sustainability is to become an integral part of strategic management and corporate planning.

The state in the field of reporting in the Czech enterprises reflects the overall global trends [29]. Czech enterprises also met with an increase in sustainability-related inquiries from stakeholders on corporate reporting. Increasing pressure created by various stakeholders (investors, banks, public etc.) was confirmed. On the other hand, enterprises usually report classical economic indicators that are compulsory. The available surveys show that evidence of all benefits that the corporate sustainability and reporting can bring to enterprises are not sufficient to make non-financial reporting a normal business practice as compared to financial reporting. Some large enterprises performing global reporting initiatives do; but the relative share of these enterprises is rather small, as confirmed by Kocmanova et al. too [18]. In order to verify the relationship between economically successful companies and companies acting in accordance with the principles of sustainability, corporate governance should also focus on the quality and content of non-financial reporting to bring relevant data that include all the financial, social and environmental corporate activities.

The results of the research conducted among enterprises in the Czech Republic showed that the integration of sustainability into corporate governance will take a lot of effort. Integration of sustainability is widely discussed on the theoretical level; its practical application is still a unrealized goal.

Further empirical research among Czech enterprises was conducted at the beginning of 2013. One hundred respondents participated in this survey; they were divided into categories of small, medium-sized and large enterprises as in the previous research. This research further examined the activities of enterprises in the social, environmental and financial areas in more detail. Based on these data we obtained from our further research, we want to focus next on methods and metrics that enterprises could use for measuring environmental and social business activities, how to convert effects of these activities into financial terms and how to express it in a report. In the Czech Republic, this issue is examined also by [30, 31].

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