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Corporate Social and Environmental Disclosure in Emerging Securities Markets

Li-Wen Lin†

I. Introduction ........................................................................ 1
II. Socially Responsible Investing and CSE Disclosure ............ 5
III. The Current Condition of CSE Disclosure Practices in Emerging Securities Markets........................................... 12
IV. The Regulatory Development of CSE Disclosure in Emerging Securities Markets........................................... 15
   A. South Africa ............................................................ 15
   B. Malaysia ................................................................. 17
   C. China ................................................................. 18
   D. Taiwan ................................................................. 22
   E. Thailand ............................................................... 23
   F. Summary ................................................................ 23
V. Challenges of CSE Disclosure Regulation in Emerging Securities Markets........................................................ 25
   A. Voluntary Disclosure ............................................... 25
   B. Mandatory Disclosure ............................................ 28
   C. Comply or Explain .................................................. 30
VI. Conclusion .................................................................... 32

I. Introduction

Corporate social and environmental disclosure (CSE disclosure) in a simple sense means that a company communicates information concerning its social and environmental performance to external audiences.1 A company may voluntarily disclose social or environmental information to the public, but at present quite a large amount of information is involuntarily disclosed due to legal

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1 See generally MARY GRAHAM, DEMOCRACY BY DISCLOSURE (2002) (exploring corporate transparency as a policy innovation).
requirements.\textsuperscript{2} There are a variety of CSE disclosure schemes in different areas of law. The traditional legal forums for CSE disclosure are in such areas as labor, occupational safety, product safety, environmental protection, and consumer protection law. In the United States, for example, under occupational safety law, employers are required to disclose information about hazardous chemicals at the workplace to workers;\textsuperscript{3} under environmental law, manufacturers are required to disclose toxic releases to the public;\textsuperscript{4} and under food safety law, food processors are required to disclose nutritional information about their products to customers.\textsuperscript{5} The disclosure schemes are based on the philosophy that information disclosure can minimize related risks through strengthening market and political pressures on companies.\textsuperscript{6} Intuitively, for example, occupational safety laws deal with occupational safety information, environmental laws deal with environmental information, and food safety laws deal with food safety information. In addition to these traditional areas, securities law has recently emerged as a new CSE disclosure forum.\textsuperscript{7} The CSE disclosure in securities markets and its relevant legal questions are the focus of this Article.

Information disclosure is an important pillar of securities markets. Traditionally, disclosure in securities markets concerns only financial information. Companies disclose four basic financial statements (balance sheets, income statements, cash flow statements, and the statement of changes in shareholder’s equity) and other relevant financial information to investors. Investors use the financial information to calculate investment risks and make investment decisions. The importance of financial information to investors is self-evident and well-accepted. Financial disclosure is the orthodox focus of securities law. But how can CSE disclosure enter into securities markets and even step into the core territory of securities law?

\textsuperscript{2} \textit{Id.} at 2.
\textsuperscript{3} \textit{Id.} at 9.
\textsuperscript{4} \textit{Id.} at 8.
\textsuperscript{5} \textit{Id.}
\textsuperscript{6} \textit{Id.} at 2.
In a conventional sense, CSE information may be deemed irrelevant to securities investment. But as this Article will explain, the emergence of socially responsible investing (SRI) poses a great challenge to the seeming irrelevancy of CSE information. Companies are expected to provide not only the quantity of goods, services and employment, but also the quality of life for those whose interests are affected by corporate activities (e.g., employees, suppliers, creditors, consumers, and local communities). Whether and how a company lives up to these public expectations can significantly affect its financial returns, which makes CSE disclosure material to investors.

The richest information source for investors of CSE information to calculate investment risks is companies themselves. Thus, a growing number of companies, particularly in developed markets, have disclosed social and environmental information along with financial information to investors. Based on the current practices in securities markets, corporate social information generally covers issues concerning labor rights (freedom of association; working conditions; equal opportunities; health and safety); human rights; community relations; consumer protection; philanthropy; or political contributions. Corporate environmental information may include issues concerning environmental law compliance; climate change and related risks; environmental management systems; or waste treatment and recycling. Specific issues may vary among sectors. More recently, many developed markets such as France, Denmark, Norway, and the United Kingdom have introduced CSE disclosure.


9 See The Danish Commerce and Companies Agency on Corporate Social Responsibility, Statutory Requirements on Reporting CSR, http://www.csrgov.dk/sw51190.asp (on Dec. 16, 2008, the Danish Parliament passed a bill making CSE disclosure mandatory in the financial annual report for the largest 1,100 Danish companies) (last visited Oct. 25, 2009).


disclosure requirements to corporate or securities law.

Most of the existing legal literature on CSE disclosure focuses on developed markets. Little attention has been paid to emerging securities markets. The purpose of this Article is to fill the void. CSE disclosure can play an important role in promoting economic prosperity, environmental sustainability and social stability, which all are interlinked with market health. This disclosure may increase public monitoring over companies’ compliance with social and environmental regulations and even press companies to go beyond compliance with the regulations. CSE disclosure therefore would make more contributions for emerging markets where law is unable to provide social and environmental protection than for developed markets where law is relatively capable of providing such protection. CSE disclosure also links with the idea of SRI, which may directly channel money toward sustainable projects.

This Article will first explain why CSE information is meaningful for investors in securities markets. It then will show that SRI is growing in some major emerging markets such as South Korea and China, and that further growth of SRI is conditioned upon a sufficient supply of CSE information. This Article will also examine current CSE disclosure practices in emerging securities markets. CSE disclosure is growing in emerging markets but still faces various problems. In order to correct the problems and promote CSE disclosure, some emerging

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13 Graham, * supra* note 1, at 4, 11.
markets have very recently set up disclosure requirements in securities regulations or stock exchanges' listing rules. Thus, this Article will examine the regulatory development in emerging markets, including South Africa, Malaysia, China, Taiwan, and Thailand. It will then compare the regulatory patterns in these markets. Finally, this Article will discuss the challenges that different regulatory approaches pose to emerging markets and give recommendations.

To clarify, the scope of emerging securities markets concerned in this Article generally adopts the classification provided by FTSE, a world leader in creating and managing indexes for securities markets, and by MSCI Barra Inc., a leading company in providing investment decision tools for investment institutions.\textsuperscript{14} The scope of emerging markets provided here, therefore, excludes very immature securities markets in the least developed and some developing countries. Emerging securities markets generally refer to countries such as Brazil, China, India, Russia, South Africa, Malaysia, Indonesia, Thailand, Taiwan, and South Korea.

II. Socially Responsible Investing and CSE Disclosure

Companies do not bother to disclose CSE information to investors if there is no market demand. Investors' demand is a major driving force for the growth of CSE disclosure in securities markets.

Many empirical studies show that corporate social and environmental performance is positively associated with corporate financial performance, particularly through the medium of reputation.\textsuperscript{15} Corporations with good social and environmental performance reputations can improve relationships with creditors and suppliers, thus attracting better employees and more consumers. The positive relationship between

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{15} \textit{See} Marc Orlitzky et al., \textit{Corporate Social and Financial Performance: A Meta-Analysis}, 24 ORG. STUD. 403 (2003) (detailing a debate about social/environmental performance and financial performance for decades, but confirming the positive relationship in a recent and important study with more rigorous methodology).
\end{itemize}
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social/environmental performance and financial performance strongly suggests that investment analysis should include social and environmental factors. This investment approach is embodied in SRI, the key strategies of which include screening, integration, and engagement. Screening is intended to control investment risks by avoiding investment in certain companies completely. Integration is intended to adjust risks by weighing social and environmental factors and giving preference to companies with better performance. Engagement is intended to control risks by actively changing corporate behavior through dialogue with companies, submissions of shareholder proposals to companies, and exercising shareholder voting rights. These SRI strategies rely heavily on the availability of credible CSE information. Without CSE information, investors do not know which companies should be screened out, which ones should be given preference, and how to exercise their voting power to press companies to change behavior.

According to statistics provided by SRI communities, over the past decade, developed markets experienced strong SRI growth. For example, in the United States, the SRI assets grew from $639 billion in 1995 to $2.71 trillion in 2007, accounting for ten percent of all assets under professional management in the securities market. In Europe, SRI assets significantly increased from €336 billion in 2002 to €2.665 trillion in 2007. SRI has evolved from eccentric practices by a small club of faith-based investors to innovative strategies by a large community of financially-sophisticated investors. Major asset management companies offer a variety of SRI products. Large institutional investors, particularly pension funds that focus on long-term growth (e.g.

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18 See Steve Schueth, Socially Responsible Investing in the United States, 43 J. Bus. Ethics 189, 189 (2003) (giving a brief history of SRI's religious origins; explaining that "[i]n early biblical times, Jewish law laid down many directives about how to invest ethically" and that the Quakers and Methodists have avoided profits at the expense of the killing and the enslavement of human begins; also arguing that the avoidance of investment in sin stocks originated from the religious beliefs).
CalPERS, the largest public pension fund in the United States, have adopted responsible investment principles. Leading financial information services have launched a number of SRI indices, including the Dow Jones Sustainability Index and FTSE4Good Index Series. Global financial institutions have endorsed SRI commitment initiatives, among which the United Nations Principles for Responsible Investment (UN PRI) is a leading example. 19 Under the UN PRI, signatory financial institutions commit themselves to integrating environmental, social and corporate governance issues into investment analysis and decision-making processes. Currently 459 financial institutions are signatories under the UN PRI, and most of them operate in developed markets. 20

Investors in emerging markets, however, present relatively weak demand for SRI. The International Finance Corporation (IFC), the private sector arm of the World Bank Group, tentatively estimated in 2003 that only 0.1% ($2.7 billion) of the SRI assets globally were located in emerging markets. 21 Yet, SRI has rapidly grown in emerging markets since that time. According to the latest IFC report on emerging markets, SRI in emerging markets reached a record high of $145 billion in 2007, although a sharp decline followed in 2008 due to the global financial crisis. 22 With a different methodology, another survey recently conducted by the IFC and the global consulting firm Mercer estimates that the size of SRI assets in emerging markets is now over $300 billion. 23 The survey also finds that forty-six percent of the 177 asset managers with investment in emerging markets have a policy regarding the integration of social and environmental factors into their

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investigation process. Interestingly, the survey finds that global asset managers with investment in emerging markets are more likely to develop SRI policies than managers without such investment in emerging markets.

International investors have recently increased their interest in emerging securities markets. As of June 30, 2009, the Dow Jones Sustainability World Index (DJSI World) included eighteen emerging-market companies from Brazil, China, India, South Africa, South Korea, Taiwan and Thailand. Domini Social Investment, one of the most prominent SRI investment companies, launched the Domini PacAsia Social Equity Fund in December 2006, focusing on socially screened diversified mid- to large-cap stocks in the Asia-Pacific region. On January 30, 2008, Standard & Poor’s, CRISIL and KLD Research & Analytics (an SRI research firm), launched the S&P ESG India Index. The India Index is the first index produced under the IFC’s project on SRI indices in emerging markets; similar indices in other emerging markets will be established under the project in the near future.

At the individual country level, for example, the Johannesburg Securities Exchange (JSE) in South Africa launched the Socially Responsible Investment Index (SRI Index) in May 2004 “in response to the burgeoning debate around sustainability globally

\[24\] See id.


\[26\] See Anne Moore Odell, New Domini Funds Invest in the World, SOCIALFUNDS SUSTAINABILITY INVESTMENT NEWS, ¶ 3 Jan. 11, 2007, http://www.socialfunds.com/news/article.cgi/2202.html. (According to Amy Domini, the founder and CEO of Domini, “International investing represents a great opportunity, and a significant challenge, for people who want their investments to make a difference on a global scale. Europe is leading the world in corporate social responsibility and sustainable business models, and we and our shareholders are excited about being a part of that. Meanwhile, dramatic economic growth in Asia has often been accompanied by pollution, deforestation, sweatshop labor, and human rights violations. This is a region where conscious, responsible investing is needed, and can really make a difference.” Id.).

and particularly in the South African context." The criteria of JSE's SRI Index are structured along the ESG (Environment, Society, and Governance) approach promoted by the UN PRI. The environmental criteria are aligned with the FTSE4Good environmental standards, while social and governance criteria are managed in a thematic manner, "with specific emphasis on local issues such as black economic empowerment, skills development and HIV/AIDS." According to the Experts in Responsible Investment Solutions (EIRIS), a world-renowned organization in the area of sustainability research, South Africa had twenty-one SRI funds with US$1.6 billion under management in 2006. More recently, a 2007 United Nations Environmental Program Finance Initiative (UNEP FI) survey estimated that as much as eleven percent of ZAR 2.3 trillion assets managed by asset managers in South Africa were under some formal SRI strategies (i.e., screening and shareholder activism). Moreover, a number of institutional investors, including South Africa's largest pension fund (GEPF) and a dozen other asset management companies, have been active in committing themselves to the UN PRI.

SRI is also developing quickly among institutional investors in Brazil. Brazilian institutional investors have an active presence in the UN PRI, including sixteen asset owners and four asset management companies. The catalyst for the mainstreaming of SRI may be the launch of the Corporate Sustainability Index (ISE)

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in 2005 by Brazil’s stock exchange (BOVESPA), with the financial support from the IFC.34 “ISE is designed to measure the return on a portfolio composed of shares of companies highly committed to social responsibility and corporate sustainability, and also promote good practices in the Brazilian corporate environment.”35

In Malaysia, two SRI funds were launched in 2003.36 The Malaysian government also directed the two major pension funds in Malaysia (the Employment Providence Fund and the Pension Trust Fund) to “consider favorably PLC’s (public listed companies) with good CSR (corporate social responsibility) practices” when making investment decisions.37 The motivation for the policy is based on the belief that CSR activities are in line with Malaysia’s socio-economic objectives and can attract domestic and foreign investors.38

The diffusion of SRI is also taking place in India and China, two giant emerging markets. In India, the office of ABN AMRO Asset Management Company launched India’s first SRI fund (ABN AMRO Sustainable Development Fund) in March 2007.39 In China (excluding Hong Kong), the Bank of China launched the Sustainable Growth Equity Fund in May 2006, and the Industrial Management Company made the initial public offering of the


38 Id.

Xingye SRI Fund in March 2008, which opened China's domestic SRI market. Moreover, China's first SRI index was launched at the beginning of 2008 by the Shenzhen Securities Information Company and Tianjin Teda Company. The "TEDA Environmental Protection Index" focuses on the top forty environmentally responsible companies listed on the two major Chinese stock exchanges (i.e., Shanghai Stock Exchange and Shenzhen Stock Exchange). In August 2009, the Shanghai Stock Exchange also launched the "Responsibility Index," selecting the top 100 companies on the stock exchange which have the best value of "social contribution per share."  

SRI is also growing in other Asian emerging markets including South Korea, Taiwan and Thailand, among which South Korea has the greatest development, with thirty-seven SRI mutual funds and six SRI pension funds.

Additionally, international development organizations have recently incorporated SRI into their development projects in emerging markets. For example, the UNEP FI launched the Emerging Market Responsibility Investment Project in November 2004 with the purpose of "increas[ing] awareness amongst investors globally of the relevance of responsible investment in emerging markets" and "creat[ing] international and domestic framework conditions that enable stable capital markets integrating social, environmental and corporate governance concerns." Moreover, the IFC launched the Social


42 See Korea, Ass’n for Sustainable & Responsible Inv. in Asia, http://www.asria.org/portal/SRI_Fund/Korea (last visited Oct. 25, 2009).


Responsibility Program to help corporations in emerging markets manage social and environmental risks related to their business operations. In October 2007, the IFC and thirty development finance institutions around the world signed the Approach Statement on Corporate Governance, "under which each institution agrees to help raise corporate governance to the level of environmental and social considerations in their due diligence and financing of private and public companies in emerging markets." Overall, although SRI is now growing in many emerging markets, it nevertheless remains rare and immature. As the IFC reports consistently find, domestic investors in emerging markets have low awareness of SRI and therefore low demand for it, while international SRI investors are discouraged from investing in emerging markets due to lack of CSE information about companies in emerging markets. If international SRI investors can increase their presence in emerging markets, then they may diffuse the SRI practices more quickly to domestic investors in emerging markets so as to create internal demand for SRI in the markets. But if CSE information is unavailable, the diffusion process will be slow. A very recent survey by EIRIS, a leading global research organization on SRI, also finds that the biggest obstacle to SRI in emerging markets is the lack of CSE information. The availability of CSE information therefore is very critical for SRI development.

III. The Current Condition of CSE Disclosure Practices in Emerging Securities Markets

Disclosure is generally regarded as essential for the operation of a securities market. Insufficient or inaccurate information may

47 See supra notes 21 & 22; see also IFC, UNDISCLOSED RISK: Corporate Environmental and Social Reporting in Emerging Asia (June 2009), http://www.ifc.org/ifcext/sustainability.nsf/Content/Publications_SustFinance.
lead investors to misjudge their investment decisions and may hamper the allocative efficiency of investment capital and other scarce resources. Given the importance of disclosure, all major securities markets have extensive regulations regarding what information to disclose and how to disclose it to investors. There are various kinds of disclosure obligations for public companies in securities markets. The most familiar type for investors is the annual report issued by public companies. In the United States, for example, the annual report contains a wide range of required information to ensure that shareholders make informed decisions when exercising their voting rights in director elections. These requirements include a general description about the company’s business and the company’s property; material legal proceedings; financial statements; management’s discussion and analysis of financial condition and results of operations; the attestation and assessment of internal control over financial reporting; the background information about directors and officers; codes of ethics; the executive compensation; and the structure of corporate governance. As shown below, the annual report is a key medium through which a growing number of companies disclose social and environmental information to investors. In addition to integrating CSE information into annual reports, companies may also disclose CSE information through separate reports, generally called corporate social responsibility reports (CSR reports) or sustainability reports.

A wealth of evidence suggests that CSE disclosure has become a common practice for large companies in developed markets. For example, according to the KPMG International Survey of Corporate Responsibility Reporting 2008, 83% (or 207 companies) of the Global Fortune 250 published SRI in a separate report or as part of the annual report. At the national level, 93% of the top 100 companies in Japan, 91% in the UK, 74% in the United States, and 62% in Canada, have published either stand-alone or integrated CSR reports.

51 See id.
52 See id.
Compared to that of developed markets, CSE disclosure generally remains a relatively rare practice in emerging markets. Nevertheless, recent evidence suggests that CSE disclosure is now burgeoning in some emerging securities markets. According to the KPMG 2008 survey, 60% of Brazil's top 100 companies published CSE information in a separate report or the annual report for the year between mid-2007 and mid-2008; compared with 17% of Mexico's top 100 companies; 42% of South Korea's; 42% of South Africa's; 26% of Hungary's; 23% of Romania's; and 14% of the Czech Republic's.

Although CSE disclosure is growing in some emerging securities markets, empirical studies generally find that the quality of such CSE disclosure suffers the following problems: A very limited amount of information; lack of comparability over years and between companies; unbalanced disclosure, with a greater emphasis on good rather than bad news; and a lack of third-party auditing to assure information credibility. In fact, developed companies have the same problems as well, though less severe.

In order to improve the quality and quantity of CSE disclosure, many developed markets such as France, Denmark, Norway and the UK have required public companies to disclose CSE information in their annual reports. As shown in the following section, some emerging markets are also building their own CSE regulatory regimes.

53 See id.
54 See id.
55 See, e.g., Karen Paul et al., Corporate Social Reporting in Mexico, 22 J. CORP. CITIZENSHIP 67 (Summer 2006); Paul Thompson & Zarina Zakaria, Corporate Social Responsibility Reporting in Malaysia, 13 J. CORP. CITIZENSHIP 125 (Spring 2004); Tianxi Zhang et al., Corporate Environmental Reporting on the Web: An Exploratory Study of Chinese Listed Companies, 1 ISSUES IN SOCIAL & ENVTL. ACCNT. 91 (2007); Ataur Rahman Belal, CORPORATE SOCIAL RESPONSIBILITY REPORTING IN DEVELOPING COUNTRIES (2008) (focusing on CSE disclosure in Bangladesh).
56 See, e.g., supra note 50 (finding that developed markets generally have better CSE disclosure in terms of information quantity and quality but CSE disclosure in developed markets remain problematic). In a series of reports on the condition of CSE disclosure globally, CorporateRegister.com, a leading global directory of CSR resources, also finds better CSE disclosure in developed markets but that still face the problems. Available at http://www.corporateregister.com/downloads/ (last visited Oct. 25, 2009).
57 See supra notes 8-11.
IV. The Regulatory Development of CSE Disclosure in Emerging Securities Markets

Currently CSE disclosure is voluntary in most emerging markets, either because there are only voluntary guidelines or no regulations at all. Yet, in recent years, securities regulators (securities regulatory agencies and stock exchanges) in some emerging markets have adopted explicit CSE disclosure requirements. These markets include South Africa, Malaysia, China, Taiwan, and Thailand. This section will examine the regulatory development of CSE disclosure in these markets and compare their different regulatory patterns.

A. South Africa

The most researched case so far may be that of South Africa. In 2002, the Institute of Directors in Southern Africa published a revised version of the King Report on Corporate Governance for South Africa (the "King Code"). The King Code is an advisory code, which recommends the best practices of corporate governance for South African companies. The King Code includes a detailed section of Integrated Sustainability Reporting, in which "every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices." Under the King Code, the board of directors should disclose CSE information based on "the principles of reliability, relevance, clarity, comparability, timeliness and verifiability with reference to the Global Reporting Initiative Sustainability Reporting Guidelines on economic, environmental and social performance." It further suggests at length that the board of directors should give specific consideration to a wide range of information. The information in short includes: objectives and

58 The Institute of Directors in Southern Africa is a membership institute with the purpose of improving corporate governance and with a historical connection with the Institute of Directors in the UK.

59 See King Committee on Corporate Governance, Executive Summary of the King Report 2002, Item 5.1.1 (2002).

60 See id. at Item 5.1.3.; see also GRI homepage, http://www.globalreporting.org/Home (The Global Reporting Initiative Sustainability Reporting Guidelines (GRI Reporting Guidelines) are the global leading standards of CSE disclosure. The GRI is a large multi-stakeholder network at the global level).
practices concerning workplace safety and occupational health; policies concerning the potential impact of HIV/AIDS on the company's operation; environmental governance that reflects the cost-and-benefit standard set forth in South African law; policies endorsing black economic empowerment; and other detailed issues concerning human capital development.  

The King Code itself is advisory in nature, but by virtue of the Listing Requirements of the Johannesburg Securities Exchange (JSE), all the public companies listed on the stock exchange must comply with the King Code or justify any noncompliance. Under the JSE Listing Requirements, a listed company is required to make "a narrative statement of how it has applied the principles set out in the King Code" and "a statement addressing the extent of the company's compliance with the King Code and the reasons for noncompliance with any of the principles in the King Code." This combination of the advisory King Code and the Listing Requirements in South Africa constitutes an adoption of the "comply or explain" approach, originating from the U.K. Combined Code on Corporate Governance. The comply or explain approach is a "two-tier order of compliance." The first tier is voluntary compliance with the substantive standards in the Code, such as whether to engage in CSE disclosure. The second tier is mandatory disclosure of whether the corporation complies with the substantive standards in the Code, and the corporation's justification for any deviations. In other words, a company may choose whether to make substantive CSE disclosure, but if the company chooses not to, it must give an explanation for the noncompliance.

A series of studies conducted by KPMG suggests that the

61 For detailed information, see supra note 59, at Item 5.1.4.
63 Id.
64 See Björn Fasterling, Prospects and Limits of Corporate Governance Codes, INTERNATIONAL CORPORATE GOVERNANCE AFTER SARBANES-OXLEY 467, 469 (Paul U. Ali & Greg N. Gregoriou eds., 2006).
65 Id.
66 See id.
67 See id.
listed companies in South Africa have improved CSE disclosure in recent years, partly due to the JSE’s adoption of the comply or explain approach. But this improvement should be regarded with caution. As another study found, the majority of listed companies in South Africa still disclose information in an “aspirational, anecdotal and episodic manner, with an emphasis on positive content.” Further, the study suggested that “the relative lack of regulatory enforcement may be one of the reasons why the majority of South African companies do not commit themselves to objective targets or report their performance against such targets.” A lack of investor pressure may be another contributing factor. If regulatory and market enforcement are conditions for the effectiveness of the comply or explain approach, existing research casts uncertainty as to whether the comply or explain approach works in South Africa for the present and near future.

**B. Malaysia**

In 2006, the Malaysian stock exchange (Bursa Malaysia) amended its listing rules to require listed companies to include in their annual reports “[a] description of the corporate social responsibility activities or practices undertaken by the listed issuer and its subsidiaries or if there are none, a statement to that effect.” As Bursa Malaysia makes clear, “[t]he practice of CSR

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70 Id.

71 See id. at 317 (“Considering South African investors’ relative lack of interest in sustainability issues . . . some corporate managers are asking themselves whether sustainability reporting is worth the considerable effort”).

72 See id. at 310-20.

73 Bursa Malaysia, Main Market Listing Requirements ch. 9 app. 9C-5 pt. A ¶ 29
activities is completely voluntary and at the discretion of listed issuers,” and “[t]he requirement for disclosure of CSR activities is for enhanced transparency and to encourage listed issuers to bear in mind CSR when undertaking their business and operations.”\textsuperscript{74} In essence, Malaysia’s approach shares the philosophy of South Africa’s comply or explain approach, but Bursa Malaysia neither prescribes the contents of disclosure in relation to CSR activities nor gives clear guidance on what and how to report.\textsuperscript{75} In the 2008 Budget Speech delivered by Malaysian Prime Minister Abdullah Ahmad Badawi, the government restated its policy launched in the previous year, requiring all publicly listed companies to disclose CSR activities in the annual report, and further ordered all publicly listed companies to disclose “employment composition by race and gender” as of the 2008 financial year.\textsuperscript{76} It is unclear how the Malaysian government will implement the CSE disclosure requirement, but there is no question that CSE disclosure has attracted political attention in Malaysia.

\textbf{C. China}

The two stock exchanges in the Chinese securities market, the Shenzhen and Shanghai Stock Exchanges, recently took action to promote CSE disclosure.


\textsuperscript{75} See id. at ¶ 3.14-.15 (stating that no “specific requirements” have been prescribed with respect to how the CSR statement should be incorporated into the annual report or what it must include).

\textsuperscript{76} Yab Dato’ Seri Abdullah bin Hj. Ahmad Badawi, Prime Minister and Minister of Finance of Malaysia, The 2008 Budget Speech (Sept. 7, 2007) (full text on file with author).
“Shenzhen Guide”). Article 36 of the Shenzhen guide states that “[c]ompanies may release their social responsibility reports along with their annual reports.” It also suggests that this report should contain at least the following information: “(1) Implementation of social responsibility relating to employee protection, impact on environment, product quality and community relationship; (2) assessment of implementation of these Instructions and reasons for the gap, if any; and (3) measures for improvement and the timetable.” A recent Chinese study analyzed the effect of the Shenzhen Guide on CSE disclosure practices by listed companies on the Shenzhen Stock Exchange. The study suggested that the Shenzhen Guide plays an important role in promoting CSE disclosure by the listed companies. Furthermore, the study found that no listed companies on the stock exchange had issued separate CSR reports before the release of the Shenzhen Guide, but that by the end of April 30, 2007, the fiscal year following the release of the Shenzhen Guide, twenty listed companies on the stock exchange had published separate CSR reports along with their 2006 annual reports, ten of which clearly mentioned the Shenzhen Guide as a reference.

Compared to the Shenzhen Stock Exchange, the Shanghai Stock Exchange appears more ambitious in cultivating CSE disclosure. In May 2008, the Shanghai Stock Exchange promulgated the “Guide on Environmental Information Disclosure for Companies Listed on the Shanghai Stock Exchange” [hereinafter “Shanghai Guide”] and “Notice on Strengthening Social Responsibility of Listed Companies” [hereinafter “Shanghai Notice”]. Under the scheme provided in the Shanghai

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78 Id. at art. 36.
79 Id.
81 See id.
82 See id.
Guide and the Shanghai Notice, there are three kinds of disclosure: (1) Real-time disclosure of significant environmental events; (2) special disclosure by blacklisted companies; and (3) CSR annual reports. The former two have underpinnings in environmental regulation and, therefore, are mandatory in nature.

Real-time disclosure of significant environmental events requires a listed company to disclose possible impact on its operation and stakeholders within two days of the occurrence of any of the following events: Significant investments in projects that have material environmental impact; significant investigations or punishments by the government because of environmental law violations; material litigations concerning environmental problems; blacklisting by environmental agencies; announcement of a new environmental law or regulation that may have material impact on corporate operation; and any other events that may have significant impact on stock prices. Special disclosure by blacklisted companies means that companies blacklisted by environmental agencies must, within two days of the announcement of the blacklist, disclose information including the type, density; and quantity of pollutants, conditions of environmental protection facilities; environmental emergency plans; and preventive measures concerning emission reduction.

As for CSR reporting, the Shanghai Guide encourages listed companies to publish annual CSR reports along with their annual

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86 See Guide on Environmental Information Disclosure for Companies Listed on the Shanghai Stock Exchange, supra note 84 at art. 2.

87 See id.
financial reports on the Shanghai Stock Exchange website. The Shanghai Stock Exchange offers suggestions about what to disclose, including the following information: Environmental protection policies, annual goals, and performance; annual consumption of resources and energy; environmental investment and environmental technology development; the type, quantity, density and location of pollutants; condition of environmental protection facilities; waste recycling; voluntary agreements on environmental improvement with environmental agencies; awards granted by environmental agencies; and other environmental information voluntarily disclosed. The Shanghai Stock Exchange also suggests that listed companies may disclose in their annual CSR reports “social contribution per share,” derived from the idea of “earnings per share.”

In December 2008, the Shanghai Stock Exchange further accelerated the development of CSE disclosure by requiring three types of listed companies to issue the CSR annual report from the 2008 fiscal year. The three types include companies which are listed in the Shanghai Stock Exchange Corporate Governance Index, companies that list shares overseas, and companies in the finance sector. According to information released by the Shanghai Stock Exchange, there were 290 listed companies

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88 See id. at art. 3.
89 See id.
90 The “Shanghai Notice” explains that the social contribution per share may be equal to the sum of earnings plus taxes paid, employee salaries paid, interest paid to banks, and donations, minus environmental pollution, and then divided by the number of shares. See Shanghai Notice, supra note 84.
92 See, e.g., The Shanghai Stock Exchange's Notice Concerning Listed Companies' Preparation for their 2008 Annual Reports, supra note 91, at art. 10.
publishing CSR reports for the fiscal year of 2008. Of these 290 companies, 258 companies issued CRS reports because of the mandatory requirement, while only 32 issued reports voluntarily.

The Securities and Regulatory Commission in Fujian Province also took regulatory measures to promote CSE disclosure. The commission issued a regulatory instruction requiring listed companies incorporated in Fujian to publish annual CSR reports along with their annual reports starting with the fiscal year of 2007. Because of the regulatory instruction, by the end of April 30, 2008, all thirty-six listed companies incorporated in the Fujian jurisdiction had published CSR reports; thirty-one published stand-alone CSR reports; while the remaining five included a CSR section in their 2007 annual reports. Meanwhile, twenty-five of the companies’ boards of directors decided to institutionalize CSR activities and periodically publish CSR reports.

D. Taiwan

In December 2008, the Taiwan Financial Supervisory Commission (FSC), the agency responsible for regulating the financial market in Taiwan, amended the disclosure rules regarding public companies’ annual reports. According to the amended rules, a public company in Taiwan is required to include in its annual report information on “systems and measures that the company has adopted with respect to environmental protection,


94 Id.


96 See Miao Kang, Fujian Zhengjianju: Xiaqu Shangshi Gongsi Bianzhi Nianbao Shi Bixu Jiaru Shehui Zeren [CSRC: Corporations Incorporated in Fujian Jurisdiction should Include CSR Information When Preparing for the Annual Report], XINHUA, Jan. 18, 2008, available at http://news.xinhuanet.com/newscenter/2008-01/18/content_7445136.htm (reporting the speech in the Fujian CSR training program delivered by Mr. Renhua Yue, the head of the commission).

97 See id.
community participation, contribution to society, service to society, social and public interests, consumer rights and interests, human rights, safety and health, and other corporate social responsibilities and activities." As of this Article's date of publication, the regulations have not yet given details on how to disclose such information.

E. Thailand

In 2006, the Stock Exchange of Thailand (SET) promulgated a revised version of the Principles of Good Corporate Governance for Listed Companies. The new Principles suggest that "[t]he board of directors should set clear policies on environmental and social issues" and the company should disclose the environmental and social policies as well as the implementation condition of the policies. The SET adopts a comply or explain approach with regard to the implementation of the new Principles. Companies have discretion in deciding whether to comply with the substantive requirements but must give justifications for noncompliance. The SET requested that companies disclose the implementation condition of the new Principles in their annual reports, beginning in 2007.

F. Summary

The five emerging markets use regulatory measures to promote CSE disclosure and demonstrate different regulatory patterns.

As with the regulator, stock exchanges seem more active in promoting CSE disclosure. Securities regulatory agencies and stock exchanges are the two major regulators in securities markets. The five case studies suggest that stock exchanges tend to play a greater role in regulating CSE disclosure than securities regulatory

100 See id. at ii, 3-4.
101 See id. at ii.
102 See id.
103 See id.
agencies. The CSE disclosure regulations in South Africa, Malaysia, China and Thailand are primarily developed by the stock exchanges, while the CSE disclosure regulations in Taiwan are developed by the securities regulatory agency. There may be two reasons to explain why stock exchanges seem more likely to take the lead in regulating CSE disclosure: First, stock exchanges are more sensitive to international competitive dynamics,\textsuperscript{104} and second, companies listed on the stock exchanges are usually larger than non-listed companies in the domestic markets and therefore have greater social and environmental impact as well as more resources to engage in socially responsible corporate conduct.

As to the regulatory approach, South Africa and Thailand both take a comply or explain approach embedded in the entire corporate governance scheme. Malaysia also adopts an approach that partly reflects the concept of comply or explain. Both China and Taiwan adopt traditional mandatory disclosure in securities regulation, requiring the disclosure of information concerning certain topics.

As to the disclosure items in the regulation, the emerging markets tailor CSE disclosure items to their local needs and exhibit innovations in improving reporting quality. In South Africa, the disclosure regulations pay particular attention to the impact of HIV/AIDS on corporate activities and the implementation of black economic empowerment policies that redress the inequalities resulting from Apartheid. In Malaysia, the disclosure regulations give priority to race and gender issues due to the perennial shadow of ethnic tensions and the cultural tradition in connection with discrimination against women. In China, the Shanghai Stock Exchange created the concept of "social contribution per share" to measure corporate social and environmental performance.

As to the specificity of the regulation, South Africa has the most detailed disclosure standards for listed companies, requiring reference to the leading global standards of CSE disclosure, i.e., GRI. China also has some specific disclosure standards as a reference for listed companies. Malaysia, Taiwan and Thailand, however, do not give much specificity concerning what to

disclose.

V. Challenges of CSE Disclosure Regulation in Emerging Securities Markets

As shown in the previous section, different emerging markets adopt different regulatory policies. At present, there are three CSE disclosure approaches in securities regulation: voluntary disclosure, mandatory disclosure, and comply or explain. Each approach has its strengths and weaknesses in advancing CSE disclosure, and the suitability of each approach in a country is complicated by the institutional environment in the country. This section analyzes the general strengths and weaknesses of each CSE disclosure approach in emerging securities markets. Policymakers may find such analysis helpful when considering CSE disclosure policies.

A. Voluntary Disclosure

CSE disclosure remains voluntary for most emerging securities markets. The effectiveness of voluntary disclosure relies on market power. Voluntary disclosure posits that if investors truly need information about a company's social and environmental performance, the company will have an incentive to provide such information. Currently the awareness in emerging markets remains low, and may be interpreted as low demand from investors. Investors are assumed to know their own interests the best. If investors do not demand CSE information, there is no need to incur the great costs of legal compliance. Companies which are particularly interested in catering to SRI investors can voluntarily disclose relevant information. From this view, voluntary disclosure seems a proper regulatory policy for emerging markets. However, do investors in emerging markets really know their own interests the best? Investors in emerging markets usually have little knowledge of the functioning of securities markets, and do not know how to protect themselves. The low demand is very likely the result of ignorance rather than calculated omission. Of course, the low demand of CSE

106 Id.
107 See id. at 78.
information by investors in emerging markets does not imply the necessity of mandatory disclosure. However, it may suggest that governments should do something to elicit the demand, such as facilitating reporting through voluntary guidelines, partnering with certain parties to support reporting, endorsing disclosure by honoring transparent firms, and demonstrating transparency of government as a positive example for companies.¹⁰⁸

For developed markets, voluntary disclosure might be regarded as a deregulatory mechanism to improve market efficiency. For emerging markets, voluntary disclosure might be deemed an (involuntary) alternative to poor governmental regulation in those markets. Voluntary disclosure can be viewed as a form of private ordering—companies and investors can arrange disclosure items and disclosure quality by themselves and without recourse to formal legal institutions. For example, sophisticated institutional investors may negotiate with companies to disclose information. Information credibility may be obtained through private arrangements, such as using sophisticated information intermediaries including investment banks, securities analysts, and auditing firms. Emerging securities markets seem able to thrive on voluntary disclosure. However, the conditions of emerging markets pose great challenges to voluntary disclosure as an approach to advancing CSE disclosure.

First, emerging markets usually do not have experienced institutional investors and qualified information intermediaries. Private ordering takes time to develop. Information intermediaries such as investment banks, securities analysts, auditing firms, and rating agencies need time to build up their reputations. Although it is generally recognized that emerging markets have weak legal systems and that private ordering can be an effective substitute for law, the substitute for securities law in emerging markets may not be easily formed as one may assume for other kinds of commercial transactions.¹⁰⁹ Comparative law studies of emerging securities


¹⁰⁹ The current private ordering literature largely builds on interesting stories about
markets have suggested that strong securities law is a crucial element for the development of capital markets. A prominent example is revealed in the comparative studies of the securities markets in the Czech Republic, Hungary and Poland. In creating their securities markets, Hungary and Poland adopted relatively strong securities regulations, especially with regard to disclosure requirements, while the Czech Republic embarked on an unregulated approach. At that time, some suggested that the Czech Republic would outperform because its strong regulation would stifle the Hungarian and Polish markets, but the result was to the contrary. State regulation may be more important for newly emerging markets than for mature markets; and "[a]s markets evolve and market watchdog institutions, such as rating agencies, emerge, the need for state regulation may decline." Second, private ordering in securities markets does not develop without support from public ordering (law). For example, legal liability is a more powerful determinant than market power for information intermediaries to provide credible information. This may imply that if information intermediaries (e.g., auditing firms) face few legal risks (which is common in emerging markets), the regulatory function of the private institutions would how merchant communities enforce commercial contracts with extra-legal mechanisms, not about securities trading in capital markets. See, e.g., John McMillan & Christopher Woodruff, Dispute Prevention Without Courts in Vietnam, 15 J.L. ECON. & ORG. 637, 640-41, 653 (1999); Barak D. Richman, How Community Institutions Create Economic Advantages: Jewish Diamond Merchants in New York, 31 LAW & SOC. INQUIRY 383, 389, 393-408 (2006) (arguing that the combination of family-based reputation mechanisms and community-based enforcement institutions allows the trading of valuable and portable articles); Lisa Bernstein, Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 J. LEGAL STUD. 115, 115 (1992); Lisa Bernstein, Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions, 99 MICH. L. REV. 1724, 1724-28 (2001).


110 Id. at 270-71.
111 Id. at 275-77.
112 Id. at 254.
be significantly constrained.

In summary, voluntary disclosure is premised on the functioning of private ordering and based on market efficiency. However, most emerging markets do not have sophisticated investors and information intermediaries. Private ordering takes time to develop and even requires input from formal law. For emerging securities markets, private ordering is an important complement, but is not a substitute for securities law. CSE disclosure might eventually thrive under voluntary disclosure, but legal rules indeed accelerate the growth.

B. Mandatory Disclosure

Mandatory disclosure means companies must disclose CSE information under regulatory requirements. Governments may directly mandate public companies to disclose CSE information through legislation. Securities regulatory agencies, pursuant to authority by law, may mandate CSE disclosure through regulations. Stock exchanges, usually private bodies with quasi-governmental authority, may require listed companies to disclose CSE information through listing rules.

The legal and economic conditions of emerging securities markets pose two challenges to mandatory disclosure. One concerns enforcement, and the other concerns the economic effects on small- and medium-sized companies.

The existence of a legal mandate does not warrant compliance; enforcement mechanisms are required. Securities laws or regulations issued by governments have private and public enforcement, both of which use legal institutions—the judiciary or regulatory agencies. However, given that the legal institutions are usually weak in many emerging securities markets, it is difficult to make mandatory disclosure effective. Further, if regulatory agencies and courts are incapable of enforcing law, does that leave mandatory disclosure pointless? The answer may vary with the different institutional environments in different emerging markets. As discussed in Section IV, empirical evidence in China suggests that mandatory disclosure can still effectively press companies to disclose some information when the regulator is actually attentive to this matter.

While stock exchanges are responsible for enforcing their listing rules, many economic interests in the real operation of
stock exchanges may undermine the effectiveness of such enforcement. For example, a stock exchange is generally unwilling to punish companies because that would tarnish the exchange’s public image and make the exchange less attractive for other companies and investors. As discussed in Section IV, current CSE disclosure regulations in emerging markets are usually issued by stock exchanges. The problems of stock exchanges’ willingness and ability to enforce their rules may raise concerns over the effectiveness of CSE disclosure in listing rules.

Another challenge to mandatory disclosure comes from the economic conditions of emerging securities markets. Studies suggest that the degree of corporate social responsibility and transparency is correlated with firm size. Large companies tend to have better performance than small and medium ones partly because of their higher visibility and implementation capability. Additionally, publicly traded companies in emerging markets are usually relatively small compared to those in developed markets. CSE disclosure may be a challenging task especially when the disclosure obligations are very specific. For example, the Global Reporting Initiative (GRI), the leading international CSE disclosure standards, requires sophisticated reporting.

115 See Marcel Kahan, Some Problems With Stock Exchange-Based Securities Regulation, 83 Va. L. Rev. 1509, 1510-18 (1997) (analyzing the factors that make stock exchanges unwilling to punish listed companies, including the brokerage commission arrangements, the listing decision controlled by corporate managers, the oligopoly market for stock listings, and public image concerns).


117 See Stanwick & Stanwick, supra note 116, at 196, 198; Elsayed, supra note 116, at 299.

processes and systems to ensure the accurate and regular flow of information, which may be a great burden for small and medium-sized companies. In this regard, mandatory disclosure may pose an entry barrier to financing through securities markets particularly for small- and medium-sized companies in emerging markets. The economic implications may suggest that policymakers should provide specially tailored technical support for small- and medium-sized companies.

A final note about mandatory disclosure is that its effectiveness may be undermined if the disclosure requirements and standards are unspecific. When adopting mandatory disclosure, policymakers should set out specific rather than vague requirements. There may be no great difference between voluntary and mandatory disclosure if disclosure requirements are vague. Moreover, given that companies in emerging markets are unfamiliar with CSE disclosure, specific requirements may give companies directions of how and what to disclose. As shown in Section IV, currently the CSE disclosure regulations in emerging markets usually lack disclosure details and therefore may not effectively press companies to disclose meaningful information.

C. "Comply or Explain"

The "comply or explain" approach combines market power with mandatory disclosure. Under the comply or explain approach, a company may decide whether to disclose CSE information; but if the company decides not to disclose, the company is obligated to make a statement explaining the nondisclosure.

The comply or explain approach is "based on the assumption that the market will monitor compliance" and "will either (a) penalize noncompliance through lowering share prices" or other mechanisms such as litigation, or (b) "accept . . . that


120 Iain MacNeil & Xiao Li, "Comply or Explain": Market Discipline and Non-Compliance with the Combined Code, 14 CORP. GOVERNANCE 486, 486 (2006).
noncompliance is justified in the circumstances.\textsuperscript{121} The comply or explain approach is usually praised as an optimal approach in developed markets because of its flexibility. But empirical evidence in developed markets does not give much support to markets actually reacting to the comply or explain condition.\textsuperscript{122} The effectiveness of the comply or explain approach may be more elusive given that the approach relies on both legal enforcement and market pressure to some important degree, and emerging markets usually have weaker market and legal underpinnings than the developed markets.

Also, as highlighted in the Statement of the European Corporate Governance Forum on the Comply-or-Explain Principle, there are conditions for the comply or explain approach to truly take effect. The conditions include (1) "a real obligation to comply or explain;" (2) "a high level of transparency, with coherent and focused disclosures;" and (3) "a way for shareholders to hold company boards . . . ultimately accountable for their decisions to comply-or-explain and the quality of their disclosures."\textsuperscript{123} It is very likely that most emerging markets do not meet those conditions. Policymakers in emerging markets should carefully consider the capacity of legal and economic institutions in local markets when adopting the comply or explain approach.

\textsuperscript{121} Id. at 487.

\textsuperscript{122} Bj\örm Fasterling, Challenging "Comply or Explain," MAKING CAPITAL MARKETS WORK THROUGH CORPORATE GOVERNANCE 89, 92 (Madhav Mehra ed. 2008) (arguing that empirical evidence in Germany and the Netherlands shows that markets do not react to compliance or noncompliance; the evidence in UK and Spain does not give much support as well); see generally MacNeil & Li, supra note 120 (questioning the effectiveness of the flexibility provided though the comply and explain principle).

The bottom line function of the comply or explain approach in emerging markets may be that it is still better than having a complete lack of measures in the initial stage of diffusing CSE disclosure practices.

VI. Conclusion

CSE disclosure practices and regulations are growing in emerging securities markets. This may signal that CSE disclosure is not an advanced topic exclusive to developed markets but a basic element in the initial stage of building a securities market. Research on CSE disclosure in emerging markets is still in an embryonic stage and requires further study. This Article examines the CSE disclosure regulations in five emerging markets and shows the different regulatory patterns in these markets. Future research may examine more emerging markets and further explore the factors that render these regulatory differences. Empirical studies on the effects of CSE disclosure regulations in emerging markets are also required. For policymakers in emerging markets, the most cost-saving means of constructing their CSE disclosure agenda would be to consult the experiences of developed markets and copy their measures. However, there is a caveat: Institutional environments in emerging markets are different from the environments in developed markets. A CSE disclosure approach that works in a developed market may not also work in an emerging market. This point is particularly important given that CSE disclosure is associated with legal and market maturity in a securities market. Moreover, CSE disclosure in a securities market is not an issue isolated in securities law, but embedded into the whole legal system concerning corporate behavior, including corporate law, labor and environmental law especially. Blindly transplanting CSE disclosure measures from developed markets into emerging markets without paying attention to institutional differences would be ill-advised. This is not to say that the CSE disclosure approach adopted by an emerging market would be necessarily different from the approach by a developed market, but the analysis of CSE disclosure in an emerging market should add institutional factors, which may strengthen or weaken a given approach if applied in an emerging market.