Corporate Reporting

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In the United States, the shareholder primacy norm posits that corporations should be built solely to respond to the interests of shareholders, who in turn are presumed to care solely about profits. The chief design mechanism for ensuring that these profits are only obtained through prosocial, rather than antisocial, behavior is to make antisocial behavior unprofitable. Regulators fine companies that break the law; consumers will not buy harmful products, and will shun corporations with a record of poor behavior; employees will flock to more prosocial competitors. Ultimately, the theory goes, antisocial business models will become expensive, and companies – purely in search of greater profits – will become better corporate citizens.

In order for this system to work, however, corporate stakeholders must have information. Regulators cannot prohibit undesirable practices if they do not know about them; employees cannot seek greener pastures if they are unaware of their options.

In the United States, however, the only system of holistic reporting for businesses is imposed by the federal securities laws. Because these laws are designed to protect investors, they focus on financial performance rather than social performance, and they do not require businesses to report at all when investors have no need for information (such as when businesses are privately held).

This system is dysfunctional. It places a thumb on the scales in favor of investors – providing them with the information they need to direct corporate behavior toward profit-seeking – without giving stakeholders countervailing power to punish profit-seeking via antisocial methods. Stakeholders frequently try to expand securities disclosures to include social information, but that requires them to reframe the information they seek as pertaining to corporate wealth maximization, potentially distorting any disclosures and muting their utility for noninvestor audiences.

This stands in marked contrast to the European Union which, over the past several years, has been developing a corporate disclosure system for all companies of a certain size, with social reporting intended not only for investor audiences, but also for other corporate stakeholders.

The United States should follow in the EU’s footsteps by developing a system of mandated disclosure for all large companies (measured by assets, employees, and revenues), intended to allow stakeholders to evaluate companies’ social performance. The relevant disclosures would include such matters as financial information (including issues pertaining to tax payments, anticorruption measures, and antitrust compliance), corporate governance, environmental impact, labor relationships (including diversity, working conditions, and pay practices), political activity, and customer protection (transparency, safety, privacy). This would be an important step toward empowering stakeholders to extract a price for corporate misbehavior, and ultimately align shareholders’ interests with the interests of society as a whole.