How do CSR Rating Schemes Influence Corporate Behavior?
Lessons from the Utility Industry

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ABSTRACT

Ninety-three percent of the world’s largest 250 companies report data to voluntary corporate social responsibility (CSR) rating schemes, and over 380 CSR rating schemes exist to assess companies’ corporate actions. While reporting to CSR rating schemes may signal that a company takes responsibility for its environmental, social, and economic impacts, the correlation between responding to CSR rating schemes and taking meaningful action to minimize those impacts is still not entirely clear. This thesis asks, “Does responding to CSR rating schemes encourage corporate sustainability within organizations in the electric utility industry?” I sought to answer this question by conducting in-depth interviews with representatives of six companies in the electric utility sector about their reporting approach to the two most widely used rating schemes, the Carbon Disclosure Project (CDP) and the Dow Jones Sustainability Index (DJSI). I focused on the electric utility industry to ensure comparability and because this sector is strongly positioned to signal corporate sustainability trends given its current technological transformation, traditional use of fossil fuels, and heavily regulated structure. Based on these interviews I conclude that CSR rating schemes have succeeded in encouraging companies to disclose corporate sustainability data through voluntary mechanisms, but due to the existence of some perverse incentive structures, reporting does not fully motivate increased participation and action on corporate sustainability. Positively, CSR rating schemes lead companies to gather and centralize internal data across business units. In addition, external recognition from high CSR scores drives pride in corporate sustainability efforts and draws the attention of executives. However, CSR reporting lacks value for those utilities without end-use customers, does not provide commensurate value for the time required to participate, drives companies to focus primarily on reporting rather than on making substantive changes, and leads to mistrust in the CSR rankings because of the difficulty in understanding scores. Based on these findings, I recommend restructuring CSR rating schemes to provide multiple, issue-based scores to each company; replacing cross-sector assessment with sector-specific assessment; and revising the current assessment approach to include in-depth, on-site valuations of corporate efforts.

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Introduction

The term “corporate social responsibility” (CSR) describes an ethical and transparent way of doing business. It has grown to encompass a field dedicated to ensuring that companies uphold positive voluntary environmental, social, and economic standards in addition to, and at times in the absence of, mandatory requirements. While scholars, environmental groups, and business executives debate CSR’s exact definition, it relates closely to a host of other concepts, including corporate citizenship, corporate accountability, and corporate sustainability. CSR describes the responsibility of corporate actors to consider and reduce the impacts of their business on society at large, and corporate sustainability is considered a strategic business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments (Dow Jones Sustainability Index, 2015). Advocates often cite CSR in relation to a company’s actions to manage current risks, while corporate sustainability takes into account the longer term positioning of a business to align with economic, environmental, and social changes.

While competing definitions of CSR form the basis for academic and corporate debate, CSR reporting organizations have forged ahead and sought to measure corporate commitment to CSR by setting a baseline for ethical and transparent business practices. CSR reporting frameworks, also known as CSR rating schemes, are voluntary disclosure programs operated by third parties such as NGOs or socially responsible investors. CSR rating schemes publicly score companies on their sustainability practices and have done so for the past 20 years. Currently, estimates suggest that there are over 380 documented CSR rating schemes working to assess companies’ sustainability reporting practices (CSRHub, 2015). Rating schemes aim to solicit corporate data, thus exposing what companies are doing and how they are defining CSR. While the last two decades of CSR reporting have helped companies increase their transparency and accountability to stakeholders, it is more difficult to measure whether responding to CSR rating schemes helps companies achieve environmental or social sustainability goals, for example, company-wide greenhouse gas (GHG) emission reduction.

According to researchers, adhering to outside standards like CSR schemes may signal both internally and externally that a firm is taking responsibility and moving
towards corporate sustainability (Bertels, 2010). However, the relationship between CSR rating frameworks and internal corporate sustainability practices is still not entirely clear. In fact, some researches consider those companies that score highly on CSR rating schemes to be laggards in corporate sustainability as opposed to leaders, as high scores may indicate that they focus their attention, time and resources on becoming more adept at responding to CSR rating schemes and not on systematic sustainable change, in this case, GHG emission reduction (Bertels, 2010). The relationship between CSR reporting and corporate sustainability is important because an increasing number of stakeholders currently rely on CSR ratings to help inform investment and consumer decisions (SustainAbility, 2010a). As more companies report to CSR rating schemes, and as more rating schemes emerge, investors and consumers take CSR scores more seriously. While this is a positive development, the more consumers pay attention to these scores, the more important it is that researchers understand the relationship between CSR scores and corporate sustainability.

The central question of this thesis is, “Does responding to CSR rating schemes encourage corporate sustainability within organizations in the electric utility industry?” To answer this question, I interviewed employees of six companies in the electric utility sector about their approach to the two most widely used CSR rating schemes, the Carbon Disclosure Project (CDP) and the Dow Jones Sustainability Index (DJSI). The employees interviewed for this research included mid-to upper-level managers in director roles with an average of eleven years of experience in the industry. Due to the variance of corporate governance structures for CSR reporting, these managers belong to a range of internal teams focused on environmental policy and services, corporate communications, supply chain operations, climate change risk, and data management. In addition to in-depth interviews, my research included analyses of the latest reports and academic papers on CSR reporting and additional interviews with experts with experience in corporate sustainability reporting and electric sector sustainability. Finally, I draw on my own experience—seven years of professional experience helping electric utility companies respond to voluntary rating schemes—to evaluate how the CSR reporting process encourages (or discourages) corporate sustainability.
I restricted my research to the electric utility industry to ensure participants interviewed shared similar issues of material risk, regulatory responsibilities, corporate structure, and operational challenges and opportunities. In addition, I chose to focus on the U.S. electric industry because corporate sustainability poses a particular challenge to the sector in that its primary product, electricity powered by fossil fuels, is antithetical to traditional environmental goals, and therefore corporate sustainability forces this sector to make investment decisions that pose challenges to the sector's traditional business model. At the same time, the sector's increasing integration of renewable energy, demand response, and energy efficiency programs place it at the forefront of the current transition towards a more sustainable economy. My research approach aimed to maximize the candor of the interviews and the in-depth understanding of each participant's experience in regards to reporting to CSR frameworks. For the purposes of this thesis, I equate corporate sustainability in the electric sector to the mitigation of GHG emissions; the most measurable and the most critical corporate sustainability metric to the electric utility industry.

Of the six companies interviewed for my research, three currently respond to CDP and to DJSI. Two of the six have never responded to either CSR rating scheme, and one stopped reporting to DJSI and CDP in the last two and four years, respectively. Table 1 outlines the participating companies and their current CSR reporting practices.

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Company Type</th>
<th>CDP</th>
<th>DJSI</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 1</td>
<td>Investor Owned Wholesale Power Producer</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Company 2</td>
<td>Investor Owned Electric Utility</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Company 3</td>
<td>Investor Owed Integrated Energy Company</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Company 4</td>
<td>Investor Owed Integrated Energy Company</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Company 5</td>
<td>Private Independent Power Producer</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Company 6</td>
<td>Investor Owned Electric Utility</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Part 1 of this thesis examines the original intent and objectives of CSR rating schemes to better understand what they hope to achieve, with a particular focus on
corporate sustainability within the electric sector. Part 2 assesses how electric utility companies are responding to CSR rating schemes and the successes and challenges of the current reporting approach. Part 3 recommends alternative approaches to CSR rating schemes to more effectively encourage reporting companies to take internal action around sustainability.

My research finds that CSR rating schemes achieve some of their intended goals but also create perverse incentives to operate in ways that are antithetical to corporate sustainability. Positively, CSR rating schemes lead companies to gather internal data on important environmental, social, and economic metrics, and motivate them to centralize this data across business units and improve upon it between reporting years. In addition, the external recognition received from a CSR rating drives company pride in corporate sustainability efforts and draws the attention of executives to the reputational benefits of high CSR scores. However, my research finds that CSR reporting lacks value for those utilities without end use customers, provides a poor time-to-value ratio for participants, drives companies to justify sub-optimal internal practices in order to obtain a high score, and, through a lack of scoring explanation, drives mistrust in the CSR rankings.

Based on these findings, I recommend three broad changes in the approach of CSR rating schemes to better incentivize measurable action toward corporate sustainability. First, restructuring the scoring methodology to include three to four issue-based scores per company would maintain the incentive for external recognition but provide better context for scores. Second, replacing cross-sector assessment with sector-specific assessment would provide more value to utilities in the reporting and scoring stages and encourage industry collaboration towards sustainability. Third, revising the current arms-length assessment approach to include an in-depth, on-site assessment of corporate sustainability efforts would elevate the process over the end score and instill more trust in CSR rankings. Ultimately, my research shows that CSR reporting has succeeded in making it common practice for companies to track and disclosure non-financial data through voluntary mechanisms. However, for the electric utility sector, CSR rating schemes can potentially drive increased corporate action on sustainability goals such as GHG mitigation by eliminating the existence of perverse incentive structures.
Part 1: What Do CSR Schemes And Frameworks Hope To Achieve?

For the past two decades, reporting through CSR rating schemes has been one of the primary positive outcomes of the corporate sustainability movement. Disclosing information has helped companies increase their transparency and accountability to stakeholders and better define what corporate sustainability best practices should look like. Given the number of companies that currently report to schemes like CDP and DJSI, the current challenge is not to encourage more reporting, but to examine whether reporting to CSR rating schemes encourages corporate sustainability.

CSR rating schemes are voluntary disclosure programs operated by third parties such as NGOs or socially responsible investors. These schemes include CDP and DJSI, among many others. As of 2010 there were over 380 documented CSR rating schemes (CSRHub, 2015). Companies report CSR-related metrics via the schemes’ standardized questionnaires and receive annual scores based on the rating schemes’ methodology for determining the strength of corporate sustainability disclosure and/or performance. As of 2012 roughly half of CSR rating schemes measured both corporate disclosure and performance (SustainAbility, 2010b). Participation in these schemes entails following specific guidance provided by the rating scheme to draft a comprehensive report with complete answers to all framework questions. Rating agencies assign scores based on the completion of each question, the inclusion of quantitative data, and the association with company-specific examples (CDP, 2015a). Rating scheme questions focus on key performance indicators (KPIs) around environmental, economic, and social goals and vary slightly depending on the rating scheme.

Rating agencies design the annual public disclosure of corporate data to CSR rating schemes to promote corporate transparency and enable companies to identify and address key issues of stakeholder concern. These agencies originally created CSR rating schemes to help investors and other stakeholders (i.e., consumers, employees) benchmark companies across sectors by presenting a universally relevant range of metrics. Sustainability reporting advocates assert that, “what gets measured, gets managed” and that corporate transparency positively impacts a company’s sustainability performance (Mosher et al., 2014). Developers of CSR rating schemes assert in their mission statements that the reporting and tracking of corporate sustainability goals minimizes
business risk and increases the likelihood of financial stability. In addition, they contend
that public disclosure helps positively influence public opinion of corporate
environmental and social performance.

Voluntary reporting of CSR metrics continues to be the primary means of
disclosure, although the existence of mandatory disclosure requirements has also helped
to drive CSR reporting. For example, the Securities and Exchange Commission (SEC)
requirements called for public companies to report potential environmental costs and
liabilities in accordance with the Sarbanes-Oxley Act of 2002. In response to requests
from investors, in January 2010 the SEC issued guidance mandating specific disclosure
of climate-related risk as “material” to business and issued formal guidance for
companies regarding the climate risk information they should disclose in their annual and
quarterly filings. The definition of a material business risk that companies should legally
include in SEC filings remains a topic of debate among CSR rating framework
developers, shareholders, companies, and corporate lawyers. According to the U.S.
Supreme Court, a fact is material if, in the event a company omits such a fact from a
particular disclosure, there is “a substantial likelihood that the disclosure of the omitted
fact would have been viewed by the reasonable investor as having significantly altered
the ‘total mix’ of the information made available” (SASB, 2015). However, each
company is ultimately responsible for determining what is material to its organization, as
materiality is relative to the size and particular circumstances of individual companies
(SASB, 2014).

Increasing stakeholder awareness of corporate sustainability issues has driven an
increase in voluntary reporting on CSR metrics in recent years. In 2013, investors filed a
record-breaking 417 social and environmental shareholder resolutions, an increase from
365 in 2012 (Elks, 2013). In part due to this rise in shareholder proxy filings for
environmental and social corporate data, and in part due to competition among
companies, voluntary sustainability reporting has become commonplace among large
companies. In fact, among the world’s largest 250 companies, the CSR reporting rate is
more or less stable at 93 percent (KPMG, 2013). This means that thousands of companies
are voluntarily participating in environmental and social goal-setting beyond existing
regulation or legislation. According to a SustainAbility research project titled Rate the
Raters, of the 108 rating schemes in their inventory, only 21 existed in 2000 (SustainAbility, 2010b). More than a third of these schemes emerged after 2005 (SustainAbility, 2010a). As more companies report their practices to stakeholders via CSR rating schemes, companies feel increasing pressure to meet or exceed the current quality of disclosure and performance among industry peers. This results in a reinforcing loop of corporate disclosure and stakeholder expectations.

**Background on CDP and DJSI**

I focus on the two CSR rating schemes most commonly used in the electric utility sector: CDP and DJSI. These schemes, especially CDP, have a heavily environmental focus that aligns with the risks faced in the electric utility sector. DJSI includes more social performance indicators in its questionnaire but is similar to CDP in its reporting process and scoring methodology, which rates companies on a public 1 to 100 scale. Both CDP and DJSI set out to encourage better corporate transparency regarding private sector impacts on environmental and social issues and to use the process of reporting and the corporate ranking system to spur better corporate performance.

CDP and DJSI are two of the earliest and most widely used CSR rating schemes. According to a 2012 SustainAbility poll, respondents considered DJSI and CDP the most credible, respectively, of the 16 most well-established rating schemes (SustainAbility, 2010b). Other well-known CSR frameworks exist but are outside the scope of my research. For example, The Global Reporting Initiative (GRI) is a heavily used CSR framework in the electric utility sector, however because GRI is self-scored by the reporting company without a third-party rating organization, I do not consider it a comparable rating scheme. In addition, the Sustainability Accounting Standards Board (SASB) is in the process of releasing sector-specific standards for companies listed in the United States in 80 industries within 10 sectors. SASB aspires to provide guidance for companies to include non-financial information in their mandatory financial reports, including their 10-K statements (Mosher et al., 2014). While SASB has had significant

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1 In order of most to least credible, the SustainAbility survey results include: DJSI, CDP, FTSE4Good Index Series, Global 100 Most Sustainable Corporations, Bloomberg SRI, Fortune’s Most Admired Companies, Newsweek’s Green Rankings, Wal-Mart Sustainability Index, KLD 400 Social Index, CRO’s 100 Best Corporate Citizens, Oekom Corporate Ratings, GoodGuide, Covalence Ethical Quote Rankings, Vigeo Ratings, ASSET4 EST Ratings, and Access to Medicines Index.
impact on the field of corporate sustainability reporting, SASB does not provide a score or rating to companies.

Founded in 2000, CDP, previously known as the Carbon Disclosure Project, is an independent not-for-profit organization that releases standardized questionnaires annually on behalf of 822 institutional investors holding $95 trillion in assets to help reveal the risk in their investment portfolios (CDP, 2015b). Largely funded by foundations and governments, CDP works with investors globally to advance the investment opportunities and reduce the risks posed by climate change by asking over 6,000 of the world’s largest companies to report on their climate strategies, greenhouse gas emissions and energy use in the standardized questionnaire format (CDP, 2015b). One of the key principles behind CDP is transparency. A company’s CDP response is public and thus current and potential investors, customers, and other interested parties can view this information. CDP scores responses, ranks companies and releases the results publicly every September. In addition to the original and most commonly used Investor CDP questionnaire focused on climate change, CDP also solicits responses to topic-specific questionnaires with topics including water, supply chain, forestry, and cities.

CDP’s mission is based on the belief that the process of measuring and disclosing information creates incentives for companies to better manage their impact on the environment. CDP asserts that by reporting companies are able to see where they can make strategic changes to increase efficiency, save money and capitalize on commercial opportunities. For example, according to CDP, more than 90 percent of companies reporting through CDP’s water program now have water management plans in place (CDP, 2013). Not only does CDP’s reporting process aim to drive increased disclosure around a company’s environmental and social impacts, but it also aims to get the attention of senior leadership by ranking companies against peers, thereby using CSR reporting and rating to encourage the internal adoption of strategic corporate sustainability practices.

CDP ranks companies responding to the Investor CDP Program with the highest scores for disclosure and/or performance in the Carbon Disclosure Leadership Index (CDLI) and the Carbon Performance Leadership Index (CPLI). According to CDP’s results, these companies are making progress in emissions reduction, environmental
disclosure, risk management and corporate transparency faster than their peers. Initially, CDP only scored company disclosure through a weighted scoring methodology on a scale of 1 to 100. However, in 2010 CDP added a corporate performance score assessed on a letter grade A to D. A presentation of U.S. electric utility disclosure and performance scores for the 2013 CDP Investor questionnaire is shown in Figure 1 below. The highest scoring companies (e.g. Entergy, Exelon, and Pepco Holdings, Inc.) were judged by CDP to be the most transparent and thorough in terms of disclosure, and to have exemplified best practices in terms of performance, including relative reductions in GHG emissions.

Figure 1. CDP Scores for the U.S. Electric Sector (M.J. Bradley & Associates, 2013)

Similarly to CDP, DJSI has a long history of soliciting CDR data from the world’s leading companies. Founded in 1999, DJSI was the first global index to track the world’s 2,500 largest companies from 58 industries based on their sustainability
performance. DJSI requests information through a survey featuring between 80 and 120 questions (depending on the industry) on “financially relevant economic, environmental and social factors” (DJSI, 2015). Using this data, DJSI aims to encourage companies to adopt goals that increase their corporate sustainability performance, such as company-wide air pollution and GHG emissions reduction. DJSI uses the data it collects to enable investors to integrate corporate sustainability criteria into their investment portfolios.

Each company that reports to DJSI receives a score between 0 and 100 points. DJSI assigns each question a pre-defined and different weight. The intent behind this weighting is to compare companies against their peers to identify leaders in the most accurate way. Like CDP, the objective of DJSI scoring is to assess the relationship between a company’s awareness of environmental and social criteria and its financial success and implementation of strategies to manage risks and capitalize upon opportunities. In addition, DJSI rates how a company measures its results from existing sustainability efforts, validates these results with a third party audit, and clearly communicates its CSR efforts and targets.

**Corporate Social Responsibility in the Electric Sector**

As a highly regulated sector, regulatory compliance and the legal mandate to provide safe, affordable, and reliable electricity drives the decisions of electric utility managers. The fact that the utility industry results in a “natural monopoly” justifies governmental oversight of the utility sector. The sector provides an essential service for the well-being of society, and the technological and economic features of the industry are such that a single provider is able to supply the overall demand at a lower total cost than a combination of smaller entities could (Regulatory Assistance Project, 2011). Because competition cannot thrive under these conditions, utilities theoretically could restrict supply or set prices higher than justified without government oversight. As a result, state commissions regulate the distribution of electricity and the states or the Federal Energy Regulatory Commission (FERC) oversee transmission.

Electric utilities include investor-owned, publicly owned, cooperative, and federal utilities, resulting in a range of governance models within the sector. In addition, some utilities are vertically integrated to include generation as well as transmission and
distribution, while others may only generate power, such as an independent power producer, or deliver it to customers, such as a utility distribution company. Investor-owned utilities, or IOUs, serve about 75 percent of the U.S. population, and are financed by a combination of shareholder equity and bondholder debt (Regulatory Assistance Project, 2011). IOUs have accepted an obligation to provide a public service in return for a regulatory agreement that the government will compensate the utility fully for the costs incurred to meet the utility’s public service obligation. While subject to regulation, IOUs are private companies that make profits for shareholders by building a profit margin into their electricity margins, which are set by state public utility commissions (PUCs).

The generation of electricity in the U.S. relies on fossil fuels (coal, natural gas, and oil), nuclear power, hydroelectricity, and non-hydroelectric renewable sources. In 2012, 68 percent of electric power was produced from fossil fuels, 19 percent was generated from nuclear power, 7 percent from hydroelectricity, and 4 percent from non-hydroelectric renewables like wind and solar. This combined generation produced approximately 4 billion megawatt hours of electricity in 2012. The burning of fossil fuels results in the release of SO₂, NOx, mercury, and CO₂ into the air. In 2012 power plants were responsible for about 37 percent of U.S. CO₂ emissions, and the electric industry as a whole accounted for more CO₂ emissions than any other sector, including the transportation and industrial sectors (M.J. Bradley & Associates, 2014).

Because of their associated public health and environmental impacts, SO₂, NOx, mercury, and most recently greenhouse gases (GHGs) are regulated under the Clean Air Act. In 2013, the U.S. Environmental Protection Agency (EPA) triggered a legal obligation to promulgate an additional rule under section 111(d) of the Clean Air Act that would limit greenhouse gas emissions from existing power plants. The president directed the EPA to finalize the rule by June 2015. As this regulatory mandate moves forward, it is affecting the mix of U.S. electric generating resources by driving investment in new, low carbon technologies such as wind and solar energy and encouraging the retirement of inefficient highly polluting power plants (M.J. Bradley & Associates, 2014).

Given EPA’s promulgation of greenhouse gas regulations, as well as other market factors—particularly the abundance of cheap natural gas—the electric power industry is undergoing a significant transition. Electricity demand growth has been relatively flat and
natural gas prices have remained low leading to more natural gas use in electric generation (M.J. Bradley & Associates, 2014). In addition, utilities are facing the increasing integration of renewable sources into the electric grid, requiring integrated power management. As a result, electric utilities expect to cope with rising costs, decreased sales of electricity in developed markets, and increasing competition from decentralized generation such as solar energy (RobecoSAM, 2014). These changes will transform the electric industry in coming decades.

Due to the environmental and health risks associated with burning fossil fuels, electric utilities are a critical sector for the adoption of practices that enhance their corporate sustainability. Given their regulatory responsibilities, electric utility managers have a legal mandate to provide safe, affordable, and reliable electricity. Therefore, corporate sustainability-related efforts must account for this responsibility. In addition, efforts to reduce emissions or water use or to invest in renewable technologies may require capital expenditures that must be approved by the state utility commission and may result in increased electricity rates for customers (The Electric Power Research Institute, 2013).

The Electric Power Research Institute (EPRI) developed a list of the fifteen most material sustainability issues in the electric industry in the environmental, social, and economic categories, including greenhouse gas and other air emissions, public safety and health, and energy reliability (Table 2). Because of the electric sector’s use of fossil fuel to provide power, greenhouse gas emission reduction is the primary topic of stakeholder concern for the electric utility industry. According to the Investor Network on Climate Risk, 110 shareholder resolutions relating to climate and environmental issues at over 94 oil, coal and electric power companies were filed in the 2013 proxy season (M.J. Bradley & Associates, 2014).
Table 2. 15 Most Material Sustainability Issues in the Electric Sector (EPRI, 2013)

<table>
<thead>
<tr>
<th>Environmental</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greenhouse gas emissions</td>
</tr>
<tr>
<td>Reductions of other air emissions</td>
</tr>
<tr>
<td>Water quality</td>
</tr>
<tr>
<td>Water availability</td>
</tr>
<tr>
<td>Habitat protection and biodiversity</td>
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<tr>
<td>Waste management</td>
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</tbody>
</table>

<table>
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<tr>
<th>Social</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public safety and health</td>
</tr>
<tr>
<td>Employee safety and health</td>
</tr>
<tr>
<td>Job satisfaction</td>
</tr>
<tr>
<td>Community support and economic</td>
</tr>
<tr>
<td>development</td>
</tr>
<tr>
<td>Engagement and collaboration</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Economic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy reliability</td>
</tr>
<tr>
<td>Energy affordability</td>
</tr>
<tr>
<td>Skilled workforce availability</td>
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<tr>
<td>Economic viability of electric utilities</td>
</tr>
</tbody>
</table>

According to EPRI, there is a fundamental challenge in meeting corporate sustainability targets in the electric power industry. As stated by electric utility managers, “There is a tight-wire act between environmental concerns, customers, employees, and financial obligations” (EPRI, 2013). To utility operators, what matters most is delivering safe, affordable and reliable electricity. According to those in the industry, “We try to apply a sustainability filter. It’s about getting the right balances and asking the right questions, as well as facing the tradeoffs between our own economic viability, customer prices, and our environmental footprint” (EPRI, 2013).
Part 2: Are CSR Rating Schemes Achieving Their Goals?

Despite the assertion by CDP and DJSI that reporting to CSR rating schemes creates incentives for companies to better manage their environmental and social impacts, research shows that reporting to these schemes may incentivize behaviors not entirely focused on corporate sustainability. The following discussion lays out the current debate about whether CSR rating schemes drive corporate responsibility.

Early in the adoption of voluntary corporate sustainability reporting, researchers claimed that the response to CSR reporting was one of positive internal change. In 1999, researchers Howard, Nash and Ehrenfeld proposed that adopting voluntary codes could be a mechanism to build a collective identity around sustainability within an organization (cited in Bertels, 2010). While voluntary codes lacked repercussions for non-compliance (by definition), the potential for transformation existed as a result of peer pressure both internal to the company and from industry peers who also adopted voluntary codes. Other researchers suggest that adherence to voluntary standards and seeking certification (e.g. through a CSR rating scheme) can reinforce internal corporate sustainability objectives, lead to continuous operational improvement, and improve internal morale (cited in Bertels, 2010). This research echoes the assertion of CDP and DJSI that there is a strong correlation between responding to CSR rating schemes and the adoption of meaningful corporate sustainability efforts.

However, subsequent research does not support the contention that voluntary certification reinforces a firm’s commitment to social responsibility. Bansal and Hunter suggest instead of a voluntary certification leading to internal commitment, the causal relationship occurred in the opposite direction (cited in Bertels, 2010). Early adopters of voluntary certification were most likely aiming to reinforce their existing strategies, and therefore already had an internal commitment to sustainability before adopting an external standard (cited in Bertels, 2010). While the reinforcement of an existing culture through voluntary disclosure is by no means negative, this is not the causal relationship that CSR rating schemes primarily claim to incentivize.

Some research finds that the positive impact of corporate environmental reporting is primarily an external public relations exercise, with little impact on improving environmental awareness (Bertels, 2010). Many environmental groups use the term
“green washing” to describe companies that communicate their environmental initiatives for the purposes of public relations with no deep internal commitment, but CSR rating schemes were designed to eliminate this practice through the extraction and scoring of detailed corporate data. Rating agencies like CDP and DJSI designed CSR rating schemes to incentivize deeper adherence to best practices.

Additional criticisms note that CSR rating schemes’ heavy reliance on submitted information raises the risk of rewarding responsiveness instead of internal corporate investments in corporate sustainability goals. In this way, those companies with the greatest capacity and resources to respond to ratings schemes receive the highest scores, rather than those companies with the best performance (SustainAbility, 2010b). Furthermore, this emphasis on responsiveness may encourage companies to direct corporate sustainability resources to reporting. While doing so promotes increased transparency, as the ratings increase in number companies run the risk of prioritizing reporting ahead of investments in corporate sustainability.

Some researchers argue that these challenges should be expected when applying uniform compliance frameworks like CSR rating schemes to an opaque field like corporate sustainability. Rigid frameworks may be poorly equipped to deal with this complexity. The ensuing tension creates a tradeoff that enhances the disparity between means and ends, encouraging some companies to symbolically adopt compliance while failing to achieve the intended goals. Alternatively, the tension CSR rating schemes create between encouraging companies to adhere to “the letter” rather than “the spirit” of corporate sustainability thwarts the achievement of the intended goals by failing to stimulate creative solutions. In this way, “the upside [of an opaque field like corporate sustainability] is that these multiple connections offer the opportunity to design and implement multiple solutions. In other words, different means can be used to achieve the same ends” (Wijen, 2014).

The following empirical research from managers in the electric utility sector categorizes the ways in which CSR rating schemes both support and impede the adoption of corporate sustainability practices. I interviewed participants about their approach to the CSR reporting process, from choosing to participate in CSR rating schemes, to allocating internal resources, gathering data, drafting and submitting a report, and receiving scores.
from the CSR rating scheme. I discuss those elements of the CSR rating process that drove positive value to the company first, followed by those that were seen as less valuable to the companies’ business and corporate sustainability goals.

**How CSR Reporting Encourages Corporate Sustainability**

The research gathered from electric utility managers on their behavior in response to CSR rating schemes shows that parts of the CDP and DJSI process clearly incentivize internal action, such GHG emission reduction, particularly in the “data gathering” and “external recognition” stages. However, the research also shows that interviewees are uncompelled or frustrated by the traditional reporting options available, are at times driven by management to focus heavily on acquiring the points that make up their annual score, and are skeptical of the final rankings. As a result, there is a missed opportunity for a more candid discussion of challenges, an increased focus on corporate sustainability programming and processes, and for flexibility in achieving corporate sustainability goals. There is also a large opportunity to better incentivize participation in corporate sustainability efforts like GHG emission reduction by those companies that see no value in corporate reporting yet have their own internal commitments. While CSR rating schemes have an important place in evaluating environmental and social disclosure, the current reporting process overlooks other opportunities for increased motivation.

**Internal Data Alignment**

For those companies that respond to CSR rating schemes annually, it is common practice to have an internal network of environmental, economic, and social subject matter experts participating in the annual reporting process. While each of the six companies I interviewed had a different internal corporate governance structure, most historically housed their sustainability efforts in their Environment, Health and Safety (EHS) department and have since transferred reporting responsibilities to the corporate communications or environmental affairs departments.

Gathering the range of data necessary to respond to CSR rating schemes requires considerable internal collaboration among various departments and levels of management. This coordination can sometimes pose hurdles. For example, the interviewee from Company 4 expressed an internal challenge with the corporate
environmental team’s ownership of the reporting data and this team’s reticence to share some of this data publicly in the detailed formats the CSR schemes request. Despite such tensions, the interviewee from Company 4 noted that developing and maintaining these internal relationships helps to streamline internal data collection and to ultimately embed corporate sustainability goals among many corporate departments.

Interviewees also mentioned the ways in which they have succeeded in turning their desire for high scores into internal action during the “data gathering” phase. Company 4’s representative described their annual effort to improve scores as an “energy treasure hunt for reduced consumption - an additional effort for sure, but it is about getting [our actions] on people’s screens.” The interviewee from Company 2 added an internal incentive for increasing the response of their suppliers to the CDP supply chain questionnaire to 60 percent in 2015. This interviewee noted that a question on internal commitments to CDP was asked on a recent shareholder call, an obvious incentive for working hard to aggregate internal corporate data. Company 1’s representative, although not a participant in CSR rating schemes, stated that they believed participating in CSR reporting would be valuable for the opportunity to more clearly track internal data. Improving the quantity and quality of their corporate internal data around emissions reduction and water use reduction was the one piece of CSR reporting viewed as highly beneficial to their business. In addition, Company 2’s representative stated that the most valuable aspect of reporting is the incentive to undertake different measures to improve scores, and the resulting corporate effort to find places where the company can improve emissions and save money at the same time. This interviewee gave a specific example of a waste disposal program that resulted in monetary savings and emission reductions.

Pride in the Scores

External recognition was the key incentive behind companies’ decisions to participate in CSR rating schemes. CSR rating schemes are designed under the assumption that publicly ranking the companies that report provides the motivation to disclose. In this way, Company 4’s representative noted the value of external corporate recognition in helping to drive the company to engage and communicate with stakeholders on environmental and social issues. Furthermore, due the external nature of CSR scores, Company 4’s participation in CDP was the first time top-level management
looked closely at the internal environmental data that the company was reporting. “If a company is ranked high, it looks good for everyone and provides the opportunity to talk internally in a positive way.” While scoring high drives improved employee morale, Company 4’s representative expressed that alternatively, it is difficult internally when they are ranked low due to the publicity of the scores. The interviewee from Company 2 agreed on the repercussions from a low score, and noted the brand recognition that CDP and DJSI may be playing into through their approach; “People pay attention to our scores because they have brand value.” CSR rating schemes recognize this brand value when designing their reporting frameworks. Executives understand the value of publicly showing customers that they are engaged on issues of environmental and social stakeholder interest, and, as shown in the case of Company 4 and 2, their participation in CSR reporting can drive organizations to deepen these external and internal conversations around corporate sustainability.

How CSR Reporting Does Not Encourage Corporate Sustainability

While interviewees agreed upon the value of data gathering and external recognition in motivating internal corporate alignment on sustainability targets, there was more negative feedback than positive on the relationship between CSR reporting and corporate sustainability efforts. Specifically, interviewees noted a lack of value to business-to-business companies, not enough value received for the time committed to reporting, an incentive to focus on the score rather than on programmatic sustainability work, and a lack of trust in the CSR rating scores.

Lack of Value for B2B Companies

The first objective of CDP and DJSI is to incentivize participation. However, among interviewees, this stage resulted in an immediate dichotomy of opinions within the electric sector. Of those engaged in reporting, all were IOUs with retail customers. Those who do not participate in reporting were independent power producers (IPPs) with generation but no retail customers. Due to their business-to-business (B2B) operations, these IPP’s did not see the value of CSR reporting to their wholesale business model. Furthermore, given EPA’s recent regulation of greenhouse gases from existing sources under Section 111d of the Clean Air Act, these company’s resources are currently
focused on meeting mandatory policies, or “turning the hose on the fire closest to the house.” In summary, those companies with power generation and no retail customers see more value in focusing their efforts on better complying with mandatory standards than with voluntary standards like CSR rating schemes.

The fact that there are two very different types of power companies is not well known to those outside the electric sector, including to those producing and reading CSR reports. According to the interviewee from Company 1, “To assume that the sector is homogeneous results in too consistent a set of measuring sticks.” According to Company 5’s representative, there is an unspoken public relations battle between IOUs and IPPs. IOUs do much more public relations work and spend more on lobbyists, but the IPP world represents most of the new electric generation being built. “Because IPPs are developing new units in a competitive, regulatory uncertain landscape, we know better how to perform on the environmental side when it comes to generation. That contrast isn’t known to people.” This interviewee went on to say, “We like to have a good reputation, but we already have that in D.C., where we are the ‘good guys’ by any standard, as well as in our local community, where we believe the rubber really hits the road. We don’t need a report to make that known.”

This separation between business-to-business and business-to-customer operations is not exclusive to the electric industry. Even in the retail sector, those companies with no consumer-facing business agree there is little to no value to them in voluntary CSR reporting. While they, like the electric sector, are subject to numerous mandatory audits and EHS policy compliance, there is no driver for participating in CSR schemes (Mar, P., personal communication, October 31, 2014). With arguably no direct business value, and if they are complying with mandatory standards and have good local and national reputations, B2B companies may not see the need to participate in CSR rating schemes to be engaged in corporate sustainability.

The way rating agencies currently structure CSR rating schemes, only customer-facing companies see an incentive to participate. This dynamic disincentivizes a large portion of companies to disclose their CSR metrics, and creates a false perception that only those companies that participate in rating schemes consider corporate sustainability in their long-term business strategies.
**Poor Time-to-Value Ratio**

Participants familiar with responding to CSR rating schemes widely accept the administrative burden of reporting, known as “reporting fatigue.” However, researchers have not substantially documented the time and resources companies spend on CSR rating schemes. According to CSRHub, an online dashboard that aggregates CSR rating information into one data set, there are 383 rating schemes currently in use. Furthermore, EPRI’s Energy Sustainability Interest Group, which was launched in 2008 and actively works with CSR rating schemes, has counted a total of 448 metrics that the electric utility industry must track for participation in voluntary rating schemes (Scott, M., Personal Communication, May 4, 2015). According to the interviewee from Company 4, “The sheer volume of resources needed to respond makes it hard to progress. There are too many things to worry about.” This interviewee stated that every year they expect the rating schemes will better streamline the data required to eliminate repetition, reduce the reporting timeline, and accept duplicative data in formats companies are already required to report through EPA mandatory reporting rules. But the schemes rarely make these changes and the amount and detail of information required remains substantial. According to Company 4’s interviewee, “It feels like they are turning up the boiling water slowly.”

In terms of monetary resources spent on reporting, most companies quantified this in terms of employees involved in the reporting process, but their descriptions of the allocation of resources varied widely. Company 2’s representative estimated that about four people work on reporting for 50 percent of their time annually, Company 3’s representative estimated that 50 different people contribute to reporting annually. Company 6’s representative estimated around 1,000 hours are spent annually on reporting, including between one and three full time positions.

According to the interviewee from Company 6, the time spent on CSR reporting would be easier to justify if both DJSI and CDP provided more transparent scoring results to participants. One of the reasons Company 6 stopped reporting to both was the lack of clarity about why they received the scores they did on both rating schemes and how to improve their score from year to year. “We like the schemes where we can see the data, where we can point to a data point and refute it if necessary.” Without this transparency...
in the scoring results, the company does not see enough value returned for the time and resources invested annual reporting.

The frustration with CDP and DJSI expressed by the interviewee from Company 6 led the company to swap these established rating schemes for lesser-known frameworks. The company currently responds to a number of different rating schemes including the Corporate Knights, the Newsweek Green Rankings, and CR Magazine, among others. While Company 6’s representative agreed that CDP and DJSI are the two leaders in the sector, he feels they do not have adequate employee capacity and resources due to the extremely intense nature of the reporting process. According to the interviewee, “CDP and DJSI both require an incredible pull. We don’t have full bore from management to engage in them.” Instead, Company 6’s interviewee currently favors an alternative CSR rating scheme, TruCost, for its data-driven focus that quantifies environmental, social, and economic impacts of company operations, giving it a less qualitative approach than DJSI or CDP. This transition shows that companies increasingly have their choice of reporting schemes, and those that drive internal value may replace traditional schemes that are seen as too cumbersome to justify the resources allocated to reporting.

The Ends Justify the Means
The interviewees that currently report to CDP and DSJI communicated frustration about the relative increase of their peer’s scores in relation to their own, resulting in their not being named to leadership indices after years (in some cases almost a decade) of maintaining these positions. For these companies, this drop in rank is not from a lack of reporting effort. Company 2’s representative has spent executive time and resources on significant research to determine why their scores are dropping relative to their peers. Company 4’s representative described their DJSI reporting process as including an investment in ordering the DJSI-provided benchmarking report, mapping the pages of their previous year’s report to a subject matter list to look for areas of opportunity, and lastly finding, meeting, and physically talking with subject matter experts within the company to better answer these reporting questions. In the words of the interviewee from Company 4, “Every year we have to make progress,” and the interviewee from Company 2, “It feels like a horserace; who will become predominant and get traction the fastest?”
Furthermore, companies believe that they have reached a plateau in terms of transparency. For example, in 2011, the annual increase in companies reporting energy use metrics slowed to five percent, from an increase of 72 percent in 2007 (Brown, 2013).

This dynamic creates anxiety referred to by those in the field as “the treadmill effect.” For example, once a company makes the DJSI Leadership Index, “they must run hard to remain on the treadmill, lest they drop off and garner unwelcome attention from colleagues or the media” (SustainAbility, 2012). Furthermore, once such a leadership position is reached, “management comes to expect we do well on a ranking year after year, and, if performance dips, they may turn the heat on teams responsible for responding to the ranking without having the time to understand why the score changed” (Sustainability, 2012).

This treadmill effect and the anxiety it produces can lead companies to a situation where the end justifies the means, or, getting a high score justifies whatever was done to achieve it. The treadmill effect leads companies to find the “right” level of transparency. As one interviewee stated, “If we are too honest, we’ll get scored for that.” It can also incentivize companies to allocate the majority of their resources to reporting instead of to invest in sustainability-related programs. As stated by one interviewee who writes company responses to CSR rating schemes, “When I took this job, I thought this role would be more programmatic and project-oriented, but it’s all reporting. These rating schemes absolutely incentivize people to answer questions and not operationalize programs within the company. They incentivize a report-focused model that needs to be more project- and program-focused.” For those companies that have invested significant time and resources in CSR reporting, the resulting CSR score is understandably important to company leadership. However, this dynamic can create a perverse outcome where CSR rating schemes fail to incentivize true transparency and internal action, but instead incentivize whatever actions will result in the highest possible CSR score.

Lack of Trust in Scores

While the external recognition received from a positive score can incentivize continued or increased action on corporate sustainability, when a company does not understand the score it receives or believes it to be inaccurately assigned, it can lead to mistrust of the CSR rating schemes. When interviewees described the delivery of their
annual CSR scores in September, many expressed feelings of confusion and helplessness. According to Company 4’s representative, “We ask how to do better next year, but there is not a lot we can do with the data we receive.” Similarly, Company 6’s representative expressed a desire to “know how the data [we report] is being utilized, and what weight CDP and DJSI give to certain data points. How close did we come to others on certain points per question? I wish we could see this and understand better.” Company 6’s representative stated that its internal team bases their reaction to their annual score on whether they understand the intent behind the questions being asked. If they agree with the intent, they work to see how to embed the effort better into their strategy. “It is about finding the value there, and then figuring out how to operationalize it internally. However, if we don’t have the data on how we can do better, this is difficult.” Company 2’s representative stated that without knowing the company and its strategy, it is almost impossible to look at the score and to understand what it truly means. “Perhaps one percent of those people even inside the company can do something with it.”

In addition to a desire for more transparency and context around the scores received, companies felt that the CSR rating schemes did not always fairly assign the scores. According to the interviewee from Company 3, “There is such pride in the scores, and we work hard at maintaining that [leadership] level, but it takes a long time to make certain changes, for example, an investment in a change in fuel mix won’t show up in the one year timescale in which we get measured.” Others expressed frustration, especially when ranked below a company with a coal-heavy fuel mix. “For those in the electric sector who know the fuel mix of their peers, “the rankings can be misleading.” According to the interviewee from Company 1, “The idea of not trusting the scores enough to make significant internal changes resonates, as does the idea of not quite trusting the rankings’ positioning of peers in our sector. I’m not sure if it’s corporate ego or lack of familiarity, but [due to this issue] I don’t see that we’d be likely to take on any significant change or investments as the result of a CSR rating score.”

Another issue interviewees had with the external scores was that investors looking at the CSR ratings could not see the full risk management picture. The interviewee from Company 3, which has both wholesale and retail operations, stated that investment analysts often do not understand the wholesale aspects of their utility business and
therefore cannot understand the full picture of what they are doing to manage risk. As a result, the interviewee at Company 3 fields calls for public data often. According to Company 3, this is largely an issue with DJSI, where investors cannot see the data behind company rankings. For this reason, investors cannot see where the company’s true strengths and weaknesses lie. If CSR rating schemes expect companies to trust their rankings and those of their peers, they must provide the same level of transparency and context for which they ask participants.
Part 3: How can CSR frameworks be Improved to Better Encourage Corporate Sustainability?

My research on corporate sustainability in the electric sector indicates that current CSR rating schemes lack value for those utilities without end-use customers, provide a poor time to value ratio for participants, drive companies to prioritize the end score above the process, and through a lack of score context, can drive mistrust in the CSR rankings. Based on these findings, I recommend three broad changes to the approach of CSR rating schemes. Reconsidering the scoring methodology, the cross-sector assessment, and relationship between the company and the rating framework will increase the value of CSR reporting. This value increase will spur more business-to-business companies to participate in reporting, will better justify the time spent reporting, will elevate the process over the end score, and will ultimately instill more trust in the reporting process.

Revise the Single Score Approach

While the external recognition received from a high CSR rating score encourages companies to discuss corporate sustainability at a management level and take pride in their internal corporate sustainability practices, the mistrust of CSR rankings and the difficulty understanding how to improve scores leads me to recommend an alternative scoring approach. Rather than assigning one score or ranking per company, I recommend CSR schemes produce three or four scores that better reflect companies’ activities on the issues most relevant to them. This would maintain the benefits of external recognition and provide more actionable feedback for companies. For example, electric utility companies could be scored on emission reduction, water use, safety and health, and energy reliability. According to the interviewee from Company 1, this reallocation of scores would make a big difference. “Right now, it feels like we’re in the peloton - in the Tour de France, there are twenty or thirty riders pedaling strong out front, and a mass of riders bunched up behind them. If you’re one of those riders up front, they’ll take your time. If you’re in the peloton, you’re just in the peloton. You’re so close together that you don’t matter. That’s what it feels like.” It is this sense of “not mattering” that makes it hard to justify participating for companies that do not currently report, or are new to
corporate sustainability. However, providing categorical scores to each participant would allow those in “the peloton” to strive for a high score on specific issues of relevance and sector-specific materiality. This would make it more likely for CSR rating schemes to recognize companies for their specific programmatic specialties or areas of thought leadership, and therefore companies would experience increased value from engaging in these efforts and reporting them via CSR rating schemes.

In addition, providing more than one score would illustrate the value internally to corporate management, who may currently see reporting as the priority over programming. According to Company 2’s interviewee, “If we could extrapolate scores into actionable sections like GHG emission reduction they would be more workable. It would drive us to focus our direction in a few specific areas, and therefore would make it easier to show the business case internally.” According to Company 6’s interviewee, the World’s Most Admired List breaks scores down into a few categories already. “We like this a lot. If you only do one or two things, do them really well. This is where we see the most bang for our buck.” According to the companies interviewed, much of the feelings of helplessness and confusion around scores comes as a result of not understanding how rating agencies generate one score from the variety of qualitative and quantitative data disclosed to CSR rating schemes. If the rating schemes broke down scores by category, it would be simpler for companies to understand where they did well in relation to their peers, and where they still need to improve.

In addition to the World’s Most Admired List, other rating schemes are beginning to adopt this categorized scoring methodology. The Ceres Company Scorecards recently began giving multiple ratings that include governance and stakeholder engagement, and DJSI now asks companies what their three most material issues are per economic, environmental, and social dimension, and gives a scoring breakdown, although companies still receive one final overall score. CSRHub categorizes company scores by community, employees, environment, and governance, with further sub scores available.

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2 The World’s Most Admired List includes nine key attributes of reputation: Innovation, People Management, Use of Corporate Assets, Social Responsibility, Quality of Management, Financial Soundness, Long Term Investment Value, Quality of Products/Services, and Global competitiveness.
for each of these four topics. While it may change the external recognition incentive to not have one leading company scoring above the rest on corporate sustainability, the accuracy of categorized scores and the increased value to companies would incentivize more participation compared to the traditional scoring methodology.

To make a multiple scoring methodology accurate, CSR rating organizations must first clarify the definition of materiality as it relates to corporate sustainability. While my research illustrates companies’ preference for disclosing and focusing on those corporate sustainability issues that are most “material” to their business, or most relevant to their bottom line, there remains a lack of clarity around how to define materiality in the context of corporate sustainability reporting. According to the interviewee from Company 3, “Within our 10-Ks, the criteria for disclosing material risks is different than it is in CSR rating schemes. Lawyers review 10-K reports. If I come along with my CDP report where we talk about other environmental and social risks, the corporate lawyers may not agree, as these statements are not consistent and may even contradict the 10-K. For this reason, it is really important that we come to a common definition of material risks in enterprise.” As Company 3’s interviewee stated, the attorneys who report financial statements to the SEC are legally required to report all risks to which the company is subject. If a company focuses largely on the risk of climate change in their CDP report but doesn’t mention it in their SEC filings, this incongruity opens up the possibility for litigation from shareholders. According to the interviewee from Company 6, “Because CDP is voluntary, my management asks why we care to talk about these things in our reports. It could cause questions as to what needs to go into our 10-Ks, and around what is truly material. In terms of the true definition, I can’t get a solid answer to this yet.” According to the interviewee from Company 6, CDP is one of the most forward-looking and asks many questions about future plans. “This is tough because it means we have to put a Safe Harbor statement on everything we publish. It means we lean on our investor presentations because we don’t want to say something in CDP that’s not aligned internally. In terms of what’s talked about in the CDP, it’s too hard to capture the changing grid, the complexity of regulated versus unregulated utilities, decentralizing power, and the micro grid, for example. Our reporting efforts will continue to evolve to meet investor needs, but until there is more than anecdotal evidence that we perform...
better the more we report on CSR issues, we have no incentive to respond to the extent the rating schemes want us to.” Because of this tension around what investors consider material in terms of CSR reporting, it is essential to better understand what topics are material within each sector and to encourage deeper corporate understanding and reporting on these issues.

The Sustainability Accounting Standards Board (SASB) has made the biggest strides towards determining sector-specific materiality. SASB focuses its organizational model on determining what is material to various industries based on the SEC’s definition of materiality. SASB aspires to provide guidance for companies to include non-financial information in their mandatory financial reporting (Mosher, 2014). This tension is likely to promote additional debate about how to define what is material to a company and whether issues considered sustainability-related should be included in these financial reports. While the inclusion of these issues in financial reporting is a separate topic, the more company- and sector-specific context that can be given to a certain score, the easier it will be for investors and companies alike to understand. Therefore, I suggest basing sector-specific scoring categories off of SASB’s chosen issues of materiality to encourage companies to report on the issues that matter most to them. This would both give companies more context for the scores they receive and provide stakeholders with a better understanding of sector materiality.

Make Rating Schemes Sector-Specific

The largest tension that emerges in developing CSR rating schemes is the desire to create common, measureable standards across sectors, and the competing pressure for rating schemes to be flexible enough to allow for varied approaches to achieving corporate sustainability goals. While there is unquestionably a value in being able to benchmark companies across all sectors on CSR criteria, much of the value of CSR reporting in the electric sector is negated when it is compared to other industries. While knowing what other companies are doing is beneficial from a learning perspective, being held to the same energy use and emissions standards as other sectors does not produce helpful comparative data. Given that companies in the electric utility industry strive for a combination of safety, affordability, reliability, and now sustainability, a sector-specific
report would ensure that tensions and tradeoffs between these goals were understood. According to the interviewee from Company 1, “If we were only compared to companies in the same sector, it would make a profound difference. Our company versus Starbucks? It’s silly to even say that.” As the interviewee from Company 6 stated: “How do you compare us to a company like Wal-Mart? We generate the power that allows Wal-Mart to operate at all.”

According to SustainAbility, nearly 90 percent of the rating schemes in their inventory assess companies across multiple industries. However, a fair number of multi-industry ratings are also beginning to produce sector groupings or weightings (SustainAbility, 2010b). The majority of interviewees responded positively to the idea of a sector-specific standard. According to Company 5’s representative, “Unlike a manufacturer, an electric company has different interfaces with public. Most people don’t give it much thought. The electric industry has really tough, unique, challenges and will continue to, including the integration of renewables and battery technology and operating more efficiently together as one system while encouraging different outcomes state by state.” Because of these challenges, the electric sector sees more value in being compared to peers to more accurately benchmark their CSR efforts. The interviewee from Company 4 agreed, “Having a human rights policy makes sense for Nike, but for a U.S. electric utility? Even if we can score 100 points on what we are doing well, there is another ceiling we won’t go above because some of what’s asked of us is not material to our sector, or relevant.”

In addition to being scored on indicators that aren’t relevant to the sector, there is a misunderstanding in rating schemes about the timeframe it takes the electric sector to make significant changes. According to the interviewee from Company 3, “We lose points for not having a diverse enough portfolio. While we are working hard on this, it is not going to change quickly due to the investment necessary and the timescale of those investments.” According to the interviewee from Company 4, “In terms of climate change, we are not able to continue reducing emissions at the same rate after we have picked the low hanging fruit. In our CDP report, we are describing everything we can, but we can’t do large-scale reductions. For example, if we are replacing SF₆ breakers, in the short-term, CDP can’t see the eventual reduction. Also, if we buy a new natural gas unit
our portfolio rate will increase, but we will be replacing higher emitting generation elsewhere, and therefore reducing someone else’s emissions.” There is currently no way to account for this type of particular anomaly when responding to CDP or DJSI, although according to the interviewee from Company 4, CDP is aware of this challenge and is trying to solve it. According to the interviewee from Company 3, “For sectors like ours with long lived assets, one year is a very short period of time.” While this company’s absolute emissions dropped by roughly 25 percent while sales increased by 25 percent over a five year timeframe, the company’s CDP report from 2013 to 2014 will only show a flat emission rate, and the company may even lose a point if emissions went up slightly during investment in a cleaner burning unit. According to the interviewee from Company 3, “This is an area where reporting could be improved. Understanding how this sector operates, and the complex decisions that go into generating and distributing power, would help CSR raters better understand the industry’s current narrative on sustainability as it relates to greenhouse gas reduction in particular.”

This lack of understanding of how the electric sector operates also drives an “us versus them” mentality. According to the interviewee from Company 6, “It is hard for rating schemes to get what the value of the electric utility industry is. In some ways, the U.S. has a $16 trillion GDP because of energy. It powers all goods and services.” To better incentivize the corporate disclosure of sustainability challenges within the sector, ratings agencies must recognize that a large part of the current stagnation in reporting to CSR rating schemes centers on building trust. According to Company 1’s representative, “There is a tension between the company and the reporting entity, as it seems the reporting frameworks are really there to advocate their positions. It feels largely like a principles-based framework that at times is hard to fit into a larger business framework, especially in the case of power generation.” In describing frustrations with CDP and DJSI, the interviewee from Company 6 added, "Also, it's a tone issue. We get it. We can do all things great economically, but we must also do them all great environmentally. We aren't the Sierra Club. And as a company that has to make a profit, there are checks and balances. Where in the grey section are we ok?"

Other interviewees described feeling like they are starting from behind simply based on the sector in which they work. As the only energy providers among dozens of

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sectors of energy users that report to CDP and DJSI, the fact that the questions are poorly tailored to them creates mistrust about who is behind the rating schemes and whether they truly want them to succeed in being both environmentally and economically sound.

Of the six companies interviewed, only one representative believed that tailoring a CSR rating scheme specifically to the electric sector would negate the value of reporting. According to Company 2’s interviewee, “If CSR rating schemes were more tailored to geography, sector, and issue, I don’t think it would be received better. The comparison to other industries is useful. What does “good” look like in different industries? It cross-exposes you to different industries in a useful way. Especially for supply chain sustainability, it is irrelevant who the end user is. We can learn more outside the industry than we can on the inside.” The remaining interviewees supported the idea of a sector-specific approach, largely because such a transition would require a deep understanding of tradeoffs necessary to achieve sustainability in the electric sector. This change would make companies more comfortable coming forward to discuss the challenges of achieving sustainable outcomes. In this way, CSR reporting frameworks would be incentivizing honesty and dialogue around the trials of corporate sustainability in different sectors.

The risk in this sector-specific method is that rating schemes will become increasingly complex given the depth of knowledge needed to assess a particular sector. However, if evaluation criteria were reduced to only focus on those issues that are material, this would incentivize more companies to disclose their actions, while also increasing the accuracy of CSR scoring given the increased context for each question. For example, EPRI’s Energy Sustainability Interest Group is currently narrowing the list of 448 metrics tracked by CSR reporting schemes for the utility industry by choosing between two and five of the most relevant metrics for each of EPRI’s designated 15 material issues (Table 2). The Energy Sustainability Interest Group is aiming to publish a paper on this project at the end of 2015 (Scott, M., Personal Communication, May 4, 2015). Furthermore, sector-specific scoring would encourage collaboration on the particular issues that currently face the industry. While some sustainability practitioners cite healthy competition as one of the intended benefits of CSR rating schemes (SustainAbility, 2012), my discussions with managers in the electric sector challenge this
claim. A deep knowledge of the sector shows that electric companies of all kinds will be required to collaborate to solve current technological and environmental problems, and the more dialogue and cooperation that occurs, the more likely it is these goals will be realized. With the EPA’s forthcoming regulation of carbon pollution under Section 111(d) of the Clean Air Act, power producers and utilities are discussing the best way to dispatch sources more efficiently to meet low-carbon requirements for the entire grid. According to the interviewee from Company 5, “We are talking about the operation of a grid system. We should be focused on sustainability goals that can be reached collaboratively through that system, and not through one company.” According to the interviewee from Company 4, the electric sector is already voluntarily making investments in efficiency and maintenance to lower costs, so the sustainability of specific company actions is not a problem that needs a solution. Rather, “the problem is how to integrate these efforts into a wholly sustainable electric grid.” According to Company 4’s representative, “to do this requires cooperation across the grid, across states, and in ways that address the real performance elements that are beyond individual company abilities to effect.” CSR rating schemes should avoid incentivizing a competitive dynamic within the industry, as a more effective route to corporate sustainability will acknowledge the interconnection of the electric utility sector and will encourage industry collaboration to reduce GHG emissions and adapt to low-carbon technologies.

Assess Companies through a Consulting Model

My research shows that the standardized nature of CSR rating schemes can fail to provide sufficient industry- and company-level context for certain corporate sustainability indicators. In addition, managers were frequently frustrated that the scores received from CSR rating schemes made it difficult to identify gaps for improvement. As a result, a more tailored assessment approach, similar to a consulting model, may be necessary to analyze private as well as public information, providing in-depth context and ultimately resulting in a robust and trusted CSR score.

Such a corporate consulting model would require a team to spend a period of time on-site with the company’s management to fully understand the company’s sustainability strategy and to assign their CSR score based on this in-depth evaluation. According to
SustainAbility, current CSR rating schemes are largely based on arms-length assessments of corporate performance due to the criteria rated and the limits of the rating organizations’ abilities to assess large amounts of data. However, if rating organizations spent a greater amount of time with the companies they are rating, they would acquire a better understanding of the company’s management team, its employee adoption of corporate sustainability practices, and the company’s priorities around CSR. With this close interaction, the raters would have a better understanding of these businesses, be able to verify publicly available information, and could help companies understand the ratings and how to improve their corporate sustainability performance (Sustainability, 2011a). According to Company 6’s representative, “An internal gap analysis on how we could align our goals with sustainability would be very helpful. If we received an internal qualitative and quantitative score that told us how we could improve, that would be great.” According to Company 3, efforts to embrace this model are already forming. EPRI’s Energy Sustainability Interest Group provides a service in which the group comes into an electric company and identifies where the sustainability gaps are. In addition, the group formed a Voluntary Reporting Committee in 2013 to gain insights on the frequency, value, and cost of voluntary reporting (EPRI, 2014).

By definition, a compliance-based standard like a rating scheme applies uniform rules and practices to a range of entities. This rigidity presents a risk that the CSR rating schemes may not allow for the achievement of corporate sustainability goals through creative practices. Especially given the corporate sustainability field’s recent acknowledgement of the material nature of corporate sustainability, and materiality’s inherent contextual basis, a consulting model than integrates flexibility in meeting effective sustainability goals should be emphasized. This assessment model elevates the importance of the internal process and actions towards sustainability, rather than the single end product of a CSR score. An assessment process that works closely with corporate management and the sustainability goals they care about would be able to better understand and encourage internal action, even if it was “off script” from the traditional CSR criteria.

A CSR assessment approach able to encourage internal action by working on-site with company managers would also give CSR reporting a human element and the
possibility of inciting motivation for sustainability on a personal level. If CSR reporting is essentially aiming to make people “care” and therefore “act,” either through transparency or better performance, the drivers for human motivation must be reexamined. Instead, CSR reporting has been decoupled from its original goals. A score or ranking may incentivize competition, but without a human connection to such a goal, the motivation to participate in corporate sustainability will plateau as we have seen with reporting. To best illustrate the importance of personal interest in terms of motivation for CSR, interviewees were asked, “If you had an unlimited budget to spend on sustainability, how would you spend it?” Interestingly, the answers ranged substantially. A manager in supply chain operations stated she would commit to component level tagging of each supply chain material at the company in a bottom up approach. A manager at a coastal utility whose community has suffered from flooding stated he would focus on resiliency to climate change and the well-being of their customers during extreme weather events. Another manager with a science background would “work to be the guy who cracks the energy storage question, and would work on it every day of the year.” Another manager would spend it on the local level, engaging and having a good relationship with the company’s neighbors. “Where the rubber meets the road is in the community.” And yet another manager would establish extremely high quality and consistent internal data gathering systems, as this is what his company needs most in its pragmatic approach to sustainability.

Not all of these companies report to CSR rating schemes, or see the value in it. Of those that do report, each expressed fatigue and lamented the administrative burden around the process. But when asked this question, the passion and belief in the need for each of these efforts was palpable. There was a personal connection to each mission that drove motivation to work hard to solve the chosen problem. While CSR rating schemes argue that investors want a quick summary of who is best in class, a more effective approach may be to find corporate sustainability goals that employees care about personally or professionally, and allow them the flexibility to become thought leaders on a specific issue. This approach would be much more valuable to investors and other stakeholders who are eager to know the internal sustainability strategy of a company.
The consulting model approach to CSR ratings would also build a foundation of mutual trust between companies and rating organizations, so that if a company wanted to do something different, and was willing to invest in it, this approach would bring a leader in supply chain, energy storage, coastal resiliency, community engagement, or data visualization to the forefront of the electric industry. As a result, perhaps the company would receive a high score on that particular issue of interest and a lower score on others, but it is unlikely, given the voluntary nature of CSR reporting, that this approach would halt or reverse any of the actions already being undertaken. Furthermore, a mutual commitment to transparency could encourage trust. CSR rating schemes will receive more honest disclosures about internal projects if they share more about themselves. According to SustainAbility, rating schemes need to “tell [companies] more about the team behind the CSR ratings: their identities, backgrounds and focus areas, how you train them, etc. Such transparency will engender greater trust in your process and improve engagement” (SustainAbility, 2011a). A large part of gaining the trust of participants resides in explaining the rationale and intent behind questions and scoring criteria. If companies feel they don’t understand how they are assessed, this breeds suspicion.

Overall, a consulting model would provide context for company-specific approaches to CSR reporting, allowing for flexibility in meeting sustainability goals and encouraging employees’ personal motivation for sustainability to be integrated into the strategy and process of each company’s approach. Furthermore, this method’s support for increased dialogue about the challenges of corporate sustainability, while still adhering to robust CSR disclosures and performance goals, would return the focus of CSR reporting to its original objective. It would not only incentivize ethical and transparent business practices, but it would leverage corporate actors to be effective agents for change for the sustainability issues upon which they have the most impact.

Conclusions

Over the past twenty years, CSR has evolved to become a field dedicated to measuring corporate sustainability, aiming to improve the transparency and outcomes of corporate actions by incentivizing companies to report and be ranked publicly on their environmental and social efforts. My research finds that CSR rating schemes achieve
some of their intended goals, but also create perverse incentives antithetical to corporate sustainability. CSR rating schemes positively encourage companies to gather internal data on environmental and social metrics and motivate them to centralize this data across business units. External recognition received from a CSR rating drives company pride in corporate sustainability efforts and draws the attention of executives to the reputational benefits of high CSR scores. However, my research finds that CSR reporting lacks value for business-to-business companies, specifically for power producers without end-use customers. In addition, CSR reporting currently provides a poor time-to-value ratio for participants, and can drive companies to put more resources into reporting than into programmatic initiatives due to the focus on the end score. Lastly, current reporting frameworks produce mistrust in the CSR rankings through a lack of sufficient explanation for company scores.

Based on these findings, I recommend three broad changes to the approach of CSR rating schemes to better incentivize corporate sustainability goals like GHG emission reduction. First, restructuring the scoring methodology to include multiple issue-based scores per company would maintain the incentive for external recognition but provide better context for scores. Second, replacing the current cross-sector assessment with a sector-specific assessment would provide more value to utilities by emphasizing the goals most relevant to their businesses and encouraging industry collaboration towards sustainability. Third, revising the current arms-length assessment approach to include an in-depth, on-site assessment of corporate sustainability efforts would elevate the importance of the process over the end score, encourage dialogue and flexibility in achieving goals, and instill more trust in CSR rankings.

As with any maturing marketplace, the CSR reporting field continues to evolve, and will likely continue to do so as the CSR rating organizations and participants realize what approaches drive the most sustainable outcomes. If ratings agencies adopt the recommendations outlined here, CSR scoring may evolve to include multiple scores per company, sector-specific questionnaires, and consultants that work directly with internal company groups to identify areas for opportunity. Eventually, if each of these recommendations is deployed, CSR reporting will progress from a mechanism that broadly identifies leaders in disclosure and performance among all sectors to a tool that
encourages companies to leverage their industry position to produce results on key metrics of global importance, like GHG mitigation from the U.S. electric utility industry. When applying voluntary compliance frameworks like CSR rating schemes to a developing field like corporate sustainability, focusing on “the spirit” rather than “the letter” of CSR reporting may in fact drive more tangible, measurable outcomes by stimulating innovative and industry-tailored solutions.

Furthermore, it is possible that reporting to CSR rating schemes may be replaced by company participation in integrated reporting, which focuses on the integration of sustainability-related information into mandatory financial filings, including clear and quantifiable CSR data that can easily be modeled by investors. Integrated reports are not scored by third parties, are sector and company-specific given their focus on materiality, and involve multidisciplinary dialogue about what should be included and improved from year to year. In these ways, my recommendations point towards integrated reporting as the future of CSR reporting. However, due to the aforementioned need to clarify the definition of materiality as it applies to corporate sustainability, as well as the legal issues involved when shifting from voluntary CSR reporting to mandatory integrated reporting, a voluntary approach to integrated reporting is most likely to occur in the near term.

Compared to traditional CSR reporting, quantifying and disclosing information that illustrates the relationship between CSR data and financial outcomes will drive increased value to companies, investors, and stakeholders, even if done so voluntarily.

In the U.S. electric utility industry, it is possible that upcoming federal policies on carbon emissions could change industry dynamics drastically, and either a legislated or regulated price on carbon could make CSR data quantifiable in a way it has not been in the past. Assigning a price per ton of carbon would not only make it easier for electric utilities to include GHG emission reduction data in financial disclosures, it would also create a market for GHG mitigation that would spur corporate sustainability best practices beyond the current scope of CSR rating schemes, reducing the CSR field’s focus on reporting as the primary lever for corporate action.

Ultimately, CSR reporting has succeeded in making it common practice for companies to track and disclose important environmental and social data through voluntary mechanisms beyond current mandatory compliance requirements. My research
shows that there is considerable potential for CSR rating schemes to drive increased corporate action on sustainability by ensuring reporting approaches are better aligned to incentivize corporate sustainability. As companies increasingly pursue sustainable actions that are more relevant to their industry, their company, and their employees, CSR reporting should welcome its own reinvention until it or a competing policy or reporting mechanism encourages the most effective process toward CSR’s original objective - ethical and transparent business practices that produce measurable environmental and social outcomes, and use innovative solutions to reduce corporate and industry impacts.
References


