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Mandatory and Discretional Non-financial Disclosure after the European Directive 2014/95/EU: An Empirical Analysis of Italian Listed Companies' Behavior

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Introduction

The present economic context is witnessing a progressive decrease of trust. Society distrusts institutions and companies as it is difficult to find out which companies are trustworthy in offering goods and services in compliance with a certain standard of quality. People find it difficult to understand if companies and institutions are acting consistently with the interest of the community. Moreover, media are more often negative news about large corporate groups as protagonists. It is easy to recall the recent Volkswagen scandal as a striking example; in the same vein, even with different facets, we can remember of accusations made against the mobile phone company Huawei, along with the Cambridge Analytica accusations and the Foxconn suicides. It appears quite clear that these companies have several things in common, namely and mainly the high profits they register annually as well as a rather questionable behavior they put in place for the exercise of their economic activity.

The negative impacts on the climate following the high CO_2 emissions, the violation of users' privacy, and corruption and exploitation of workers aimed at increasing profits are just some examples of the negative actions taken by several companies. These behaviors can go further at least until consumers and the community in general no longer place trust in those companies. Of course, this fall of trust could be the triggering point of unfavorable situations which in most cases lead to negative impacts on performance and further serious consequences such as the dissolution of companies.

This is the main reason why academics, practitioners, regulators, and users of companies' information have always considered *transparency* in corporate communications as an infallible value. Moreover, transparency has been pursued and claimed traditionally for financial information and, since the last decades, it has been extended to non-financial information (NFI) and its accountability in supporting the users' decision process (ICAEW, 2016; Lai, Melloni, & Stacchezzini, 2018). Boundaries between the former and the latter have been defined and redefined (Girella, Abela, & Ferrari, 2018). In this context, standard setters and regulators play an important role in encouraging (or mandating) firms to provide more useful and transparent information. In fact, the public dissemination of companies' prospectuses expressly focused on NFI constitutes a valid instrument with which companies relate to the vast audience of stakeholders. Moreover, the growing interest in the explicit reference to ethics and social responsibility issues has led to a significant evolution and implementation of reporting models.

There have been numerous initiatives which started to build the theoretical background behind the possible approaches to guide the non-financial reporting. Various international organizations have been established, such as the International Integrated Reporting Council (IIRC) and the Global Reporting Initiative (GRI), among others. These institutions have proposed specific guidelines and frameworks with the aim of providing standards to follow in addressing companies' NFI consistently with users' needs.

In this context, the doctrinal and professional debate has also been addressed on the *voluntary vis-à-vis mandatory* feature of NFI reporting. In Europe, the EU Directive no. 2014/95 of October 22, 2014, amending Directive 2013/34 EU, has represented an important shift from the regulator perspective as it is the first attempt to settle a mandated content for European-based companies with specific reference to NFI. According to this directive, large undertakings and groups are mandated to draft a report (that could be separate as well as included in the annual report) to communicate their commitment and policies on specific topics such as the environmental and climate protection, the employee protection and management of staff, respect for diversity, the fight against corruption, and the fight against the violation of human rights.

With this work we intend to investigate the companies' behavior in preparing NFI disclosure in the aftermath of the new directive issuance, with specific reference to the evolution of reporting tools and the frameworks proposed by international organizations to outline homogeneous standards for comparability purposes. Considering the shift from voluntary to mandated information, special attention will also be given to the problem of managerial discretion that could occur when managers act for their own interests rather than those pursued by companies and community (Fiandrino, 2019). Moreover, EU Directive 2014/95 has been implemented in all EU member states with laws country specific. Anyway, considering that the directive settled a basic blueprint, at the European level there are not significant differences in the adoption of the above directive across countries.

With reference to the topic of NFI, generally, extant literature does not find unanimous agreement on the potential benefits deriving from more or improved regulation (Chauvey, Giordano-Spring, Choand, & Patten, 2015; Costa & Agostini, 2016; Venturelli, Caputo, Cosma, Leopizzi, & Pizzi, 2017). Therefore, more research is required, especially if we consider the push for authorities to regulate more and more the requirements for companies about NFI disclosure in response to stakeholders' expectations.

However, the transposition of the EU Directive into the national legal systems raised skepticism among academics and practitioners regarding its real impact. In fact, the absence of a specific content, a definitive method of reporting, a valid enforcement system for the provision of NFI, and the coexistence of voluntary and mandatory items in the EU Directive pushed toward a limited influence on NFI reporting (Farneti, De Villiers, & Dumay, 2018). Moreover, the above Directive requires to large undertakings and public interest entities (PIEs) to provide a specific disclosure about social, environmental, employee, respect for human rights, anti-corruption and bribery matters. Furthermore, the NFI should disclose the business model, the policies related to those issues, the main risks involved in them, and the outcome of those policies. In this regard, recent contributions have tried to assess the level of compliance to the new requirements (Fiandrino, 2019; Venturelli et al., 2017). However, there is not a unanimous assessment about the impact of this new information package on the company performance.

To this end, we intend to address the research question whereas improved regulation and mandated NFI disclosure could affect, and eventually improve, companies' economic performance.

Therefore, in order to provide empirical support to the above research question, we opted for analyzing Italian context where the directive has been adopted with the legislative Decree no. 254/2016 valid for the fiscal year 2017. Through this analysis, we aim to provide an up-to-date portrait of how companies mandated to adopt the new regulation have (or have not) experienced an improvement of their economic performance.

To address this research aim, the book is based on the Italian context firstly because there are evidences of the importance that CSR reporting assumed in Italy (KPMG, 2013; Rossi & Tarquinio, 2017). Secondly, the mandatory disclosure of NFI in Italy is more stringent than the EU directive as it has been adopted with the Italian Decree no. 254/2016 which introduced a cogent system of external controls, imposing the assurance of the disclosure and a sanctioning regime for directors, required to draft and publish non-financial declarations and supervisory bodies, called to control them. At the same time the Italian legislator has provided for a wide range of methods of reporting NFI, with the possibility of also using an autonomous reporting methodology and of voluntarily disclosing NFI for SMEs, with less burdens than those the larger companies are obliged to bear (Muserra, Papa, & Grimaldi, 2019).

The study makes an original contribution as it is one of the pioneering studies investigating the mandatory disclosure on NF risks in the Italian context in the aftermath of the new regulation. Specifically, this study extends the prior literature by addressing the informativeness of the Italian financial market NFI disclosures. In fact, in the aftermath of the above Decree, it is worth understanding to what extent companies disclose NFI and if the firms have different behavior in disclosing this information depending on the industry, size, and governance variables. This study could also be useful in the policymakers' perspective, by providing guidance on the various differences between NFI reporting approaches.

In addition, our results could help managers and investors with regard to the reporting and identification of information considered critical for maximizing company value. Furthermore, these first results could help companies to follow the best practices and to adopt approach able to face the trade-off between being transparent or secretive, and they also could help companies not obliged to NF disclosure to understand the relevance to disclose (and manage) NF information.

As for the policy implications of the study, since the improvement of company disclosure of social and environmental information (including information about risk) represents one of the eight areas in which EU policy has put forward an action agenda, our results could represent relevant evidence for European policymakers of the action agenda in a twofold way: improving the convergence between European Policies and the global approach to NF disclosure, and improving the company disclosure and, in turn, management of companies' non-financial risks.

The remainder of this book proceeds as follows. Chapter 1 will provide an introduction to the evolution of corporate communication models and about how these are shaped according to the stakeholder theory, whether financial or non-financial. In fact, the evolution of the number and the quality of stakeholders has forced companies to prepare additional information to meet the various information needs, where financial information has been considered a starting point to provide NFI, originally on a voluntary base and more recently as a necessity to comply with law.

Chapter 2, as a consequence, is devoted to the review of the doctrinal debate about voluntary information, and how it constitutes a valid support for the creation of added value. This last condition has been deemed to have contributed over the years to the evolution of the relevance of issues as social responsibility, business ethics, and sustainability. Besides, the increasing use of companies' sustainability reporting tools has prompted international bodies, mainly IIRC and GRI, to promote guidelines on how such disclosures should be carried out. In this context, with the above directive, Europe played a pioneering role, by mandating all listed companies and PIEs to disclose their non-financial information concerning the protection of the environment, the management and defense of employees, the fight against corruption, and the protection of diversity and human rights.

Then, Chapter 3 is focused on the debate about the management discretion in providing NFI and incentives to do so. In fact, the possibility of different and conflicting interests between managers and organizations may affect the typology, the extensiveness, and the quality of NFI resulting in information asymmetry, "window dressing" information, and other negative consequences.

Lastly, in Chapter 4 an empirical analysis is introduced, to assess the possible influence of NFI on the market performances of companies listed on the Milan Stock Exchange (Italy). The main purpose of this analysis is to observe whether in the aftermath of the new regulation there are some appreciable benefits as recognized by the market performance or, on the contrary, positive effect could only be expected on the long run.