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## LITERATURE REVIEW ON THE NONFINANCIAL REPORTING OF THE STATE-OWNED ENTERPRISES

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### **Abstract**

Two pillars of reporting are represented by the governance and the nonfinancial aspects. As these are more recently provided as compared with the financial reporting, our research objective is to conduct a literature review in the area of the nonfinancial reporting of the state-owned enterprises. In this respect, we examine the papers dedicated to the nonfinancial reporting of the state-owned enterprises. Our findings show that the quantity of literature dedicated to state-owned enterprises is lower than the one dedicated to private entities. The usual research methods specific to nonfinancial reporting are employed. While many articles analyse the variables determining the nonfinancial reporting, there is a need for studies dedicated to the barriers of nonfinancial reporting and nonfinancial reporting in practice.

### **Keywords**

CSR reporting, corporate governance, state-owned enterprises, literature review.

### **JEL Classification**

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### **Introduction**

Nonfinancial reporting (NFR) includes environmental, social and governance reporting. Concerns about sustainability have become a constant in our lives over the past decades. As such, entities are increasingly reporting on these issues.

Most of the research conducted in the area of NFR is centred on private entities (Ball et al, 2014). Our research is dedicated to a special type of entities, which is represented by the state-owned companies (SOEs). SOEs are entities which are expected to provide public services. They are established in order to correct market failures and create jobs (OECD, 2011). As such, their activity has an important social component. In the same time, some of the services provided (such as the public transport) have a considerable environmental impact. Also, they are connected with the government and the government is expected to implement diverse tools to support the progress in the CSR direction. It was established that SOEs contribute with 10% at the world GDP (Bruton et al., 2015), employ over 6 million

people, obtain operating revenues representing 19% of the international trade and sales representing 6% of the world's gross national income (Florio et al., 2018). They use large volumes of resources (Garde-Sanchez et al., 2017a). They can be used by governments to implement policies and thus are providing an example to other companies and to the society (Garde-Sanchez et al., 2018). For all these reasons, we consider that the SOEs represent an interesting research setting.

SOEs are also called hybrid organizations, because they are owned by the government (depending on it like the public sector entities), are politically governed, but act on the market like the private entities (sometimes, being for-profit organizations). Given the interesting characteristics of these entities and their reason for being, our research objective is to conduct a literature review in the area of NFR of the SOEs.

Our paper is structured as it follows: first, we present a literature review dedicated to the NFR. Our research method follows. We present the results of our study afterwards. Our paper end with the conclusions of the authors.

### **Literature review**

Entities initially adopted a voluntary approach in the NFR. As the number of reports increased, guides were needed. The first stage was the Triple Bottom Line (Elkington, 1994). The concept means extending the traditional reporting framework to take into account social and environmental performance, in addition to financial performance. In the second stage of the development of corporate social responsibility reporting, some independent organizations which launched theoretical reporting frameworks appeared. The most important body created in this regard is the Global Reporting Initiative (GRI). The frameworks launched by GRI have reached the fourth generation and are now the most widely used worldwide in the field of sustainability reporting. In 2010, the International Integrated Reporting Council (IIRC) was created, who's declared purpose was to issue a theoretical framework applicable by all entities in the world that want to develop an integrated report. Integrated thinking and reporting can help the sector make the most of resources, encourage the right behaviors, and demonstrate to stakeholders how the strategy is implemented and value in the short, medium and long term is created. The focus on creating value beyond profit is more flexible and has benefits for SOEs. Integrated reporting can contribute to strengthening governance, transparency and accountability through more comprehensive presentations, focusing on performance-oriented management and explaining how sustainable outcomes will be achieved for a range of stakeholders over time. In the third stage, the authorities began to recognize the importance of NFR for stakeholders and issued regulations. There are countries (such as those included in the European Union) where certain aspects of this form of reporting became mandatory. In response to the great financial scandals of the early 21st century, in 2002 the Sarbanes Oxley Act instituted in the U.S. a set of strict laws for governance. At the same time, the Combined Code has introduced a set of good governance practices in the UK. One of the six OECD principles of governance relates to reporting and transparency. According to it, the corporate governance framework should ensure the timely and correct disclosure of all material aspects related to the entity, including the financial position, performance, ownership and governance of the company. Therefore, the annual financial statements must be prepared in a timely manner and include all the elements of interest to the shareholders. The first aspect related to the NFR that was regulated at the European Union level was the one regarding governance. Thus, the EC Directive 2006/46 required that all listed companies in Europe include a corporate governance statement in their annual report. Most Member States have integrated this into their national legislation by 2010. In 2013, the European Commission identified two major issues related to NFR across the Union: (1) insufficient transparency of nonfinancial information in the business environment and (2) insufficient diversity boards of

companies, which is considered primarily a matter of corporate governance processes. As a result, the European Directive 2014/95 / EU was issued and became mandatory for large companies in 2017.

For SOEs, better information can help improve governance, show how money is spent and rebuild confidence in a post-crisis global economy where capital raising and promoting sustainable growth are essential (World Bank, 2018). A higher level of transparency vis-à-vis stakeholders may result in the discharge of responsibility. This implication can act as a strong motivation and an incentive, especially for organizations with a wide range of stakeholders (Oprisor, 2017). Worldwide, leaders of SOEs are looking for tools and theoretical frameworks to help them demonstrate effective resource allocation and accountability – communicating not only for the sake of transparency, but also to ensure that all stakeholders understand how their organization works.

### **Research method**

Our research objective is to conduct a literature review in the area of the NFR of the SOEs. We chose to study SOEs as there are fewer works dedicated to SOEs than private companies. In this respect, we examined the papers dedicated to the NFR of the SOEs. We searched for them on Google Scholar. The keywords used were “nonfinancial reporting” and “state-owned enterprises.” We read the title and the abstracts and retained the articles considered as suitable for the purpose of this study. Our sample includes 69 articles. The articles were read and the main ideas showing the characteristics of the NFR in SOEs were kept.

### **Results and discussion**

Reporting of entities in the public domain, including SOEs, was developed in parallel with the reporting of companies with private capital, according to the requirements of the stakeholders (Garde-Sánchez, Rodríguez-Bolívar, & López-Hernández, 2017a). NFR is important in SOEs, as it was found that it improves performance, efficiency and confidence of the stakeholders (Royo et al., 2017).

The articles are concentrated in certain geographical areas: China (Cheng et al., 2017; Wang & Zhang, 2019), Italy (Allini, Manes Rossi, & Hussainey, 2016), Spain (Andrades, Martínez, Larrán, & Herrera, 2019; Córdoba-Pachón, Garde-Sánchez, & Rodríguez-Bolívar, 2014; Garde-Sánchez et al., 2017a). There are some parts of the world (for instance, the less developed countries), which are under-researched. Yet, we consider that from the point of view of the nonfinancial aspects, especially these areas are interesting (as they include the environmental aspects, in relation to which these countries do not have a tradition, social aspects, in relation to which there are numerous abuses reported, risks, which are different as compared with the developed countries, or corruption, which has a higher incidence in these areas).

Many studies refer to listed companies (e.g. Allini et al., 2016; Wang & Zhang, 2019). There are studies focused on SOEs controlled by the local authorities (Córdoba-Pachón et al., 2014) or state authorities (Royo, Yetano, & García-Lacalle, 2019). There are studies dedicated to specific domains, such as utilities (Adams & McNicholas, 2007; Cormier & Gordon, 2001), or to environmentally-sensitive entities (Cheng, Wang, Keung, & Bai, 2017; Hassan & Ibrahim, 2012). Most of the studies are based in one country (for instance, Andrades Peña & Jorge, 2019), but there are exceptions. For instance, Traxler & Greiling (2019) use in their study 83 sustainability reports published according to Global Reporting Initiative guidelines G4 by companies from 28 different countries.

Most of the work is based on empirical studies. Data is generally obtained from annual reports, websites or questionnaires. There are studies based on one company (for instance,

Farneti, Casonato, Montecalvo, & de Villiers, 2019) to studies with samples made up of more than one hundred companies (Garde-Sánchez et al., 2017a).

As a theoretical basis, all the theories generally used in studies dedicated to CSR reporting are employed: stakeholder theory (Andrades Peña & Jorge, 2019; Garde-Sánchez et al., 2017a; Garde-Sánchez, Rodríguez-Bolívar, & López-Hernández, 2017b), legitimacy (Andrades Peña & Jorge, 2019; Cormier & Gordon, 2001; Garde-Sánchez et al., 2017a, 2017b), and to a lesser extent agency theory (Allini et al., 2016) and institutional theory (Montecalvo, Farneti, & de Villiers, 2018). Although the theories are described, in many articles they are no longer used to interpret the results. The legitimacy theory is a very good premise to explain why SOEs – especially non-listed ones that provide services of public interest – are motivated to report integrated on governance, social and environmental issues. The legitimacy theory is very important in this context, because an entity must justify its existence at a social level, especially if it offers public services. Motivation of legitimacy is also important, but in Romania unlisted state-owned companies are also unprofitable, so the hypothesis issued here is not verified. Some SOEs are too big to fail, which causes them to report nothing, because they do not have to be justified in front of the public. Both stakeholder and legitimacy perspectives are very useful in explaining the motivations for integrated reporting for SOEs, especially for social and environmental issues. The agency theory is very good for integrated reporting on governance issues and for strategic decisions, like internationalization.

The purpose of reporting is to improve the legitimacy of the company (O'Dwyer, 2002), to control the perception and priorities in terms of environmental performance (Larinaga-Gonzalez et al., 2001), to provide on account in front of the stakeholders (Adams and McNicholas, 2007). Some articles address only certain aspects reported. For example, Allini et al. (2016) dedicated their study to risk reporting, Farneti et al. (2019) to social issues etc. One of the main aspects studied regarding the reporting of SOEs are the factors that determine the reporting of companies with state capital in accordance with the legal requirements. Corporate governance is seen as a determinant of the NFR. A set of variables chosen for the studies is presented in table no. 1.

Other studies are dedicated to the inhibitors of the NFR in SOEs. Among them, the accountability style, the ambiguity of the laws and the lack of sanctions are found (Andrades Peña & Jorge, 2019).

Many articles analysed show differences between the NFR of private entities and SOEs (Adams & McNicholas, 2007; Muttakin & Subramaniam, 2015). There is evidence that the quantity of NFR disclosed by SOEs is lower than the one disclosed by private entities (Andrades et al., 2019; Andrades Peña & Jorge, 2019). A reason is the lack of awareness of the responsibility. There is a need to actively integrate the CSR actions in the daily activities, to adopt a proactive CSR vision, dynamic and aware of the stakeholders (Córdoba-Pachón et al., 2014).

Most of the articles from Spain (Andrades et al., 2019; Andrades Peña & Jorge, 2019; Royo et al., 2019) show that the quantity of NFR is reduced. There are items which are not presented at all, such as the politics, objectives and corporate governance structures. The investors are still considered the most important stakeholders.

Another interesting finding is that the general aspects are more frequently disclosed than the aspects specific to the domain (Traxler & Greiling, 2019). There are significant differences from one company to another (Wang & Zhang, 2019).

**Table no. 1 Variables used in the studies**

Studies	Variables related with	Examples of variables	Variables with significant influence
Allini et al., 2016; Esa & Ghazali, 2012; Lewis et al., 2013; Muttakin & Subramaniam, 2015; Robertson and Barling 2013; Wang & Zhang, 2019	The board of directors	Size, frequency of the meetings, independent members, diversity, age	Diversity and age of the members of the board are correlated with the risk disclosure. The size and independence of the board are associated with the CSR disclosure.
Allini et al., 2016; Andrades Peña & Jorge, 2019; Cormier & Gordon, 2001; Cormier et al., 2005; Esa & Ghazali, 2012; Hossain and Reaz, 2007; Kansal et al., 2014; Muttakin & Subramaniam, 2015; Traxler & Greiling, 2019; Wang & Zhang, 2019; Webb, 2004	The entity	The size of the institution, the environmental sensitivity, profitability, leverage, government ownership, type of public capital (state or local), visibility on the internet, stakeholders' pressure stock exchange listing	The size, age, type of capital, stock exchange listing, stakeholders' pressure, domain, profitability and visibility are correlated with the NFR disclosure.
Garde-Sánchez et al., 2017a	The managers	Age, sex, the profile of the CSR education, responsibilities related with the CSR	Responsibilities related with the CSR influence the online disclosure of the CSR information.

*Source: authors' compilation*

The relevance of the environmental disclosure is questioned. While the quantity of the disclosure increases, Cheng et al. (2017) show that negative information regarding the environment was hidden by their sample companies. The social reporting is preferred. The researchers noticed that the amount of information disclosed by SOEs varies in line with the size of the entity and the nature of public ownership (Andrades et al., 2019). A central theme discussed in the articles is the accountability of the SOEs. It is generated by the combination between public and private characteristics of these entities. "Who is accountable for whom" and "for what" is to be answered (Grossi & Thomasson, 2015). One question refers to the accountability style (Royo et al., 2019): is it characteristic to the public or private sector? Accountability is important for shareholders taxpayers and other stakeholders who are the recipients of the services provided by SOEs (Ferguson et al., 2012).

### Conclusions

Some authors (e.g. Garcia Sanchez, Andrades Pena) published several articles dedicated to this topic, which shows that this is their main research interest. Many articles are published very recently (for example, in 2019), which demonstrates an increase in researchers' interest in this topic.

Correlations are made that have contradictory results from one sample to another. It would be interesting to see what is going on in companies, how decisions are made about what is reported. Other research methods could be used for this (case studies, interviews). In line with Garde Sanchez et al. (2018), we find that there are few articles dedicated to the impact of CSR in practice. Research in this field is significant especially in countries where the state has a strong presence in the companies.

If the State is the only shareholder, then the public remains as the only interested party in the NFR of companies. In Romania, it is wrongly assumed that the public is not interested in this reporting, and therefore NFR is not offered by the respective entities. It can be argued that the NFR is justified by the existence of the public responsibility of the respective entities, if their role is not an exclusive one to make a profit, but to correct the market deficiencies.

As a future research topic we consider that it is interesting to see what is the difference, theoretically, between listed and unlisted companies, in terms of their nonfinancial (integrated) reporting. For example, to what extent NFR can help a company such as Metrorex, CFR, or Posta Romana, which have significant social or environmental problems. Which are the motivations for unlisted companies to report nonfinancial aspects? Does reporting differ depending on this idea: to what extent does the entity offer public services versus profit seeking?

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