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Balancing Transparency and Competitive Advantage in Sustainability Reporting

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Abstract

The increasing transparency of sustainability reporting is a current matter as new regulations and stakeholder pressures are reshaping the reporting landscape. Companies need to find new strategies to protect their sensitive information and maintain their competitive edge. To find ways for companies to balance the transparency and competitive advantage in sustainability reporting, first this literature review studies the challenges and advantages of increasing transparency and then gives suggestions how this balance could be achieved.

The main challenges are related to proprietary costs and the risk of exposing sensitive information, which can lead to weakening of reputation and competitive position. Also, increasing transparency can lead to short-term financial costs. However, there are several advantages to transparency including increased stakeholder trust, potential reputational benefits, and opportunity for differentiation. Additionally, transparency can improve company value over time and attract long-term investors.

This research comes to conclusion that the balance between transparency and competitive advantage can be achieved by voluntarily and proactively reporting on sustainability while protecting the proprietary information with different strategies. Other sensitive information, such as environmental mistakes, should be also disclosed with transparency to keep and rebuild the trust. Lastly, building credible and effective sustainability reports is important to get the competitive benefits of transparency.

Keywords Sustainability Reporting, Transparency, Competitive Advantage, Proprietary Information, Voluntary Reporting

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Tiivistelmä

Kestävyysraportoinnin läpinäkyvyyden lisääntyminen on ajankohtainen aihe, sillä uudet säädökset ja sidosryhmien paineet muokkaavat nykyistä raportointi kenttää. Yritysten on löydettävä uusia strategioita suojatakseen arkaluonteisia tietojaan ja säilyttääkseen kilpailuetunsa. Tasapainon löytämiseksi läpinäkyvyyden ja kilpailuedun välillä kestävyysraportoinnissa tämä kirjallisuuskatsaus tarkastelee ensin läpinäkyvyyden lisääntymisen haasteita sekä etuja, ja sitten esittää ehdotuksia tasapainon saavuttamiseksi.

Suurimmat haasteet liittyvät liikesalaisuuskustannuksiin ja riskiin arkaluontoisten tietojen paljastumisesta, mikä voi johtaa maineen ja kilpailuaseman heikkenemiseen. Lisääntynyt läpinäkyvyys voi myös johtaa lyhyellä aikavälillä taloudellisiin kustannuksiin. Läpinäkyvyydellä on kuitenkin useita etuja, kuten lisääntynyt sidosryhmien luottamus, mahdolliset mainehyödyt ja tilaisuus kilpailijoista erottautumiseen. Lisäksi läpinäkyvyys voi parantaa yrityksen arvoa pitkällä aikavälillä ja houkutella pitkäaikaisia sijoittajia.

Tässä tutkimuksessa päädytään siihen johtopäätökseen, että tasapaino läpinäkyvyyden ja kilpailuedun välillä voidaan saavuttaa vapaaehtoisesti ja ennakoivasti raportoimalla vastuullisuudesta samalla kun suojataan liikesalaisuuksia eri strategioilla. Myös muut arkaluontoiset tiedot, kuten ympäristövirheet, tulisi julkistaa läpinäkyvästi luottamuksen säilyttämiseksi sekä palauttamiseksi. Lisäksi uskottavien ja tehokkaiden kestävyysraporttien laatiminen on tärkeää kilpailuetujen saavuttamiseksi.

Avainsanat Kestävyysraportointi, Läpinäkyvyys, Kilpailuetu, Liikesalaisuudet, Vapaaehtoinen raportointi

Table of Contents

1 Introduction

The demands for transparency in sustainability reporting have recently intensified as new regulations and stakeholder pressures are reforming the reporting landscape. This movement towards transparency might result in companies having to disclose sensitive information more than ever before. Due to the increasing regulation, heightened investor expectations, and growing consumer awareness, transparent sustainability reporting is becoming expected for all companies moving forward. The push for this shift comes from the European Union (EU) which recently enforced the new Corporate Sustainability Reporting Directive (CSRD). CSRD will make it mandatory for many European-based companies, and even some non-European ones, to report on sustainability starting from first reports being published in 2025 (KPMG, 2022).

Before delving deeper into the topic, it is important to define the term "sustainability reporting". Sustainability reporting essentially means that companies make public non-financial reports on their progress on several sustainability related issues. As for the official definition, the Global Reporting Initiative (GRI) explains the term as follows. Sustainability reporting is the act of companies publicly sharing their most important economic, social, and environmental efforts towards the boarder goal of more sustainable development, whether the contributions are positive or negative (GRI, 2016). Corporate Social Responsibility (CSR) information or reporting is another term often used interchangeably with sustainability reporting.

As noted, sustainability reporting is becoming mandated for many companies, especially for ones operating in Europe (Hummel & Jobst, 2024). Consequently, this expands the number of companies that disclose their environmental, social, and governance (ESG) impacts. The goal of this increase in regulation is to make sustainability reports more comparable and transparent (KPMG, 2022). However, the quality and depth of these reports can still vary from a company to another. Ultimately, it is up to the companies to decide whether they will just comply with regulations or go beyond them. Each company will have different approaches to what they report and how they choose to disclose their information.

Consequently, companies now face both challenges and advantages from these expectations for transparency. Potentially the biggest challenge is the risk of exposing sensitive information. For example, disclosing poor environmental results could lead to bad publicity or even scandals. Also, companies may have valuable information that they want to protect, e.g. secret technology. On the other hand, advantages of transparency should not be overlooked. Research by Reichheld et al. (2023) shows that especially younger generations value transparency highly, and they are more likely than the older generations to spend more money on brands that they consider transparent. This encourages companies to use transparency as an advantage, because younger generations will soon have the biggest purchasing power (Reichheld et al., 2023). Because of these diverse challenges and advantages, this thesis is particularly current and relevant.

Regardless of the recent regulatory changes, the academic research on how companies can balance this increasing transparency with their competitive advantage is limited. The past research mostly focuses on positive or negative impacts of transparency for companies. More research is needed on how these aspects could or should be balanced. This gap probably exists as regulation is just coming to an effect and practical suggestions are becoming even more relevant. This makes my thesis important from the academic viewpoint, and topical as companies need to adapt to more transparent landscape. As H. Christensen et al. (2024) noted, there's growing need for accounting research, especially on sustainability, because around the globe sustainability reporting is being standardized and mandated.

This brings me to my research question: How can companies balance transparency and competitive advantage in sustainability reporting? The purpose of my thesis is to find best practices how companies can balance protecting sensitive information while keeping their competitive advantage. To do this, I will first gather information about the challenges and advantages of transparency in sustainability reporting, and then find ways to balance them. My research is not focused on any specific field or industry but rather discusses this topic in more general level while using theories as a base.

As for how my thesis is structured, after methodology in section 2, my aim is to summarize the historical background as well as the current reporting landscape. Further on, in section 4 I present the theories and concepts, and in section 5 I will conduct the literature review. At the end of this thesis, I will discuss the best practices, and lastly conclude my research.

2 Methodology

The objective of this thesis is to find the best practises how companies can balance transparency and competitive advantage in sustainability reporting. I have chosen literature review as my research method. As new sustainability reporting regulation is coming to an effect, many studies examine the opportunities and challenges this brings (see e.g. H. B. Christensen et al., 2021 and Haji et al., 2023), making literature review relevant approach. However, there is need to review the literature in the perspective of transparency and competitive advantage together, as that subject has not yet been studied. I will connect different studies and analyze the topic by using theories so I can come to conclusions without the specific literature.

To find this appropriate literature I have used specific keywords systemically to guide my research. I started by using different combinations of "transparency", "competitive advantage" and "sustainability reporting". As I extended the scope of my search, I added keywords such as "proprietary information", "differentiation" and "firm value". I had to use variety of keywords, and their combinations, as this topic is quite complex. Moreover, I had to use different sources creatively to reach meaningful conclusions. The primary search engines used for this research are Google Scholar and Scopus database.

The literature review section of this thesis is conducted with 22 papers. To ensure the quality of my literature sample, I used the Chartered Association of Business Schools (ABS) journal ranking system, which rates journals from 1 to 4*. Most of my sources are from journals with rating 3 or above, with limited number from those rated 1 or 2. Journals without ranking are used only if they are peer-reviewed and essential for my topic. Additionally, I have included few non-journal sources, such as legislative websites and industry reports from reputable firms, which are appropriate for the purposes of this study.

3 Background

Before going deeper into the topic of this thesis it is vital to understand the two main concepts discussed, which are “transparency” and “competitive advantage”. Furthermore, it is beneficial to understand these terms in the context of sustainability reporting.

In the business field the most widely used definition for transparency is making information available to everyone who has the right to know, so that they can make educated decisions (Higgins et al., 2020). Building on this, transparency in sustainability reporting means companies giving accurate information about their ESG practices and impacts, in a form that is easy for stakeholders to understand and acquire. Transparency is the element in sustainability reporting that builds relationships with different stakeholders (Fernandez-Feijoo et al., 2014). By building relationships companies can also build trust, and this is why it is important that the reports are true and give the whole picture. This trust-aspect of transparency will be discussed further in the literature review section.

Generally, competitive advantage refers to company’s capability to surpass its competitors in performance by doing something better and thereby providing higher value to its customers (Porter, 1985). According to Porter (1985) competitive advantage comes from producing more value to the customers than it costs the company to produce it. This can be done by two ways: cost leadership and differentiation (Porter, 1985). This is the classical way of defining competitive advantage, which is still relevant today.

Cost leadership refers to company providing product or service at lower cost than its competitors can provide them (Porter, 1985). Differentiation, on the other hand, means that company offers a product or service that is valued by customers on other aspects than just the cost (Porter, 1985), e.g. Apple through its sleek product design. Differentiation gives companies opportunity to ask for higher prices, and it may build brand loyalty with customers. Brand loyalty means that customers choose same company's product or service repeatedly rather than the competitor's option (Chaudhuri & Holbrook, 2001).

Lately, there has been more conversation in the field of competitive advantage about linking social advantage with superior financial success (Nayak et al., 2022). It takes into notion how companies can create social value and have positive impact, e.g. on community, which can also create competitive advantage. This further connects competitive advantage to this thesis' theme of sustainability reporting.

3.1 History of Sustainability Reporting and Transparency

The history of sustainability reporting starts from growing environmental awareness and progresses to increasingly standardized practices. Consequently, the transparency of sustainability information has increased along the way.

Environmental activism and the awareness of the environmental impact of companies grew in the 1980s. Part of the reason for this was the academic research that began to demonstrate the need for more sustainable practices. In 1987 The Brundtland Report was announced by the United Nations World Commission on Environment and Development (Dănescu et al., 2021). It explained the term "sustainability" as development that fulfills current necessities without jeopardizing the future generations (Dănescu et al., 2021). This new understanding of sustainable development also affected companies and encouraged them to use more responsible practices. As a result, by the late 1980s the very first sustainability reports were published (Dănescu et al., 2021).

Transition to more standardized sustainability reporting begins in 1990s when associations like the Global Reporting Initiative (GRI) were formed. GRI was founded in 1997 and released its initial guidelines in 2000 (GRI, 2022). It was the first organization to construct a global framework for sustainability reporting (GRI, 2022). Five years later the EU introduced the Transparency Directive (2004/109/EC). This directive's goal was to increase the transparency of publicly traded companies by having certain disclosure requirements, regarding financial reporting.

Although non-financial information was not regulated at this time, some organizations already made efforts to make non-financial information more transparent, as well. For example, transparency has been a guiding principle of GRI’s mission from the start, and it has continued to update its guidelines and made even more information transparent (Clarkson et al., 2008). In 2016 GRI moved from guidelines to publishing Sustainability Reporting Standards which enhanced clarity and comparability of sustainability reporting (GRI, 2022). This gives a more complete picture of companies impacts and consequently increases their non-financial transparency.

Further on in 2017, sustainability reporting field started to develop more standardized practises when the EU’s Non-Financial Reporting Directive (NFRD, 2014/95/EU) became effective (Charitou, 2022). With this directive, some of the large companies registered in the EU were mandated to disclose their non-financial information (Charitou, 2022). This was important turning point in the reporting field because it started the period of more consistent and standardized sustainability reporting.

This trend continued four years later in 2021, when the EU introduced its Corporate Sustainability Reporting Directive (CSRD, 2022/2464) (KPMG, 2022). This directive broadened mandatory reporting, as prior to this only minimal number of companies were required to report on sustainability. The CSRD will eventually obligate sustainability disclosures from almost all listed companies and large companies within EU (KPMG, 2022). The first companies will publish their sustainability reports under this directive in 2025, with information from 2024 (KPMG, 2022). All of this leads us to this day, where sustainability reporting is quickly becoming expected practice for all and mandated one, as well.

3.2 Current Reporting Landscape

As for right now, sustainability reporting landscape is progressing towards increased transparency. Behind this movement are regulatory bodies and global initiatives, as well as increased expectations from customers and investors. At the same time, the reporting landscape is becoming more fragmented than ever before (Krivogorsky, 2024). The current state of fragmentation comes from overlapping requirements and regional differences in sustainability reporting practices, as well as newly enforced mandates. Notably, the CSRD is fighting this fragmentation by introducing broader and more standardized mandatory requirements.

The CSRD will affect around 50,000 companies globally, and it mandates companies to report on their environmental, social, and governance (ESG) issues (KPMG, 2022). The companies reporting with CSRD will be using the European Sustainability Reporting Standards (ESRS), which are designed by European Financial Advisory Group (EFRAG) (KPMG, 2022). These standards give framework for companies to report on sustainability and integrate stakeholder as well as double materiality perspective into their sustainability reports (Dechow, 2023). This means that the reports will take into notion what the stakeholders consider to be important information, i.e. stakeholder perspective (Dechow, 2023). Double materiality, on the other hand, means that reports consider both the economic impacts of sustainability issues on the company and the company's impacts on the environment and society (Dechow, 2023). Moreover, the ESRS are designed to be compatible with the

GRI standards. This helps companies with the transition to new requirements, as the GRI standards are widely used ones at the time (GRI, 2022).

The CSRD will be implemented in phases. By 2028, even some non-EU companies will have to report under CSRD, if their turnover in the EU is over €150 million (KPMG, 2022). This expands the scope of mandatory sustainability reporting significantly (KPMG, 2022). Although, even with the new mandates, there is still voluntary aspects in sustainability reporting. For example, companies can still choose how detailed they make their reports. Also, they have the option to disclose more than is mandated. Consequently, the quality and depth of the reports can still vary, even with the new mandates. Of course, there are still companies that don't fall under any regulation for sustainability reporting, and for them all of these disclosures are voluntary. The remaining voluntary aspect of reporting is what makes this thesis particularly relevant. With mandatory requirements or not, companies will have to balance the level of transparency with protecting their sensitive information.

Another important body in sustainability reporting field is the International Sustainability Standards Board (ISSB), which focuses on forming a clear baseline for sustainability reports around the globe (Krivogorsky, 2024). There have been efforts to standardize and harmonize the reporting field, and therefore also ISSB and EFRAG have worked together to make their standards compatible (Krivogorsky, 2024). For that same purpose, the ISSB has integrated different standards from separate entities into one unified framework. The harmonization of current reporting landscape is needed because investor demands for more reliable and comparable ESG data are increasing (Adams & Abhayawansa, 2022). Lastly, companies would benefit from harmonization as it would relieve the burden of different requirements.

Also, in the United States, sustainability reporting will soon have mandatory aspects. In March of 2024, Securities and Exchange Commission (SEC) finalised their new rules on sustainability reporting for publicly traded companies

(PwC, 2024). Public companies will be mandated to disclose several ESG impacts e.g. scope 1 and scope 2 emissions, and climate threats (PwC, 2024). Differing from the CSRD, SEC has not made it clear could other standards, such as the GRI, be used to meet their requirements. SEC announced that they will observe how global standards are developing and if they will be good enough to satisfy their standards (PWC, 2024). It is evident that this lack of alignment could increase the fragmentation of the reporting field.

All things considered, transparency of sustainability information is expected to increase vastly in coming years, due to the new and upcoming mandates. However, the landscape remains fragmented, and companies will have to adapt to different demands quickly.

4 Conceptual Framework

To understand how companies can manage the increasing transparency while keeping their competitive advantage its necessary to look at the relevant theories. Therefore, in this thesis I will be using two theories, signaling theory and legitimacy theory. This approach links this research to an appropriate theoretical base and adds to its usefulness in the accounting field. Additionally, it is important to define the concepts relevant to this topic.

4.1 Theories

Firstly, signaling theory is used to describe situations where two sides have different information, i.e. there is information asymmetry (Connelly et al., 2011). To further, signaling theory is essentially an idea of decreasing this information asymmetry between two different parties (Connelly et al., 2011). Sustainability reporting is a way to lower this information asymmetry between the stakeholders and company (Friske et al. 2023). Of course, transparency in these reports is the aspect that truly lowers the information asymmetry.

Secondly, the idea behind legitimacy theory is that there is this social contract which requires companies to act in a way that meets society's expectations (Cho et al., 2015). They may lose their right to operate, or society may withdraw its support to them, if they do not comply with these norms (Cho et al., 2015). Legitimacy theory suggests that in addition to immediate stakeholders, companies are motivated by society's broader expectations. By reporting on sustainability, companies can show that they meet these society's expectations and norms (Nikolaeva & Bicho, 2011). Accordingly, companies use sustainability reporting for legitimization purposes (Cho & Patten, 2007).

These two theories are also connected by sustainability reporting. It is important to understand that companies often have to tackle between internal motivators and external expectations. Companies might be eager to report on their good sustainability actions, and therefore they signal these positive outcomes strongly (signaling theory). However, often they tend to be opposed to disclosing the negative aspects (Bellucci et al., 2019), such as high levels of emissions, due to the social pressure from stakeholders (legitimacy theory). Companies fear that exposing negative activities could damage their legitimacy (Bellucci et al., 2019). Therefore, companies must balance between signaling enough of the good and not disclosing too much, to answer the expectations and to keep their legitimacy.

Of course, if a company is exposed of hiding information their legitimacy will be eventually hindered. Therefore, it might not be wise to seemingly adhere to social norms just to keep their legitimacy. This is also shown in the literature which finds that companies that have worse environmental performance will compensate this by making more voluntary sustainability disclosures, on other aspects (Cho & Patten, 2007; Patten, 2002). This is way for them to offset the worse performing areas by signaling stronger the other ones. This is because, the companies use these disclosures as a method for legitimization, and worse performers may have greater losses if they are exposed (Cho & Patten, 2007).

4.2 Concepts

Proprietary information is one of the most central concepts in this thesis. It refers to information that is valuable for the company's competitive success, like trade secrets such as innovations. This proprietary information has economic benefits because competitors don't have access to it or can't use it (Glaeser, 2018). Therefore, companies try to hide this valuable information, so that they can get competitive advantage. To be noted here, not all sensitive information is proprietary information. For example, information of environmental misconduct is not proprietary as it does not give competitive advantage, but it is sensitive information in nature.

Customer attachment is another concept discussed later in this thesis. Customer attachment is similar to brand loyalty, which was mentioned earlier, but it goes deeper. It is more about the emotional connection between the company and customer (Park et al., 2010). Attached customers feel personal connection to the company, e.g. company supports customers individual values or goals (Park et al., 2010). Moreover, this strong connection leads to positive behavior, e.g. customers may defend the brand and use positive word-of-mouth (Park et al., 2010).

Other important concepts in this thesis are reputation and stakeholder trust. Company's reputation is essentially the general perception that stakeholders and the public have of a company (Helm, 2011). Reputation can be built on many things including company's actions, values, and achievements. It is built from the past actions as well as the current ones, and it can also change over time (Helm, 2011). Stakeholder trust, on the other hand, is more specific. It generally refers to how confident stakeholders are of company's actions and intentions. According to Iwasaki (2023) stakeholder trust is built from high competence, the right intent, meeting of expectations and promises, and being transparent.

Competitive position and company value are also discussed later in this thesis. Competitive position refers to how company is positioned relative to its competitors in the same industry (Porter, 1985). It tells how well company does compared to others in the same field. There are several factors that affect company's competitive position such as brand strength, customer loyalty, or market size. Strong competitive position helps company to stand out and achieve competitive advantage. Company value means generally what is the financial worth of a company e.g. how much would it cost to purchase company. There are several ways to measure this and to examine effects on value. In this thesis the research papers by Haji et al. (2023) and Friske et al. (2023) discuss effects on company value and these effects are measured by Tobin's q. It is the most widely accepted measure (Friske et al., 2023).

5 Challenges and Advantages of Transparency

There are several challenges and advantages that rises from new sustainability reporting regulation as well as stakeholder demands for transparency. It is valuable to understand what these challenges and advantages are, in detail, so that companies can protect their competitive position and use transparency as an asset. Therefore, in this section of my literature review I will examine the existing literature on the challenges and advantages that transparency poses to companies' competitive advantage. This section is divided into five sub-sections which I consider to be most important for companies' competitive advantage.

5.1 Proprietary Information

The central concern that companies have, regarding transparency, is the fear of exposing their proprietary information or otherwise sensitive information. This same concern is also reflected in the literature which has the consensus that increased transparency can indeed risk revealing companies' sensitive information (H. B. Christensen et al., 2021; Glaeser, 2018; Liu et al., 2023; Schnackenberg & Tomlinson, 2016). Despite this finding, transparency might not be just a choice for much longer, so companies must find ways to guard their valuable information.

Thus, the proprietary costs are central challenge for companies. Proprietary costs are the costs that come with disclosing proprietary information, which their competitors can then acquire and use for their advantage. These costs occur because of disclosures being aimed at many different stakeholders e.g. to customers as well as investors (H. B. Christensen et al., 2021). As a result, companies must balance different demands and perspectives in their reports. Companies' decisions might be influenced by these costs e.g. the fear that disclosing information can damage their competitive position (Healy & Palepu, 2001). Moreover, H. B. Christensen et al. (2021) point out that the challenge of proprietary costs could be even more noticeable for CSR reports, because they are often specifically targeted for certain industry, for example.

According to Imhof et al. (2022) it is common that competitors pay close attention to each other's reports, also non-financial ones, to gain competitive advantage. This leads to decreased transparency for companies that have high costs of losing proprietary information (Glaeser, 2018; Imhof et al., 2022). This means that the cost of this sensitive information getting to their competitors is high, for example because of the industry is very competed. Similarly, García-Sánchez & Martínez-Ferrero (2017) suggests that companies that have high cost of proprietary information may be averse to disclosing their CSR information. Thus, it can be stated that transparency of sustainability reports is a greater challenge for companies that have close competitors, as they have higher costs of proprietary information loss.

However, there are different strategies that companies already use to lessen the negative effects of proprietary costs. Firstly, as Glaeser (2018) finds, some companies choose to disclose more non-sensitive data in place of the proprietary information. Secondly, Imhof et al. (2022) find that companies sometimes make their reports harder to compare by their rivals, to protect sensitive information. These are ways for companies to seem transparent without disclosing too much information. Interestingly, these findings suggest that even when companies don't want to share all information, they want to appear as transparent as possible. Transparency seems to be something that companies want to signal to their stakeholders, maybe because of its effects on stakeholder trust.

5.2 Reputational Impact & Stakeholder Trust

As a whole, the literature suggests that transparency indeed increases stakeholder trust (Andrus et al., 2023; Liu et al., 2023; Schnackenberg & Tomlinson, 2016; Tang & Higgins, 2022). Furthermore, trust can help to build companies reputation too. However, the literature also shows that transparency can affect companies' stakeholder trust and reputation in contrasting ways. For example, transparency can also expose unflattering details about company's ESG efforts e.g. poor labor practices, which can lead to reputational damages.

The case of Estra (De Micco et al., 2021), brings up a noteworthy risk which comes with transparency and its reputational impacts. Estra was exposed of knowingly and opportunistically neglecting the reporting of their corruption policies, which came to light when they started to increase transparency of their sustainability reports (De Micco et al., 2021). This shows that there is indeed a risk of getting negatively exposed when transparency increases. This is not the first time that companies have been caught red-handed, like witnessed by the famous scandal of Volkswagen, where they tried to hide illegal emission levels (Higgins et al., 2020). Undoubtedly, high-profile public scandals are detrimental for companies' reputation. To reiterate, H. B. Christensen et al. (2021) state that poor CSR performance has negative effect on companies' reputation, and it creates bad publicity.

However, transparency does not always have negative impact on reputation, even when mistakes are made. In contrast to previous findings, research by Rim et al. (2019) found that signaling transparency, even when revealing bad sustainability results, does not always negatively affect companies' reputation. Furthermore, transparency has the possibility to better the perceived integrity of company (Rim et al., 2019). These findings show that if companies are being open and transparent about their mistakes it can possibly build trust and therefore in the long term build better reputation. This is also supported by Tang & Higgins (2022) who state that transparency offers a method to establish, rebuild, and preserve trust among the stakeholders.

Building on this, signaling the transparency in a right way seems to be important to harness the reputational benefits. The study by Baraibar-Diez &

Luna Sotorrío (2018) shows that companies signaling their CSR actions, transparently, can have improvements to their reputation. Transparency becomes the mediator between CSR actions, like sustainability reporting, and stakeholders (Baraibar-Diez & Luna Sotorrío, 2018). Furthermore, clear signaling of transparency leads to increased trust and more favorable reputation. These findings show that transparency should go beyond simple disclosure. After all, the way information is presented also matters if companies want to get the positive outcomes from their sustainability reporting and transparency efforts (Tang & Higgins, 2022).

5.3 Differentiation & Customer Attachment

One of the positive outcomes from transparency might be the possibility of differentiation from competitors, which in turn can give competitive advantage (Porter, 1985), as discussed. This is also supported by Clarkson et al. (2011) who suggest that proactive environmental strategies can offer product differentiation. However, the increasing mandatory reporting is gradually making the reporting landscape more even, and therefore it can be more difficult to stand out than before. To stand out, companies must put in more effort and likely also be more transparent than their competitors.

Showing real commitment to ESG issues, through transparent sustainability reporting, could set companies apart. Still, achieving true differentiation is a challenge for many companies. This is because sustainability reports are not made in the same rigorous style as the financial reports (Wagenhofer, 2024). Wagenhofer (2024) finds that because of this lack of standardization in the reporting field, it is hard to compare companies based on their environmental impacts. If consumers or other stakeholders can't compare the data, it is also hard to create differentiation. Similarly, H. B. Christensen et al. (2021) state that also investors would prefer more comparable sustainability information.

However, recently many different organizations and regulatory bodies have shown efforts to standardize the sustainability reporting landscape, and it may lead to better comparability in future (H. B. Christensen et al., 2021). Still, there is not a lot of evidence that stakeholders actually read the sustainability reports, and often they are considered to be unclear and poorly targeted (Tang & Higgins, 2022). If stakeholders are not even aware of the company's ESG efforts obviously differentiation is not possible. These findings suggest that standing out with sustainability reporting is not easy.

In contrast, better differentiation outcomes might be achieved if companies use creative reporting efforts, and also voluntary ones. As the trend for environmental awareness grows, especially customers are interested in companies ESG impacts. To further, Liu et al. (2023) find that companies that, at the same time, are transparent and report on their ESG impacts, build strong customer-firm relationships. Also, the transparent reporting of ESG efforts can encourage their customers to engage in socially responsible behaviors themselves (Liu et al., 2023). These engaged and committed customers can create a strong attachment to the company, thus companies should put resources into building these relationships. As mentioned in section 4.2., attachment in turn creates positive behavior from customers e.g. they may be willing to pay more for company's products or services. These attached and active customers are road to true differentiation.

As should be noted here, just sticking to the mandated reporting requirements is not enough if company wants to stand out. If companies are able to integrate transparent reporting practises with creative ways to communicate them to their stakeholders, they could stand out from the crowd.

5.4 Costs & Profits

Like stated before, in today's landscape companies should use innovative strategies to get the benefits of transparency. Some global fashion companies, such as Patagonia and Nike Inc., have implemented creative strategies including data visualization and interactive content, to improve engagement with their sustainability reports (Tang & Higgins, 2022). However, using creative strategies to signal transparency of sustainability reports requires a lot of resources. Moreover, the complexity of reporting landscape and increasing regulation can be costly.

Increasing transparency in sustainability reports comes with direct and indirect costs to companies. The direct costs come from the creation, certification, and distribution of reports (H. B. Christensen et al., 2021). Indirect costs are the costs associated with proprietary information losses (H. B. Christensen et al., 2021), as discussed before in chapter 5.1. Additionally, with increasing transparency companies need competent employees. Research by H. Christensen et al. (2024) raised the concern that it can be very hard and expensive to find skillful employees that know how to comply with the new requirements. Moreover, finding employees with knowledge of how to go beyond the requirements wisely may be very expensive.

In contrast to earlier findings, according to H. B. Christensen et al. (2021) there are many studies suggesting that voluntary sustainability reporting, and therefore greater transparency, can also have financial benefits. These financial benefits mainly result from increases in brand loyalty and trust (H. B. Christensen et al., 2021). For example, these positive effects of transparency are found to cause higher revenues and lower costs (H. B. Christensen et al., 2021). Also, sustainability reporting can attract more long-term investors (Krivogorsky, 2024). In turn, these long-term investors can bring stability to companies which can increase their profitability (Harford et al., 2018).

To be noted, transparency and disclosing sustainability information is not just an expense.

Another often studied aspect of transparency in sustainability reports is its effect on cost of capital. Firstly, Healy & Palepu (2001) couldn't find definite answer if voluntary disclosures increase or decrease the cost of capital. Secondly, Clarkson et al. (2013) did an empirical study and found that cost of capital and voluntary sustainability reporting are not connected. H. B. Christensen et al. (2021) suggest that increasing transparency through mandated requirements can lower the cost of capital if the mandates can expose new and better information, i.e. lower information asymmetry. It seems that literature has not yet found definite answers how cost of capital is affected by voluntary efforts, especially beyond the mandates.

The literature is also mixed on what is the overall effect on profits, which refers to how much money is left after all the expenses are paid, when sustainability reporting and consequently transparency of reports increases. H. B. Christensen et al. (2021) argue that improvements in CSR lowers profitability, productivity, or market share, on the short-term. Also Haji et al. (2023) find that there's evidence that increasing transparency through mandated requirements lowers company profitability, but they also mention that the literature is still inconclusive on this issue. Chen et al. (2018) did an empirical study on Chinese stock exchange and found that companies required to initiate CSR reporting indeed experienced decrease in their profits.

In contrast, empirical study by Liu et al. (2023) found a positive connection between companies' profits and transparent CSR reporting. They found that companies with high levels of transparency had better profits, even if their levels of CSR reporting were lower (Liu et al., 2023). This finding is in line with the earlier discussion in section 5.2. that transparency is the mediator between sustainability reporting efforts and stakeholders. High transparency communicates the actions better which results in better profits, too.

The difference in these findings could be from several reasons. Interestingly, also Liu et al. (2023) did their research on Chinese stock market, like Chen et al. (2018). However, the time frame of these studies was different; Chen et al. 2006-2011 and Liu et al. 2015-2019. Over the years sustainability issues have become more important, so this could be the reason for these contrasting findings. To support this, also Friske et al. (2023) found that investors attitudes towards sustainability reporting has changed from 2010's to more positive direction.

5.5 Company Value & Competitive Position

It is important to take into notion that CSR actions often come with short-term losses e.g. possible profit loss, but the long-term benefits e.g. reputational ones, can make it still worth it (H. B. Christensen et al., 2021). Despite the costs previously discussed, the literature suggests that voluntary sustainability reporting improves company value over time (H. B. Christensen et al., 2021; Clarkson et al., 2013; Friske et al., 2023).

Moreover, Haji et al. (2023) found that this effect comes from capital-market effects and not necessarily from real effects. This means that the value comes from lowered information asymmetry with stakeholders and higher liquidity that companies have, not from change of behavior e.g. better operational performance (Haji et al., 2023). This is supported by Friske et al. (2023) who state that the value comes from companies learning to be better communicators i.e. companies learn to signal transparency better which lowers information asymmetry. These findings show that voluntary and transparent sustainability efforts are important in building value in the long-term.

Thus, transparency seems to be valuable signal, but it is not entirely straightforward how to get the benefits from it. Clarkson et al. (2013) suggest that transparent voluntary reports increase the company value if the signal is credible, and the information doesn't differ too much from what the investors already know. Andrus et al. (2023) found that the level of transparency matters, which means that strong transparency may lead to higher value but moderate one is not as beneficial. Interesting thing is that very low transparency is seen sometimes positively by market actors, such as investors (Andrus et al., 2023). By having lower transparency, a company can signal that it has strategic advantage e.g. it has valuable information that it protects or that it manages the costs of transparency better (Andrus et al., 2023). To be noted here, higher transparency is still important for companies' long-term success as it attracts more long-term investors (Krivogorsky, 2024), as discussed previously. Committed investors can bring stability which in turn can help companies to keep their competitive position.

Competitive position may also be improved by having proactive environmental strategy (Clarkson et al., 2011). This is because not all companies have the resources and knowledge to proactively be better environmentally and signal it to their stakeholders (Clarkson et al., 2011). Therefore, companies that are able to put the needed time and money to build better sustainability performance and communication strategies can also better their competitive position. This is in line with the literature that suggests that often the advantages come from high levels of transparency, i.e. proactive voluntary efforts (e.g. Andrus et al., 2023).

6 Best Practices to Balance Transparency and Competitive Advantage

Based on the insights gathered from the literature review on the challenges and advantages, this section discusses best practices for companies to balance transparency and competitive advantage in sustainability reporting.

6.1 Protecting Proprietary Information

Being transparent does not mean that companies should disclose every detail of their sustainability operations. Stakeholders generally don't scrutinize companies for not disclosing their vital competitive secrets, as they understand that it provides competitive advantage (Schnackenberg & Tomlinson, 2016). Therefore, companies should not disclose their most proprietary information relating to sustainability if it is possible to avoid.

Companies can instead provide more non-proprietary information to mitigate the information asymmetry, as Glaeser (2018) found that companies with high trade secrecy do. Additionally, identifying material issues to disclose could prevent over sharing information. To find the material details to disclose, companies may use stakeholder engagement (Bellucci et al., 2019). This can be done through meetings, focus groups, or interviews with the key stakeholders, for example (Bellucci et al., 2019).

However, as the regulation relating to sustainability reports increases, companies may be mandated to disclose their proprietary information. In this case companies can use different strategies to alleviate the proprietary costs. For example, companies can decrease the comparability of their reports (Imhof et al., 2022), or distort the information, so it is hard to understand as an outsider, e.g. using difficult terminology (Schnackenberg & Tomlinson, 2016).

6.2 Disclosing Sensitive Information

In contrast to proprietary information, stakeholders do not see hiding all sensitive information as legitimate behavior, e.g. concealing poor performance from stakeholders (Schnackenberg & Tomlinson, 2016). Therefore, hiding weak sustainability performance or instances of misconduct may not be beneficial, and better practice is to moderate the reputational impacts.

Firstly, to prevent reputational damage companies should report on sustainability, as companies that have disclosed sustainability information before misconduct happens can face fewer consequences (D. M. Christensen, 2016). Secondly, to moderate the damages on reputation, companies should strongly signal transparency when disclosing unfavorable information. As discussed in section 5.2., signaling the transparency strongly can help companies to maintain their integrity (Rim et al., 2019), improve their reputation (Baraibar-Diez & Luna Sotorrío, 2018), and rebuild the trust after mistakes happen (Tang & Higgins, 2022).

6.3 Building Credible and Effective Signals

To get the advantages of CSR actions, such as increased trust, stakeholders must be aware of companies' efforts (H. B. Christensen et al., 2021). Additionally, the effectiveness of sustainability reporting signals depends on their credibility (Friske et al., 2023). Therefore, to get the competitive advantages from transparent sustainability reporting, companies should consider how they can build credible and effective signals.

The credibility of sustainability reports can be improved by using external auditors (Clarkson et al., 2019; Friske et al., 2023). There are also further competitive advantages to building credibility, as externally audited voluntary sustainability reports are positively associated with company value, and assurance can prevent accusations of greenwashing (Friske et al., 2023).

To make sure that the stakeholders are aware of the transparency, companies should think creative ways to disclose sustainability information. One way to do this is thinking of reporting as a marketing tool, as Friske et al. (2023) note that some organizations already do. For example, Patagonia has created feature films that explain how they address important social and environmental issues (Tang & Higgins, 2022). This way of disclosing sustainability information can alleviate the problem of stakeholders finding sustainability reports unclear and difficult to interpret (Tang & Higgins, 2022). Furthermore, these creative efforts have potential to clearly signal transparency in sustainability issues and to lower the information asymmetry, thus building long-term value (Haji et al., 2023).

6.4 Leveraging Voluntary and Proactive Reporting

As discussed, simply disclosing sustainability information is not enough to get competitive advantage, as it is becoming basic expectation for consumers when making purchasing decisions (Reichheld et al., 2023). However, voluntary and proactive transparency in sustainability efforts may have potential to give competitive edge. Accordingly, Clarkson et al. (2013) argue that adopting proactive environmental strategies and disclosing them with voluntary sustainability reporting is worthwhile, as it can increase company's stock price. In addition, voluntary environmental disclosures have the potential to show investors the competitive advantages of company related to its industry peers (Clarkson et al., 2013), creating differentiation.

Therefore, companies should have the courage to be transparent by going beyond compliance and building proactive sustainability reporting strategies. Proactiveness and voluntary efforts can be shown by adopting multiple sustainability standards, in addition to GRI for example (Friske et al., 2023), and complimenting the standards with the creative reporting tactics discussed previously.

7 Conclusions

This thesis analyzed how companies could achieve balance between transparency and competitive advantage in sustainability reporting. This topic is especially important in the context of increasing regulation in the sustainability reporting landscape, as well as investors and customers demanding more transparency. A literature review was conducted analyzing the challenges and advantages that transparency brings, to further discuss the best practices for how the balance could be achieved.

Challenges that emerged from the literature were connected to revealing information that the companies prefer to keep undisclosed. The most pressing concerns are proprietary costs and reputational risks of increased transparency in sustainability issues. Additionally, there is short-term monetary costs associated with improving the transparency of reports. Advantages that the literature highlighted include increased stakeholder trust, reputational benefits, and opportunity for differentiation. Moreover, transparency can improve company value over time and attract long-term investors.

To conclude, companies can balance transparency and competitive advantage in sustainability reporting by strategically protecting proprietary information while voluntarily and proactively disclosing sustainability efforts – including sensitive information – to get the competitive advantages. In regulated environments it is important to go beyond the minimum requirements to benefit from transparency. Additionally, building credible and effective sustainability reports is an important practice to get the competitive benefits of transparency.

7.1 Limitations

This thesis' first limitation is connected to lack of research on this specific topic. The current research field lacks the perspective of companies and practical application methods for balancing transparency and competitive advantage. Second limitation is the timing of this thesis. Sustainability reporting landscape is in the edge of a new era with increasing mandatory reporting and demands for transparency growing quickly. It is not yet seen how companies answer to these challenges and how they use it to their advantage.

Furthermore, the scope of this research is limited to general level recommendations, due to the timing constrictions and to keep the depth within the bachelor’s thesis level. This broader outlook does not take into notion how the size of company or the industry may affect what are the challenges, advantages, and best practices. Lastly, even though this thesis was not intended to address only specific regions the literature is mostly focused on the EU, USA, or other developed countries. This could affect the applicability of finding for companies in different regions.

7.2 Suggestions for Future Research

With increasing regulation, such as the CSRD, companies need more information how they can increase transparency in competitively sustainable way. This is something that further research, especially empirical studies, needs to address. Further empirical or longitudinal study on how companies balance these issues and adapt over time would be beneficial when these regulations are fully in effect.

Creating best practises for different fields and different size companies would be also a way to further this research. Finally, a lot of studies are focused on increasing transparency through mandatory requirements. The effects of voluntary reporting and going beyond the regulation would be interesting and current topic to research.

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