

## **“CSR is a WMD”**

Paper presented

by

**John M. Green\***

at

**NSW Supreme Court & Law Society of NSW Conference**

***“Directors’ Duties & Corporate Social Responsibility”***

Banco Court, Supreme Court of NSW, Sydney

Monday August 21, 2006 at 2.30pm

—0—0—0—

Tony Blair’s government is beefing up directors’ duties to make Corporate Social Responsibility the law in Britain. (Well, if you can’t find one weapon of mass destruction, why not create your own?) In truth, this British development is wonderful... for Australian companies, though not British ones. (More on that later.)

Corporate Social Responsibility is an oozy seductive term, but don’t let its politically-correct sugar-coating fool you, as Mr. Blair has been, yet again.

CSR is like the ‘friend’ some kid chats to on the internet but who turns out to be an axe-wielding pedophile. And just like that kid, business has been duped. In 2005, 88% of executives surveyed said CSR was ‘central’ or ‘important’ to their corporate decision-making.<sup>1</sup> There are two key reasons for this folly, the first bad and the other worse.

The first derives from the cunning fact that most of CSR’s broad ambit claim is no more than good business practice, what we’re doing already. So it’s tempting to just shrug our padded corporate shoulders and pay lip service to the rest of it so we can get pats on the back and enjoy a quieter life. Tell that to the poor boiling frog. (If you drop a hapless frog into a pot of boiling water, it will leap out immediately. But, if you put it into a pot of cool water, and gradually heat it to boiling, the frog won’t notice until it is too late.)

---

*\*John M. Green is a director, investor and writer.*

*In his previous career he was an investment banker and, before that, a lawyer.*

*He is an occasional commentator on a variety of issues & is currently writing a book on how directors might better sniff out corporate crises before they happen.*

The second reason businesspeople embrace CSR is we hate being hated. So spending money to popularise business—especially shareholders’ money—is attractive. But it’s also foolish. Trying to win friends for business through hugging trees or embracing CSR—much the same thing—is as smart as defending the family by asking your husband to sleep with Paris Hilton.

Worse, business’s efforts to win *Australian Idol* are based on a false premise. No matter what even the best companies do, the public will stay archly sceptical. With remarkable consistency over the last 30 years, the annual *Roy Morgan* Survey of Professional Reputation has dumped business executives way down at the bottom of the barrel, even below lawyers. But thankfully, above politicians and journalists, though not by much<sup>2</sup>.

The next Sunday lunch you turn up to, even if you’re sporting a *Greenpeace* T-shirt and wearing environmentally-friendly sandals made out of braided palm fronds, the moment you let your guard down and admit to being a company director, the other guests will still screw up their noses at you as if you’d trodden in something unpleasant on the way in.

Luckily, when I go to BBQs these days, I don’t have to reveal I’m a company director. I can just give my kaftan a self-deprecating tug and say I’m a writer.

### **Plain old ‘Corporate Responsibility’**

So, back to that boiling frog. If we dissect CSR into two parts, we expose its insidious trap. If you slice away the word ‘Social’, what you’re left with is plain old Corporate Responsibility. It’s a well-understood term that’s been around a very long time; even before Bhopal though, scandalously, Union Carbide had trouble translating it into Hindi.

The problem with this word ‘social’ is it can justify almost anything as publicly desirable. “It’s a weasel word,” wrote lawyer Tom Bostock in the *Company Director* and quoting Friedrich Hayek. It sucks “out from the words it qualifies any real meaning, just as a weasel sucks out the contents of an egg.”<sup>3</sup>

Almost 20 years ago, when I was still a lawyer, I coined the term “fuzzy law”, advocating we stop writing black-letter laws in favour of laws based on general principles, laws a little fuzzy at the edges to encourage those affected to pull back into the safe zone rather than get too close to the edge and trip over the brink.

But this CSR stuff isn’t just fuzzy at the edges, it’s so mushy and fluffy, if you put your foot anywhere near it, it will suck you in and smother you like quicksand.

CSR’s glib appeal is to encourage companies to look to wider purposes than just making money. It’s also about corporate gift-giving.

CSR advocates criticise corporations for being solely devoted to making profits, letting all else go hang. They quote this, usually with a sneer, as a classic Milton Friedman dog-eat-dog formulation. But fortunately, it’s become fashionable to check sources—we used to call it scholarship—and if, like me, you spend three minutes reading Friedman’s famous 1970 article in *The New York Times*<sup>4</sup> you’ll find what he actually said:

“There is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition without deception or fraud.”

Let me translate that into my own simpler prescription: *a corporation’s fundamental responsibility is to increase its profits over time through worthy endeavour, free competition and honest practices.*

For most companies, telling the truth, selling reliable products for fair prices, and treating your people well are not virtues, they are duties.

How can it be a company’s duty to condemn sick employees to hardship and penury just to save a few bucks? Try explaining that to your kids at the kitchen table.

What’s really lurking behind CSR is the insidious and false assumption that CSR really stands for Crooks, Spivs or Retards... caricatures of rich white thieving bastards who yearn for nothing better than ripping off their customers with shoddy goods, screwing their employees with lousy pay and working conditions, all so they can spend their afternoons sinking back in their soft leather armchairs and puffing on fat cigars while they count their ill-gotten greenbacks. Maybe that was a fair generalisation once, but it isn’t today. (For a start, you can’t smoke anywhere, even if you wanted to.)

The true believers in CSR, when they’re talking privately, want to reign in the excesses of capitalism. But their brand of CSR will reign in the wrong excesses, and in particular, what capitalism does best: creating wealth and lifting living standards.

It’s just that the CSR zealots do see capitalism as a zero-sum, just as Karl Marx did. But happily, as we know, capitalism’s earlier 19<sup>th</sup> and 20<sup>th</sup> century adversaries got it wrong. Sure, the rich got richer, as predicted, but the poor got richer, too.

Al Gore, a former US vice-president, complained earlier this year that “we are operating the Earth like it’s a business in liquidation.”<sup>5</sup> Spoken not just like a true believer, but a true president. (And he got so close!)

Some quick World Bank statistics about this world in supposed meltdown... In 1981, a shocking 40% of the planet’s people lived in absolute poverty on less than \$1 per day. But 20 years later, by 2001, that 40% had halved to 21%<sup>6</sup>. Amazing enough.

But contemplate that fall as actual numbers of people and it’s even more startling. Despite around 2 billion more people cramming into the world, the actual number of people in absolute poverty didn’t also balloon, as you might expect, it shrank. And not by a little, but by 400 million. 400 million real people escaped the clutches of absolute poverty at the same time as the world’s population exploded.

And which people, where, have especially benefited from this? Those in our own neighbourhood: South Asia, East Asia & the Pacific, especially China. And what’s driven that? Yes, globalisation and its chief financier and growth engine, the corporation.

Over the 15 years from 1990 to 2004, trade in East Asia has outstripped everywhere else in the world. And according to the World Bank, East Asia is the region where poverty has *decreased* the most. Some more numbers: over that 15-year period, merchandise imports into East Asia skyrocketed by over 5.5 times, but in Sub-Saharan Africa—where poverty *increased* the most—merchandise imports went up by only 2.5 times.<sup>7</sup> (And merchandise exports told a similar story.<sup>8</sup>)

So, since capitalism’s 21<sup>st</sup> century adversaries can’t really argue with a straight face that the poor are getting poorer—at least in places where trade is encouraged—they wrap

themselves inside the warm fake-fur of their CSR cloaks, and preach that the real problem today is how capitalism is making people too rich and it’s not spending enough on what really matters, the environment and so on.

So they want the law to force corporates to redistribute all that fabulous wealth, before shareholders get their greedy mitts on it, so they can change the world for the better. (As if that wasn’t what governments were for.)

But haven’t these people been paying attention? Corporations *are* changing the world for the better, not because some law forces them or because we asked them nicely, but because it is a natural by-product of what they do best: increasing profits over time through worthy endeavour, free competition and honest practices.

### **Giving Back: Philanthropy**

Occasionally, even smart businesspeople use loose language to tug our heartstrings to ‘give something back’.

When they mean that we should give back personally, as individuals who have done well, then yes. Contributing to our community even beyond our jobs and taxes is something I know many of you already do. And if you don’t, I encourage you to. And if you’re at a loss where to spend your philanthropic dollars or your time, please ask me and I’ll happily suggest some worthy projects and charities for you.

But hello! When it comes to the corporation, giving back is precisely what it does for its day job. Corporations are not free-riders, unjustly enriching themselves to the detriment of the community<sup>9</sup>. How corporations give back best is by being successful and thereby contributing to our economy and our society.

I believe virtue is giving away what’s yours, not giving away what’s someone else’s. And corporate philanthropy, by definition, is giving away other people’s money—what *The Economist* calls ‘borrowed virtue’.<sup>10</sup> (It was no accident that the same journal’s headline on Bill Gates’ massive private gift to his foundation was *Billanthropy* and not *Excel*.)

I must make two admissions here. The first is that, as well as personal philanthropy, I also strongly believe in corporate philanthropy but, because it is other people’s money, I say you need to satisfy two simple conditions first. My second admission is I’m a director of three not-for-profits: one gives corporate money away, and for the two others I happily go cap-in-hand seeking donations from individuals, foundations and, yes, corporates

So what are the two criteria for legitimately spending other people’s money? First, that they knowingly consent to it. Some companies mandate gift-giving in their constitutions. Others have been doing it for years, openly referring to it in shareholder communications. As someone said, a firm should “no sooner make an anonymous donation to a charity than it would buy 30 seconds of silence on the radio.”<sup>11</sup> Second, that you’re donating to advance a legitimate corporate purpose. Not just to make directors and managers feel good, be invited to the right parties and save you spending your own money. Not as a salve to help justify the CEO’s possibly excessive salary. Some examples are clear: A health fund giving money to educate the public about staying healthier and thus not becoming a bigger drag on your fund. An engineering firm giving scholarships to promote engineering studies to help show your employees you value education and self-

improvement. A bank funding literacy and numeracy programs. A mining company bringing the arts to the remote local communities your workers live in.

But fundamentally, I believe corporations give back best by building businesses that over time can reliably pay increasing dividends to people, those saving for a home, a holiday, their kids' education or their retirement. They give back best by creating worthwhile jobs and fulfilling careers for those same people or their kids. They give back best by innovating products for better prices so those same families can afford them.

Sure, there are firms who try to squeeze out every last penny, who behave as anti-capitalists would expect, seeing it their duty to maximise profit in a zero-sum way. Well, sadly, there are people who enjoy eating other people too, but that doesn't mean we have to invite them to dinner.

Firms like this are few, and they're very short-sighted. Which is precisely why there are so few... because long-term, short-termism doesn't pay. If you run your business only for the short-term, it won't last into the long-term. And not many shareholders will trust you with their money for that.

### **How big is the problem?**

Astonishingly, Australia has 1.4 million corporations<sup>12</sup>. That's almost as many corporations as Shane Warne has supposedly had lovers!

Now tell me... how many of our companies are run by bastards? Each of us could name a handful, probably the same handful. *Enron* was run by shysters who defrauded their investors, but if you travel to Houston as I did recently, *Enron's* name is plastered all over nearly every museum and art gallery. A great CSR practitioner, but tell that to the employees and retirees and other shareholders whose life savings were tied up in the company's now worthless shares. And *HIH*. Another philanthropic giant.

And, ah, yes, there's... but let's not get personal. Let's use ASIC statistics as an anonymous proxy, on the assumption that if a firm's reported for corporate misconduct, maybe they're also a bit grubby in their other practices. Well, last year ASIC received 10,752 reports of crime or misconduct<sup>13</sup> out of those 1.4 million companies. Even with the unlikely assumption that each complaint was about a different company, that's less than 1% of the corporate population. Is there a serious problem here?

Now take note of another statistic: a Hays Survey says 86% of workers just won't work for a firm with a bad employer reputation even if it offers them more pay than a firm of good reputation<sup>14</sup>. This is not rocket science. If a firm gets a name for treating people like washroom handtowels, ripping them off, using them and tossing them on the floor, of course that firm will have to offer more money to persuade people to go there.

And if you already work in such a place, either you'll quit or you'll be so bitter you'll take it out on customers, dismissing them back to the end of the line just because they filled out a form wrongly. And what do customers do if they keep getting grumpy service? They flee, too.

So if your workers don't give a toss and your customers desert you, it's obvious that your financial results and your shareholders will suffer. So much for being penny wise.

From how the CSR advocates talk, you’d expect that all the sacred texts of better business would be preaching the virtues of short-termism, wouldn’t you? But if you leaf through any popular business book written in the last generation, what you *won’t* find are preachers of the ‘maximise profits at all costs’ gospel. What you *will* find are proponents, if I can simplify it, of the mantra, ‘happy worker means happy customer means happy shareholder’. Yeah, yeah, I see some of you thinking, that’s just rhetoric and management school mumbo-jumbo, isn’t it?

Not at all. Substantive research shows that going nuts about this and not merely being a good employer, but striving to be a great employer, achieves something every capitalist aspires to: it rewards shareholders disproportionately to the costs. A *Hewitt Associates* book called *Leadership & Talent in Asia*<sup>15</sup> highlights some of this:

- A Vanderbilt University study showed firms with high staff engagement out-perform their competitor set on average as follows: 20% greater return on assets... 23% higher price-to-book ratios... nearly double the cumulative stock price returns.
- A Rutgers University study showed that high engagement firms got a 12% boost to their share prices, produced US\$27,000 more sales per employee... generated US\$3,800 more profit per employee and \$18,600 more market value per employee.

You don’t need to be an enlightened corporation to want to do this. You’re actually a dumb corporation if you don’t.

Pure unadulterated corporate financial self-interest is best served by creating a firm so enticing that employees jump out of bed each day keen to rush in to serve customers who are lining up in droves at the door hungry for your products.

## British Folly

Now why did I claim at the outset that, if Britain changes its law on directors’ duties to impose CSR, it would be good for Australia?

The proposed UK law says directors must promote the company’s success for the benefit of members as a whole but—and this is the important part—in doing this they must look to wider interests than those of shareholders, such as the interests of employees, the need to foster relationships with suppliers, customers and others—I repeat, others—the impact of the company’s operations on the environment, and so on.

Let’s take two examples.

Suppliers. How exactly do you have regard to “the need to foster the company’s business relationships with suppliers”? Let’s say you supply pencils to Selfridges, but the lead keeps breaking, so Selfridges strikes you off their supplier list. That’s hardly fostering a relationship with you, is it? Sounds like a fabulous idea for a law suit to me. Won’t happen, I hear you say? Just watch it.

The next example is the breathtaking requirement that directors must look to “fostering their company’s business relationship with ‘others’.”

Who wrote this drivel? The scriptwriters for *Lost*? *Lost* is one of my favourite TV shows. Does anyone else here watch *Lost*? Well, what happens in *Lost* is a plane mysteriously crashes on a weird Pacific Island midway between Sydney and L.A. An island where lots

of really bad stuff happens. And on this island, there's a group of people called, you guessed it, the 'others'. And the thing is, neither the good guys in the show, nor you the viewer, has a clue about who these *others* are, why they're there, or even what they want.

Which is exactly what it'll be like for a British company director who now, by law, will have to worry about fostering a business relationship with the vague interests of some indeterminate *others*. Don't people who get elected to Parliament realize that people can go to prison for this rubbish? This isn't the rule of law, it's the fool of law.

Imagine waking up and unwrapping *News of the World* to read how *BMW* is suing *Virgin*. Not the German *BMW*, but a newly-formed NGO, *Britons to make Martians Welcome*. Richard Branson is to be pilloried, not because of his hurtfully youthful good looks, but because *Virgin* planes aren't Martian-friendly. But there aren't any Martians, you say? Not yet, says *BMW*. And, they burble on, do you really think they'll want to come to Earth if they're not guaranteed a lie-flat bed in coach?

What is especially horrifying about all this is that the CSR advocates might actually become right: that we will justifiably complain that directors aren't accountable to anybody. Because they'll be accountable to everybody and won't have a clue about how to balance the various interests they're supposed to be worrying about. If you don't know where to go, you just won't go anywhere.

### **What does all this mean for Australia?**

The good news is Britain has unwittingly but graciously offered itself up to us as a guinea pig for a test trial. And the precautionary principle demands that it's in Australia's national interest to watch them try it out over there, all by their lonesome, from as far away as possible and for as long as possible.

Let me make a bold and serious prediction: if this British folly unfolds as I think it will, the returns of UK companies will fall and their cost of capital will rise. Investors will see UK firms as a riskier repository for their mobile capital. And if it's more costly for UK companies to raise capital, but relatively cheaper for Australian firms unburdened by CSR, eventually Australians will be able to buy British companies cheaper... except we won't want to.

Ladies and gentlemen, the Australian Parliamentary Joint Committee that's already examined CSR said, and both sides of politics were speaking, that we *shouldn't* try this here.<sup>16</sup> Exactly.

My submission to the ongoing CAMAC enquiry and the Hon. Mr Chris Pearce, the Parliamentary Secretary who asked CAMAC to look into this is: please, listen to your Australian co-legislators on this, take a cold shower and terminate your CAMAC enquiry.

Let Britain do all the work for us and in the meantime, Mr. Secretary, you can still be a hero to CSR advocates by saving a few trees by *not* producing ten thousand copies of some three-hundred page report.

And in the meantime, Australians can quietly and indecorously chuckle and smirk as we watch UK companies get dragged through years of litigious hell.

So, finally, my plea to the Australian government: Don't follow Britain onto this battlefield.

Endnotes to paper by John M Green, “*CSR is a WMD*”:

- 
- <sup>1</sup> CAMAC (Corporations & Markets Advisory Committee) Discussion paper, *Corporate Social Responsibility*, November 2005. Page 1.
- <sup>2</sup> Roy Morgan Research *Survey of professional ethics and honesty* conducted on November 17/18, 2005, <http://www.roymorgan.com/news/polls/2005/3938/>
- <sup>3</sup> Tom Bostock, *Company Director*, December 2004
- <sup>4</sup> *The New York Times Magazine*, September 13, 1970.
- <sup>5</sup> “For People and Planet,” by Al Gore & David Blood. *Wall Street Journal*, March 28, 2006
- <sup>6</sup> *World Bank 2006 World Development Indicators*, [http://devdata.worldbank.org/wdi/pdfs/table2\\_5.pdf](http://devdata.worldbank.org/wdi/pdfs/table2_5.pdf); *In Defence of Global Capitalism*, Johan Norberg, Centre for Independent Studies, 2005.
- <sup>7</sup> *World Bank 2006 World Development Indicators, 1990-2004*, <http://devdata.worldbank.org/wdi2006/contents/Section4.htm>, table 4.5
- <sup>8</sup> Ditto, table 4.5
- <sup>9</sup> “Business Ethics Gone Wrong,” by Alexei M. Marcoux, *Cato Policy Report*. May/June 2000
- <sup>10</sup> *The Economist*, January 20<sup>th</sup>, 2005 in its Survey on CSR
- <sup>11</sup> “Corporate Social responsibility—or good advertising?” by Andrew C. Coors & Wayne Winegarden. *Regulation*, Spring 2005
- <sup>12</sup> ASIC Annual Report 2004-2005
- <sup>13</sup> Ditto
- <sup>14</sup> Hays Survey, <http://www.hays.com.au/news/newsdesc.aspx?id=149>
- <sup>15</sup> Mick Bennett & Andrew Bell, *Hewitt Associates*, “Leadership & Talent in Asia,” 2004, p.106 and 107
- <sup>16</sup> Parliamentary Joint Committee on Corporations and Financial Services. “*Corporate Responsibility: Managing Risk and creating value.*” June 2006.