

24 February 2006

Mr John Kluver  
Executive Director  
Corporations and Markets Advisory Committee  
GPO Box 3967  
SYDNEY NSW 2001

Dear Mr Kluver

**Re: Inquiry into Corporate Social Responsibility**

This letter constitutes our submission to the Corporations and Markets Advisory Committee (CAMAC) regarding its current inquiry into corporate social responsibility (the current enquiry). By way of additional context, we would like to draw CAMAC's attention to our earlier submission to the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in September 2005. Our submission to the PJC complements the views expressed below and is attached. We provide here a brief excerpt from that earlier submission in order to highlight the core of our position as reflected in this document:

We believe that the use of legislation, regulation and surveillance as the principal means for protecting the interests of stakeholders other than shareholders is misguided. Our concerns are twofold. First, an over-reliance on such an approach is largely ineffective because it invites a negative culture of compliance characterised by indifference to the principles that inform the legislation or regulations. In these circumstances, corporations become adept at playing a game of 'regulatory arbitrage' – across jurisdictions and through the exploitation of loopholes.

Second, we believe that an over-reliance on regulation and surveillance can inadvertently weaken the ethical sinews of society. When people comply by merely 'ticking the box', then they are absolved (or absolve themselves) of any responsibility for choosing to act in a manner that is right and good. One of the unintended consequences of a system designed to ensure that people cannot choose to do what is wrong is that they can no longer choose to do what is right. They no longer choose at all – they merely comply. This weakening of the ethical sinews of society generates considerable, latent risk. If for any reason the regulations fail, the lack of underlying resilience can lead to a broad failure of responsible conduct.

We should be clear on one point; the corollary of our argument against an over-reliance on regulation and surveillance is that business voluntarily seek to maintain and improve its conduct and that its performance be measured and reported on using a credible, independent instrument to do so.

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The particular focus of this submission is in answering the third question posed in the Terms of Reference for CAMAC's current enquiry. In addressing this question we have taken into consideration the three sub-questions posed by the Committee.

**Question 3: Should Australian companies be encouraged to adopt socially and environmentally responsible business practices and if so, how?**

- To what extent are voluntary initiatives leading to improvements in corporate social and environmental performance?
- What lessons might be derived from any experience with voluntary initiatives?
- What would be the nature of any proposed initiative, what would be its intended purpose and consequences, how might it be implemented and what would be its costs and other implications?

Yes, Australian companies should be encouraged to adopt socially and environmentally responsible business practices.

It is widely acknowledged that public confidence and trust in business is low. Some might be tempted to address this phenomenon by using legislation, regulation and surveillance to create a 'virtuous marketplace'. While a responsible and prudent government will ensure a sound legislative environment supported by appropriately resourced regulators, it will not rely on this set of instruments alone. Beyond the Centre's reasons for holding this view (as outlined above) the Business Council of Australia has argued that the current extent of business regulation and surveillance imposes unsustainable costs on the economy of Australia. Consequently, there is a strong case for reducing the incidence of regulation and surveillance – on the condition that such reductions lead to an increase in corporate responsibility. Ideally the increase in performance in this area should be the result of voluntary commitments made by Australian business.

In the current environment, there is growing interest in the value of measuring the incidence of corporate responsibility and on reporting performance as one of the ways directors discharge their responsibility to act in the best interests of the company as a whole. However, many companies need encouragement and support in this area. Part of this is provided by leading companies who have blazed a trail for others to follow. However, where the spirit may be willing, the infrastructure needed for an effective voluntary response by business is relatively weak. Thus the conditions are ripe for the Government to facilitate the expansion of a voluntary initiative of the kind outlined below.

We believe that the voluntary use of a common, principles-based tool for performance measurement and enhancement is the most effective way to achieve high levels of corporate responsibility without excessive recourse to regulation. A tool designed to assist companies to manage and report on their non-financial risks and impacts would strengthen the overall management capacity of Australian businesses and help to build public confidence in the institution of business.

**Proposed Initiative: The Corporate Responsibility Index**

*Desired State*

To achieve a shift in business focus to long-term performance with the principles and practices of corporate responsibility widely adopted as the accepted standard of good business practice (across the board).

*Intended Purpose of the Initiative*

To assist Australian business to be more sustainable (high trust=lower costs) through the establishment of a voluntary, credible and independent tool by which Australian business can measure and improve its performance across the leading indicators of corporate responsibility.

### *The Tool*

St James Ethics Centre is trustee of the Corporate Responsibility Index (CRI) in Australia. The CRI is currently the only voluntary self-assessment tool for measuring corporate responsibility in Australia. Critical to its credibility is the existence of a robust, professional and independent validation process. The CRI is an existing tool with global credentials with strong support from participants, partners and members of the CRI advisory groups<sup>1</sup>.

Designed by business for business, the principal purpose of the CRI is to help companies drive improved performance. The public reporting of high level results, for company performance, provides additional information for investors (who increasingly see the relevance of such data when making mid to long-term investment decisions) and helps to build public confidence in the ability of business to self-regulate.

As was noted in the Corporate Social Responsibility Discussion Paper released by CAMAC in 2005 (section 5.3.3 Market indices p.107) the CRI is comprised of four key components on which companies must report. These include:

1. **Corporate Strategy:** examines how a business' activities influence its company values, how these tie into strategy and how they are addressed through risk management, development of policies and responsibilities held at a senior level in the company.
2. **Integration:** examines how companies organise, manage and integrate corporate responsibility throughout their operations. Is it part and parcel of the company culture? Is it integrated into the strategic decision-making processes of the company and linked through into internal governance and risk management systems?
3. **Management:** successful integration is assessed through the Management section where the processes for managing different stakeholder relationships are reviewed. It examines the policies, objectives and targets set to manage key issues in the Community, Environment, Marketplace and Workplace arenas and how these are communicated, implemented and monitored.
4. **Performance and Impact:** examines how a company is actually performing in practice across a range of social and environmental impact areas and whether targets for performance and management improvement are being set and met across these impact areas.

### *CRI background*

- Research conducted by Business in the Community<sup>2</sup> (BITC) in 2000 identified a need for reliable, standardised information that would enable a company's performance to be compared with that of its peers. On the back of these research findings and the seven year success of the Business in the Environment Index, BITC designed the CRI framework in conjunction with over 80 UK businesses.
- St James Ethics Centre identified a similar need for an Australian voluntary, business-led Index. Using sound methodology this Index was to engage with companies from all sectors and focus on corporate responsibility.

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<sup>1</sup> The CRI external stakeholder advisory group involves representatives from industry (for example, Financial Services Institute of Australia, ICAA, AICD), NGO groups (for example, Greenpeace, ACF, Amnesty, EPA Victoria) and sustainability practitioners. An advisory group from business has also been established with representatives from current participating organisations (BHP Billiton, Rio Tinto, Toyota Australia, Westpac Banking Corporation).

<sup>2</sup> Business in the Community is a unique movement of 700 member companies in the UK committed to improving their positive impact on society. Please refer to [www.bitc.org.uk](http://www.bitc.org.uk) for further information.

- BITC donated the CRI under licence to St James Ethics Centre for use in Australia. St James Ethics Centre is trustee of the CRI in Australia, overseeing the quality and integrity of the project. The CRI has been implemented as a partnership between St James Ethics Centre, media partners *The Sydney Morning Herald* and *The Age*, and Ernst & Young who validate company submissions<sup>3</sup> to the CRI on a *pro bono* basis.
- The CRI was launched in Australia<sup>4</sup> in late 2003 and is now in 2006 in its third cycle. To date, 32 Australian businesses have participated<sup>5</sup>, including 14 from the ASX50. Sectors represented include: consumer discretionary, consumer staples, energy, financials, healthcare, industrials, information technology, materials, professional services, telecommunication services and utilities. We have also had one New Zealand participant to date.
- The CRI is now in its fifth year in the UK with over 130 participants drawn from FTSE 100, FTSE 250, DJSI sector leaders and selected members of BITC.

#### *Advantages of the CRI model*

- **A Management, Measurement and Reporting Tool Allowing Benchmarking:** the CRI is a management tool that helps organisations to improve their actual performance and to benchmark within and across sectors.
- **Improved Business Performance:** research demonstrates a link between corporate responsibility and improved business performance. The results of the AMP Capital Investors 'Financial Payback from Environmental and Social Factors' survey states that companies with a higher corporate social responsibility rating<sup>6</sup> have outperformed the ASX200 Index by more than 3.0% per annum over 4-10 year periods<sup>7</sup>.
- **Improved Stakeholder and Public Confidence:** a voluntary approach by business, supported by sound external verification of claims, and reported publicly, assists to improve public confidence and trust in business.
- **Reduces the need for Regulation:** the CRI encourages a principles-based approach, reducing the risk of a compliance-based culture. It assists companies voluntarily to improve corporate behaviour by providing a framework for building internal capacity. Increased public confidence through greater business transparency will reduce the need for regulation. It is possible that a model of regulatory relief may be considered for those organisations demonstrating good performance<sup>8</sup>.
- **Broadly Applicable:** the CRI is relevant to a wide range of organisations. It is currently completed by both public and private organisations and interest has been expressed by government organisations and non-profits. Furthermore, the creation of an integrated suite of tools associated with the CRI is currently under development which will facilitate uptake by both SMEs and 'starter' companies.

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<sup>3</sup> Ernst & Young validate all submissions in Australia, except global submissions, which are validated by BITC.

<sup>4</sup> Please refer to [www.corporate-responsibility.com.au](http://www.corporate-responsibility.com.au) for further information on the CRI in Australia.

<sup>5</sup> Companies formally invited to participate include the top 250 business enterprises listed annually in BRW magazine and members of the Business Council of Australia (BCA).

<sup>6</sup> Based on companies selected for inclusion in AMP Capital Investors Sustainable Future Australian Share Fund.

<sup>7</sup> AMP Capital Investors 'Financial Payback from Environmental and Social Factors', page 1.

<sup>8</sup> Current models exist (for example, EPA Victoria, ATO) whereby companies demonstrating better management of specific issues, and thus classified as lower risk, are subject to lighter scrutiny/regulation.

## Improved performance is demonstrated

To date, the CRI has seen two cycles of measurement and reporting completed in Australia. In the second cycle, a number of companies demonstrated significant progress, reflecting both management and performance improvements. This is evidenced in the average scores of companies completing the CRI, on their Australian operations in both 2003 and 2004, which rose from 78.7% in 2003 up 4.3% to 83% in 2004. This was achieved despite the need for participating companies to overcome a challenging timeframe (the first two cycles were run only six months apart instead of according to the normal annual cycle). Furthermore, the value of the CRI as a gap analysis tool was demonstrated by the exemplary performance of one participating company which increased its results by over 15% to achieve a final silver-star rating within a six-month period.

Results for the 2005 CRI are due out on 15<sup>th</sup> May 2006. An initial analysis indicates that a similar trend in improvement is likely amongst continuing participants, demonstrating the CRI's usefulness as a management tool and framework.

## Lessons learnt

The current model has been successful to date and could still work in its current form in the future. There would be advantages in developing the CRI so that the information it provides could also assist decision-making by regulatory bodies such as APRA, ASIC or the ATO.

However, participation in the CRI is yet to reach a critical mass. One of the significant implementation challenges currently faced is encouraging companies to participate in a voluntary, public benchmarking exercise for the first time.

The primary barriers to increased participation have been identified as:

- the need for broader market exposure – there is currently a lack of awareness and understanding regarding the CRI tool
- reticence by some businesses to partake in a voluntary public analysis and disclosure of their business practices
- the high level of resourcing needed to complete the CRI, particularly in the first year

Support from Government could assist to overcome these hurdles faced by first time participants through both encouragement of voluntary benchmarking and reporting, and supporting the development of transitional tools.

## Costs

### *Implementation Costs*

To date the costs of running the CRI project have been met by contributions from the three project partners: St James Ethics Centre; *The Sydney Morning Herald* and *The Age*; and Ernst & Young. The costs of the project to date, comprising partner contributions both in-kind and direct, have totaled \$2,035,800.

It is envisaged that participation rates in the CRI will grow significantly over the coming years. The current model cannot support the proposed expansion of participants without additional funding.

In order to maximise the potential of the CRI project and ensure its sustainability, St James Ethics Centre has asked the Federal Treasurer, the Hon. Peter Costello MP, to consider a request that the Commonwealth Government invest in transitional funding during a three year period after which the process would be self-funded by business.

Transitional funding would provide support for:

- projected core costs that are expected to increase significantly with an increase in the number of participants
- employment of additional staff to support project implementation
- addressing identified barriers to entry
- the creation of an integrated suite of tools (relevant to organisations across the spectrum from starters to leaders) that can be used by all types of business and by other organisations (including government and non-profit organisations)
- the transition to a self-funding model

#### *Participation Costs*

Participation for organisations in the CRI is currently free of charge. Presently the expense incurred by participating companies relates solely to internal costs of both time and resources required to complete a full CRI submission. Whilst there is therefore a significant cost associated with first year participation<sup>9</sup>, this has been shown to reduce markedly in subsequent years. Current participants have estimated that costs in subsequent years reduce annually by approximately one third<sup>10</sup>. For this reason in particular it would be pertinent for Government to examine ways to facilitate first year participation.

In transitioning to a self-funding model it is anticipated that in the future there will be an annual cash cost required from companies to participate, related primarily to funding the validation of their submissions, likely to be in the realm of \$5,500 per company. In addition, there will be ongoing internal costs associated with participation. However, in a world where assurance of non-financial matters is growing steadily in importance it is probable that these costs would be incurred in any case. The CRI would therefore bring significant additional value to an existent cost.

#### **In conclusion**

Currently there is no one standardised, voluntary reporting tool in the market. Government leadership in this area, through active engagement and support for the role of business benchmarks such as the CRI, can assist in resolving the current confusion and allow for coordination of the voluntary efforts made by corporate Australia. It will also lead to greater transparency and comparability for users of this information.

Thank you for taking this initiative into consideration in examining how Australian companies should be encouraged to adopt socially and environmentally responsible business practices. Please feel free to contact me should you have any further questions or if I can be of any assistance in your deliberations.

Regards,



Dr Simon Longstaff  
Executive Director  
St James Ethics Centre

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<sup>9</sup> Companies have indicated that it takes between three to ten weeks to complete a first CRI submission dependent on the internal availability of data/information, the complexity of operations, and the sophistication of current corporate responsibility practices and reporting mechanisms.

<sup>10</sup> This year updates have been made to the CRI tool allowing for an automatic transfer of data between years. This has allowed past participants to simply update previously entered information and has significantly reduced the time involved. This is reflected in the increased retention rate of participants submitting in Australia from 2004-2005.