Submission to the Corporations and Markets Advisory Committee

Corporate Social Responsibility Discussion paper November 2005

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Introduction

This submission addresses the release of the CAMAC Corporate Social Responsibility Discussion Paper (November 2005). I have attempted to provide informed debate on the critical issues discussed in the paper. Some of the suggestions made in this submission are of a policy nature and question the need for change.

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Explanatory Note

For the sake of clarity and coherency in this submission, parts of the draft discussion paper have been reproduced where necessary.

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General Observation

Companies today are put in a difficult position. The public expects companies to be good citizens and investors require companies to concentrate on their bottom line, profit. It is not always possible for everyone to be satisfied with the policies adopted by a company.

For instance, some pharmaceutical companies like Roche, GlaxoSmithKline, Astrazeneca and Bristol Myers Squibb are not drug companies but innovation companies. They invest huge sums of money in the development of new effective drugs and use patents to recoup the cost of that innovation for a limited time before generic manufacturers, who bear none of the costs of research, can move in to copy and produce cheaper versions of those drugs. Without patent protection, those companies cannot innovate. Without new drugs in the pipeline, they will fail.[1]

As long as these pharmaceutical companies have new drugs at their disposal, they will make profits and their shareholders will prosper and be happy. This seems to be an ideal type of business: the new drugs heal people and the shareholders are content because the company is making profits. However, a dilemma is created when we take into consideration the millions of poor people around the world who need the products of this innovation in order to live, but whose governments lack either the means or the will to purchase the required drugs at full price, and the innovation model loses some of its appeal.[2]

For example, with the onset of AIDS as a tragic reality in Africa, these companies found the innovation model fundamentally challenged by a broad mass of the public who, disinclined to dwell on the niceties of pricing policies, rode a wave of moral revulsion that profits could be made from drugs which people needed to live. The industry defended the status quo by noting that companies existed to make profit, and realised only too late that the rules had fundamentally changed. These companies needed to take

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[1] Mallen Baker, “If Roche sneezes, the Pharmaceutical Industry catches a cold”, 87 *Business Respect* (30 Oct 2005), <http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1507> viewed on 9 February 2006.

[2] Ibid.

into consideration not only their own profit margins but also the impact their actions had on society.[3]

There is a lot of talk today about corporate social responsibility, but it remains a grey area. What exactly is corporate social responsibility, and when does it apply? For instance, we believe that killing people is wrong. This is one of the earliest principles established by any civilized society. So is it possible that a company could be considered socially responsible if its products, used as instructed, result in loss of human life? Immediately the tobacco companies spring to mind. The use of tobacco can result in cancer, yet companies are allowed to sell this product.[4] Are those companies socially responsible?

A discussion of corporate social responsibility is needed. It will encourage companies to look at a range of stakeholder interests, and can push us to understand how the potential risks and opportunities a business faces might be reconciled with the wider social or environmental consequences.[5] The discussion paper, *Corporate Social Responsibility*, November 2005, looks at the debate around corporate social responsibility and the need for development of good corporate social practices through changes in the law.

1. The issue of Corporate Social Responsibility

How might corporate social responsibility usefully be described for working purposes?

For many companies, corporate social responsibility is still a vast and unknown dimension. To determine the meaning of corporate social responsibility, one needs to take into consideration four different levels of corporate social responsibility as indicated in the pyramid below:[6]

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3 Ibid.

4 Mallen Baker, "Can companies that make products that kill be socially responsible?" 86 *Business Respect* (18 September 2005) <http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1492> viewed on 9 February 2006.

5 *Corporate Social Responsibility: A Government Update*, p 6 <http://www.societyandbusiness.gov.uk/pdf/dti_csr_final.pdf> viewed on 10 February 2006.

6 The pyramid is taken from: Thomas Loew, Kathrin Ankele, Sabine Braun and Jens Clausen, "Significance of the CSR debate for sustainability and the requirements for companies" (30 June 2004)

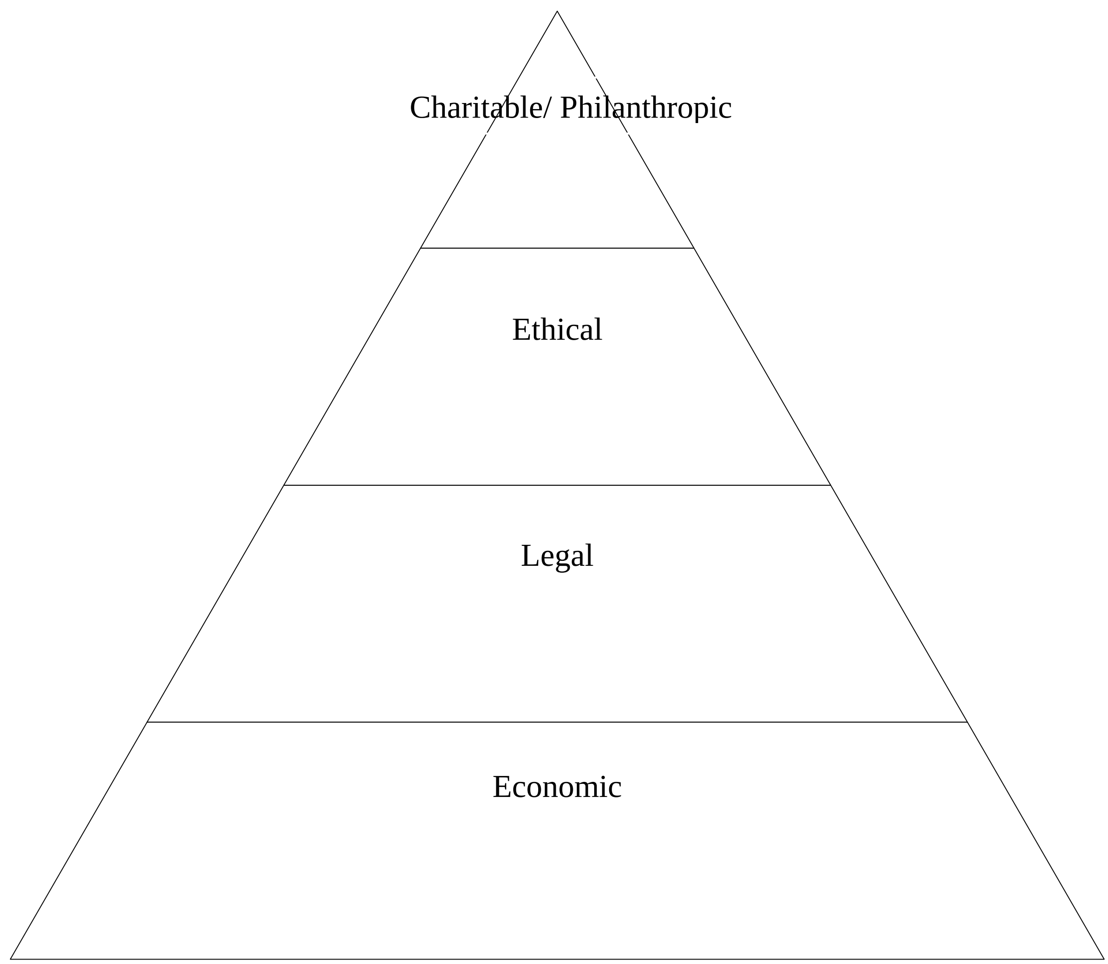

Figure 1: Levels of social responsibility

Some of the levels in the pyramid are mandatory considerations for companies, while others could be said to be merely desirable in a company's behaviour. For instance, a company must make a profit to survive, and every company must obey the law. Economic and legal considerations are therefore essential governors of corporate behaviour. By contrast, there is no mandatory requirement that a company be ethical, yet

< http://www.4sustainability.org/downloads/Loew-etal-2004-CSR-Study-Summary.pdf > viewed on 14 February 2006.

it could be said to be desirable. Similarly, companies are not required to be charitable or good corporate citizens, yet we see these behaviours as desirable. There will necessarily be limits to the application of the top levels (ethical/charitable) of the pyramid to corporate behaviour because a company cannot apply them without taking into consideration the lower two levels (economic/legal). A balance needs to be struck between these elements.

For instance, sponsorship activities and other community programs that benefit companies and hence their shareholders are acceptable. It is not just legitimate for directors and managers to spend money on such activities; it is their duty to do so if it benefits the company. In this case, we could say that such action complies with all four levels of the pyramid. On the other hand, not every charitable action of a company can be applauded. Activities of a purely charitable nature that do not benefit the company as a whole would, as a result, not be legitimate. If a company spent money on a pet charity of the managing director's wife, for example, this would involve a conflict of interest and accordingly breach the legislation unless the company's shareholders had agreed to it.[7]

It is my view that the definition of corporate social responsibility we should adopt is that put forward by Deborah Doane, as this best represents the four levels of the pyramid seen in Figure 1. Corporate social responsibility can thus be seen "as the efforts corporations make above and beyond regulation" (the legal level) "to balance the needs of stakeholders" (charitable/ethical levels) "with the need to make a profit" (the economic level).[8]

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[7] New Zealand Business Roundtable, "Making Sense of Corporate Citizenship" (21 April 2004), <http://www.scoop.co.nz/stories/BU0404/S00208.htm> viewed on 16 February 2006.

[8] D. Doane, "The Myth of CSR The problem with assuming that companies can do well while also doing good is that markets don't really work that way", (Fall 2005) *Stanford Social Innovation Review*, 23, 23.

Which approach or combination of approaches to responsible corporate behaviour is most appropriate?

Are voluntary initiatives sufficient to implement corporate social responsibility or are more drastic measures, such as putting regulation in place, needed? Certain groups such as trade unions and civil society organisations have emphasised that voluntary initiatives are not sufficient to protect workers' and citizens' rights. They believe that a regulatory framework which establishes minimum standards of compliance and ensures a level playing field is the best solution.[9] So should we legislate in relation to corporate social responsibility? Many countries, like France, the United Kingdom and the United States, have done so. In all these instances the legislation when first enacted was heavily criticised for increasing costs for and putting unreasonable expectations on corporations… but was that really true? Table 1 illustrates the difference between what was predicted and the reality in relation to some corporate social responsibility legislation.[10]

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[9] Commission of the European Communities, *Corporate Social Responsibility: A Business contribution to Sustainable Development*, (Brussels, 2 July 2002), 4 < http://europa.eu.int/comm/employment_social/soc-dial/csr/csr2002_en.pdf> viewed on 13 February 2006.

[10] This table is taken from the following article: D. Doane, "The Myth of CSR The problem with assuming that companies can do well while also doing good is that markets don't really work that way", (Fall 2005) *Stanford Social Innovation Review*, 23, 28.

Regulation	**Prediction by Business**	**Reality**
National minimum wage	Would result in over 1 million U.K. job losses within two years	Unemployment fell by 200,000
EEC introduction of catalytic converters	The cost of the technology would be £400-£600 per vehicle, with a fuel consumption penalty on top	Real costs of around £30-£50 per converter; technological innovation led to smaller and cheaper cars
US Clean Air Act	Would cost the US $51-$91 billion per year and result in anywhere from 20 000 to 4 million job losses	Yearly cost of $22 billion to business but employment in areas affected up by 22 percent; the benefits arising are between $120-$193 billion
Montreal Protocol	Opposed by industry on economic cost, but no projected figures	No impact; substitute technology may have saved costs, according to follow-up studies

Table 1: Regulation or burden?

This table demonstrates that regulation which imposes mandatory rules on companies to ensure that they behave in a socially responsible manner does have certain benefits. It is quite apparent when looking at Table 1 that the predictions made in relation to the implementation of the legislation were farfetched. It could be argued that legislation is beneficial for it brings with it predictability and innovation. It also has a positive effect on consumers and employment. For example, it can change the way consumers think by making them more aware of the importance of corporate social responsibility. Social labeling laws, for instance, have been an extremely effective tool for changing consumer behaviour in Europe. Following the enactment of legislation, all appliances had to be labeled with an energy efficiency rating. Today, the appliances rated as the most energy efficient capture over 50 percent of the market. Added to that, the standards for the ratings are continuously improving, through a combination of both research and legislation.[11] Minimal regulation such as this can play an educative role and increase the awareness of the public in relation to the issues it deals with.

However, regulation by itself is not enough to implement corporate social responsibility in companies. We also need the involvement of the relevant stakeholders and each company should have a monitoring system in place to ensure that it is properly implementing corporate social responsibility. There is a need to ensure that companies are not simply claiming to be committed to the environment and society in general. We need a system to tell us if companies truly are doing what they say they are doing.

What are the incentives or disincentives for a company to conduct its business in a socially responsible manner?

Incentives that will motivate a company to conduct its business in a socially responsible manner include:[12]

- Protecting, building and enhancing reputation: it is very commonly said that corporate social responsibility is good public relations. Companies behave in a socially responsible way in order to protect their reputation, bearing in mind that it takes just a single incident to ruin a perfectly good reputation;
- Reducing costs through eco-efficiency: if doing business in a socially responsible manner reduces the cost of running a business, then companies will usually be motivated to behave in this way;

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11 D. Doane, "The Myth of CSR The problem with assuming that companies can do well while also doing good is that markets don't really work that way", (Fall 2005) *Stanford Social Innovation Review*, 23, 28.

12 Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 8, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

- Attracting and retaining skilled and motivated employees: if employees believe that the company cares for them and has the same beliefs as they do, they will be more loyal to the company and will be motivated to perform their jobs to the best of their ability. For instance in the mid-1990s, Shell suffered negative publicity that led to a productivity downturn and a low employee morale. The company's subsequent commitment to collaboration and stakeholder responsiveness turned things around;
- Protecting or enhancing the resources (environmental or human) on which the business depends;
- Anticipating costs (including insurance costs), societal and stakeholder expectations, customer demands, and future legislation;
- Retaining the "license to operate", that is, if there is regulation which demands that companies follow certain rules in relation to corporate social responsibility, companies will follow the legislation at the risk of being penalised and losing their licence to operate;.
- Improving quality and effectiveness;
- Being an attractive prospect for investors: companies are aware that certain investors seek to invest in line with their own values, or in line with an expectation that companies with a socially responsible approach will be better investments;[13]
- Improving relationships with stakeholders;
- Attracting consumers: certain consumers will choose a product or service from one company over another on the basis of their understanding of a company's environmental or social credentials.[14]

[13] See below for more details.
[14] See below for more details.

Similarly, a company might face certain obstacles when trying to adopt socially responsible behaviour:[15]

- Uncertainty about what is involved. Corporate social responsibility is a complex and uncertain notion. It is a vague terminology which everyone has heard of but no one can easily define. There are also unclear parameters that need to be clarified like, for instance, who are the stakeholders? Are they the community at large, or only people directly affected by a company's actions?
- Cost: undertaking to behave in a socially responsible manner involves continuous effort and adaptation. There may be costs, such as the time and investment needed to plan and implement new ways of doing things. Evidence of the benefits of corporate social responsibility is generally poorly available (aside from eco-efficiency benefits) and remains in some cases elusive. A company might well question the wisdom of paying huge amounts of money to implement a system which has only elusive benefits.
- It is costly and time consuming for companies to collect information in relation to their performance and it is even more difficult for the public to ascertain the reliability of such information.
- Directors' dilemma: are the directors breaching their duties when practicing corporate social responsibility?[16]

Do different or additional implications arise depending on the nature or size of the enterprise?

It is important to note that the implications arising in relation to conducting one's business in a socially responsible manner will vary according to the size, age and activity of the company, and its geographical, political and cultural context. Accordingly, different factors will motivate different companies to take corporate social responsibility on board. What may seem important to one corporation is not necessarily equally

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15 Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 8, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

16 This point will be developed in part 2 in more detail.

important for all. Some factors will be more relevant to small businesses, and some to larger businesses. It is also the case that something which is seen as an obstacle by one organisation may be seen by other organisations as a driver or a success factor.[17]

A study done in Canada showed that small businesses practise corporate social responsibility often without recognising that they are doing so. Several businesses noted that "they do not consider their practices to be particularly responsible, just good business." For instance, many small and medium companies started their corporate social responsibility efforts with a range of environmental initiatives such as changing the type of paper they purchased. In relation to community engagement, however, the study showed that the small and low profile companies had very few, if any, community initiatives underway. On the other hand, the larger and higher profile companies had stronger links to their community and as a result evidenced more community engagement. [18] This Canadian study clearly shows that when small and medium businesses have the means to practise corporate social responsibility, they do so.

Factors that will be taken into consideration by small and medium companies when implementing corporate social responsibility include:[19]

- Identifying credible tools or practices: each company has different needs, depending on its goals and size. The identification and development of effective and credible tools or practices, which suit the company's particular and changing circumstances, could be difficult because a practice that is relevant for one company may not be for another. In addition, the particular language of corporate

17 Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 7, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

18 Canadian Business for social responsibility, *Engaging Small Business in Corporate Social Responsibility* (October 2003) < http://www.cbsr.ca/files/ReportsandPapers/EngagingSME_FINAL.pdf> viewed on 16 February 2006.

19 Ibid and look at Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 7, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006 .

social responsibility may need to be adapted and made concrete for small and medium businesses.

- Cost: depending on the size of the company, the cost of implementing socially responsible practices might be crippling. Even if they believe that the company might benefit from it, small and medium companies might lack the skills, resources or experience to implement corporate social responsibility. Other companies might have more pressing concerns, such as competing priorities, to worry about.
- Time: Small and medium businesses might lack the time to identify and engage their stakeholders.
- Sourcing environmentally friendly product can be very hard for small and medium businesses because they rarely have the purchasing power to influence their suppliers to provide them with environmentally and socially responsible products.
- Consumers: a large number of consumers do not make their purchasing decisions based on how environmentally or socially friendly a product is, but on the price of the product for instance. Accordingly, it is not appealing for small businesses to produce products that are more socially and environmentally responsible if no-one will buy them because they are more costly.
- Training of employees: limited resources may make it hard for small and medium companies to implement a proper communication system and the education of their employees on corporate socially responsible practices.

Accordingly, adopting corporate social responsibility is a gradual process for small and medium businesses. We should not impose new rules to force them to comply with corporate social responsibility because the experience in Canada shows that they undertake new socially- and environmentally-friendly activities when it is financially feasible, when time permits and when consumers demand it.

To what extent is corporate decision-making driven by stakeholder concerns?

Can companies satisfy the interests of all stakeholders? The answer to this question can be easily found in past experience.

In the 1970s a number of countries were involved in a push for ‘industrial democracy’, involving workers' representation on company boards and the formation of workers' cooperatives. These experiments ended soon after because they did not work properly. For example, in Sweden after the Second World War there was a desire to ensure democracy for workers and employees. A series of agreements on co-operation, such as the 1970 agreement on the position of the club chairperson within the enterprise and the 1975 agreement between SAF, LO and PTK on economic committees and independent experts, were adopted. None of these agreements, however, resulted in the desired employee representation in the decision-making process and legislation had to be enacted to ensure the protection of employees.[20]

“Stakeholder theory” is another concept that needs to be taken into consideration. When applied to corporations, “stakeholder theory” argues that managers should make decisions by taking into consideration the interests of all the stakeholders in a firm. This situation seems ideal and the perfect solution to a successful application of corporate social responsibility. However, Michael Jensen of the Harvard Business School points out that it is logically impossible to capitalise in more than one direction because the company is ultimately accountable to those who have entrusted their capital to the firm, its shareholders.[21] It is next to impossible to take into consideration the interests of the shareholders, stockholders, wholesalers, sales force, competition, customers, suppliers, managers, employees, and government.[22]

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[20] “Industrial Democracy”, < http://www.eurofound.eu.int/emire/SWEDEN/ANCHOR-F-Ouml-RETAGSDEMOKRATI-SE.html > viewed on 16 February 2006.

[21] New Zealand Business Roundtable, “Making Sense of Corporate Citizenship” (21 April 2004), <http://www.scoop.co.nz/stories/BU0404/S00208.htm> viewed on 16 February 2006.

[22] Brenner, S.N., and Cochran, P. 1991 “A stakeholder theory of the firm: Implications for business and society theory and research”. *Proceedings of the International Society for Business and Society*: 449-467.

Experience shows that some of the companies which have attempted to run themselves on stakeholder lines have failed miserably. Under CEO Bob Haas, Levi Strauss attempted to prove that a company driven by social values could outperform one driven by profits. The company involved everybody in decision-making, set up 80 task forces to make the company more "aspirational", promoted diversity, vetted contractors for labour practices and so on – and took its eye off the ball of profitability. Its costs blew out, its market share plummeted, it was forced to lay off 16,000 workers and its market value shrank from US$14 billion to US$8 billion before it was forced to abandon "its failed utopian management experiment."[23]

In the end one can say that corporate decision-making should be driven by stakeholders' concerns as long as those concerns benefit the company and ultimately the shareholders. Companies will try to find a middle ground between the expectations of the shareholders and the expectations of the broader community. Directors are fully aware that their companies' primary mission is to make profits, but they also are under pressure to demonstrate that their businesses have a social conscience. Accordingly, corporate decisions will take into account the following matters (and again these elements represent an application of Figure 1):[24]

- Strong, sustained economic performance: how will a company's decision improve the financial performance of the company?
- Rigorous compliance with financial and legal rules: will the decision of the company breach any legislation?
- Ethical and other citizenship actions, beyond formal requirements, which advance a corporation's reputation and long-term health: how will ethical and charitable decision-making affect the image of the company and in the end its bottom line?

[23] New Zealand Business Roundtable, "Making Sense of Corporate Citizenship" (21 April 2004), <http://www.scoop.co.nz/stories/BU0404/S00208.htm> viewed on 16 February 2006.

[24] "Corporate Social Concerns" <http://online.wsj.com/public/article/SB113355105439712626.html?mod=home_in_depth_reports> viewed on 16 February 2006.

An application of these elements will ensure a balance between the interests of the different stakeholders without having negative repercussions on the profit of the company.

In practice, to what extent do stakeholders consider a company's social responsibility performance when making assessments or decisions about a company?

Surveys have been done in Canada and the European Union in relation to stakeholders' attitudes toward a company's efforts at social responsibility.

A Conference Board of Canada poll showed that 77% of Canadians are most likely to invest in, 81% to purchase from, and 79% to work for companies they view as socially responsible. Recent Schulich School of Business research also revealed that 9 out of 10 Canadians believe corporate social responsibility should be a top corporate priority and, in fact, should be part of an international Canadian competitive strategy. Accordingly, in Canada, the expectations of stakeholders for corporate behaviour are high. Sixty-six percent of Canadians surveyed want firms to go beyond obeying laws. They want corporations to be fully accountable for any conduct that might undermine social and environmental health.[25]

In 2000, Market and Opinion Research International interviewed 12 000 consumers across 12 European countries on their attitudes towards corporate social responsibility and its application by companies. Seventy percent of European Consumers said that they would take into consideration the company's commitment to social responsibility when buying a product or service, and one in five would be willing to pay more for products that are socially and environmentally responsible.[26]

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[25] Susan Flynn, "Winning with Integrity: The Business Case for Corporate Social Responsibility" < http://www.cbsr.ca/files/ReportsandPapers/WinningwithIntegrityAMpdf.pdf > viewed 16 February 2006.

[26] "Stakeholder Dialogue: Consumer attitudes" < http://www.csreurope.org/whatwedo/Stakeholderdialogue/consumerattitudes/ > viewed on 17 February 2006.

Accordingly, it can be seen that some stakeholders will take a company's social responsibility performance into consideration.

2. Directors' duties: current position

Does the current law give directors sufficient flexibility to balance long-term and short-term considerations in their decision-making?

Howard has observed: [27]

> "We seem to have achieved the worst of two worlds; a system of regulation that goes too far while it also does too little."

This observation reflects today's reality. A huge number of regulations and penalties are contained in the *Corporations Act* yet there are still situations that escape regulation. We are considering putting even more regulation in place in an attempt to clarify the law and cover scenarios that escape the current legislation. But before burdening directors with more regulation to force them to take into consideration corporate social responsibility issues we need to answer these two questions:

1. Does the *Corporations Act* allow directors to take into consideration the interests of different stakeholders? Do directors breach their duties if they implement corporate social responsibility?
2. What problems might appear if more duties are imposed on directors?

1. Does the *Corporations Act* allow directors to take into consideration the interests of different stakeholders? I believe that it does, because when directors comply with corporate social responsibility, such compliance will have positive effects on the company itself. A study in Canada has shown that when small and medium companies

[27] Philip K Howard, *The Collapse of the Common Good: How America's Lawsuit Culture Undermines Our Freedom* (Random House, 1994), 11.

implemented corporate social responsibility their businesses profited from their initiatives.[28]

Let's take the most damning example: James Hardie's treatment of its employees suffering from mesothelioma caused huge problems for the image of the company. The company's shares, reputation and business suffered. But when the directors of James Hardie acted in a more socially responsible way (even though it was done under pressure), their actions improved the situation of the company. James Hardie recovered its status of good corporate citizen and that led to an increase of the company's share price and profit. The directors did not breach their duties when they recognised the interests of the company's stakeholders (the asbestos victims), because such recognition benefited the company and in the end its shareholders.[29]

Another example is BHP Billiton, a company which is today taking a leadership position on climate change. Such an approach will give the company an edge in the eyes of government officials and could potentially deliver it access to government-controlled oil deposits. Ultimately, this implementation of corporate social responsibility will benefit the company and thus the shareholders. Its directors will not have breached their duties.

What about donations? Are corporate donations allowed? Some groups, like the ASA, note that directors should not commit to donations on behalf of the company because they are not using their money, but their shareholders' money. Is that totally true? Does the *Corporations Act* prohibit such donations? As long as the donations are going to benefit the company as a whole, they are not in breach of the *Corporations Act*. As a result, if the donations improve the image and reputation of the company, they will benefit the company and they should be allowed. Are the Tsunami donations legal? The answer is yes because they will benefit a company on many levels, such as:[30]

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28 Canadian Business for social responsibility, *Engaging Small Business in Corporate Social Responsibility* (October 2003) < http://www.cbsr.ca/files/ReportsandPapers/EngagingSME_FINAL.pdf> viewed on 16 February 2006.

29 James McConvill, "Direcotrs' Duties to Stakeholders: A reform Proposal Based on three false assumptions" (2005) 18 *Australian Journal Corporate Law* 88.

30 Peter Henley, "Where Corporate Tsunami Donations Made Legally?" (2005) 30 *AltLJ* 154, 157.

- by generating local and international publicity, and accordingly increasing brand awareness;
- by motivating its employees in showing that the company has the same beliefs as its staff. For example, ANZ matched its employees' tsunami donations;
- by avoiding negative publicity: there is not a company that would like to be seen as a bad corporate citizen.

If directors commit to such donations they would not be in breach of their duties because these donations are justifiable for they benefit the company. On the other hand, donations that are not justifiable would need shareholder approval because they won't benefit the company. For example, as considered previously, if a company gives money to a charity supported by a director's wife, such a donation can be considered as a breach of duty because a conflict of interest will exist. Should we allow such donations? The answer is we should not, because they are not just legally wrong but ethically wrong. Directors should not use a company's money and position to promote their own interests and such donations might do that.

In the end, the *Corporations Act* notes that directors need to take into consideration the best interests of the company as a whole. Does that mean that directors can't act in the best interests of the stakeholders? Again, the answer is no. The duty of directors towards the company as a whole means that directors have a duty to any stakeholder who might have an influence on the day-to-day operation of the company. This was confirmed in the 1989 report of the Senate Standing Committee on Legal and Constitutional Affairs. The report clearly noted the following:

> "The courts have associated directors' duties with the 'interests of the company'. This does not necessarily mean that directors must not consider other interests. The 'interests of the company' include the continuing well-being of the company. Directors must not act for motives foreign to the company's interests, but the law permits many interests and purposes to be advantaged by company directors, as long as there is a purpose of gaining in that way a benefit to the company."

The *Corporations Act* does not stop directors from taking into consideration the interests of different stakeholders. They can do so as long as their action does not breach the legislation. **The interests of the company and the interests of the stakeholders are interdependent** because a company can't function without the support of its suppliers, consumers, shareholders… Directors will be breaching their duties under the *Corporations Act* if they do not try to ensure the long term financial stability of the company. Such stability will only be reached if the directors take into consideration the interests of the relevant stakeholders.

2. What problems might appear if more duties are imposed on directors?

The first problem that might arise if the *Corporations Act* imposed more duties on directors is that directors might be faced with more legislation than is necessary because directors do not merely have to comply with the *Corporations Act*. Directors of companies must obey laws relating to environmental protection, taxation, occupational health and safety, trade practices and consumer protection, as well as many others. Failure to comply with these laws not only exposes companies to potential fines but, in appropriate cases, directors and officers can be held personally liable, both civilly and criminally.[31]

Adding more legislation might lead to duplication and contradictions between the *Corporations Act* and the other laws in place. When legislation puts a high burden on the community, such legislation may be seen as unreasonable and those regulated do not always respond positively: their actions can become shaded with anger and resentment at the departure from common sense. This leads to the application of the following vicious cycle:

[31] R Baxt and I Ramsay, 'Corporations law a fragile structure', *The Australian Financial Review*, 19 November 2004, p 55.

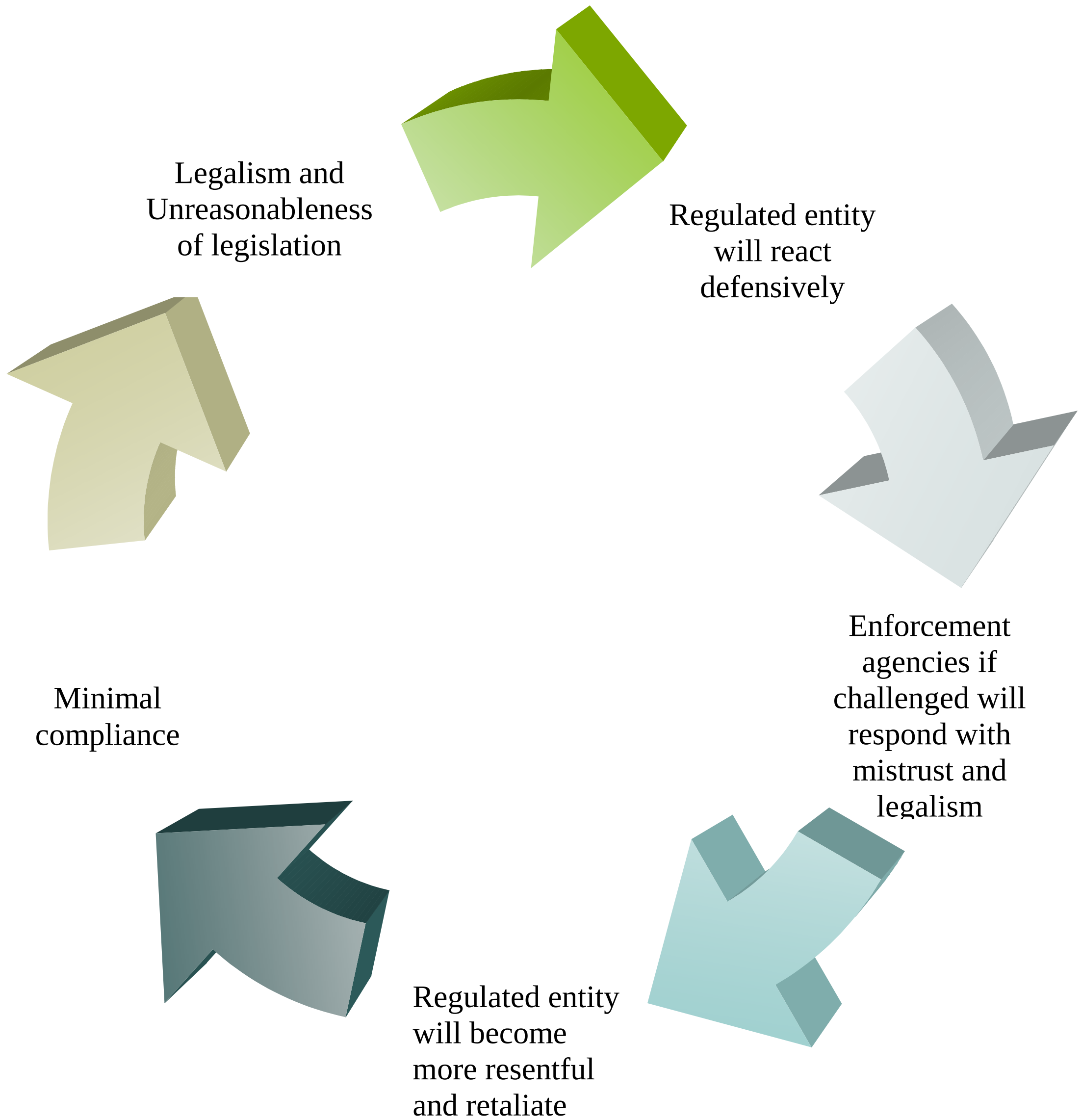

Figure 2: Vicious cycle resulting from excessive legalism and unreasonableness of legislation.[32]

Resentment toward the regulator can blossom if those regulated believe that the rules imposed are unreasonable or excessively legalistic. For instance, if regulated entities have a fine imposed on them when they believe that they acted responsibly, the result can be counter-productive. Some business managers might respond by taking the position that they will act no more responsibly than the regulator's rules require them to. Such an

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32 This figure is based on information given by Bardach and Kagan, above n 31, 105. This author took the information and formulated it in the form of Figure 2.

attitude will sadly lead to minimal compliance and yet more legalistic and unreasonable legislation.[33] Accordingly, any new changes to the *Corporations Act* need to take into consideration such a scenario. Telling directors what is in the best interests of the company might backfire, because what can be seen as a positive endeavour for one company might have a catastrophic effect on another.

The second problem that might arise is in defining the stakeholders. Who will be considered as stakeholders? Is it the community at large or certain people whose interests are linked to the company?

The third problem is connected to the market mentality: 'Don't miss a quarter'. As noted previously, companies will usually profit from implementing corporate social responsibility. But the accruing benefit might take some time to be felt. Accordingly, directors will be under pressure: provide quick profits or risk seeing the shares of the company plummet. Such a dilemma might push directors away from corporate social responsibility. A change in the mentality of both directors and shareholders is needed. There should be an understanding that a high share price today will not by itself guarantee future success. It is the policies of the company that will ensure the survival of the organisation. People need to be educated that the effect of corporate social responsibility might not be felt directly, but it will benefit the company in the long run. This third problem is not really with what duties might be imposed on directors by more legislation, but with the mentality of both directors and shareholders in automatically linking the price of a company's shares to its success. It is not always the case that one represents the other. Just look at the WorldCom example. No amount of legislation will change such mentality, however: education alone can.

In the end the question that can be asked is: Do we need to broaden the duties of directors? The answer is no. What we can do is provide guidelines to assist directors in their implementation of corporate social responsibility, and these should include educational courses to enhance directors' understanding of their duties in relation to

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33 Eugene Bardach and Robert A. Kagan, above n 31, 105.

corporate social responsibility. The directors' duties imposed by the current *Corporations Act* are enough to cover the actions of directors because as long as the directors implement corporate social responsibility in the interests of the company, they will not be breaching their duties.

Are any changes needed to the current law regarding the right of shareholders to express their view by resolution at general meetings on matters of environmental or social concern?

No legislative changes are needed to give members the right to express their view by resolution at general meetings on matters of environmental or social concern. If members want to do such a thing they need simply alter their constitution to allow themselves such powers. The choice should be left to individual companies and ultimately their shareholders.

3. Directors' duties: matters for consideration

Should the Corporations Act be revised to clarify the extent to which directors may take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

The *Corporations Act* should not be revised to clarify the extent to which directors may take into account the interests of stakeholders. Such a situation should be left to the discretion of the directors because each company is unique and each has different requirements. Enacting more legislation in the guise of guiding directors will lead to excessive legalism, unreasonableness and, ultimately, resentment. Directors are the people best placed to know what will benefit their companies.

Should the Corporations Act be revised to require directors to take into account the interests of specific classes of stakeholders or the broader community when making corporate decisions?

The *Corporations Act* should not be so revised because it already requires directors to take into account the interests of the different stakeholders. Directors are supposed to act for the best interests of the company as a whole and that includes stakeholders. A company cannot function in the long run without doing so.

4. Corporate reporting

Should the Corporations Act require certain types of companies to report on the social and environmental impact of their activities?

The recent increase in corporate social reporting over the years is linked to the demand for greater accountability and transparency of companies: key stakeholders today not only expect businesses to have a positive social and environmental impact in the world, they also want to be kept informed on how companies are performing in this respect. The financial community is a key driver for corporate social reporting. [34] Some people have criticised corporate social reporting by commenting that some reports are little more than spin. The perfect example of this can be found in Enron's rosy and glossy corporate responsibility annual report, which noted for instance the following:

> "Enron's Code of Ethics is published in English, Spanish, and Portuguese and distributed with universal acknowledgement and agreement to comply by its employees. Among other areas of coverage, the Code of Ethics specifically reinforces Enron's Principles of Human Rights and the Environmental, Health and Safety Principles; and **states that business is to be conducted in compliance**

[34] Employment, Social Affairs and Equal Opportunities, *Responsible reporting*, < http://europa.eu.int/comm/employment_social/soc-dial/csr/060403_cover_en.html > viewed at 13 February 2006.

with all applicable local and national laws and regulations, and with the highest professional and ethical standards."[35]

Unfortunately, this paragon of corporate social responsibility collapsed under the weight of its executives' greed and criminality.[36] Another example is Shell, which has a much publicised corporate social responsibility policy and was a pioneer in triple bottom line reporting,[37] but was involved in 2004 in a scandal over the misreporting of its oil reserves which seriously damaged its reputation and led to charges of hypocrisy.[38]Putting to one side such sad realities, while most of the corporate social responsibility reporting done today is voluntary, some countries have put in place mandatory reporting. If the *Corporations Act* was to require certain types of companies to report on the social and environmental impact of their activities, this would have mixed repercussions.

On the one hand, the company will attract certain investors who are interested in the social and environmental impacts the company is having on the community. Such reports would also allow shareholders to know what their company is doing and how its actions are helping society.

In Canada, the government noted that the publishing of such reports was very useful because it had:

- internal benefits to the company by keeping the workplace informed and motivated, by improving data collecting in the company, by giving information to the public about the company's performance, and by ensuring the functioning efficiency of the company;

[35] Enron, Corporate Responsibility Annual Report, 9, <http://www.enron.com/corp/pressroom/responsibility/CRANNUAL.pdf> viewed on 14 February 2006.

[36] Joel Bakan, *The Corporation: the Pathological Pursuit of Profit and Power* (Free Press, 2005), 57-58.

[37] Juergen Daum, "A Revolution in Stakeholder Oriented Corporate Disclosure- Case Study: The Shell Report" (12 May 2001), *The New Economy Analyst Report* < http://www.juergendaum.com/news/05_12_2001.htm> viewed on 11 February 2006.

[38] Wikipedia, *Corporate Social Responsibility*, <http://en.wikipedia.org/wiki/Corporate_Social_Responsibility> viewed on 13 February 2006.

- external benefit to the company by improving the reputation of the company.

In France, reporting has been found to benefit companies by improving the dialogue between different categories of stakeholders.

On the other hand, imposing more reporting requirements on companies might have some adverse effects. Firstly, the financial cost of compiling and publishing such reports might be high. Secondly, companies will spend time collecting data to generate the reports, which might otherwise have been directed to finding new ways to improve business practice. Such reports are intended to drive performance improvement, thus the process of gathering data to compile the reports should be streamlined, but this seems rarely to be the case.[39]

Thirdly, the information required to be included in such reports would need to be specified and standardised. The guidelines in the Global Reporting Initiative would be a good place to start. However, adjustments might need to be made to ensure their requirements are easily adoptable by Australian companies. French companies had difficulties implementing all the guidelines in the Global Reporting Initiative because some were too AngloSaxon and not relevant in France. In addition, the information required to be reported should be useful to the company and to the community.[40]

Fourthly, any introduction to the *Corporations Act* of regulation in relation to corporate social responsibility needs to be reasonable, taking into consideration both the content and form of any reports that are required to be made. In 1977, Bardach and Kagan began a study on the pro-regulation movement that was at its height at this time. They noticed that a good deal of the regulation in place around the world was self-defeating. Their research demonstrated that increasing regulation would not ensure the protection of the

[39] Mallen Baker, "CSR Reporting faces its next challenge" 85 *Business Respect* (29 Jul 2005) < http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1478> viewed on 9 February 2006.

[40] Ibid.

community, because even the best regulation can produce a deplorable result if it is considered by the public to be unreasonable. Even if the “unreasonableness” of a regulation is unintended and is incidental to the accomplishment of a larger purpose, it may still be felt as unreasonable by the individual subjected to it.[41] Accordingly, if any reporting required did not serve a particular purpose, the business community might view the requirement to report as a burden and a backlash could take place.[42]

An important lesson that may be derived from a review of the corporate social responsibility reports published to date is that such reports need to be targeted to the selected audience. Vast amounts of money and time go into the production of these reports and it is known only too well by the companies that the stakeholders at whom the reports are aimed largely don't read them. Sooner or later, businesses will begin to question the use of these reports. No-one wants to continue to spend half a million dollars on reports that are not read. For this reason, some companies are issuing reports specifically targeted at certain elusive audiences. For example, the Centrica report, as well as being produced in conventional form, is produced in a separate edition for employees. The employees' report is based on the same information, presented in more of a 'magazine' format to make it more attractive to that audience. It is very possible that different reporting channels for different key stakeholders are essential to ensure that the reports are actually being read, and this should be taken into consideration by any legislation planning to introduce mandatory reporting on corporate social responsibility.[43]

Any legislation should likewise ensure that that the expectations of what these reports can tell us are not unrealistic. A company's financial reports will necessarily provide something much more concrete, for figures are figures and, properly gathered and represented, they will give an accurate indication of the financial situation of the company. Corporate social responsibility reports deal with more intangible matters. It is

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[41] Eugene Bardach and Robert A Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Temple University Press, 1982) ix, 6.

[42] See Figure 2.

[43] Mallen Baker, “CSR Reporting faces its next challenge” 85 *Business Respect* (29 Jul 2005) < http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1478> viewed on 9 February 2006.

very rare when the content of a corporate social responsibility report gives an indication of how a company is doing. As a result, many reports contain lots of photos of smiling children which try simultaneously to present data and to tell stories. The company becomes its own interpreter - and that is why so much of the focus on reporting remains on the quality of the report, rather than on what the report is actually telling us.

Lastly, other questions should be asked: How are we going to monitor that what is said in the report has actually been, or is going to be, applied? What penalties should be imposed for breach of the reporting requirements? For instance, should they be the same as the penalties applied for breach of general disclosure requirements? Any legislation implementing a corporate social responsibility reporting requirement needs to provide a system for monitoring that reporting. The person or body monitoring the reports would need clear guidance.

It is interesting to look at how other countries have dealt with compulsory reporting on corporate social responsibility. In France, legislation requires all French companies listed on the "premier marche" to include in its annual report information on how that company is addressing the social and environmental impact of its activities. The law also indicates what information should be included in the report. The reasons behind the implementation of the French legislation are the following:[44]

- to ensure transparency in the way companies deal with social and environmental issues by showing the consequences of their activities in the social and environmental areas;
- to compare the different performances of companies in those areas; and
- to encourage French companies to follow the international movement in relation to reporting on corporate social responsibility.

[44] *Rapport de Mission Remis an gouvernement: Bilan Critique de l'Application par les enterprises de l'article 116 de la loi NRE*, April 2004 < http://www.orse.org/fr/home/download/rapport_NRE.pdf> viewed on 10 February 2006.

In 2004, the French government asked Orée, Orse and EpE to report on the method by which French companies are applying section 116 of the *Nouvelles Regulations Economic* and here are a few of their observations:[45]

- One difficulty is the distinction between information required by legislation to be included in the report and information companies are voluntarily giving to the public which is not required by legislation. This causes company reports to be different in style and content, with some companies fulfilling their obligations under the legislation and others going beyond what the legislation requires. This lack of uniformity can occur because the legislation is couched in broad terms. The forms of reports varied considerably, and the smaller the company the less the report complied with the legislation. Some companies produced stand alone reports and others included this reporting as part of their annual report.
- The requirements of the law were vague and sometimes difficult to apply, causing some problems for companies. In addition, while the requirements were relevant to enterprises which dealt with specific activities, they might be difficult to apply for companies that had many activities. The three associations suggested that the requirements should only be applied to companies to the point where it actually served the companies' interest.
- The cost of the reports can be crippling for an organisation. (It was noted that a report could require 12 employees to work for six months collecting the necessary data, the publication costs

[45] Mallen Baker, "CSR Reporting faces its next challenge" 85 *Business Respect* (29 Jul 2005) < http://www.mallenbaker.net/csr/CSRfiles/page.php?Story_ID=1478> viewed on 9 February 2006.

could reach 100 000 euros, and the cost of external certification of reports could be high.)

- The companies found it difficult to target all the interests of the different stakeholders in one document.

In France, the legislation in relation to reporting seems to be accepted by both the companies and the stakeholders, and the people who criticised mandatory reporting no longer question the benefits of such reporting. In spite of the reporting requirement being accepted by French companies, it is not being applied properly by all of them, and in addition a single report does not necessarily answer all the questions of the different stakeholders.[46]

In Germany, research done in 2004 compared ten selected corporate social responsibility reports from companies listed on Germany's DAX-30 index. This exercise found that most of the companies were quite advanced in their reporting of environmental matters, but they devoted less attention to the issues of countering corruption, taxes and subsidies.[47]

5. Encouraging responsible business practices

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

I believe that companies should be encouraged to adopt socially and environmental business practices because it is the way of the future. Corporations have been given huge powers. They have all the benefits of being a legal entity but they don't have the limitations. For decades we have been removing limitations on companies and extending their powers without thinking of the consequences. Today a company has perpetual

[46] Ibid.

[47] Thomas Loew, Kathrin Ankele, Sabine Braun and Jens Clausen, "Significance of the CSR debate for sustainability and the requirements for companies (30 June 2004) < http://www.4sustainability.org/downloads/Loew-etal-2004-CSR-Study-Summary.pdf > viewed on 14 February 2006.

existence, may enter into any contract it wants, and can be involved in any business. Our world revolves around corporations. Without them we cannot properly function. So it is time to hold those corporations liable, socially and environmentally. It is time to reshape the corporate citizen by encouraging corporations to be more socially and environmentally responsible. Obviously this can't happen in one day, and for this reason I propose the following system.

Companies are artificial creations that are not bound by personal morality. However, companies are motivated by profit and the maximisation of their shareholders' return. Profit usually takes precedence over community well-being, worker safety, public health, peace, environmental preservation and national security. Accordingly, all the decisions a company will make are usually motivated by profit. The practice of "greenwashing" has appeared and is intended to coax more people to buy a company's products, services or stock by letting the company's persona appear altruistic. As a result, a company will practise corporate social responsibility as long as such a practice serves its purpose. But when benefits do not accrue, such practices will be put aside. For instance, Exxon Corporation executives realised that their spending to mitigate damage to Alaskan shores after the Valdez oil spill was not swaying public opinion enough to benefit the company's bottom line. As a consequence, they dropped their pretence of ethical behavior and stopped the cleanup.[48]

This example illustrates that whether or not companies will practise, or continue to practise, corporate social responsibility is connected to profit. Since this is the case, the best way to motivate companies to commit themselves to voluntary initiatives in relation to corporate social responsibility is to give them an incentive to do so. A system of reward is the best solution: apply corporate social responsibility properly and you will be rewarded for it. For maximum success, the incentive should affect the profit of the company.

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[48] Jeff Milchen, "Inherent Rules of Corporate Behavior" <http://reclaimdemocracy.org/corporate_accountability/corporations_cannot_be_responsible.html> viewed on 12 February 2005.

Rewards can play a positive role in compliance. They encourage regulated firms to abide by the law by giving them incentives to do so. Positive incentives can take the form of green stickers, grants, subsidies, bounties, fees and commissions, tax breaks or loan guarantees.[49]

Today there are certain private organisations such as the Association of Chartered Certified Accountants that give awards for sustainability reporting in order to encourage better sustainability reporting and to serve an educational role. But a broader arrangement is needed. Governments, and not just private organisations, need to get in on the action and make companies feel that if they miss out on the rewards offered their bottom line will be affected.

Government can encourage companies to be more socially and environmentally aware by noting that companies implementing corporate social responsibility will be granted government contracts while companies that do not practise corporate social responsibility will miss out, for instance.

The linking of corporate social responsibility and corporate profit will remove certain dilemmas faced by directors: directors will be able to apply moral standards without fearing a backlash from shareholders, because their actions will be motivated by profit. If they won't act in accordance with corporate social responsibility, their bottom line will suffer because they will lose all financial rewards they might have got if they had implemented corporate social responsibility.

A second way to encourage good corporate governance practice is to issue reports on companies' performance to show the companies that their efforts are being acknowledged. This is already being done in the form of surveys and indices. The

[49] Peter N Grabosky "Regulation by Reward: On the Use of Incentives as Regulatory Instruments" (1995) 17 *Law and Policy* 257.

positive or negative publicity generated by these reports may lead companies to be more motivated to implement corporate social responsibility. [50]

The problem with this method is that it attracts lots of criticism in relation to bias and the existence of conflicts of interest between companies and the people in charge of the surveys or indices. For instance, Laurel Grossman developed the Reputation Index, and then RepuTex. The RepuTex is a product that is very different from stockmarket indices (such as the Dow Jones Sustainability Index) which are investment tools, or the GRI (Global Reporting Initiative) which is really a reporting model. The Good Reputation Index (later becoming the RepuTex) was unique and looked at companies from a different perspective.[51] The strongest criticism of the RepuTex, however, concerns its lack of partiality and the conflict of interest. The Business Council of Australia complained (and still complains) that the RepuTex ratings are based on the views of a small group of apparently arbitrarily selected organisations which will lead some of them to be partial to particular corporations. For instance, in the first Good Reputation Index in 2000, the St James Ethics Centre rated Leighton Holdings "tops on ethics", but the organisation failed to disclose that it had given Leighton advice on ethics in return for a fee after Leighton had suffered adverse findings in a Royal Commission. The IPA's Mike Nahan noted that the St James Ethics Centre "had financial relationships with 37 of the 100 corporations in the Index and disclosed none of them."[52]

Another criticism is: who is actually financing the reports that are being made? RepuTex now is raising funds by selling the 650-page report of its assessments for the price of $25,000 each to the companies involved and any other person who is interested in purchasing the report (it is safe to say that only sophisticated or institutional investors will be able to afford the report; small investors will not). This has released a deluge of complaints. Some commentators even labelled it extortion. However, it is important to note that it is not compulsory to buy the report. For instance, the company which

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[50] Colleen Ryan, *The reputation wars*, <http://www.afrboss.com.au/magarticle.asp?doc_id=22574&listed_months=14> viewed on 12 February 2005

[51] Ibid.

[52] Ibid.

received the top rating this year, Westpac, declined to purchase it to avoid any signs of conflict of interest. Accordingly, for any report on corporate social responsibility to have an impact it needs to be impartial and to be independently funded, which is in itself hard to achieve.[53]

A third method that may be used is education. I believe that promoting corporate social responsibility through education is very useful because it will ensure that businesses are aware of the notion of corporate social responsibility and that they understand the concepts it involves and how to apply it. A critical element in a successful implementation of corporate social responsibility is the understanding of the officers of the company of the importance of corporate social responsibility. This understanding ensures the commitment of key people in the company, such as directors and senior managers, to integrate the values and visions of corporate social responsibility into the company and its culture.[54] Education will help companies to apply not only the letter of the law and codes, but also the spirit that is behind them. Education will also help employees to determine current practices in corporate social responsibility. But education by itself is not enough. It needs to be implemented with something else such as a reward system for the practice of corporate social responsibility.

For its voluntary initiatives to be fruitful, a company needs to apply them properly. It is important to note that not every time a company says it is complying with corporate social responsibility principles it is actually doing so. On many occasions companies say that they are doing everything they can to help the community when in reality they aren't doing much beyond giving the appearance of being good corporate citizens. For instance, Coca-Cola stresses that it is 'using natural resources responsibly', yet a wholly-owned subsidiary in India has been accused of depleting village wells in an area where water is in notoriously short supply and has been told by an Indian court to stop drawing from

53 Ibid.

54 Employment, Social Affairs and Equal Opportunities, *European Multistakeholder Forum on CSR: Final Results and Recommendation* (29 June 2004), 7, <http://forum.europa.eu.int/irc/empl/csr_eu_multi_stakeholder_forum/info/data/en/CSR%20Forum%20final%20report.pdf> viewed on 13 February 2006.

ground water.[55] In relation to this issue, Coca-Cola's claims of corporate social responsibility mean nothing, because it is not applying what it is preaching.

Even worse, evidence has emerged that at least in some cases, factory officials in charge of manufacturing consumer goods for Western markets are falsifying records in order to appear to be in compliance with the tougher labour standards demanded by their multinational corporate customers because they want to concentrate on making the highest profit possible at the detriment of human life and ethics.[56]

Conclusion

Corporate social responsibility should be taken into consideration by companies. However I do not believe that a change in the current legislation is needed. Directors already have a range of duties and responsibilities imposed on them by law. The current rules already cover the responsibility of directors towards the different stakeholders.

Changes in relation to corporate reporting in the *Corporations Act* might be a good idea, but before implementing any legislation, it is necessary to look at the problems faced by other countries which have put in place mandatory reporting in relation to corporate social responsibility, so that we will not repeat mistakes that have been made. Watching further developments in these countries over a longer time period may be beneficial.

Companies should be encouraged to apply corporate social responsibility through a system of rewards and education. The reward system will show the company and shareholders that the company is benefiting from being a good corporate citizen, and education will teach the officers and employees of the company the importance of corporate social responsibility.

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55 Christian Aid, *Behind the Mask: The Real Face of Corporate Social Responsibility*, < http://www.christianaid.co.uk/indepth/0401csr/index.htm> viewed on 12 February 2005.

56 Oxfam GB, "Play Fair at the Olympics," *Clean Clothes Campaign, and Global Unions*, March 2004.