CHAPTER 3

DRIVERS AND PRINCIPLES OF CORPORATE RESPONSIBILITY

3.1 In the course of the inquiry the committee heard much about the factors that drive 'responsible' and 'sustainable' behaviour on the part of corporations and organisations. In addition, many views were put to the committee regarding the principles that shape, or should shape, engagement with a corporate responsibility agenda.

3.2 This chapter firstly outlines the evidence presented on the drivers of corporate responsibility, and secondly, the views put forward about the principles that should shape the concept of corporate responsibility.

Drivers of corporate responsibility

3.3 Given the traditional focus of corporations has been on generating profit to provide a financial return to shareholders, the question arises: why would a corporation use company resources to undertake activities that are apparently without direct financial return? Alternatively, why would a profit-driven company choose to engage in such activities that have the potential to distract them from pursuing their main business interests and weaken their financial performance?

3.4 In evidence, Mr Cooper, Deputy Chairman of the Australian Securities and Investments Commission (ASIC) succinctly provided one half of the answer when, referring to large global companies, he said 'what is driving them is the realisation that behaving without regard to these sorts of principles causes them *immense commercial damage*.'[1] (emphasis added).

3.5 The other half of the answer lies in the fact that, in an increasingly competitive and globalised marketplace, companies are looking for new ways to create lasting company value. Leading companies in this area have realised that integrating the notion of sustainability and corporate responsibility into their everyday business practices can have a range of benefits for company value. In addition, companies recognise that by paying due attention to their impact on the environment and on the community, future risk to the corporations may be reduced or mitigated. Companies may note the experience of the Hardie Group, whose product range and use many years ago did not appear to foresee future shifts in legal and community standards. Since they were not reporting on risk under a corporate responsibility framework, directors were evidently not alerted in time to the dangers facing the corporation.

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1 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, p. 24.

3.6 Due to a number of drivers many corporations are finding that there is a growing business case to undertake activities beyond their traditional business interests. The benefits of activities such as working with employees, suppliers, communities and environmental groups are often not immediate and can be intangible, for example employee commitment, consumer trust and corporate brand and reputation. However, as corporate value becomes increasingly dependent on intangible assets, many companies are realising the benefits of better managing their social and environmental risks, with a view to protecting and enhancing these assets and improving their long-term financial viability. Reputational risk is particularly important for many companies. The case of Nike Corporation is often quoted in this regard. Many commentators have noted that Nike's attempt to maximise profit by setting up manufacturing facilities in low-wage countries, and the reporting of its alleged exploitation of third-world workers, resulted in significant brand damage.

3.7 It is apparent that a range of market drivers is responsible for the burgeoning interest in corporate responsibility, and some of these are discussed below.[2] However, it is useful at the outset to make several general observations.

General observations

3.8 Firstly, the dominant motivations for improved sustainability performance are the usual economic forces of informed and competitive commercial markets. The other main motivating factors are the recent changes in community expectations as well as some companies genuinely being committed to ethical decision making or 'doing the right thing'.

3.9 As community and financial market expectations of what constitutes good corporate behaviour change and evolve over time, in most cases corporations respond by modifying their operations and activities accordingly. For example Insurance Australia Group's (IAG) submission recognised that '[s]trong companies are sustained because they understand, and respond to changing customer and community priorities.'[3]

3.10 Companies that embrace the concept of corporate responsibility are realising that the long term financial interests of a company are 'not mutually exclusive'[4] with acting fairly in the interests of stakeholders (other than shareholders).

3.11 Indeed for some companies, considering broader stakeholder interests can have a significant benefit for their long-term financial position. For example, Westpac, a leading proponent of corporate responsibility in Australia, gave evidence of its positive experience in implementing corporate responsibility initiatives:

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2 Many submissions discussed these drivers, for example: Australian Institute of Company Directors, *Submission 73*, p. 8; and Business Council of Australia, *Submission 108*, pp 14–40.

3 Insurance Australia Group, *Submission 29*, p. 1.

4 Business Council of Australia, *Submission 108*, p. 4.

> It became fairly obvious that everything we touched in this area was value adding. I can say right to this point there is nothing Westpac have done in our journey over what is getting close to 10 years with [corporate responsibility] which has not been shareholder value adding. I do not think we know of any case. There can be situations where there is a very short term cost—for example, energy efficient devices in buildings—but the payback period is so rapid that it quickly turns into being a bottom line plus.[5]

3.12 BHP Billiton, another leading Australian company in the area of corporate responsibility, supported this view:

> Rather than proving a burden to our businesses, CSR has been viewed throughout BHP Billiton as critical to our long term success. The BHP Billiton Charter states that we will only be successful when our host communities value our citizenship.[6]

3.13 Secondly, there are connections between the various commercial drivers of improved sustainability performance, and these drivers can be reinforcing in nature. For example a company which proactively manages its material non-financial risks, will in the longer-term improve its competitive position. Similarly a company which considers and where appropriate responds to community and consumer expectations, will enhance its corporate reputation, which should also improve its competitiveness.

3.14 Thirdly, the pressure companies experience from the various drivers is increasing and is likely to continue to increase into the foreseeable future. It will be the companies that respond most effectively to those drivers which will have a competitive edge in the future.

3.15 Finally, it is also apparent that different companies are influenced differently by the drivers depending on company attributes such as the nature of the business, size, location and industry sector. The Business Council of Australia (BCA) submitted:

> The innovative and creative CSR activities being undertaken by Australian companies reflect each company's unique operational experience and expertise. The CSR activities vary depending on the nature of the corporation's activities, their impacts and the communities within which they operate... What is an appropriate CSR activity for the banking sector, for example, will be very different from the activities pursued in the manufacturing sector.[7]

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5 Dr Noel Purcell, Group General Manager, Stakeholder Communications, Westpac Banking Corporation, *Committee Hansard*, 23 November 2005, p. 99. Wesfarmers made a similar observation: see *Committee Hansard*, 20 February 2006, p. 17.

6 BHP Billiton, *Submission 13*, p. 1.

7 Business Council of Australia, *Submission 108*, p. 8.

The next section of this chapter discusses the following drivers of corporate responsibility:

- competitiveness and profitability;
- attracting investment;
- attracting and retaining employees;
- reputation;
- risk management;
- corporate failures;
- community expectations and license to operate;
- avoidance of regulation; and
- globalisation.

Competitiveness and profitability

3.16 As outlined earlier, the underlying catalyst for companies to adopt the concept of corporate responsibility is economic market forces, coupled with community pressure. Companies are becoming increasingly aware that managing non-financial risks and pursuing opportunities to undertake corporate responsibility activities may benefit long-term financial performance. The BCA recognised that '[i]t is simply good business for companies to recognise the impacts they have, the opportunities and risks these present and then to respond effectively.'[8] The BCA identifies competitiveness opportunities such as: developing the economy and community in which it operates; working with government to facilitate better regulatory regimes; integrating environmental breakthroughs into assets to reduce lifecycle costs and improve efficiency; and effective communication with customers.[9]

3.17 The Chamber of Commerce and Industry of Western Australia recognised the potential for both mitigating negative impacts and taking advantage of positive impacts. Its submission stated:

> [t]he commercial incentive is not purely to avoid negative outcomes. Many businesses have implemented triple bottom line accounting and achieved improvements in operating efficiency or savings in input or waste management costs. These measures are adopted by firms because they make good business sense and are in the interest of shareholders.[10]

3.18 The concept of corporate responsibility has created a range of new business opportunities for corporations to increase their competitiveness and profitability. More companies are seeking to improve their competitiveness by taking advantage of

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8 Business Council of Australia, *Submission 108*, p. 14.

9 Business Council of Australia, *Submission 108*, p. 29.

10 Chamber of Commerce and Industry of Western Australia, *Submission 92*, p. 18.

synergies with their broader stakeholder communities. For example, BHP Billiton submitted:

> The dynamic nature [of the corporate responsibility] agenda provides an opportunity for corporate groups such as ours to seek competitive advantage, by exploring new ways of approaching and engaging in relationships with their key stakeholders.[11]

3.19 Westpac also recognised the competitive advantage:

> Sustainability is seen as a competitive differentiator for Westpac. Whereas much of the broad debate on corporate responsibility focuses on risk amelioration, Westpac is very much pursuing the business upside from adopting responsible and sustainable business practices; for example through cost reduction, and pursuing new products and new markets.[12]

3.20 The recent empirical work conducted for the Department of the Environment and Heritage found that issues relating to competitiveness were cited frequently by large companies as the benefits of producing sustainability reports. The four most often cited benefits were reputation enhancement (82%); ability to benchmark performance (68%); operational and management improvements (64%); and improved management of risks (62%).[13] All have some bearing on a company's competitiveness, revenue and profitability.

3.21 The impact on a company's financial performance of 'responsible corporate behaviour' was a recurring theme during the inquiry. In this vein the Prime Minister, the Hon John Howard MP, has previously acknowledged that '[b]eing a good corporate citizen, building trust, engaging with and supporting communities can add value to the bottom line in a variety of ways.'[14]

3.22 The committee was referred to a number of studies which attempt to demonstrate a positive or negative relationship between company financial performance and responsible corporate behaviour. A 2005 study by researchers in the UK investigated the relationship between corporate social performance and financial performance, and found that companies which rated poorly in corporate responsibility terms achieved higher financial returns than those which rated well:

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11 BHP Billiton, *Submission 13*, p. 1.

12 Westpac Banking Corporation, *Submission 94*, pp 10–11.

13 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 32.

14 The Hon John Howard MP, Prime Minister of the Commonwealth of Australia, 'The 1999 Corporate Public Affairs Oration' presented to the Centre for Corporate Public Affairs, 26 March 1999, cited by the Consumers' Federation of Australia , *Submission 89*, p. 6.

> ...firms with higher social performance scores tend to achieve lower returns, while firms with the lowest possible [corporate social performance] scores of zero considerably outperformed the market.[15]

3.23 Alternatively, other research indicated a positive relationship. The results from CPA Australia's *Confidence in Corporate Reporting 2005* survey demonstrate that a significant majority of respondents (86%) agreed with the proposition that 'better management of a company's social and environmental concerns benefits shareholders.'[16] Interestingly, there was general agreement on this proposition from the various classes of respondents which included shareholders, analysts, advisors and brokers, directors, CEOs and CFOs.

3.24 The ASX Corporate Governance Council in its *Principles of Good Corporate Governance and Best Practice Recommendations* also recognised the potential commercial benefits. Principle 10 of the recommendations states:

> There is growing acceptance of the view that organisations can create value by better managing natural, human, social and other forms of capital. Increasingly, the performance of companies is being scrutinised from a perspective that recognises these other forms of capital. That being the case, it is important for companies to demonstrate their commitment to appropriate corporate practices.[17]

3.25 The committee notes that there is a mounting body of anecdotal evidence which suggests a link between companies that take account of broader stakeholder interests and positive long-term financial performance. Several submissions referred to the detailed meta-analysis carried out by Orlitzky and Rynes, which integrates 30 years of research of 52 previous studies.[18] This report, which appears to be the most comprehensive study in the field, concluded that 'corporate social performance and financial performance are generally positively related across a wide variety of industr[ies].'

3.26 KPMG commented that hard proof that corporate responsibility benefits shareholder value remains elusive, but noted that there is a growing body of circumstantial evidence. KPMG indicated the difficulties of drawing a link:

> It has not yet been possible to make a strong, causal, quantitative link between corporate responsibility actions and financial indicators such as

15 Mr Stephen Brammer, University of Bath; Mr Chris Brooks, Cass Business School; and Mr Stephen Pavelin, University of Reading, *Corporate Social Performance and Stock Returns: UK Evidence from Disaggregate Measures,* June 2005, p. 13.

16 CPA Australia, *Submission 103b*, p. 19.

17 ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 59.

18 For example Dr Zappalà, *Submission 2*, Mr Turner, *Submission 5*, the Hon Dr Ken Coghill, Dr Leeora Black, Mr Dough Holmes, *Submission 71*, Mr Ben Neville, *Submission 87*, and Amnesty International, *Submission 90*.

> shareholder wealth. Some correlations have been shown to exist, but that does not necessarily demonstrate a causal link.[19]

3.27 It should be noted that because of the relatively recent emergence of the concept of corporate responsibility, and the fact that 'responsible corporate behaviour' is said to be a value proposition for companies in the longer-term, it is premature to conclude that there is any definitive connection between 'responsible corporate behaviour' and improved financial performance.

Attracting investment

3.28 The strong performance of sustainable investment funds and the emergence of sustainability market indices provide further evidence of a link between corporate responsibility and positive long-term financial results. Such targeted investment is also one of the strongest drivers of corporate responsibility and is likely to become more influential in the future. This is a classic demand-driven phenomenon. When a significant number of investors put a value on corporate responsibility, corporations respond by trying to satisfy that demand.

3.29 An earlier chapter of this report has referred to the significant increase over recent years in Australian funds managed as sustainable investments (known as Sustainable Responsible Investment (SRI)), outlining increases in SRI in excess of 2000 per cent over the last five years.[20]

3.30 Mainstream investors are also responding to the growing demand for SRI products. The Treasury noted in its submission that '[a]ll four major banks and several of the larger institutional investment houses have introduced socially responsible investment funds.'[21]

3.31 A recent survey of mainstream professional investors found that within five years, 44 per cent of Australian investment managers expect the integration of social and/or environmental corporate performance indices will be common place (and rising to 94 percent within 10 years).[22] This view is further supported by evidence from groups such as the Australasian Investor Relations Association which submitted that 'corporate social performance is increasingly a factor in shareholders' investment decisions and in financing decisions of financial institutions.'[23]

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19 KPMG, *Submission 53*, p. 2.

20 Ethical Investment Association, *Sustainable responsible investment in Australia 2005*, p. 5.

21 Department of the Treasury, *Submission 134*, p. 8.

22 Mercer Human Resources Consulting, *SRI: What so investment managers think?* 21 March 2005, http://mercerhr.be/summary.jhtml;jsessionid=04AXPUGEXMNR4CTGOUGCHPQKMZ0QYI2C?idContent=1174905 (accessed 1 June 2006).

23 Australasian Investor Relations Association, *Submission 97*, p. 2.

3.32 One of the reasons for this trend is that mainstream institutional investors, in seeking to understand better a company's overall risk profile, are giving greater consideration to the business risks posed by environmental and social factors when determining the overall value of a company. These considerations are increasingly being reflected in a company's underlying financial performance. Institutional investors, and their position in relation to corporate responsibility, are discussed further in chapter 5.

3.33 As access to investment capital is extremely important to a company's ability to continue its ongoing activities and to expand into new ventures, companies are giving serious consideration to this new investment market dynamic. In this regard, the ASX's Corporate Governance Council has stated that 'demonstrably good corporate governance practices are increasingly important in determining the cost of capital in a global capital market.'[24]

3.34 A recent KPMG business survey on sustainability reporting in Australia found that 59 per cent of respondents cited 'gain[ing] confidence or investors, insurers and financial institutions' as a key benefit of sustainability reporting.[25]

3.35 The increase in sustainability indices is also an indicator of the investment market's growing interest in good corporate behaviour. According to the Finance Sector Union:

> [t]he growing profile of various ratings agencies who provide assessments of companies' activities according to various ethical, environmental, labour, safety criteria are a strong sign that the market and society are increasingly interested in the 'non-financial' aspects of a company's behaviour.[26]

Attracting and retaining employees

3.36 Many submissions recognised that employees are a strong driver of corporate responsibility. In its submission, ANZ recognised the contribution of employees, stating that 'arguably our people invest more in the company than the shareholders'.[27] Companies seeking to be an 'employer of choice' are using corporate responsibility initiatives to bolster their claim. In particular, submitters indicated that corporate responsibility improved three important aspects of developing and maintaining a high-quality workforce: recruitment, motivation and retention of staff.

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24 Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003, p. 4.

25 KPMG, *Submission 53*, p. 3. The report, *The State of Sustainability Reporting in Australia 2005*, was commissioned by the Department of the Environment and Heritage and is available from http://www.deh.gov.au/settlements/industry/corporate/reporting/survey.html.

26 Finance Sector Union of Australia, *Submission 24*, p. 3.

27 ANZ, *Submission 101*, p. 3.

Recruitment

3.37 Employees are becoming more discerning of a prospective employer's responsible workplace practices (such as corporate volunteering and giving programs) as well as its broader social and environmental performance. For example, KPMG noted:

> [a] new generation of employees, and especially graduate recruits are more acutely aware of social responsibility and care about how potential employers go about their business.[28]

3.38 This view was supported by the Australian Institute of Company Directors (AICD) which stated:

> [s]ometimes now you get employees that you are recruiting asking you what you do in [the area of corporate responsibility], because they want to feel proud about the organisation that they join. So there is that positive pressure.[29]

Motivation

3.39 Maintaining employee motivation was cited by the BCA as a driver for corporate responsibility. BCA quoted Mr John McFarlane, ANZ CEO:

> Turning staff into stakeholders… How people feel about working at an organization and how passionate and engaged they are in its agenda, is what makes the difference between good and great companies.[30]

3.40 The partnership between the ANZ Mortgage Group and Habitat for Humanity Australia provided an excellent example of the way in which a company's social engagement can improve staff morale:

> Through our day to day business at ANZ Mortgage Group, we put more than 150,000 families into homes each year. And, yet, the support we provide to Habitat for Humanity Australia, which enables it to place but three families in homes each year, touches the hearts and minds of our staff significantly more.
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> Our association with Habitat for Humanity Australia has enabled our staff, through their generosity of spirit, to help with the projects and to touch the lives of those families in need—often in small ways, but making a huge difference to those families.[31]

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28 KPMG, *Submission 53*, p. 1.

29 Mr Tony Berg AM, Member, Corporate Governance Committee, Australian Institute of Company Directors, *Committee Hansard*, 23 November 2005, p. 95.

30 Business Council of Australia, *Submission 108*, p. 16.

31 Habitat for Humanity, *Submission 125*, p. 13, quoting Mr Chris Cooper, Managing Director, ANZ Mortgage Group.

Retention

3.41 In evidence, Westpac provided the example of paid maternity leave as one way it responds to the driver of staff retention:

> It costs us about $50,000 or $60,000 to replace somebody, basically, by the time they are trained, accredited and brought up to standard. We are talking about why paying maternity leave is a positive value generator for us compared to where we were, and how that has absolutely increased the return-to-work rate and retention.[32]

3.42 Alcoa supported this view and has implemented a number of programs to support flexible workplace arrangements which are said to 'not only promote a diverse workforce, they also help retain valuable corporate experience and knowledge.'[33]

3.43 Employment considerations such as recruitment, motivation and retention are likely to become a more influential driver of corporate responsibility as competition for talented and experienced employees intensifies and as labour markets are further liberalised.

Reputation

3.44 Corporate reputation has become one of the more valuable intangible company assets. A strong company reputation provides a real opportunity for brand differentiation in increasingly commoditised markets.

3.45 Maintaining and improving company reputation was cited by the majority of submissions as a key driver of corporate responsibility. This view is supported by the KPMG Australian company survey, which showed that reputation enhancement was the most popular key benefit of sustainability reporting (cited by 86% of respondents).[34] In its submission, KPMG also made the point that intangible assets such as reputation underlie the value of a company's physical assets.[35]

3.46 The issue of reputation management is treated very seriously by companies such as Shell Australia. Shell summarised the impact of reputational risk in the following way:

> Those companies that [manage well their approach to corporate social responsibility, sustainable development and to reputation enhancement] will be ultimately rewarded for doing so, while those that don't will suffer the reputational and, ultimately, business costs for not doing so.[36]

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32 Dr Noel Purcell, Group General Manager, Stakeholder Communications, Westpac Banking Corporation, *Committee Hansard*, 23 November 2005, p. 106.

33 Alcoa World Alumina Australia, *Submission 78*, p. 13.

34 KPMG, *Submission 53*, p. 3.

35 KPMG, *Submission 53*, p. 1.

36 The Shell Company of Australia, *Submission 74*, p. 9.

3.47 Shell's submission went on to explain that:

> in Australia, the Chairman has specific tasks under the terms of his appointment which require him to provide assurance to [the Shell parent company] that due attention has been given to the interests of stakeholders as an essential part of managing Shell's reputation.[37]

3.48 The association between a company's reputation and its non-financial risk and performance was highlighted by BT Governance Advisory Service (BTGAS):

> Companies that do not manage community, customer and employee expectations are exposed to boycotts, protests and negative media attention all of which lead to reputation damage for the company.[38]

3.49 Corporate decision-making that ignores or disregards social and environmental impacts can very rapidly tarnish a company's good reputation, a reputation that may have taken years to develop. Recent corporate scandals clearly demonstrate how companies that disregard the social and environmental impacts of their actions risk their sales performance, share price, and regulatory intervention.

3.50 Even the threat of litigation can be damaging to a company's reputation. A recent report on the increased risk of litigation against corporations in environmental areas (such as climate change) and social areas (such as human rights) points out that litigation can be damaging to a company's reputation even when the litigation is unsuccessful.[39] Acquittal of itself is not necessarily a shield against the risk of reputational damage.

Risk management

3.51 Risk management and minimisation was mentioned by many participants in the inquiry as a driver for corporate responsibility. Research and rating consultants RepuTex defined corporate and social responsibility in terms of risk management:

> [Corporate responsibility] may be ... defined as a form of management to minimise conventional notions of non-financial risk in areas such as governance, environmental and social impact and workplace practices. Sound management in such areas controls risk, increases productivity and provides enhanced business opportunities. Companies which engage with the community and adopt a sincere CSR management approach gain an advantage from an enhanced capacity to be aware of and control risk associated with new or altered demands from government regulators, employees, community stakeholders, shareholder activists and consumers.[40]

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37 The Shell Company of Australia, *Submission 74*, p. 9.

38 BT Governance Advisory Service, *Submission 19*, p. 1.

39 SustainAbility, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability*, January 2005.

40 RepuTex Ratings & Research Services, *Submission 86*, p. 2.

3.52 RepuTex also expressed the view that companies managing their non-financial risk were better placed competitively than those who did not:

> Minimising non-financial risk ultimately places a company in a stronger, more sustainable market position than an unengaged competitor who is likely to be exposed to a greater number of external variables.[41]

3.53 BTGAS argued that risk management involved managing stakeholder expectations:

> We believe that companies that manage their stakeholders' interests are managing their shareowners' interests, especially over the long-term. This arises from the fact that risks to companies arise not just from typical financial risks but also from regulatory, community and litigation risks. By managing stakeholder expectations, companies begin to manage many of these risks.[42]

3.54 BTGAS went on to comment that not all companies are managing non-financial risks as well as they could, and that:

> Organisational decision makers need to pay more attention to longer term sustainability and governance risks that give rise to community, regulatory and litigation risks.[43]

3.55 The Chamber of Commerce and Industry Western Australia argued that investment analysts were taking account of a company's management of its non-financial risks:

> More hard-nosed corporate investment analysts have also turned their attention to the social, ethical and environmental practices of the businesses they invest in, driven not so much by desire to penalise behaviour deemed immoral, as by concern for the financial risks associated with it. In part this may reflect under-estimation of risk in the past. But it seems to be driven more by the fact that the financial penalties associated with being held guilty of improper behaviour are much greater than ever before, whether guilt is in the eyes of the public, NGOs, or the courts. Boards and directors, as well as shareholders and investment analysts, are reacting to this changed risk environment.[44]

3.56 Corporate responsibility has encouraged corporations to move into performance audits. Traditionally (unlike the public sector) corporations have focussed almost entirely on financial audits, so avoiding broader risk appraisal. Performance audits are better at exposing longer term risks than financial audits.

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41 RepuTex Ratings & Research Services, *Submission 86*, p. 2.

42 BT Governance Advisory Service, *Submission 19*, p. 2.

43 BT Governance Advisory Service, *Submission 19*, p. 3.

44 Chamber of Commerce and Industry of Western Australia, *Submission 92*, p. 9.

Corporate failures

3.57 Another factor influencing the take-up of a corporate responsibility agenda has been the reaction to recent corporate scandals and collapses. A number of submissions referred to cases such as HIH in Australia, and Enron and WorldCom in the US, which have influenced perceptions of corporations by the community, by other corporations, and by financial markets.

3.58 Mr Turner argued that poor corporate behaviour has raised the profile of the corporate responsibility movement:

> The corporate social responsibility (CSR) movement ... has gained momentum through corporate disasters such as the Exxon-Valdez oil spill in Alaska in 1989, the increased strength of non-governmental organisations (NGOs) and publicity given to anti-globalisation and anti-big business movements. When added to the general increase in the social and environmental conscience of society, and all time low consumer trust of big business following the corporate collapses and accounting scandals of the last five years, CSR has emerged as the debate of the next decade.[45]

3.59 Ms Cox referred to the effect these collapses have on organisations and the pressures created for greater accountability:

> The collapses a few years ago of some large corporations and the problems others have with their reputations ... raise some serious questions about ethics and how organizational cultures affect corporate structures and governance. These added to increasing political and consumer pressures on both commercial and non commercial organizations and corporations for greater accountability and transparency.[46]

3.60 Corporate failures and scandals have led for calls for increased regulation by governments and market regulators, and this in itself can prompt some corporations to engage more with a corporate responsibility agenda, in order to forestall regulatory responses.

3.61 The investment sector has also responded to corporate collapses. A submission from researchers at Monash University argued that in the wake of several high profile corporate collapses there is an increasing tendency for institutional investors to take a more activist stance, thus creating a push for responsible corporate behaviour.[47] The researchers noted, however, that:

> To date however, such engagement has tended to be ad hoc and reactionary, occurring after the event or in response to stakeholder pressure rather than an integral component of investment strategy.[48]

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45 Mr Richard Turner, *Submission 5*, p. 2.

46 Ms Eva Cox, *Submission* 26, p. 1.

47 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Doug Holmes, *Submission 71*, p. 56.

48 The Hon Dr Ken Coghill, Dr Leeora Black, Mr Doug Holmes, *Submission 71*, p. 48.

Community expectations and licence to operate

3.62 The concept of a company's 'community' or 'social' 'license to operate' was raised in several submissions. By effectively engaging with the communities in which they operate, companies gain tacit permission to continue in operation. BTGAS provided this description:

> Community risk: community stakeholders often determine what is referred to as a ‘social license to operate’. If companies do not manage the expectations of the communities in which they operate they will not retain or gain the social license necessary for operation.[49]

3.63 A community licence to operate was mentioned with particular reference to the mining industry. The Centre for Corporate Public Affairs related how:

> The mining industry in Australia was one of the first sectors to lead the way in CSR activity in the 1970s and early 1980s, after stakeholders demanded it better engage the communities in which it operated. The key issues the community wanted addressed were land access, indigenous employment and environmental impact. These issues were linked with the social and community license to operate.[50]

Avoidance of regulation

3.64 The desire by business to avoid regulatory responses by governments was also identified as a driver of corporate responsibility. By taking voluntary action to improve corporate conduct, corporations may forestall regulatory measures to control their conduct. The BCA submitted:

> Poor corporate behaviour ... increases the risk of regulatory intervention by Governments. In most cases, it will be less costly for corporations to resolve issues themselves, rather than have regulation imposed. Even where regulation is being imposed, the standing of corporations in the community will determine their ability to influence the regulatory outcome. Poor corporate behaviour therefore increases regulatory risk.[51]

3.65 BTGAS commented:

> Regulatory risk arises when community risks are so great governments respond by developing policies and regulatory mechanisms to curb a particular activity or introduce taxes or pricing incentives to restructure the burden of the costs away from external stakeholders and towards the business. This not only has the potential to create direct cost imposts on a company but also increases the transition costs through compliance with the regulation.[52]

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49 BT Governance Advisory Service, *Submission 19*, p. 1.

50 Centre for Corporate Public Affairs, *Submission 135*, p. 3.

51 Business Council of Australia, *Submission 108*, p. 27.

52 BT Governance Advisory Service, *Submission 19*, p. 1.

3.66 The Prime Minister recognised this risk of increased regulation in a 1999 speech:

> Companies and industries which are trusted and respected in the community for doing the right thing are likely to find themselves less constrained by government pressures or regulatory intervention, or pressure from interest groups and the community generally.[53]

Globalisation

3.67 Globalisation was raised as a factor driving corporate responsibility, influencing the corporate response in several different ways. Mr Cooper of ASIC argued that the forces of globalisation were one factor that was already driving corporate responsibility.[54] Mr Cooper pointed out that companies with operations in several countries were influenced by trends and regulatory systems around the world. He used the example of BHP Billiton:

> [BHP Billiton] operates around the world, including in the US, so as an entity it absorbs a lot of these principles of regulatory systems. What tends to happen is that it brings the whole entity up to the highest level of regulation in any one of those areas...[55]

3.68 Oxfam noted that the increasing conduct of business on a global basis has been a driver for corporate responsibility. Oxfam's Mr Ensor expressed the view that much of the trend towards adopting a corporate social responsibility agenda has been in response to the recognition by global companies that poor environmental and social performance can affect bottom lines.[56] He told the committee:

> [the initiative around the CSR agenda] ... has occurred principally in Europe. A lot of it has been driven from Europe [and] because of the globalised nature of business, the joint listing of companies on various stock exchange indices across Europe, the US, the UK, and Australia, that has been part of the driver. ...[O]ur experience is that, relatively speaking, the better performance tends to be with globalised companies with very high brand risk profiles in terms of reputation that can translate into the bottom line very quickly.[57]

3.69 The Australasian Investor Relations Association pointed out that when looking for investment opportunities globally (including in Australia), the

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53 The 1999 Corporate Public Affairs Oration presented to the Centre for Corporate Public Affairs by the Prime Minister, the Hon John Howard MP, Melbourne, 26 March 1999, available at http://www.pm.gov.au/News/Speeches/1999/corppubaffairs2603.htm.

54 Mr Jeremy Cooper, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 29 March 2006, p. 11.

55 *Committee Hansard,* 29 March 2006, p. 23.

56 Mr James Ensor, Director, Public Policy and Outreach, Oxfam Australia, *Committee Hansard,* 24 February 2006, p. 35.

57 *Committee Hansard,* 24 February 2006, pp 35–36.

international investment sector was influenced by the non-financial, sustainability performance of companies.

> ...at the end of the day the investment community increasingly is a global industry and it looks for the same types of [non-financial] information. Whether it be an analyst sitting in Boston or a fund manager sitting in Frankfurt or a fund manager sitting in Melbourne, they do consider the same sorts of information sets whether financial ... or, increasingly, non-financial. Perhaps to a lesser extent it is non-financial but I think the information that the investment community and other stakeholders are looking for is largely the same.[58]

3.70 The free flow of information globally was also cited by some as an influencing factor. Mr Ensor of Oxfam described how modern technology facilitated the rapid flow of information, and also facilitated the involvement of the media in reporting company behaviour:

> One of the fundamental drivers of this agenda is [the] element of globalisation that enables there to be such a rapidly instantaneous flow of information analysis around the world. I can receive an email from a remote village in the middle of West Papua containing detailed information about an event that may have happened two or three hours ago. I have the capacity to get that information on to page 1 of the New York Times within a 10- or 12-hour period in theory. That aspect of globalisation has fundamentally driven the CSR agenda.[59]

3.71 Finally, globalisation is significantly increasing the rate of sustainability reporting observed in Australia. According to a recent study by the Centre for Australian Ethical Research, the rate of production of sustainability reports by foreign owned companies operating in Australia is more than twice that of Australian owned companies.[60]

Principles of corporate responsibility

3.72 The evidence presented to the committee on factors that drive corporate responsibility indicates that there is a wide range of influences governing the behaviour of companies and organisations. Also emerging from the evidence were some common themes regarding the principles that should underlie corporate responsibility. This section discusses these principles.

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58 Mr Ian Matheson, Australasian Investor Relations Association, *Committee Hansard,* 27 March 2006, p. 5.

59 Mr James Ensor, Director, Public Policy and Outreach, Oxfam Australia, *Committee Hansard*, 24 February 2006, p. 35.

60 Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia 2005*, March 2006, p. 27.

Business led or government led?

3.73 A theme emerging in evidence to the committee was an industry preference for corporate responsibility to be led by business, and not imposed by government. Evidence regarding factors that drive corporate responsibility presented earlier in this chapter indicates that long-term sustainability practices are already being taken up by business, responding largely to market forces, rather than to any push from government.

3.74 Ms Mostyn of IAG told the committee that government had a role in providing the right environment for companies to engage with sustainable business practices:

> [by] providing an environment where companies are encouraged to create innovative corporate responsibility and sustainability approaches by providing for flexibility, competitive and market led developments.[61]

3.75 Similarly, GlaxoSmithKline representative Mr Gosman expressed support for government activities that encouraged corporate responsibility:

> We believe that the role of government is essentially one of encouragement rather than mandatory reporting or the prescribing of activities. In that respect, activities that encourage companies to take an interest in this area, such as the Prime Minister's corporate social responsibility awards, are what we believe is needed to go forward. We very much favour a voluntary approach rather than a mix of prescriptive or proscriptive regulations.[62]

3.76 The role of government in encouraging corporate responsibility is discussed in some detail in chapter 8.

Mandatory or voluntary?

3.77 Central to the question of business versus government as the driver for corporate responsibility is the issue of whether sustainable behaviour should be mandatory or voluntary. The committee received much evidence regarding the appropriateness of measures to mandate corporate responsibility and was told more than once that it is not possible to mandate good corporate behaviour. For example, Westpac's Dr Purcell argued that:

> ...it is difficult, if not impossible, to mandate good values based business behaviour through legislation or regulation—and there are plenty examples of that. In the future if there is inadequate corporate progress in adopting

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61 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 4.

62 Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 44.

responsible business practices there may be a case for considering non-prescriptive type approaches.[63]

3.78 The St James Ethics Centre expressed the view that mandating corporate responsibility was not appropriate:

> 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. ... 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.[64]

3.79 Some evidence to the committee questioned whether voluntary mechanisms were sufficient. The Brotherhood of St Laurence, for example, commented that:

> ...many of the initiatives taken by enterprises to demonstrate that they are good corporate citizens or to demonstrate their commitment to CSR have been through the introduction and application of voluntary mechanisms. While voluntary mechanisms are a useful starting point and a useful tool to help harness an enterprise's thinking about CSR, we have seen that in reality they are not adequate to guarantee that an enterprise's risk management strategies will be met, their brand will be protected and ... in supply chain management, labour standards will be upheld.[65]

3.80 The Australian Network of Environmental Defenders Offices also doubted the effectiveness of voluntary mechanisms, and argued in favour of regulation:

> The position at the moment ... is essentially based on voluntary codes and mechanisms of that ilk. Such codes, as we have seen, are not binding. They are practised by a few large corporations, and they are not regularly independently monitored. Such codes are problematic. I think most people, and perhaps even corporations privately, would concede that fact. We need to move beyond this to clear and enforceable rules that would allow for a level playing field and produce better outcomes.[66]

3.81 The mandatory versus voluntary debate is discussed further elsewhere in this report. It is discussed in chapter 4 in the context of directors' duties, in particular the option of changing those duties to require that the interests of stakeholders other than shareholders be taken into account. A discussion of mandatory versus voluntary sustainability reporting is included in chapter 7.

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63 Dr Noel Purcell, Group General Manager, Stakeholder Communications, Westpac Banking Corporation, *Committee Hansard*, 23 November 2005, p. 98.

64 St James Ethics Centre, *Submission 50*, pp 5–6.

65 Ms Serena Lillywhite, Manager, Ethical Business, Brotherhood of St Laurence, *Committee Hansard*, 24 February 2006, pp 19–20.

66 Mr Jeffrey Smith, Chief Executive Officer, Australian Network of Environmental Defenders Offices, *Committee Hansard*, 9 March 2006, p. 111.

A medium to long-term outlook

3.82 Another theme emerging in evidence was that there was a tendency for capital markets to focus on companies' short-term gains, which militated against the medium to long-term view of sustainability and profitability that was required to engage with a corporate responsibility agenda. This 'short-termism' was raised by many submitters as a barrier to increasing the uptake of sustainable behaviour.

3.83 Mr Berg of the AICD told the committee that there are a lot of pressures in the market for short-term financial performance:

> Companies are being encouraged to give guidance as to what their results will be and then obviously there is a lot of pressure to meet the guidance that has been given. The markets have tended to punish companies that fall short of profit forecasts, whether they have given the guidance or whether it has just been the market forecast. Their share price is often punished quite severely when they fall short. Inevitably amongst top management and boards there is quite a focus on that short-term performance.[67]

3.84 Ms Mostyn of IAG echoed this view, and pointed out that pressure for short-term performance was great when shares were traded on a daily and hourly basis:

> [There is a] need to get away from this rampant short termism that is driven by markets where trillions of dollars are washed in and out through day traders where it does not matter that we have a long term view; they are looking at a share price differential on a daily, or even hourly, basis.[68]

3.85 Mr Mather of BTGAS even pointed out that existence of so-called 'minute traders' or 'minute investors', 'seeking to arbitrage a moment in time.'[69]

3.86 Other market forces are also apparent that encourage a short term view. Directors and senior executives are often provided incentives through their remuneration arrangements to pursue short term company profits. The committee heard evidence that these incentives can negatively impact a company's long term performance. On the other hand, the committee also heard evidence that some companies are making a positive link between corporate responsibility performance and remuneration packages. For example:

> there is one building materials company that I can think of whose chief executive suffers a seven per cent diminution in their performance bonus for a death in the workplace, and that is cumulative. So, in that instance—

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67 Mr Tony Berg AM, Member, Corporate Governance Committee, Australian Institute of Company Directors, *Committee Hansard*, 23 November 2005, p. 90.

68 Ms Sam Mostyn, Group Executive, Culture and Reputation, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 16.

69 Mr Erik Mather, BT Governance Advisory Service, *Committee Hansard*, 10 March 2006, p. 68.

> and this is an adverse example—if 13 people died, you would get no bonus.[70]

3.87 However BTGAS pointed out that this was the exception rather than the rule.

3.88 Ms Mostyn of IAG argued that markets needed to take a longer term view:

> Corporate responsibility and sustainability only work if those markets begin to take notice of these issues and move their investments accordingly and show the value over time to their investors.[71]

Integration into company core business and strategy

3.89 Evidence received by the committee over the course of the inquiry strongly underlined the importance of integrating the consideration of broader community interests into the core business strategy of companies, if corporate responsibility was to succeed.

3.90 A number of companies told the committee that corporate responsibility was central to their core business, rather than being an add-on or a 'sideshow'. For example, IAG told the committee:

> We actively make sustainability central to our core business by embracing opportunities and managing risks deriving from the full range of economic, environmental and social factors that interact with and impact on our operations every day.[72]

3.91 The National Australia Bank emphasised that corporate responsibility was not a side function:

> By having CSR embedded into our group strategy function ... the two are intertwined and that we cannot look at strategic issues, such as how we expand, without taking into account CSR. We have not made it a side function; we have integrated it with our group strategy activities and given it significant prominence organisationally.[73]

3.92 The ANZ Bank also took this view:

> The core point from ANZ's perspective is that what we have sought to do at ANZ is infuse our business strategy with corporate responsibility issues or perspectives as opposed to the reverse, which is to have a stand-alone corporate responsibility strategy. We have sought to integrate the relevant

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70 Mr Erik Mather, BT Governance Advisory Service, *Committee Hansard,* 10 March 2006, p. 72.

71 Ms Sam Mostyn, Insurance Australia Group, *Committee Hansard*, 9 March 2006, p. 16.

72 *Committee Hansard*, 9 March 2006, p. 3.

73 Mr Cameron Clyne, Executive General Manager, Group Development, National Australia Bank, *Committee Hansard*, 5 April 2006, p. 6.

issues into our business strategy and make them a very important part of that approach.[74]

3.93 Westpac said of its approach:

> Corporate responsibility is at the heart of Westpac's business model. Consequently, there is no corporate responsibility or sustainability strategy as such; rather this is integrated into the core business strategy. In turn, corporate responsibility is built into strategic decision-making across the business.[75]

3.94 Wesfarmers' representative Mr Kessell emphasised the importance of embedding sustainability reporting mechanisms into company culture:

> I have no hesitation in saying that [data collection, analysis and reporting] is now totally a part of the culture of the company, right from the managing director of Wesfarmers, through his managing directors into the general managers and down to supervisors, who are asked to provide the data to go into this report. It is part of the way of doing business.[76]

3.95 Despite the positive approaches taken by some companies, some submitters expressed concern that Australian companies were lagging behind in engaging properly with corporate responsibility. Mr O'Donoghue of the Australian Council of Social Service (ACOSS), which conducted extensive research into rates of workplace giving in 2005, told the committee:

> In our view, corporate social responsibility should be seen as part of good governance. I think that Australia has got a long way to go in terms of integrating corporate social responsibility initiatives into general decision making and good governance in corporations.[77]

3.96 The Smith Family supported an increase in the number of companies moving towards integrating corporate responsibility into their core business:

> ...the Smith Family supports and encourages the position that the time has arrived for a greater number of Australian companies to move from viewing CSR as a minimum standard to an integrated component of strategy and operations in providing leadership in the continuing development of a distinctive model of corporate social responsibility.[78]

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74 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group, *Committee Hansard*, 5 April 2006, p. 35.

75 Westpac Banking Corporation, *Submission 94*, pp 10–11.

76 Mr Keith Kessell, Executive General Manager, Corporate Affairs, Wesfarmers, *Committee Hansard*, 20 February 2006, p. 48.

77 Mr Philip O'Donoghue, Deputy Director, Australian Council of Social Service, *Committee Hansard*, 23 November 2005, p. 65.

78 Dr Robert Simons, National Manager, Strategic Research and Social Policy, The Smith Family, *Committee Hansard*, 23 November 2005, p. 56.

Corporate responsibility is an evolutionary process

3.97 A strong message from the evidence received was that progress towards sustainable corporate behaviour for corporations is an evolutionary process, which requires flexibility to respond to changing expectations of the community, employees, and other stakeholders.

3.98 BHP Billiton described how influences such as community expectations shaped its approach to corporate responsibility:

> BHP Billiton's approach to Corporate Social Responsibility ("CSR") and associated public reporting has evolved over time, in step with our own experiences and perceptions of the environment within which we operate, community expectations communicated to BHP Billiton and, in some instances, regulatory requirements.[79]

3.99 Many companies used the analogy of a 'journey' when referring to their experiences with adopting responsible corporate practices and integrating them into core business. Ms Sheehan of Holden GM described that company's journey:

> Corporate social responsibility is a journey. ... [P]rior to 2001 our community programs were fairly ad hoc—it was basically chequebook philanthropy. What we wanted to do was try and come up with something that was better aligned with our business strategy. When we reviewed our community relations programs we decided that we should try and develop priority areas that were actually linked to the brand and to our business strategy. As we go down that corporate responsibility journey, that will get a better buy in from our stakeholders, including our internal stakeholders—our employees and the board.[80]

3.100 NAB representatives also referred to the journey of corporate responsibility:

> We recognise that it is a continuing journey... It is evolving all the time. The benchmark for what is good disclosure is moving all the time and so we have made a commitment to basically take ourselves on a continuous journey, improving where we can as we go.[81]

3.101 ANZ representatives told the committee that ANZ's corporate responsibility journey was one that unfolded over time, rather than being well-planned.[82] ANZ also referred to the impediments in changing company and staff practices, engaging with

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79 BHP Billiton, *Submission 13*, p. 1.

80 Ms Catherine Sheehan, National Manager, Corporate Responsibility, General Motors Holden, *Committee Hansard*, 5 April 2006, p. 29.

81 Ms Rosemary Bissett , Group Manager, Corporate Social Responsibility, National Australia Bank, *Committee Hansard*, 5 April 2006, p. 12.

82 Ms Jane Nash, Head of Government and Regulatory Affairs, Australia and New Zealand Banking Group, *Committee Hansard*, 5 April 2006, p. 44.

the community and empowering local branch staff. ANZ representative Mr Brown likened the process to changing the course of a supertanker:

> Organisations like ANZ are supertankers and they take a long time to turn around. Whilst we have started down that pathway, we still have a long way to go. ...[T]hings take a long time to flow through.[83]

3.102 Unilever Australasia referred to the 'long journey' of bringing capital markets to an understanding of the long-term benefits of sustainable practices.[84] This journey then is one undertaken not only by companies and their employees, but also by other stakeholders, such as institutional investors.[85]

One size doesn't fit all

3.103 The committee heard repeatedly that the range of companies and organisations of different sizes and from different sectors meant that it was inappropriate to apply a 'one-size-fits all' approach to corporate responsibility and any mechanisms used to encourage it.

3.104 The Australian Banker's Association emphasised that all companies were different, and that stakeholder interests could also be different:

> It is important to recognise that for companies to deliver greatest value for all stakeholders, a "one size fits all" approach does not adequately recognise the diverse and complex needs of all stakeholders. A "one-size-fits-all" approach to corporate responsibility or sustainability will not work due to the uniqueness of each business and the variation in strategic approach across companies. The dynamics of the relevant industry, market sector, operating environment, product or service means that each company is different. The real and comparative influence of, and priority assigned to, varying stakeholder interests will be different.[86]

3.105 GlaxoSmithKline also argued against a one-size-fits-all approach:

> We recognise that the concept of corporate social responsibility will mean different things for companies of different sizes and different sectors. Therefore, it is not really appropriate to have the one size fits all. ....appropriate types of corporate social responsibility activities will vary greatly across sectors. What makes sense to an organisation involved in the

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83 Mr Gerard Brown, General Manager, Corporate Affairs, Australia and New Zealand Banking Group, *Committee Hansard*, 5 April 2006, p. 43.

84 Mr Nicholas Goddard, Corporate Relations and Communications Director, Unilever Australasia, *Committee Hansard*, 9 March 2006, p. 8.

85 Ms Linda Funnell-Milner, Corporate ResponseAbility, *Committee Hansard,* 10 March 2006, p. 36.

86 Australian Banker's Association, *Submission 106*, p. 15.

> health care industry could be quite different to what makes sense to [those in] the resources industry.[87]

3.106 GlaxoSmithKline's submission commented that one-size-fits-all legislative approaches ran the risk of constraining other possible responses.[88]

Cost-effective, comparable, and transparent sustainability reporting

3.107 Other principles that emerged during the inquiry related primarily to sustainability reporting. Many submitters argued that any sustainability reporting mechanisms, whether voluntary or mandatory, had to be cost-effective, comparable across companies, and transparent. These issues are discussed separately in chapter 7.

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87 Mr Alex Gosman, Director, Government and Corporate Affairs, GlaxoSmithKline, *Committee Hansard*, 23 February 2006, p. 45.

88 GlaxoSmithKline, *Submission 49*, p. 3. See also the Group of 100 *Submission 27*, p. 3.