CORPORATE SOCIAL RESPONSIBILITY:
SHOULD DISCLOSURE OF SOCIAL CONSIDERATIONS BE MANDATORY?

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ABSTRACT

Corporate social responsibility is fast becoming a major factor in corporate regulation around the world. One issue is whether listed companies should be made to disclose information about their social and environmental practices, policies and performance to the market. This question has been given very little attention in the Australian context. This paper aims to answer the question of whether listed companies in Australia should be made to disclose social and environmental information. Firstly, this paper establishes the necessary definitions and provides a brief overview of the corporate social responsibility movement. A review of the existing literature is then undertaken. The current regulatory framework in Australia is then established, considering both "hard" and "soft" law initiatives. The current levels of social and environmental disclosure provided by Australian companies is examined, and compared with other modern jurisdictions. Importantly, the quality of voluntarily disclosed social and environmental information is explored. Having established the current law and practice, this paper then examines two arguments for mandatory social and environmental disclosure: (i) that social and environmental information is considered material by a significant proportion of the investing public; and (ii) that Australia needs to introduce mandatory social disclosure to protect and enhance our national competitiveness. The effects of introducing mandatory social disclosure are considered, and criticisms addressed. The paper then explores the regulatory options available to introduce mandatory social disclosure. Finally, the paper briefly examines how mandatory social disclosure could be coupled with other "non-regulatory activist" initiatives to provide a pluralist approach to corporate social responsibility regulation.

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LIST OF ABBREVIATIONS

ASIC	Australian Securities and Investments Commission
ASX	Australian Stock Exchange
CERES	Coalition for Environmentally Responsible Economies
CSA	Canadian Securities Administrators
CSR	Corporate Social Responsibility
DJSI	Dow Jones Sustainability Index
EMS	Environmental Management System
FTSE	Financial Times Stock Exchange
G100	The Group of 100
GRI	Global Reporting Initiative
JSE	Johannesburg Securities Exchange
MD&A	Management discussion and analysis
NRE	Nouvelles Regulations Economiques
NYSE	New York Stock Exchange
OECD	Organisation for Economic Cooperation and Development
OFR	Operating and Financial Review
PMCBP	Prime Minister's Community Business Partnership
SEC	Securities and Exchange Commission
SRI	Socially responsible investing
TBL	Triple Bottom Line
UNEP	United Nations Environmental Programme

Introduction

'… with the increased power of corporations come[s] increased responsibility, and increasingly now the community is requiring that we deliver for all stakeholders and that we report transparently and in a trustworthy fashion on our broader impact on society'

David Morgan, CEO of Westpac[1]

As corporations gain increasingly more power and influence, their role in society has come under increased scrutiny. Do corporations owe a wider duty than the traditional view of profit maximisation for shareholders? The corporate social responsibility **(CSR)** movement, which answers "yes" to this question, 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. Many believe the revolution will ride in on the coat-tails of the current corporate governance reforms, and will be the next area of scrutiny, reform and controversy.

The focus of this paper, the disclosure of social and environmental practices by listed corporations, forms part of the greater CSR debate. This paper aims to examine the question of whether listed corporations should be forced to disclose information about their social and environmental practices to the public.

Chapter One will examine the CSR movement, its theoretical underpinnings, and how mandatory disclosure fits into the greater CSR debate.

Chapter Two will then examine the existing academic thinking in the field, with a focus on Cynthia A. Williams who has been a prominent and influential thinker in the United States.

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[1] ABC PM program, 18 July 2002.

Chapter Three will examine the current law in Australia, which permits but does not mandate social disclosure. The various "soft" law initiatives will also be canvassed.

Chapter Four will examine the quantity and quality of social and environmental information currently being disclosed in Australia. It will be seen that disclosure is at unacceptably low levels, especially when compared with other countries, and what is disclosed is biased and of little utility at best, and misleading at worst.

Chapter Five will argue that social and environmental information *must* be disclosed as there is strong evidence that such information is material to the investment choices of a significant sector of the investing public. Hence, disclosure is required to support market efficiency and investor empowerment and confidence.

Chapter Six will argue that additionally there are other, public policy, justifications for mandating disclosure. After showing how Australia is lagging dangerously behind many other developed countries in regulatory initiatives and the prominence of the CSR debate, it is argued that mandatory disclosure is required to maintain and protect our national competitiveness. The principle reason being that high levels of social disclosure will increasingly be needed to remain competitive in the attraction of capital both into Australia generally, and into our companies more specifically.

Chapter Seven will briefly examine other possible public policy justifications such as the "business case" (ie. that companies do well by being 'good') and the role of social reporting in sustainability.

Chapter Eight will answers criticisms and examine issues which would be involved in the implementation of a mandatory disclosure system.

Chapter Nine examines the regulatory options for mandating social and environmental disclosure. It will be concluded that the most effective and practical option would be the introduction of disclosure requirements by the Australian Stock Exchange **(ASX)**, using a model similar to the recently introduced ASX Principles of Good Corporate Governance and Best Practice Recommendations.

Chapter Ten will briefly examine how this step should be part of a pluralist approach to CSR in Australia.

In writing this paper, the author has come to a number of conclusions which need to be addressed as Australia moves forward in the CSR arena. Firstly, much of the evidence and literature in this field is weak, incomplete, inconclusive or biased. There is a great need for academic thought and in particular empirical studies of the key issues in the CSR debate (being (i) do investors really consider environmental and social information to be material to investment choice? (ii) what is the attitude of corporations to CSR and reporting on it? and (iii) does the adoption of CSR practices lead to increased profits and share prices?). Secondly, Australia is alarmingly behind most other modern markets when it comes to CSR. Comparatively, our companies have very poor reporting practices, our Government has been very lethargic in putting CSR on the corporate policy agenda, and our Parliament has barely debated any legislative options or approaches in this realm. We need to pick up the pace!

Chapter 1

DEFINITIONS

1.1 Definition of "corporate social responsibility"

Of central importance to this paper is the definition of "corporate social responsibility" **(CSR)**. There is no real consensus or consistency as the labels and definitions used are 'fuzzy, varied and constantly evolving'.[2] Indeed there is not even consistency in name, as the terms "corporate social responsibility", "corporate social transparency", "triple bottom line", "corporate sustainability" and "social and environmental responsibility" are all used to refer to the same concept. The phrase "corporate citizenship" is also used to refer to notions of CSR.[3] These phrases will be used interchangeably in this paper. This inconsistency reflects the confusion in the movement itself. All this despite CSR being a 'global phenomenon'.[4]

The common threads of most definitions point to an analysis of the obligations of the corporation extending beyond the duty to maximise profits for shareholders. Harwell Wells defines the CSR debate as being

> whether the directors and managers of large, publicly held corporations should have a legal duty, when making decisions for the corporation, to take into account not only the needs of the shareholders but also other groups affected by the corporations' actions, such as its employees, customers, or the communities in which they are based.[5]

But importantly, not all CSR proponents argue for a legal duty to take into account non-shareholder stakeholders. As such, Dr Gianni Zappala more accurately captures the thrust of

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[2] Dr Gianni Zappala, 'Corporate Citizenship and the Role of the Government: the Public Policy Case', Working Paper no.4 2003-04, Politics and Public Administration Group, 2003, 1.

[3] Zappala uses the terms "corporate citizenship" and "corporate social responsibility" interchangeably. However, she does outline that in many circles, 'corporate citizenship' is seen as a more holistic approach and is a progression from CSR. Good corporate citizenship involves 'taking into account social, ethical, environmental, economic and philanthropic values in the core decision making processes'. See Ibid 3-4.

[4] Matt Tilling, 'Corporate Social Reporting – A Cook's Tour', (Research Paper Series 01-9, Flinders University School of Commerce, 2004), 4.

[5] Harwell Wells, 'The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century' (2002) 51 *University of Kansas Law Review* 77, 78.

CSR, defining it as 'understanding and managing a company's influence on society and all its stakeholders'.[6]

It is necessary to define who is a "stakeholder". Michelle Greenwood gives various definitions of "stakeholders", from the narrow definition that stakeholders are 'groups vital to the success and survival of organisation'[7] to the broader definition that stakeholders consist of 'group[s] or individual[s] who can affect or be affected by the organisation'.[8] A less technical approach has been taken in the CSR debate - the practice has been to specifically define the various stakeholder groups. The World Business Council defines stakeholders as including shareholders, employees, business partners, suppliers, pressure groups, local communities and the environment.[9] This has become the most widely accepted definition of stakeholders, and is used by many national governments including our own.[10]

For the purposes of this paper, CSR will be defined as a movement which argues that corporations owe obligations (legal or otherwise) to consider a wide range of stakeholders, including shareholders, employees, business partners, suppliers, pressure groups, local communities and the environment. Good "corporate citizenship" is taken to mean the practice of integrating CSR values into the core decision making process of a company.

1.2 The CSR debate

The core of the CSR debate revolves around the role of the corporation in society. Wells characterises CSR as a challenge to shareholder primacy.[11] The shareholder primacy doctrine stipulates that corporate managers have a single duty when managing a company, and that is to maximise profit for shareholders. Milton Friedman, one of the most famous proponents of shareholder primacy and free market forces, famously said:

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[6] Zappala, above n 2, 1.
[7] Michelle Greenwood, 'Community as a Stakeholder in Corporate Social and Environmental Reporting' (2001) 4 *The Journal of Corporate Citizenship* 31, 3.
[8] Ibid.
[9] World Business Council for Sustainable Development, *Corporate Social Responsibility: The WBCSD's Journey* (2002), 2.
[10] This is the definition used by the Prime Minister's Community Business Partnership (see 3.2.5), the Department of Environment and Heritage in *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators* (see 3.2.2) and the Department of Family and Community Services in *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Social Indicators* (see 3.2.3).
[11] Wells, above n 5, 80.

> There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition, without deception or fraud.[12]

In Australia, it is accepted that management only owes duties to the corporation, which is generally taken to mean the shareholders.[13] This is generally characterised as the duty of directors to act bona fide in the interests of the company as a whole.[14] Shareholder primacy is accepted as law in the US,[15] UK[16] and Canada.[17]

The debate about whether directors owe a duty only to shareholders, or to a wider range of stakeholders dates back to the 1930s, and is still raging today. A.A. Berle and E. Merrick Dodd debated the role of managers throughout the early thirties.[18] Many in the shareholder primacy "camp" cite Berle as the founder of the doctrine that the only duty of company directors should be profit maximisation for shareholders.[19] Although arguably this is an error.[20] The debate gained significant momentum in the 1970s as pro-CSR thinkers such as Ralph Nader, Mark Green, and Joel Seligman[21] and Christopher Stone[22] battled the likes of Friedman,[23] Henry Manne,[24] and David Engel.[25] Currently Cynthia Williams is the most

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[12] Milton Friedman, 'The Social Responsibility of Business Is To Increase Its Profits', *New York Times*, (New York, United States) 13 September 1970, 33.

[13] See: Dyson Heydon, 'Directors' Duties and the Company's Interests' in P D Finn (ed), *Equity and Commercial Relationships,* (1987), 120; Corporate Law Economic Reform Program, *Directors Duties and Corporate Governance,* Proposals for Reform No 3 (1997), 60; Harold AJ Ford, *Ford's Principles of Corporations Law*, (10th Ed, Butterworths, Melbourne, 2001), 305-306 ;and *Ngurli Ltd v McCann* (1953) 90 CLR 425, 438. There have been cases where management have been allowed to consider non-shareholder stakeholders in decisions (see *Kinsella v Russell Kinsela Pty Ltd (in liq)* (1986) 4 NSWLR 722, *Parke v Daily News Ltd* [1962] Ch 927, *Teck Corp v Millar* (1973) 33 DLR although there is doubt in relation to creditors after the decision in *R v Spies* 201 CLR 603 (2000), see: Andrew Keay, A, 'The Director's Duty to Take into Account the Interests of Company Creditors: When is it Triggered' (2001) *Melbourne University Law Review* 11).

[14] See: Ford, above n 13, 320-355.

[15] *Dodge v Ford Motor Company* 170 N.W. 668 (Mich. 1919) held that the 'corporation is organized and carried on primarily for the profit of the stockholders' (at 684).

[16] See: *Parke v Daily News Ltd* [1962] Ch 927, 963 (Plowman J).

[17] *Teck Corp v Millar* (1973) 33 DLR, 313, where Berger J of the Supreme Court of British Columbia held 'the classical theory is that the directors' duty is to the company. The company's shareholders are the company … and therefore no interests outside those of the shareholders can legitimately be considered by the directors' .

[18] See A A Berle Jr., 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049, E Merrick Dodd, Jr, 'For Whom Are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145 and the response: A A Berle, Jr, 'For Whom Corporate Managers Are Trustees: A Note' (1932) 45 *Harvard Law Review* 1365.

[19] Wells, above n 5, 81.

[20] What almost all people exclude is the qualifier undisputedly included by Berle. He could see corporate power becoming too centralised in the future as too much wealth would rest in the hands of too few corporations. Hence, he stated that in the future, directors should have responsibilities not only to shareholders, but to 'the workers, the consumers, and the State': Berle, 'Corporate Powers as Powers in Trust' above n 18, 1050. Furthermore, almost all people exclude the fact that Berle came to strongly advocate this position in the late forties and fifties. In fact, Berle went so far as to conclude 'the argument has been settled … squarely in favour of Professor Dodd's contention': A A Berle Jr., *The 20th Century Capitalist Revolution* (1954), 5.

[21] See: Mark Green, Ralph Nader, and John Seligman, *Taming the Giant Corporation* (1976).

[22] See: Christopher Stone, *Where the Law Ends: The Social Control of Corporate Behaviour* (1976).

[23] See Milton Friedman, *Capitalism and Freedom* (1962), and Friedman, Milton, *The Social Responsibility of Business Is To Increase Its Profits,* above n 12, 33.

[24] See: Henry Manne and Henry Wallich, *The Modern Corporation and Social Responsibility* (1972).

[25] See: David Engel, 'An Approach to Corporate Social Responsibility' (1979) 32 *Stanford Law Review* 1.

prominent pro-CSR proponent,[26] with Easterbrook and Fischel, and Hansmann and Kraakman maintaining the shareholder primacy position.[27] More recently an alternative theory has been proposed to regulate the role of corporate managers: the 'team production' theory developed by Blair and Stout.[28] Blair and Stout propose the role of the board as a "mediating hierarch", which is responsible for balancing the competing groups with claims to financial returns from the company (ie. managers, shareholders, employees).

While many proponents of CSR argue for a legal duty on corporations to consider non-shareholder interests, this does not represent the movement as a whole. Many proponents of CSR acknowledge the legal status quo of shareholder primacy, but argue that non-shareholder interests should be considered while striving to maximise profit. Cynthia Williams falls into this category of what may be labelled as "pro-shareholder primacy CSR proponents". The arguments put forth in this paper fall into this category, as there is no proposal to regulate corporate behaviour except for corporations to disclose to the public their social and environmental practices. Put bluntly, the author supports shareholder primacy but believes that corporations must disclose social and environmental information to the market. As such, the debate over the role of the corporation is not considered further in this paper but is included to provide context for the reader.

1.3 Definition of "social disclosure"

What must be noted as a starting point is that the term "social disclosure" is often used as an abbreviation for the more correct term "social and environmental disclosure". For convenience and consistency, this paper adopts this practice. Cynthia Williams gives a useful practical definition of "financial information" being *whether and to what extent* a company generates profits, and "social information" as bearing primarily on *how* a company generates profits.[29] For the purposes of this paper, social disclosure is defined as the disclosure of a company's practices, policies and performance in relation to social and environmental issues. As will be discussed later, there are various guides to social and environmental disclosure, such as the Global Reporting Initiative **(GRI)**[30] and Guides to Reporting Against Social and Environmental Indicators produced by the Australian government.[31]

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[26] See: Cynthia A Williams, 'The Securities and Exchange Commission and Corporate Social Transparency' (1999) 112 *Harvard Law Review* 1197, as will be discussed in greater detail in 2.2.2.

[27] See: Frank Easterbrook, and Daniel Fischel, *The Economic Structure of Corporate Law* (1991), and Henry Hansmann, and Reiner Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal.* 439.

[28] Margaret Blair, and Lynn Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

[29] Williams, above n 26, 1201.

[30] See Chapter 3.3.1.

[31] See Chapters 3.2.2 and 3.2.3, and Appendix A and Appendix B.

1.4 The role of "Triple Bottom Line" reporting

The use of the term "triple bottom line" **(TBL)** is widespread throughout CSR literature, and is particularly favoured in Australia. An examination of its' definition is instructive in that it neatly highlights the different emphasis that different people put on social reporting. Some see it as the provision of investment information, and some see it as a driver of corporate change in the internal dynamics of a corporation. TBL is often viewed as an accounting method that involves financial, social and environmental (ie. triple) reporting. The 'Group of 100'[32] **(G100)** define TBL as 'denot[ing] any form of communication of environmental, social and economic information to stakeholders'.[33] Many proponents of TBL see this as the narrow definition,[34] and argue that TBL is an 'integrated philosophy requiring a company to address its economic, social and environmental values, strategies and processes'.[35] John Elkington, the founder of the term,[36] describes this disparity:

> At its narrowest … Triple Bottom Line is used as a framework for measuring and reporting corporate performance against economic, social and environmental parameters. At its broadest, the term is used to capture the whole set of values, issues and processes that companies must address in order to minimise any harm resulting from their activities and to create economic, social and environmental values.[37]

Hence, as the Department of Environment and Heritage views it, 'TBL can be seen as both an internal management tool, and an external reporting framework'.[38]

1.5 How mandatory disclosure fits into the CSR debate

Disclosure is primarily the means by which companies provide information to the market, which is then used by investors to make investment decisions. However, disclosure has other roles and effects, as it is seen as a powerful tool for changing the practices of corporations, and is particularly vital for making corporate managers responsible to non-shareholder constituencies.[39] Stacey Cunningham characterises disclosure as part of the dialogue between

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[32] The Group of 100 is an 'association of senior accounting and finance executives representing the major companies and government-owned enterprises in Australia', see: Group of 100, *Sustainability: A Guide to Triple Bottom Line Reporting* (2003), 4, available at www.group100.com.au.

[33] Group of 100, Ibid 4.

[34] See for example: Monica Vandenberg, *TBL Victoria – Scoping Study*, TBL Victoria, (2002), 1.

[35] Ibid.

[36] John Elkington, *The Ecology of Tomorrow's World* (1980), cited in Zappala, above n 2,16.

[37] Vandenberg, above n 34, 5 citing from Elkington, above n 36.

[38] Environment Australia, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators,* Department of the Environment and Heritage, (2003), 3.

[39] This is the view proposed by C. A. Harwell Wells, above n 5, 135.

the company and the stakeholders.[40] Parker argues social disclosure has even more roles, as it is used for: (i) assessing the social and environmental impact of corporate activities, (ii) measuring the effectiveness of CSR programmes, (iii) reporting upon a company's discharging of its CSR responsibilities, and (iv) establishing external and internal information systems allowing comprehensive assessment of all corporate resources and impacts (social, environmental and economic).[41]

As will be discussed in greater detail in further chapters, social disclosure is generally argued on two separate grounds: (i) social information is materially relevant to investment decisions and hence must be disclosed to the investing public, and (ii) social disclose should be used as a tool of public policy to increase the CSR practices of corporations. This paper focuses on the materiality of social information, and is not arguing for the regulation of corporations to improve CSR performance. However, as disclosure has many effects, it would be naïve of the author not to acknowledge that mandating social disclosure would put CSR firmly on the agenda and lead to increased CSR practices in Australian companies. Undoubtedly disclosure is a driver for internal change. Hence, the 'flow down' effects of social disclosure will be examined in this paper, and concluded to be positive. So while the use of disclosure to increase CSR practices inside companies is not used as a justification for mandating social disclosure, it is concluded by this author to be a positive side effect.

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[40] Stacey Cunningham, 'Theoretical perspectives of corporate environmental disclosure in annual reports', (PhD Paper, Central Queensland University, 2002), 3. This is also said about corporate governance guidelines such as the Cadbury Code in the UK which describes itself as a 'ready-made agenda' for shareholders to ask questions at company meetings.

[41] Parker, L, 'Polemical Themes in Social Accounting: A Scenario for Standard Setting' (1986) 1 *Advances in Public Interest Accounting*, 67.

Chapter 2

LITERATURE

2.1 Overview of literature

While there is a healthy body of CSR literature, the existing literature on mandatory social disclosure is shallow, fragmented and plagued by inconsistencies which is a reflection of the modern CSR movement in general. This is the result of a modern landscape comprised of a multiplicity of organisations, guidelines and thinking, many of which overlap at best and contradict at worst. Furthermore, the vast majority of literature in this field is produced by organisations and groups either strongly advocating or opposing social disclosure. The result is a plethora of biased literature, which is insufficiently researched and referenced.

2.2 Academic literature

As touched on in Chapter 1.2, over the past century there has been significant academic debate about the role of the corporation in society, and how best to regulate corporate managers. This debate is still healthy today. However, with a few clear exceptions, most sources meander through the issue of social reporting and few explore the whole concept and come to conclusions. Compounding this problem is the lack of disclosure based literature in the Australian context. Most of the literature is jurisdiction specific, with the majority of it being produced in Europe, the United States or Canada and written in response to a particular set of circumstances or legal affairs. As will be argued later, this reflects the level of advancement of the CSR movement in Australia vis-à-vis other modern jurisdictions – we are well behind.

2.2.1 Setting the scene of the CSR debate

The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century[42] by CA Harwell Wells is highly useful for mapping out the territory of the CSR debate. Using an historical approach, Wells puts into perspective the two "sides" of the CSR debate as described earlier. Wells engages in an innovative and exciting exploration of the debate between AA Berle and E Merrick Dodd which began in 1931, and argues it to be the birth of the CSR movement. The examination of the views put forth by both prominent thinkers is highly valuable as it sets out the arguments and positions that are still being taken today. Moreover, it gives perspective to each side of the debate – perspective that is often lacking in current literature.

2.2.2 Cynthia Williams

From an academic standpoint, Professor Cynthia Williams' article *The Securities and Exchange Commission and Corporate Social Transparency*[43] is the only recent substantive academic exploration of the issues involved in mandatory social disclosure. The article was well received as a thought provoking piece of literature. Williams argues that the Securities and Exchange Commission **(SEC)** 'can and should require expanded social disclosure by public reporting companies to promote corporate social transparency comparable to the financial transparency that now exists'.[44] The article engages an in-depth and well structured examination of the legislative and intellectual history of US securities laws. The majority of her article focuses on two particular periods: (i) the late twenties and the thinking of Brandeis, Frankfurter, Berle and Means; and (ii) the push for, and rejection of, expanded social disclosure during the 1970s. The absolute exclusion of the debates of Dodd and Berle by Williams can only be seen as a glaring weakness in her article, and it is Wells' analysis of this period that is preferred in this paper.

The article is useful in that it canvasses all the issues involved in the realm of debate over mandatory social disclosure. The utility is limited, though, by the fact that it is very US specific. In addition to examining and structuring her article around the wording of particular US statutes,[45] the legislative and regulatory framework is different in Australia, as are the

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[42] (2002) 51 *University of Kansas Law Review* 77.
[43] (1999) 112 *Harvard Law Review* 1197.
[44] Ibid 1201.
[45] Principally the *Securities Exchange Act of 1934* (US)

powers of the Australian Securities and Investments Commission (**ASIC**) to those of the SEC. Even more important is the absence of the proxy disclosure tool in Australian law.

Furthermore, Williams fails to clarify and acknowledge the distinction between the concepts of "materiality" and "public interest". It can be argued that social disclosure is mandatable as 'material' information to investors, or, in the public interest, or both. Williams oscillates between the two motivations, and confuses the reader in the process. If social information is material, as Williams argues convincingly, then disclosure may be mandated on that basis alone. Williams could also argue that social disclosure should be mandated because it is in the public interest to do so, as a tool of driving corporate change. Williams stops short of this, and instead argues that because it is in the public interest it is somehow relevant to materiality. By arguing a hybrid of the two arguments and not admitting the obvious social agenda of her article, Williams emerges with one, less effective, argument.

The article has also been cited for dismissing criticisms too hastily. There is insufficient discussion and analysis of the costs borne by mandatory disclosure, and an almost complete lack of acknowledgement of the profit-maximisation position which is the obvious opponent to Williams' arguments. Other factors, such as exclusion of Dodd from the examination of the background to the Securities legislation in the 1930s, suggest that while Williams' article is authoritative, highly important and respected, it does have its shortcomings.

Surprisingly there has been little response to her viewpoints in the academic media, with the most substantive being a Note in the Harvard Law Review: *Should the SEC expand Nonfinancial Disclosure Requirements?* .[46] The Note, despite articulating significant criticisms, supports the conclusion of Williams that the SEC *can* mandate social disclosure. Importantly, the Note goes on to examine the question of *should* the SEC mandate social disclosure – an obvious extension that Williams spent too little time examining.[47] This discussion is particularly useful as it fills a void left by Williams, and canvasses both sides of the debate in a comprehensive fashion.

[46] Note, 'Should the SEC expand Nonfinancial Disclosure Requirements?' (2000) 115 *Harvard Law Review* 1433.

[47] The authors notes 'Professor Cynthia Williams argues convincingly that the SEC has authority under the proxy rules to require disclosure of "social" information … she is less successful in arguing that the SEC *ought* to require such disclosure', See: Ibid 1435.

2.2.3 Australian literature

Extensive and varied research by the author uncovered a significant amount of CSR-related literature in Australia, but no significant academic analysis of social disclosure.[48] The only piece to examine the issues thoroughly is *Corporate Citizenship and the Role of the Government: the Public Policy Case*[49] by Dr Gianni Zappala. Zappala argues there is a role for the Federal Government in the area of corporate citizenship, and puts forth ideas for Australia's public policy using a "non-regulatory activist model". She believes the Australian Government can do more 'via supportive, coordinated and enabling policies and showing strong political leadership'.[50] Although she does not discuss the materiality argument, Zappala does focus heavily on the issue of national competitiveness. The article comprehensively maps out a lot of the territory of the CSR debate in Australia, and was of great use to the author.

2.2.4 Opponents of CSR and mandatory social disclosure

The first and most widely argued criticism of government intervention is based on the shareholder primacy arguments of Milton Friedman. The 'economic case' is based around the proprietary rights of the shareholders. Creating obligations to other groups deprives the shareholders of their proprietary rights, and spending the money of the company in relation to such groups amounts to a tax on the shareholders.[51] It is argued that this tax will distort the operation of the free market,[52] as capital cannot freely flow to its highest value.[53] Richard Teather,[54] David Henderson[55] and Hansmann and Kraakman[56] are currently the most prominent proponents of this argument.

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[48] The only literature the author could find on point was: Matt Tilling, 'Corporate Social Reporting – A Cook's Tour', (Research Paper Series 01-9, Flinders University School of Commerce, 2004) (which focuses heavily on accounting issues), and Julian Blanchard, 'Corporate Social Reporting' (1998) 23 *Alternative Law Journal* 173 (Blanchard vigorously attacks the issues, but the utility of the article is limited by the length – 4 pages). See also: Michelle Greenwood, 'Corporate Social Reporting – Getting to the "Other" Bottom Line' (Working Paper 57/02, Monash University Faculty of Business and Economics, 2002); and *The Corporate Citizen* magazine produced by the Corporate Citizenship Research Unit at Deakin University, Melbourne.

[49] Working Paper no.4 2003-04, Politics and Public Administration Group, 2003.

[50] Zappala, above n 2, 18. Suggestions include: (i) appointing a Minister for Corporate Citizenship, (ii) creating a corporate citizenship 'unit' inside a department, and (iii) devoting money to research - particularly a comprehensive nationwide survey.

[51] Richard Teather, 'Corporate Citizenship: A tax in disguise', Ludwig von Mises Institute, Alabama, 5 August, 2003, available at www.mises.org

[52] David Henderson, *Misguided Virtue: False Notions of corporate social responsibility*, New Zealand Business Roundtable, Wellington, 2001.

[53] Richard Teather, 'Corporate Citizenship: A tax in disguise', Ludwig von Mises Institute, Alabama, 5 August, 2003, www.mises.org (accessed 17 May 2004).

[54] Ibid.

[55] See: David Henderson, *Misguided Virtue: False Notions of corporate social responsibility*, New Zealand Business Roundtable, Wellington, 2001, www.nzbr.org.nz/documents/publications/publications-2001 (accessed 17 May 2004).

[56] Hannsman and Kraakman, above n 27.

The other main critique of the CSR movement is that any steps by government to encourage or mandate CSR practices would have the effect of legitimising the NGOs who push the CSR agenda. Zappala characterises this school of thought as the 'political critique' of CSR.[57] According to the critics, these NGOs are 'undemocratic, ill-informed and unaccountable'[58] and this process would give NGOs 'power at the expense of the electorate through Parliament creating a form of "civil socialism"'.[59] Gary Johns argues that this third regulator of business is dangerous as there are only two legitimate regulators of business – the government and the market.

2.3 Empirical studies

Empirical and analytical studies and surveys play an important role in the exploration of the concept of mandatory social disclosure, and in particular materiality. Studies used in this paper to support the "materiality" argument fall into two broad categories: (i) the prevalence of social and environmental preferences in the investment community, and (ii) the level of social and environmental disclosure currently being provided by companies. For many of the reasons outlined in 2.1, the results of these studies, while displaying undeniable trends, are flawed. As will be shown, most if not all, of this material is produced by organisations pushing the CSR agenda. Beyond this problem of bias, the studies are either outdated, not sufficiently on point, or unreliable due to questionable methodology.[60]

While obviously disappointing on face value, two distinct and vital points may be drawn from the empirical studies. Firstly, it is undeniable that investor interest and reliance on social disclosure has increased dramatically and that current social and environmental disclosure is poor. Secondly, while CSR is of great importance and increased notoriety, the attention given to it is disappointingly low, especially in Australia. An in-depth, reliable examination of the level of demand for social disclosure in the Australian investment community would be of great benefit.

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[57] Zappala, above n 2, 11.

[58] Gary Johns, 'Corporate Social Responsibility or civil society regulation?', Paper presented at The Hal Clough Lecture for 2002, Institute of Public Affairs, Melbourne, 2002.

[59] Ibid 2.

[60] See Chapter 5.2.

2.4 Governmental and NGO literature

The last, and easily most substantive, source of literature comes from direct players in the CSR movement. This includes government produced information such as guidelines, legislation, regulatory action (implemented and unsuccessful) and consultation papers. Literature produced by the Australian Government and state governments, such as the *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators,*[61] is of value as it reveals the Governments' attitudes towards CSR issues. There is also an abundance of literature produced by pro-CSR groups such as guidelines, newsletters, reports and submissions. While being of value, this literature is plagued by bias, lack of comprehensiveness, lack of authority and lack of in-depth exploration of issues.

[61] Environment Australia, above n 38.

Chapter 3

CURRENT LAW IN AUSTRALIA

Before examining if and how mandatory social disclosure can be implemented, it is necessary to examine the current legal and regulatory position vis-à-vis the disclosure of social and environmental information in Australia.

Corporate disclosure can be separated into three distinct categories: prohibited disclosure, permitted disclosure and mandated disclosure. Broadly speaking, the current position is that the disclosure of social and environmental information is permitted, but not mandated in Australia. As will be discussed in Chapter 4 , this does not mean social information is not disclosed, but simply that it is not required to be disclosed under any law.

In the dense legal pluralism of corporate regulation today, it is necessary at this point to introduce the concept of "soft" and "hard" law. "Hard" law encompasses legislation and regulations, whereas "soft" law includes voluntary codes, best practice guidelines and arguably even international reporting guidelines. Hard law initiatives usually represent an interventionist approach by government, whereas soft law initiatives can be described as "non-regulatory activist" and often do not originate from government. This chapter will examine the current soft and hard law operating in Australia.

3.1 Current mandatory social disclosure

There are only two minor disclosure requirements in the Corporations legislation and Regulations which focus on social and environmental issues. Section 299(1)(f) of the *Corporations Act 2001*(Cth) stipulates that:

> if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or State or Territory – details of the entity's performance in relation to environmental regulation

must be provided in the annual report.

Applying only to financial products, s 1013D(1)(l) of the *Corporations Act 2001*(Cth) states that:

> if the product has an investment component, the extent to which labour standards or environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment

must be disclosed. Commenting on the legislation, ASIC Deputy Executive Director of Consumer Protection Delia Rickard said:

> ASIC does not intend to tell product issuers what labour standards, or environmental, social or ethical considerations they should look at … Rather we are saying while it is up to the product issuers to determine … they must ensure consumers are aware of their approach.[62]

More recently, ASIC released *Policy Statement 175*, which requires advisors providing personal finance advice to their clients to enquire whether social, environmental and ethical considerations are important to their clients.[63]

There are other ad hoc disclosure requirements, mostly environmental in nature, in other legislation which arguably can be categorised as mandatory social disclosure. For example the Environmental Protection Agencies can request a company to develop an Environmental Improvement Plan (EIP),[64] although this is largely being adopted voluntarily,[65] and certain high environmental impact companies must publicly disclose their emissions to the National Pollutant Inventory (NPI).[66]

The only attempt so far to introduce social disclosure in Australia was the *Corporate Code of Conduct Bill 2000*.[67] The Bill aimed to regulate companies employing more than 100 people in offshore operations with respect to human rights, environmental, health and safety, and labour standards. The Bill proposed mandatory disclosure of compliance with the proposed standards by submitting a Code of Conduct Compliance Report to ASIC.[68] The Bill was referred to the Parliamentary Joint Statutory Committee on Corporations and Securities which

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[62] William Baue,'Australia to Require Investment Firms to Disclose How They Take SRI into Account', *SocialFunds.Com*, 3 January 2003, available at www.socialfunds.com, (accessed 20 August 2004)

[63] Australian Securities and Investments Commission, *Policy Statement 175 Licensing: Financial product advisers – conduct and disclosure* (2003).

[64] See: www.epa.vic.gov.au/EnvAudit/ for information about EPA Victoria's processes.

[65] Vandenberg, above n 34, 14.

[66] See www.npi.gov.au/handbooks/index.html#who

[67] The Bill was introduced by Vicki Bourne of the Australian Democratic Party into the Senate on 6 September 2000: Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporate Code of Conduct Bill 2000*, Parliament of the Commonwealth of Australia (2001), 1.

[68] *Corporate Code of Conduct Bill 2000,* subclause 14(1).

ultimately recommended it be rejected. Overall, it was considered unnecessary and unworkable and the Committee recommended that in such areas, the 'Australian Parliament should not move hastily' and should move 'slowly and wisely'.[69]

3.2 Current 'soft' law initiatives

3.2.1 Operating reviews

ASX Listing Rule 4.10.17 requires all listed companies to include in their annual reports a "Review of Operations and Activities Disclosure". As part of CLERP 9, companies must also include a "Management Discussion and Analysis" in the Directors' Report section of their annual reports. This is in addition to the previous requirement that companies include a general review of operations and activities as required by s 299 of the *Corporations Act 2001* (Cth). The explanatory memorandum directs companies to the *Guide to Review of Operations and Financial Condition*, produced by the Group of 100.[70] The publication recommends a focus on key performance indicators, both financial and non-financial.

3.2.2 Guide to Reporting Against Environmental Indicators

In June 2003, Environment Australia launched *Triple Bottom Line Reporting: A Guide to Reporting Against Environmental Indicators.*[71] The guide builds on the GRI Guidelines (see 3.3.1) and complements the GRI's work by 'providing Australian organisations with tangible and easy to use methodologies for measuring performance against key environmental indicators'.[72] The guide found 'strong support' for the GRI framework during stakeholder consultation.[73] Some minor deviations from the GRI were adopted to address Australian conditions, reduce complexity, or in response to shareholder feedback. The reporting is broken up into "environmental management indicators" which 'provide information on how a company manages any environmental impacts of its operations, products and services',[74] and "environmental performance indicators" which 'calculate and report on the impact its

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[69] Parliamentary Joint Statutory Committee on Corporations and Securities, above n 46, 46.
[70] Group of 100*, Guide to Review of Operations and Financial Condition* (2002)
[71] Environment Australia, above n 38.
[72] Ibid iii.
[73] Environment Australia, above n 28, 10.
[74] Ibid 14.

operations have on the environment'.[75] For a summary of the reporting requirements under the Guide see Appendix A.

3.2.3 Guide to Reporting Against Social Indicators

The Department of Family and Community Services is also preparing a guide to assist companies called *Triple Bottom Line Reporting in Australia – A Guide to Reporting Against Social Indicators.*[76] Initially the guide was to be released in August 2003,[77] but is still in draft form at the time of writing this paper. The guide is being developed along the same lines as the environmental guide described above, using the GRI as a basis, and building upon it through stakeholder consultation. Obviously social indicators are less quantitative than environmental indicators, and tend to require more information about internal processes and policies than actual performance. As such, the major challenge with social indicators is to ensure consistency with definitions in order to allow comparability. For a summary of the reporting requirements under the Guide see Appendix B.

3.2.4 ASX Principle of Good Corporate Governance 10

The ASX Principles of Good Corporate Governance and Best Practice Recommendations, released by the ASX Corporate Governance Council in March 2003, list ten core corporate governance principles.[78] Under each principal is a number of recommendations on specific actions corporations should take in order to move towards achieving that principle. Best Practice Recommendation 10.1 recommends companies 'establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders'.[79] The Code of Conduct must be made available publicly (ie. on the company website) and an explanation of any departure from instituting the Code must be included in the annual report. The efficacy, legal effect and enforcement of this regime will be discussed in greater detail in Chapter 9.4 as it is similar to the proposal of this paper.

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[75] Ibid 20.

[76] Department of Family and Community Services, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Social Indicators*, Draft in Discussion, July 2004. A draft copy can be obtained from the Prime Minister's Community Business Partnership at www.partnerships.gov.au.

[77] Environment Australia, above n 28, 3

[78] Australian Stock Exchange Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, Australian Stock Exchange (March 2003).

[79] Ibid 59.

3.2.5 Prime Minister's Community Business Partnership

The Prime Minister's Community Business Partnership **(PMCBP)**, located within Department of Family and Community Services, was established in 1999 by the Prime Minister. It is a group of prominent business and community representatives which advise and assist the government with issues related to the community and business. In particular, they help the government with initiatives to 'develop and promote a culture of corporate and individual social responsibility'.[80] Currently, the Partnership is assisting the Department of Family and Community Services prepare the *Guide to Reporting Against Social Indicators* discussed in 3.2.3.

3.2.6 Reputex Social Responsibility Ratings

The Reputex Social Responsibility Ratings Committee, run by the Macquarie Graduate School of Management and chaired by Dr John Hewson, rate Australia's top 100 organisations[81] on how socially responsible they are.[82] The 2003 survey found that 36 companies received a B rating or less,[83] with only 11 companies receiving a high or very high rating.[84] Notably Westpac received the only AAA rating.[85] The weakest area was Environmental Impact where there were 12 satisfactory and 86 not satisfactory ratings.[86] Even more damning is the fact that government owned companies (such as Australia Post) were the best performers, followed by subsidiaries of overseas multinationals, with ASX corporations performing the worst.[87]

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[80] Prime Minister's Community Business Partnership, *Fact Sheet*, available at www.partnerships.gov.au/pdf/fact_sheets/1_partnership.pdf

[81] From Business Review Weekly (BRW) magazine's annual list of top 100 companies.

[82] The 'Reputex Ratings' ratings, released annually, rank corporations, private companies, and governmental bodies in 4 areas: (i) Environmental Impact, (ii) Corporate Governance, (iii) Social Impact and (iv) Workplace Practices. They also provide an overall "Social Responsibility Ranking" See: Reputex, *Social Responsibility Ratings 2003,* available at www.reputex.com.au

[83] Dr John Hewson, 'Corporate Social Responsibility Is Not Only Vital, But Inevitable', Transcript of speech given at National Press Club, 13 October 2003, previously available from www.reputex.com.au, copy in file of author.

[84] Reputex, above n 82.

[85] Ibid.

[86] Dr John Hewson, above n 83.

[87] Ibid.

3.3 International guidelines and codes

3.3.1 Global Reporting Initiative

The Global Reporting Initiative **(GRI)** was founded in 1997 by the Coalition for Environmentally Responsible Economies **(CERES)** in partnership with the United Nations Environmental Programme **(UNEP)** with 'the goal of enhancing the quality, rigour and utility of sustainability reporting'.[88] The guidelines are a framework for reporting on an organisation's economic, environmental and social performance. The *2002 Sustainability Guidelines* released in September 2002,[89] were designed through a consultation process with more than 10,000 participants from more than 75 nations.[90] They are the most widely accepted and referred to guide to social disclosure. Currently, the database of companies explicitly using the GRI reporting framework exceeds 500,[91] including 40 Australian companies.[92]

3.3.2 Other guidelines and codes

According to an Organisation for Economic Cooperation and Development **(OECD)** survey, there are almost 250 voluntary codes of conduct with relevance to corporate citizenship.[93] Although there are eight prominent codes recognised as the "Global Eight", of which the GRI is a member.[94] An important initiative is the OECD *Guidelines for Multinational Enterprises.*[95] The guidelines, which aim to regulate multinational enterprise conduct, contain a number of recommendations and policies with social or environmental goals. According to Halina Ward, the guidelines are 'politically binding on participating countries',[96] and are hence neither voluntary or mandatory in the true sense of either word. In addition, there has been the emergence of purely ethical ratings agencies such as Vigeo in

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[88] Global Reporting Initiative, *2002 Sustainability Guidelines*, United Nations Environment Programme, 2002, i.

[89] Ibid.

[90] Ibid, i.

[91] GRI News, *New database launched as GRI hits the 500 mark,* Global Reporting Initiative,10 August 2004, available at www.globalreporting.org/news/updates/article.asp?ArticleID=338

[92] Centre for Australian Ethical Research, *The State of Sustainability Reporting in Australia in 2004,* Department of Environment and Heritage (2004), iii.

[93] Zappala, above n 2, 12. Other people suggest the number to be around 50: Kelly Parsons, and Patrick Wilkins, 'Corporate Social Responsibility : Visions of Utopia' (July 2003), *The European Lawyer*, 20.

[94] The 'Global Eight' is recognised as: (1) the Global Reporting Initiative, (2) International Labour Organisations Conventions, (3) the OECD Guidelines for Multinational Enterprises, (4) ISO 14000 Series, (5) the United Nations Global Compact, (6) the Global Sullivan Principles, (7) Social Accountability 8000 and (8) AccountAbility 1000.

[95] Organisation for Economic Cooperation and Development Committee on International Investment and Multinational Enterprises, *Guidelines for Multinational Enterprises*, Organisation for Economic Cooperation and Development (2001).

[96] Parsons and Wilkins, above n 93, 17.

Europe,[97] and the international ratings agencies Standard & Poors, Moody's and Fitch have all created new departments specifically to deal with CSR.[98]

[97] Ibid 13.
[98] Ibid.

Chapter 4

CURRENT SOCIAL DISCLOSURE IN AUSTRALIA

Although social disclosure is not mandated, some Australian corporations decide to voluntarily provide it to the market. Westpac, for example, has an outstanding record of social disclosure, and annually releases a comprehensive "Social Impact Report".[99] The following sections examine the prevalence and quality of the social disclosure being voluntarily provided by Australian corporations.

4.1 Increased prevalence of social disclosure

It is clear from studies in this field that there has been an increase in social disclosure over the past decade.[100] Currently, 45% of the Fortune Global Top 250 companies now publish sustainability reports (ie. triple bottom line reports, environmental reports and community reports).[101] This trend is consistent across the world, and should come as little surprise given the steady increase in disclosure requirements generally, coupled with an increased emphasis on social and environmental issues on the corporate agenda. There is no doubt that such disclosure will continue to increase in the future.

The Centre for Australian Ethical Research, in collaboration with KPMG and Deni Greene Consulting Services, surveyed 509 of Australia's top companies[102] in *The State of Sustainability Reporting in Australia in 2004.*[103] The survey found that 116 companies produced sustainability reports (or included such information in their annual report or on the company website), of which 53% were in the mining or manufacturing sectors.[104] It was found that foreign-owned companies were more likely to produce such reports than Australian

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[99] Westpac Banking Corporation, *Our 2003 Social Impact Report*, July 2003, available from www.westpac.com.au
[100] See: Tilling, above n 4, 3 and Cunningham, above n 40.
[101] Centre for Australian Ethical Research, above n 92, i-ii.
[102] The survey consisted of companies in the S&P/ASX 300 and Australia's top 100 public unlisted companies and top 100 private companies.
[103] Centre for Australian Ethical Research, above n 92.
[104] Ibid ii.

owned companies.[105] Only about 60% of the reports produced contained social and environmental information, as 40% contained only environmental information.[106]

4.2 Quality of social disclosure

The two main problems identified with current disclosure is the absence of any negative information, and the misleading 'spin' put on the information which is disclosed. Deegan and Gordon, who conducted a study in 1996 of 71 Australian companies who were identified as producing environmental information, found that 'environmental disclosures are typically self-laudatory'.[107] They found only 14 companies produced "negative information", and what was disclosed was minimal.[108] Matt Tiling, in *Corporate Social Reporting – A Cook's Tour,*[109] reviewed a number of similar studies, finding support in the US and UK for the same conclusion. Tiling quotes a study by Harte and Owen,[110] where the authors found 'social information provided within annual reports tends not to be directly related to quality of actual performance and can indeed be positively misleading'.[111] Stacey Cunningham supports the findings above.[112] Cunningham found a propensity for positive information, and little, if any, negative information.[113] Furthermore, 'empirical evidence has shown users of annual reports can be misled regarding environmental performance'.[114] The current situation has led authors like Julian Blanchard to argue that social reporting has 'degenerate[d] into a public relations exercise that reveals very little of companies' true social performance'.[115]

Beyond these two major problems with the content of social disclosure, there are also problems with the presentation of information for investor digestion. The GRI identifies a number of factors as characterising 'good' disclosure. They are: transparency, inclusiveness (of stakeholders), auditability, completeness, relevance, sustainability context, accuracy, neutrality, comparability, clarity and timeliness.[116] It is clear that most, if not all, of these are not provided for investors currently. Beyond completeness and neutrality as discussed above,

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[105] Ibid ii. This is consistent with the findings of the Reputex Social Reposnsibility Ratings Committee as discussed in 3.2.6.
[106] Ibid 13.
[107] Deegan, C, and Gordon, B, 'A Study of the Environmental Disclosure Practice of Australian Corporations' (1996) 26 *Accounting and Business Research* 198.
[108] Ibid 199.
[109] Tilling, above n 4.
[110] Harte, G, and Owen, D, 'Environmental Disclosure in the Annual Reports of British Companies: A Research Note' (1991) 4 *Accounting, Auditing and Accountability Journal,* 59.
[111] Tilling, above n 4, 5.
[112] Cunningham, above n 40, 1.
[113] Ibid.
[114] Ibid.
[115] Blanchard, above n 48, 174.
[116] Global Reporting Initiative, above n 88, 22-30.

there are no guarantees as to clarity, accuracy and timeliness. Perhaps most importantly, there is currently a total lack of comparability.

4.3 The international context

Disturbingly, Australian corporations are among the worst performing in terms of social disclosure. Comparing US corporations with Australian corporations, Julian Blanchard found that significantly more US corporations provide social disclosure than their Australian counterparts, and that the comprehensiveness of disclosure is much higher in the US.[117] What is most damning for Australia though, are the results of *KPMG International Survey of Corporate Sustainability Reporting 2002.*[118] The survey focused on the number of corporations producing social or environmental reports in the top 100 companies of 19 countries. Australia was found to be the twelfth worst performer, with only 14% of our top 100 corporations producing social or environmental reports.[119] 14% is abysmal when compared to countries such as the US with 36%, the UK with 49% and Japan with an astounding 72%.[120] Australian corporations are poor performers by global standards!

4.4 Conclusion

There is a strong argument that if the market requires information, companies will be forced to produce it. This is because companies need to provide information in order to attract capital over rival investment opportunities. Naturally, investors recoil from companies which fail to provide information, as successful and confident companies will voluntarily provide information.[121] Various economic models conclude that these market forces will lead to voluntary disclosure without the need for government intervention.[122] However, it is clear that this does not always work in practice, and hence, mandatory disclosure is sometimes

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[117] Blanchard, above n 48, 173-4.

[118] KPMG Global Sustainability Services, *KPMG International Survey of Corporate Sustainability Reporting 2002*, KPMG, 2002.

[119] This must be compared with *The State of Sustainability Reporting in Australia in 2004*, which found 116 of the top 509 companies in Australia produced sustainability reports, equating to 23%: Centre for Australian Ethical Research, above n 92, ii. This discrepancy can probably be explained by the fact that the KPMG report was completed two years earlier in 2002. This type of increase would not be surprising from 2002 to 2004. However, it must be remembered that the other countries would also have improved their performance, Even if they have not, Australia is still performing badly.

[120] KPMG Global Sustainability Services, above n 118, 1.

[121] Frank Easterbrook, and Daniel Fischel, 'Mandatory Disclosure and the Protection of Investors' (1984) 70 *Virginia Law Review,* 669, 683.

[122] 'Should the SEC expand Nonfinancial Disclosure Requirements?' examines the models of 'competitive information disclosure' and 'unravelling'. See: Note, above n 46, 1445-46.

required.[123] A pertinent example of the failure of voluntary disclosure is that since the Prime Minister of the UK called for Financial Times Stock Exchange **(FTSE)** 350 companies to report on environmental impacts by December 2001, less than a third have done so.[124] The introduction of mandatory corporate governance disclosure in most jurisdictions is a recent example of governments deciding voluntary disclosure to be insufficient.

While some corporations (such as Westpac) are star performers, Australian corporations are voluntarily providing much less social disclosure than in other modern jurisdictions. Social disclosure is improving in volume, but it is often misleadingly presented and any negative information excluded, as corporations use it as a tool for public relations. Beyond this, there is no consistency in format, timeliness or content which makes comparability of corporations' social performance near impossible. Most Australian corporations are providing little, if any, social disclosure, and what is being provided is of little use to the investor.

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[123] See: John Coffee Jnr., 'Market Failure and the Economic Case for a Mandatory Disclosure System' (1984) 70 *Virginia Law Review* 717 and Joel Seligman, 'The Historical Need for a Mandatory Corporate Disclosure System' (1982) 9 *Journal of Corporate Law* 1.

[124] EU News, 'Is it time to make CSR reporting mandatory?', *EU Business,* 7 October 2003, available at www.eubusiness.com/topics/CSR/EUNews.2003-10-07.3604, citing the New Economics Foundation.

Chapter 5

THE CASE FOR MANDATORY SOCIAL DISCLOSURE - MATERIALITY

Having seen that Australia's companies currently provide low levels of social disclosure, this chapter will show that a substantial amount of investors desire such information for their investment decisions.

5.1 The social/economic investor dichotomy

The archetypal "economic" investor is one who focuses purely on the financial position, strength and returns of corporations, while the archetypal "social" investor is concerned with other factors such as the human rights record or environmental performances of corporations. Obviously the social investor does have some interest in the finances of companies, otherwise they would not be an "investor". In reality, Williams argues almost all investors will have an aspect of both in them:

> It is unlikely that people are pure economic investors or pure social investors, however. Rather different mixtures of economic and non-economic preferences inform investors' views. Most "economic" investors would recoil from even extraordinary profitable investments in slave-labour camps, for instance, were such things legal in another country, just as most "social" investors would recoil from investments that promised no return. These labels ought to be understood then, as describing the relative priorities of investment preferences …[125]

Williams concludes that both have an interest in social information, as a company's financial position can be affected by its social and environmental behaviour.[126] As one author noted, 'hippie, or yuppie, the shareholder needs to know if a firm is a toxic polluter so that she can divest herself of the moral guilt or the Superfund liability-in-waiting, whichever concerns her'.[127]

Two important ideas emerge from this analysis. Firstly, that most investors have some social conscience, which will vary in degree. It is validly noted in *Should the SEC expand Nonfinancial Disclosure Requirements?* that shareholders and citizens are the same people,

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[125] Williams, above n 26, 1277
[126] Ibid 1284.
[127] Note, above n 46, 1436.

and ‘it is not plausible that a citizenry that votes across a political spectrum reflecting all combinations of narrow self-interest and altruism should, upon calling its brokers, become a purely profit-driven mass’.[128] This is especially relevant in Australia, given more Australian households own shares, either directly or indirectly, than in any other country.[129]

Secondly, social and environmental performance can affect a company’s financial performance, particularly if it is adverse, and good social performance may also correlate with profit.[130] This is in many ways similar to the effect of corporate governance practices on company performance and share price. While many consider good corporate governance will result in good financial returns, the link has so far been very hard to prove.[131] However, it is clear that bad corporate governance often results in poor financial returns and in extreme cases, company failure. Undoubtedly environmental problems, product liability issues, employee concerns and other reputational issues impact on short and long-term share prices. Poor management of social and environmental factors can financially affect a company directly (through fines, increased costs) and indirectly (loss of reputation, supply failure, production interruption, property damage, customer loyalty).

5.2 Do investors want social disclosure?

One way to determine if social disclosure is material to investment decisions is to look at the demand for social information from the investing public. Unfortunately, there is little academic research in this area. There are, however, other sources which point both directly and indirectly to the fact that investors are increasingly considering social and environmental factors in their decision making.

5.2.1 Investor demand for social disclosure

Much of the literature that boasts high levels of investor demand for social disclosure is hard to verify, and may likely be exaggerated or incorrect.[132] The weight of evidence, though, is

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[128] Ibid 1438.

[129] Dr Mary Sweeney et al, ‘Australian Banks as Corporate Citizens: Are they toeing the triple bottom line?’ (2001) 4 *The Journal of Corporate Citizenship* 91, 94 citing Eakin, J, ‘Individuals Steal March in Direct Share Ownership’, *The Age*, 19 August 2000, 2

[130] This is discussed in Chapter 7.1.

[131] See for example: Ian Ramsay and Geof Stapeldon, ‘Institutional Investors: Corporate Governance and the New International Financial Architecture’ in *Key Developments in Corporate Law and Trust Law*, 73 (Ian Ramsay ed., Butterworths 2002). Although the authors argue corporate governance has an affect on the ability of companies to attract finance.

[132] For example, the Social Investment Organisation boasts ‘in a national survey conducted by the American Institute of Certified Public Accountants in 2000, 79 % of investors believed social and environmental information is required for investment decision making’: see Social Investment Organisation, *Improving Corporate Governance through Mandatory Social and*

undeniable. Alan Murray released a paper exploring whether stock market participants in the UK exhibit any discernible reaction to the social and environmental disclosures made by the largest 100 companies. [133] Murray states that a review of 'the extant literature concerning the relationship(s) between corporate social responsibility, social reporting and the stockmarket …[found] the field is still relatively inconclusive and largely under-specified'.[134] As part of his conclusion, Murray stated confidently that there is 'fairly convincing evidence that investors often show more than a passing interest in social and environmental disclosures'.[135]

Globescan Inc[136] conducts annual surveys of 'citizens' changing expectations of companies as social responsibility becomes an important driver of corporate reputation and accountability'.[137] The *Corporate Social Responsibility Monitor 2002*[138] was compiled after conducting face-to-face interviews with representative samples of 1000 citizens from 25 strategically selected countries.[139] When asked if they would sell shares in a company or fund which behaved in a socially irresponsible way, 32 % disagreed,[140] while 60 % agreed[141] they would be inclined to dispose of the share/fund.[142] Even more importantly, they found that over one in five shareholders in G7 countries report having made a 'buy or sell decision based on a company's social performance'.[143] This powerful fact is amplified by the statement that 'people in Australia, North America and Northern Europe are most actively rewarding and punishing companies because of corporate social performance'.[144]

Two recent studies have also confirmed that investment advisors and stock brokers use social and environmental information in their analytical assessments. In 1997, Ernst & Young completed a study called *Measures that Matter* which aimed to investigate the extent of the

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Environmental Reporting, September 2002, available at www.socialinvestment.ca, 3. The author, despite significant research (including a comprehensive search of the AICPA website), could not find any evidence to confirm this statement. What is concerning is that the study was frequently referred to in CSR literature.

[133] Alan Murray et al, 'Do Financial Markets Care About Social and Environmental Disclosure? Further Evidence and Exploration from the UK' (2001) *University of Glasgow Discussion Paper.*

[134] Ibid 3, referring to Richardson A.J., M. Welker and I.R. Hutchinson (1999) 'Managing capital market reactions to social responsibility' (1999) 1 *International Journal of Management Reviews* 17.

[135] Ibid 4, citing as giving evidence of this: Benjamin, J and Stanga, K, 'Difference in disclosure needs of major users of financial statements' (1977) *Accounting and Business Research* 187; Chenall, R and Juchau, R, 'Investor information needs: An Australian study' (1977) *Accounting and Business Research* 111; Epstein, M and Freedman, M, 'Social disclosure and the individual investor' (1994) 7 *Accounting , Auditing and Accountability Journal* 94; and Firth, M, 'The extent of voluntary disclosure in corporate annual reports and its association with security risk measures' (1984) 16 *Applied Economics* 269.

[136] Formerly Environics International.

[137] Globescan, *Corporate Social Responsibility Monitor 2004 – Brochure*, available at www.globescan.com

[138] Environics International, *Corporate Social Responsibility Monitor 2002 – Executive Brief*, available at www.globescan.com. The *Corporate Social Responsibility Monitor 2004* is available for order for USD$14,000.

[139] The countries include Australia, UK, US, France, Germany, South Africa, Canada, India and China. All together, 26013 interviews were conducted. See: Ibid 2.

[140] 11 % 'strongly disagreed', 21 % 'somewhat disagreed'.

[141] 29 % 'strongly disagreed', 31 % 'somewhat agreed'.

[142] Environics International, above n 138, 4.

[143] Ibid

[144] Ibid 2.

impact of non-financial matters on investor decision making.[145] Interestingly they found that 'non-financial measures matter to corporate executives, but more importantly that investors take these measures into account when valuing companies'[146] and that non-financial data is already taken into account by Wall Street and it reflects and affects corporate financial value.[147] The study found 35% of investment decisions on Wall Street are driven by consideration of non-financial data.[148] However, the study did define non-financial data as including not only social and environmental policies, but also 'brand name, market share, remuneration, product quality and management forecasts'.[149] *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing*[150] looked at 'how key market players integrate sustainability considerations into their equity valuations'.[151] The report, compiled from information gathered from the world's leading brokerage and asset management entity's,[152] found unanimously and overwhelmingly that social and environmental issues impact positively and negatively on long-term shareholder value and share prices.[153]

5.2.2 The prevalence of "ethical investing"

Many CSR proponents, including Williams, point to the prevalence of 'ethical investing' or 'socially responsible investing" **(SRI)** as evidence of the need to provide social disclosure to the market. The terms, which are used interchangeably, refer to the practice of using non-financial criteria in investment decision making.[154] The studies below, despite their shortcomings, show that socially responsible investments make up a significant proportion of total investments.

The Ethical Investment Association aims 'to provide credible data on the size and growth of the Australian SRI market and to compare trends in Australia's financial market and SRI

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[145] Ernst & Young, *Measures That Matter* (1997), 5.
[146] Ibid 2.
[147] Ibid 5.
[148] Ibid 8.
[149] Ibid 7.
[150] United Nations Environmental Programme Finance Initiative (UNEPFI), *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing,* UNEP, 2004.
[151] Ibid 3.
[152] The 11 contributors include BNP Paribas, Citigroup, ABN AMRO and HSBC.
[153] The issues most highlighted as most likely to have an impact were climate change, occupational and public health, human rights and labour policies and corporate trust and governance. United Nations Environmental Programme Finance Initiative (UNEPFI), above n 150, 4.
[154] For example, in March 2001, AMP Henderson Global launched a socially responsible investment product called 'Sustainable Future Funds', which offers customers an 'investment portfolio that focuses on industries of the future including healthcare, communications, renewable energy and education, and on companies committed to operating in a socially responsible way', see AMP, *AMP Shareholder News,* August 2001, available at www.amp.com.au/shareholdercentre

internationally'.[155] *Socially Responsible Investment in Australia – 2003*[156] found that SRI rose to at least $21.3 billion by 30 June 2003, representing an increase of 54% since the benchmarking study in 2002, and 104% since 2001.[157] In the study, SRI was defined to include: managed SRI funds, private SRI portfolios, investments by religious organisations, investments by charitable trusts using SRI criteria, employer super funds using "SRI overlays"[158] and shareholder resolutions on social and environmental issues.[159] It is also important to note that these studies exclude private investors - 'a very large, but difficult group to identify'.[160]

The questionable reliability of the overall figures in such reports is demonstrated by the $6.7 billion figure (out of the total $21.3 billion) quoted for 'shareholder resolutions on environmental and social issues'.[161] This came from a single set of resolutions at the National Australia Bank and Commonwealth Australia Bank annual meetings to cease investing in or lending to companies damaging old growth forests.[162] The most reliable figures in these types of studies is that of SRI funds and portfolios, as the amount invested in them can confidently be labeled as socially responsible. Of the $21.3 billion quoted by the study, $2.5 billion comes from SRI funds and portfolios. This figure seems consistent with Louise O'Halloran's study which found the Australian 'ethical funds sector grew 37 % from $1.6 billion in June 2002 to $2.2 billion in net assets in June 2003'.[163] The number of SRI funds increased from 10 in 1996, to 46 in 2001, to 63 in July 2003.[164] These figures show that ethical investment is becoming increasingly prevalent and is something which cannot be ignored.

The Social Investment Forum in the United States releases biennial reports examining socially responsible investing trends.[165] The 2003 Report found that a total of USD$2.16 trillion in assets was 'identified in professionally managed portfolios using one or more of the three core

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[155] Ethical Investment Association, *Socially Responsible Investment in Australia – 2003* (October 2003), 4.
[156] Ibid.
[157] Ibid 1.
[158] Using "SRI overlays" is the practice of investing along normal guidelines, and then identifying CSR issues with companies and meeting with those companies to discuss ways of overcoming and managing the issues: Ibid 2.
[159] Ibid 1.
[160] Ibid 17.
[161] Ibid 1.
[162] The report puts a capital value on the shares held by investors and institutions who engage in shareholder advocacy based on social and environmental issues. It is a small, put arguably permissible, jump to then say that these shareholders are ethically minded and would hence be interested in corporate social disclosure. However, upon closer reading, the $6.7 billion figure comes from one set of shareholder actions led by the Wilderness Society which spearheaded anti-woodchipping resolutions The amount of shares voted in favour (23% of shares at the CBA meeting (94 million out of 413 million shares) and 23% at the NAB meeting (125 million out of 553 million shares)) results in the $6.7 billion figure. See: Ibid, 16-17.
[163] Louise O'Halloran, *The unseen revolution – ethical investment in Australia*, The State Chamber of Commerce (NSW), 2001.
[164] Ethical Investment Association, above n 155, 1.
[165] The Social Investment Forum is a national non-profit organisation providing research and education on socially responsible investing. Social Investment Forum, *2003 Report on Socially Responsible Investing Trends in the United States* (2003), available at http://www.socialinvest.org/areas/research/trends1999-trends.htm, 39.

socially responsible investing strategies – screening[166], shareholder advocacy[167], and community investing[168],[169] which amazingly amounts to 'more than one out of every nine dollars under professional management'[170] in the US today. It is important to note that out of the USD$2.16 trillion figure quoted, USD$2.14 trillion comes from SRI funds. SRI has grown rapidly in the US, with the amount under SRI management expanding from USD$40 billion in 1984, to USD$639 billion in 1995, to where it is today. The figures are put into perspective by the fact that in 1975, there were only 2 active mutual funds for social investors, with combined assets of USD$18.6 million - roughly 0.0005% of money under mutual fund management.[171] Similar trends have been documented in Canada, the UK and across Europe.[172]

5.2.3 Other evidence

The number of shareholder resolutions based on social or environmental grounds has increased radically, showing that social and environmental factors are playing on investors minds. The number of such resolutions in the US increased from 219 in 2001, to 802 in 2002, to 998 shareholder resolutions in the first 4 months of 2003.[173]

Furthermore, there is the emergence of ethical stock indices. Created in September 1999, the Dow Jones Sustainability Index (DJSI)[174] aims to be a world leader in tracking the 'financial performance of sustainability leaders on a global scale'.[175] It is comprised of the top 200 global companies who satisfy certain criteria on environmental protection, sustainability issues, social issues, stakeholder relations and human rights.[176] In the UK, the FTSE decided in 2001 to launch a series of ethical stock indices known as the "FTSE4Good". In South Africa, the Johannesburg Securities Exchange **(JSE)** created the "SRI Index" as a means to

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[166] 'Screening is the practice of including, excluding or evaluating publicly traded securities on social and environmental criteria', with companies such as tobacco or weapons producers often being excluded. Ibid 3.

[167] Shareholder advocacy refers to the capital amount of shares held by investors or funds who actively engage in advocacy (such as filing proxy resolutions) based on social and environmental issues. Ibid 3.

[168] Community investing represents the amount of capital from investors to communities that are underserved by traditional financial services. Ibid 3.

[169] Ibid i.

[170] Ibid.

[171] Williams, above n 26, 1251 (citing Commission Conclusions and Rule Making Proposals, Securities Act Release No. 5627, Exchange Release No. 11,733 [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH), Oct. 14, 1975).

[172] For example, Eurosif published a study in mid-October 2003 which found that sustainable and responsible investment is already in the mainstream financial markets in some European countries, and that 'European Institutional SRI could be as high as EUR 336 billion'. See: Eurosif, 'SRI goes mainstream', *EU Business*, 22 October 2003, available at www.eubusiness.com/topics/CSR/EUNews.2003-10-22.0158

[173] Social Investment Forum, above n 165, 3.

[174] See: www.sustainability-index.com

[175] Ibid.

[176] See: www.sustainability-index.com/htmle/assessment/overview.html

identify those corporations listed on the JSE that integrate the principles of SRI and sustainability into their business activities.[177]

5.3 Conclusion

Despite questionable methodologies, it is clear from the empirical evidence that social and environmental information is material to investment choice for a significant proportion of the investing public. This is confirmed through studies examining investors attitudes, and importantly, the attitudes of financial advisers and stock brokers. The rise of SRI and the huge amounts of money under management using SRI principles prove this point.

How can we ignore the needs of one in five investors in Australia; 35% of investment decisions on Wall Street; the needs of stockbrokers from the world's leading institutions; and one out of every nine dollars under professional management in the US today?

[177] Johannesburg Securities Exchange, *JSE SRI Index, Background and Selection Criteria* (6 October 2003), 2.

Chapter 6

THE CASE FOR MANDATORY SOCIAL DISCLOSURE – NATIONAL COMPETITIVENESS

In addition to the materiality argument, mandatory social disclosure is also arguable as a tool of public policy. These arguments can be categorised in one of two ways, either (i) higher levels of social disclosure are desirable for external reasons (ie. flow of capital, national competitiveness), or (ii) mandatory social disclosure will be a driver of corporate change, forcing corporations to pay more attention to CSR issues and hopefully increasing their CSR performance. As outlined earlier, this focuses on the former category – 'national competitiveness and flow of capital'. In order to examine national competitiveness, it is necessary to establish how the Australian regulatory landscape (Chapter 3) compares with other modern jurisdictions.

6.1 International regulatory developments

To put it starkly, Australia has moved little if anywhere down the path of corporate responsibility and sustainability while all our financial peers have made significant steps. According to Dr John Hewson:

> Improved corporate social responsibility is not only vital but inevitable. As a community, if we are to move on, if we are to be taken seriously on the global stage, we have to be seen by the rest of the world to be taking sustainability seriously … I would like to draw a couple of comparisons and talk about the corporate social responsibility debate, or lack of it, in this country. Corporate social responsibility is now an accepted part of corporate practice in most developed economies … in Australia, we've lagged behind.[178]

At the time of writing, legislative and regulatory initiatives in various countries across the world are in different stages of development and consultation. France and South Africa are two countries which have introduced mandatory social and environmental disclosure for listed companies. Many other European countries such as the United Kingdom, and the European

[178] Hewson, above n 83.

Union itself, have thoroughly debated disclosure alternatives and settled on varying degrees of disclosure requirements, albeit not as thorough as those in France or South Africa.

6.1.1 France

The *Nouvelles Regulations Economiques* **(NRE)**, passed by French parliament on 15 May 2001, require all French corporations listed on the "premier marche" (those with largest market capitalisation) to include 'information on how the company takes into account the social and environmental consequences of its activities'.[179] Companies were required to start including this information in their annual reports in 2003.[180] The Assemblee Nationale subsequently issued Decree Number 2002-221 on 20 February 2002 which established nine social and nine environmental categories of indicators including human resources, community issues and engagement, labour standards, health and safety and environmental impact, management and protection.[181] It is not a comprehensive reporting system such as the GRI, but instead imposes a legal obligation for corporations to publicly disclose against these general indicators. As such, the system has been criticised to date for failing to establish 'specific indicators and methodologies to be utilised in disclosure'[182] and could arguably be improved by the official adoption of a set of guidelines or reporting standards. In addition to the NRE, France also appointed a Minister for Sustainable Development in June 2002.[183]

6.1.2 South Africa

Following the 2nd King Report into corporate governance[184] (King II), all companies listed on the JSE have been required since 1 September 2003 to report on their social and environmental performance using the GRI as a framework.[185] The Report implements a Code of Corporate Practices and Conduct which applies to companies with securities listed on the

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[179] Lucien Dhooge, 'Beyond Voluntarism: Social Disclosure and France's Nouvelles Regulations Economiques' (2004) 21 *Arizona Journal of International and Comparative Law* 441, 443.
[180] Ibid.
[181] Sarj Nahal, 'Mandatory CSR Reporting: France's Bold Plan', *Business for Social Responsibility*, available at www.bs.org/BSRResources/Magazine/CSRTrends.cfm?DocumentID=844 (accessed 7 April 2004). This includes mandatory reporting on (i) employees: health and safety, working hours, training and remuneration, (ii) community: local impact, engagement with stakeholders, (iii) environment: air, water and ground emissions, consumption of energy and raw materials, policies and management system, compliance with standards, (iv) labour: compliance with ILO standards.
[182] Dhooge, above n 179, 444.
[183] Ibid 447.
[184] King Committee on Corporate Governance, *King Report on Corporate Governance in South Africa 2002 (King II)* (March 2002), hard copy available for order from Institute of Directors in South Africa at www.iodsa.com.za . The King Committee on Corporate Governance was formed in 1992 under the auspices of the Institute of Directors of South Africa and chaired by Mervyn King.
[185] Ibid 2.

JSE.[186] In the section headed "Integrated Sustainability Reporting", the Code states that 'every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental policies and practices',[187] and goes on to stipulate that the GRI is to be used as the 'framework for such reporting'.[188] The JSE created the "SRI Index" as a means to identify those corporations listed on the JSE that integrate the principles of SRI and sustainability into their business activities, and as a way of increasing compliance with the King II recommendations.[189] Companies must meet criteria to be included in the index, and they are then scored according to their level of adoption and implementation.[190]

6.1.3 Europe

The European Union and the separate national governments have been working together and independently towards advancing the CSR agenda for many years. Many see Europe as encompassing the frontier for CSR, as Denmark, the Netherlands, France and Germany have already passed CSR-related laws.[191] Denmark mandated public environmental reporting in its "Green Accounting Law" in 1995, requiring over 3000 Danish companies to publish a "Green Account" describing their impact on the environment and the way in which they manage this impact.[192] Similar legislation has been enacted in the Netherlands affecting over 300 of the nations largest companies.[193]

The European Union has also been active on many fronts, fostering consultation and debate about CSR issues.[194] In June 2003, the EU's Council of Ministers adopted a new accounting directive known as the "Accounts Modernisation Directive",[195] requiring inclusion of certain social and environmental information in annual reports. Starting in 2005, affected large and medium sized companies will be required to provide 'a balanced and comprehensive analysis of the development and performance of the company's business …[which] shall include both financial and, where appropriate, non-financial key-performance indicators … including

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[186] Code of Corporate Practices and Conduct, King Report II, 1.1.1.
[187] Code of Corporate Practices and Conduct, King Report II, 5.1.1.
[188] Code of Corporate Practices and Conduct, King Report II, 5.1.3.
[189] Johannesburg Securities Exchange, above n 177, 2.
[190] Only 74 of the 155 companies listed on the FTSE/JSE All Share Index applied for inclusion in the index during the first round in October 2003, and only 54 companies made it on for the launch in May 2004. SocialFunds.Com, 'Socially Responsible Investing News and Information', www.socialfunds.com/news/archive.cgi/briefs.html, (accessed 24 August 2004).
[191] Parsons and Wilkins, above n 93, 13.
[192] Dhooge, above n 179, 446.
[193] Ibid.
[194] See: Parsons and Wilkins, above n 93, 15.
[195] Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003, see: www.europa.eu.int/comm/internal_market/accounting/officialdocs_en.htm

information relating to environmental and employee matters'.[196] The European Council of Bars and Law Societies, Europe's largest organisation of lawyers, issued advice in October 2003 stating the unanimous view among the representatives that social reporting becoming mandatory is only a matter of time.[197]

The United Kingdom has seen a lot of CSR-related activity over the past few years. Significantly, the Government took the step of creating a Minister for Corporate Social Responsibility in May 2002.[198] Stephen Timms, the appointed Minister, believes the supporting CSR policy framework 'must use the right mix of tools – including fiscal and regulatory measures where appropriate'.[199] In 2002, a Corporate Social Responsibility Bill was introduced to Parliament which proposed to make TBL reporting mandatory.[200] Although the Bill was ultimately rejected, there was significant parliamentary debate over the Bill, with the general consensus being that some movement in the direction of mandatory CSR reporting is warranted. Following more than 300 MPs expressing support for expanding the CSR agenda in the UK,[201] a similar Bill – the Corporate Responsibility (CORE) Bill - was tabled in Parliament in Sept 2003. The Bill was passed in the House of Commons on 29 January 2004, and is currently being debated in the House of Lords.

In July 2002, the UK White Paper *Modernising Company Law*[202] was released for consultation, with the Government proposing that listed companies (of which they are 1260)[203] should have to produce an Operating and Financial Review **(OFR)**, including in the review the impact of the company on society and the environment. The UK Secretary for Trade and Industry Patricia Hewitt released a consultative draft of regulations in May 2004, with the consultation period ending 6 August 2004.[204] The Government proposes to introduce the OFR through secondary legislation under existing company law.[205] It is proposed the OFR will have to cover:

> the issues traditionally seen as key to a company's performance – an account of its business,

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[196] Modernisation Directive 2003/51/EC Article 1.14(1)(b)

[197] Parsons and Wilkins, above n 93, 13-17.

[198] The Minister for CSR is currently Stephen Timms, jointly Minister for Energy, e-commerce and Postal Services. See: Department of Trade and Industry (UK), *Corporate Social Responsibility: A Government Update* (May 2004), available at www.csr.gov.uk.

[199] Ibid 4.

[200] Parsons and Wilkins, above n 93, 16.

[201] Hewson, above n 83.

[202] See: www.dti.gov.uk/companiesbill/whitepaper.htm

[203] Department of Trade and Industry (UK), *Draft Regulations on the Operating and Financial Review and Directors' Report – A Consultative Document* (May 2004), 19.

[204] Ibid.

[205] Ibid, 7.

objectives and strategy, a review of the developments over the past year and a description of the main risks. But it will also cover prospects for the future and, where necessary, information about the environment, employees, customers or social and community issues where that information is important for the assessment of the company'[206]

If the directors decide CSR issues do not affect the company, they must explicitly say so.

6.1.4 The United States and Canada

When compared with Europe and South Africa, the US and Canada have been slower to embrace the CSR debate and take regulatory and legislative action. It seems to the author that these two jurisdictions, and in particular the US, are still focusing on corporate governance issues. The SEC does require certain disclosure of some environmental and social information,[207] but generally the rules are vague and poorly enforced.[208] Environmental disclosure has been under focus in the US over the past few years,[209] but the focus has mostly been on potential environmental liabilities. While the academic debate is the most advanced in the US, it seems that the trend is that regulatory steps are only pursued where there is a blatantly obvious link with financial issues. The lack of regulatory attention is surprising given the high levels of SRI.

In Canada, regulatory steps are still in their infancy. In May 2004, the Canadian Institute of Chartered Accountants revised its guidance statement on preparation of the Management Discussion and Analysis (MD&A) section of the SEC Form 10-K,[210] recommending that companies include information about workforce, workplace organisation and culture, safety, environmental responsibility and social responsibility.[211] Currently, there is debate over whether the proposed *Multilateral Policy 58-201 - Effective Corporate Governance,*[212] released by the Canadian Securities Administrators **(CSA)**, will move from encouraging social disclosure to mandating it.[213]

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[206] Ibid, 6.

[207] For example, *SEC Regulation S-K Item 101 General Description of Business Operations* requires disclosure of 'material effects that compliance with Federal, State and local provisions … may have upon capital expenditures, earnings and competitive position', and *SEC Regulation S-K Item 103 Legal Proceedings* requires companies to disclose material environmentally-related judicial and administrative proceedings.

[208] *Environmental and Social Disclosure and the SEC: Meeting the Information Needs of Today's Investors*, Minutes of Conference held on 10 July 2003, Washington DC, available at www.corporatesunshine.org/sympagenda.pdf.

[209] Ibid. For example, in 2003 the SEC conducted a review of Fortune 500 Company filings and issued comments to a number of companies regarding their environmental disclosure. The Commission found 'many companies did not provide adequate disclosure' on environmental issues. See: www.sec.gov/divisions/corpfin/fortune500rep.htm

[210] Canadian Institute of Chartered Accountants, *Management's Discussion and Analysis – Guidance on Preparation and Disclosure* (revised May 2004).

[211] Ibid 38.

[212] See: www.tse.com/en/pdf/ProposedCSAPolicy-MP58-201_EffectiveCorpGovernance.pdf

[213] Social Investment Organisation, *Comments on proposed Multilateral Policy 58-201* (31 May 2004), available from www.socialinvestment.ca/Policy&Advocacy/CSACorporateGovernanceMay3104.doc

6.2 National competitiveness and flow of capital

Probably the most compelling public policy case for mandatory social disclosure is national competitiveness. Australia's poor record of environmental and social disclosure vis-à-vis other modern jurisdictions affects our national competitiveness and the ability of our corporations to attract international capital. Our lethargy in fostering the CSR debate, especially in the legislative and regulatory realms, exacerbates this concern.

Having a poor reputation for CSR can affect Australia and our companies in a number of ways. It will affect the ease with which Australian corporations can enter and operate in countries with an emphasis on CSR (e.g. France). The inverse is also true. If we create a reputation as a world-leader in CSR though introducing mandatory disclosure, Australian companies would have greater ease entering other markets. Additionally, Australian multinationals would meet less resistance in regard to environmental and social issues in their operations if such a reputation was developed.[214] Australia as a nation would gain legitimacy in social and environmental matters, which could be of benefit in trade negotiations and international dealings (e.g. the Kyoto Protocol).

Probably the biggest impact would be on the ability of Australia to attract foreign capital and labour. Arthur Levitt, the former Chairperson of the SEC, famously noted:

> 'If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere. *If investors are not confident with the level of disclosure, capital will flow elsewhere.* If a country opts for lax accounting and reporting standards, capital will flow elsewhere. *All enterprises in that country* – regardless of how steadfast a particular countries practices may be – *suffer the consequences* … It serves us well to remember that no market has a divine right to investors' capital'[215] [emphasis added]

The Asian economic crisis is a pertinent example of investors losing confidence in the corporate governance systems of markets and withdrawing their capital. While it is unlikely that such withdrawal of capital would occur in Australia due to CSR issues, it is likely that company's will have more and more trouble securing flow of capital and labour from sources and countries which value CSR. *The State of Sustainability Reporting in Australia in 2004* surveyed companies producing sustainability reports on the major benefits they receive from

[214] Consider the hypothetical situation where a large Australian multinational miner was trying to persuade a foreign government that the effects of a drilling operation would not be severe on the surrounding environment in their country. If Australia had a reputation for CSR, the company would have greater ease and a higher likelihood of success in convincing that government to permit the drilling program.

[215] King Committee on Corporate Governance, above n 184, 9.

them, with the most common responses being ‘reputation enhancement’ and ‘gain confidence of investors, insurers and financial institutions’.[216]

Probably the clearest demonstration of this for companies themselves is the inability to attract capital from socially responsible investors and funds which use socially responsible guidelines. Take for example CalPERS, the Californian Public Employees Retirement System, which is the world’s largest pension fund with over USD$150 billion in assets and uses SRI guidelines to manage its investments.[217] As a result of applying this SRI criteria, CalPERS has disqualified from consideration companies from Colombia, Egypt, India, Indonesia, Jordan, Malaysia, Morocco, Pakistan, China, the Philippines, Russia, Sri Lanka, Thailand and Venezuela.[218] While it is unlikely Australian companies would receive a blanket disqualification, our companies will find it difficult to access this capital. Given the size of the SRI fund market overseas, and the rate at which it is increasing, Australian companies will be put at a significant disadvantage if they do not have access to this capital.

Introducing mandatory social disclosure is a great opportunity to establish our reputation as a country that respects CSR. It is also an opportunity to establish a reputation that our companies operate in a socially and environmentally responsible manner. The Joint Committee on Corporations and Securities is of the opinion that high levels of social disclosure would ‘enhance the reputation of Australian’s corporations, and for that matter, the reputation of Australia itself’.[219] This would ensure optimal access to capital and put our companies and nation at a competitive advantage to our competitors and contemporaries. A failure to rectify the current ‘gap’ in disclosure practices and regulatory initiatives would put us at a competitive disadvantage and inevitably increase the cost of foreign capital.

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[216] Centre for Australian Ethical Research, above n 92, 19.
[217] Johns, above n 58..
[218] Dhooge, above n 179, 458.
[219] Parliamentary Joint Statutory Committee on Corporations and Securities, above n 67, 36.

Chapter 7

THE ‘FLOW DOWN’ EFFECTS OF MANDATORY SOCIAL DISCLOSURE

Forcing Australian companies to provide social disclosure will have the effect of increasing CSR practices. Dr John Hewson opined ‘it is clearly evident that where a legislative, regulatory and compliance framework is present, companies, because they are required to comply, tend to perform better in terms of social responsibility’.[220] Corporations with weak CSR practices and policies will no longer be able to hide this from the investing public. Hence, these corporations will improve their performance in order to be able to release better information about themselves to the market. It would be naïve of the author not to acknowledge this. As a result, it is necessary to look at this ‘flow down’ effect . Although the following arguments are not relied upon, they show that increasing CSR practices in Australian company’s is certainly not a bad thing.

7.1 The “business case”

Many proponents of CSR argue the “business case” for CSR that ‘companies do well by being good’.[221] The Group of 100 see the following potential benefits from introducing CSR practices into a company: reputational and brand benefits; securing a ‘social license to operate’; attraction and retention of high caliber employees; improved access to the investor market; establishment as a preferred supplier; reduced risk profile; and innovation.[222]
As with corporate governance, this link between practice and profitability is hard to prove. However, there is an expanding field of academic literature and analysis which points to a connection between good corporate social performance and good financial performance.[223]

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[220] Hewson, above n 83.
[221] Zappala, above n 6.
[222] Group of 100, above n 32, 14-16.
[223] Some of the more favourable (and questionable) studies have come to conclusions such as “companies that have adopted codes of ethics reported that their stock market performance was two to three times better than their counterparts without such policies”: Peter Sinton, ‘Crisis of Conscience: Corporations are Finding Social Responsibility Boosts the Planet and the Bottom Line’, *San Francisco Chronicle*, (San Francisco, United States) 22 November 2001, at B1. Similarly, a Harvard University

Orlitzky and Rynes in their detailed study *Corporate social and financial performance: A meta-analysis*[224] found that 'corporate social performance and financial performance are generally positively related across a wide variety of industry[ies]'.[225] Given the detailed and methodical nature of the study, and the fact that it is based on 52 previous studies,[226] it can be tentatively stated that the relationship exists. The phenomenal performance of the Dow Jones Sustainability Index adds further evidence. Since its inception in October 1999, the top 200 companies on the DJSI have outperformed the Dow Jones Global Index (DJGI) by approximately 10 %.[227] Comparing the performance of the companies initially included on the DJSI (ie. the 200 companies who were initially chosen) from the beginning of 1994 to the end of 1998, the DJSI posted a return of 125.80%, while the DJGI only managed 80.58%.[228]

7.2 Sustainability

Dhooge outlines that 'disclosure may also encourage the development of a corporate culture in which social responsibility and environmental stewardship are more readily accepted'.[229] Many see today's corporate climate, and the conduct of corporations, as 'rapacious, self-serving and short-termist'.[230] Undoubtedly, CSR is seen as a key driver for making corporations and our society consider sustainability, and adopt practices which are more sustainable. An interesting example is that of air pollution in the United States, where following the introduction of mandatory disclosure requirements, air pollution emissions decreased 35 % over four years.[231] Hence, mandatory social disclosure will contribute to sustainability.

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study found "stakeholder balanced" companies generated four time the revenue growth and eight times the employment growth of companies maintaining a 'shareholder-only focus': cited in See: Dhooge, above n 179, 460.

[224] M. Orlitzky, F.L. Schmidt and S.L.Rynes, 'Corporate social and financial performance: a meta-analysis', *Organisational Studies*, vol 24, no 3, 2003, pp. 403-441.

[225] Marc Orlitzky et al, 'Corporate social and financial performance: a meta-analysis' (2003) 24 *Organisational Studies* 404.

[226] Orlitzky and Rynes conducted a meta-analysis of 52 studies yielding a total sample size of 33,878.

[227] See: www.sustainability-index.com/htmle/djsi_world/keyfacts.html

[228] see Ibid

[229] Dhooge, above n 179, 467.

[230] Murray et al, above n 133, 6.

[231] Sweeney et al, above n 129, 3, citing Estes, R., 'A New Scorekeeping System' (1996) *Business Ethics Special Report #1*, 3.

Chapter 8

CRITICISMS OF MANDATORY SOCIAL DISCLOSURE

There are a number of issues that would need to be dealt with in order to implement a system of mandatory social disclosure, and a number of criticisms of the idea itself.

8.1 Costs

8.1.1 Disclosure costs

It is undeniable that mandatory social disclosure would impose extra costs on businesses which do not currently provide adequate levels of such disclosure. It is important to consider whether the benefits are worth this extra cost. As Easterbrook and Fischel warned 'one must be careful … about committing the fallacy of thinking that if some information is good, more is better … information is costly, and the costs are borne in large part by investors'.[232] To disclose information to the public costs money,[233] and includes legal, accounting, auditing, marketing and printing expenses. *The State of Sustainability Reporting in Australia in 2004* found that the biggest impediment to sustainability reporting was the additional costs and resources of doing so.[234] So how much would it cost companies to disclose the information contained in Appendix A and B?

While this is impossible to determine exactly, some factors suggest it might not be too expensive. As a point of comparison, it is estimated that the average cost of an OFR report in the UK will be £29,000, with £19,000 being for auditing and legal fees.[235] Obviously, the costs of disclosure are 'quite cheap if the data to be disclosed were already regularly collected' [236]. The costs of communicating already collected though an existing avenue (ie. the annual report) will in reality be small. As the requirements outlined in Appendix A and B

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[232] Easterbrook and Fischel, above n 121, 696.
[233] Tilling, above n 4, 5.
[234] Centre for Australian Ethical Research, above n 92, 20.
[235] Department of Trade and Industry (UK), *Draft Regulations on the Operating and Financial Review and Directors' Report – A Consultative Document* (May 2004), 80. OFR reports were discussed in 6.1.3.
[236] Note, above n 46, 1451.

are either quantitative (e.g. amount of water used) or descriptive (e.g. outline equal opportunity policies), it is likely that the disclosure costs would be minimised. Disclosure costs placed on corporations can be justified if it is to the advantage of the public and/or the market. Corporate governance is the perfect example of where disclosure costs have been justified as the information is necessary for investors, and disclosure is in the public interest to leverage better corporate governance practices from companies.

8.1.2 Reputational costs

While perhaps not frankly admitting it, the major concern of many companies with social disclosure is the effect on a company's profits and stock price caused by a negative reaction to disclosures and the consequent reputational effect. A pertinent example is Talisman Energy Inc - a Canadian company heavily involved in Sudanese government oil projects. Following a public campaign exposing the company's investments in Sudan, and its subsequent exclusion from socially responsible funds, it is estimated that Talisman has lost USD$3 billion in market capitalisation.[237]

This however, is not an argument against mandatory social disclosure, but is indeed an argument in favour of it. This example demonstrates the materiality of social and environmental information. It also displays that many investors are willing to act on the basis of such information. Hence, the current void of information from the market means the market is operating inefficiently as it is not fully informed. The universal disclosure of social and environmental information would involve both negative and positive effects on some companies financial strength. This initial correction would mean the market subsequently operates more efficiently as it is more informed.

8.1.3 Activity level costs

Easterbrook and Fischel characterise another type of cost borne by mandatory disclosure as "effects on activity level", which is the cost felt when disclosure leads a company to change or abandon profitable projects which they would have pursued had it not been for the fact they must now disclose details about them.[238]

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[237] Adam Pener, *Capital Markets Transparency and Security: The nexus between U.S.-China Security Relations and America's Capital Markets* (report to the US-China Commission) 32-40 (2001), available at http://www.uscc.gov/rese.htm, 39, cited in Note, above n 456, 1444. Pener also noted that Sinopec (a Chinese oil company) had to slash its planned initial public offering on the New York Stock Exchange from a planned USD$10 billion to USD$2.9 billion due mostly to adverse reactions to its dealings in Sudan.

[238] Easterbrook and Fischel, above n 121, 708.

What must be noted before addressing this concern is that mandatory social disclosure does not directly regulate a company's activities. Companies would be under no obligation, legal or otherwise, to alter their behaviour or to continue with their current behaviour. Mandatory disclosure simply means the company must give more information to the public about what it is doing. Hence, the argument becomes similar to that argued against reputational costs. As the investing public obviously care about social and environmental issues, company's must report on them. It is hardly justifiable to remain with a system which allows companies to proceed with projects which they would not proceed with if investors were informed about them! This information disparity must be corrected so that corporations are accountable for their actions to the investing public.

As acknowledged in Chapter 7, mandatory social disclosure would effect corporate change. If the goals of sustainability and responsibility are achieved at the cost of some environmentally or socially harmful yet profitable projects, then surely this must be seen as a net benefit to society. If society does not care about such issues, then the corporations would be able to continue with the projects, disclose details of them, and suffer no repercussions. Obviously this will not occur, and as has been proven already, society can and will punish companies who are socially or environmentally irresposnsible.

8.2 Auditing social disclosure

Many consider that a company's social and environmental statements are not credible unless they are independently verified. Obviously auditing involves costs to the company.[239] Additionally, it is more difficult to audit social disclosure compared to financial disclosure, as social disclosure involves a greater degree of non-quantitative information. The GRI outlines the following options to enhance credibility and quality of reports: stakeholder consultation panels, strengthened internal data collection and information systems, issue-specific audits by appropriate experts, internal audits of data collection and reporting systems, and reviews and commentaries by independent experts.[240] *The State of Sustainability Reporting in Australia in 2004* found that of the 116 companies producing sustainability reports, 32 companies had their reports independently verified.[241] A third used accounting companies for verification,

[239] It is estimated legal and auditing costs for preparing an OFR in the UK will be approximately £19,000 per company per report: Department of Trade and Industry (UK), *Draft Regulations on the Operating and Financial Review and Directors' Report – A Consultative Document* (May 2004), 80.
[240] Global Reporting Initiative, above n 88, 19.
[241] Centre for Australian Ethical Research, above n 92, ii.

with two thirds relying on consulting firms or university departments.[242] Firms such as Pricewaterhouse Coopers provide auditing services for social and environmental reports,[243] and use social and environmental experts to work with the accountants in order to verify reports. Hence, auditing and verification is not only possible but is already occurring.

It is recommended by this paper that auditing of social information be encouraged, but not mandatory. This will allow companies to alleviate costs if they wish to. In reality, most corporations will invoke some sort of auditing procedure to ensure the legitimacy of their disclosure. Once companies become comfortable reporting, and as auditing services become more readily available, mandatory auditing or verification of social disclosure could be mandated at a future date.

8.3 The nature of compliance

One of the most common concerns levelled at any type of mandatory disclosure is that it leads to 'compliance process' rather than 'compliance culture'. Mark Goyder questioned the value of mandatory social reporting in *Redefining CSR*, articulating the distinction between what he describes as 'compliance CSR' and 'conviction or values led CSR'.[244] There are however, many forces which oppose the above problem. One way to combat it is to ensure that where possible, disclosure requirements are quantitative rather than qualitative (see Appendices A and B). This also has the benefit of allowing easier and greater comparability. Competitive market forces would also play a role in 'ramping up' the quality of the disclosure, as market leaders who wish to distinguish themselves from competitors raise the standard for their sectors. In disclosure terms, this is known as the 'race to the top'. Other initiatives (such as those outlined in Chapter 10) can encourage companies to embrace CSR, and consequently reduce the likelihood of tick-the-box disclosure being provided.

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[242] Ibid 18.

[243] William Baue, 'Auditing Sustainability Reporting', *SocialFunds.Com*, 21 June 2004, available at www.socialfunds.com, (accessed 20 August 2004)

[244] Mark Goyder, *Redefining CSR* (2003), available for order from Centre for Tomorrow's Company at www.tomorrowscompany.com.

8.4 Lack of flexibility

The last, and quite pertinent, criticism of mandatory legislation is that is inflexible. This is of concern with an issue such as CSR, which has only recently appeared on the regulators agenda, and is still surrounded by a large amount of confusion, debate and disagreement. However, as will be discussed in the next chapter, there are regulatory options which provide flexibility.

Chapter 9

OPTIONS FOR MANDATING SOCIAL DISCLOSURE

Having established that mandatory social disclosure is required for reasons of materiality, and desirable in terms of national competitiveness and flow of capital, it is now necessary to turn the question of how best to do it?

Avenues which may be considered as a tool for introducing mandatory disclosure include: (i) the annual report, (ii) prospectus disclosure, (iii) continuous disclosure, or (iv) the introduction of a new, separate document focusing on social and environmental disclosure.[245]

9.1 Annual report disclosure

The annual report, which must be prepared and distributed by listed corporations, consists of a financial report and a directors report. Annual reports must be lodged with ASIC and the ASX and made available to members and the public. As such, the annual report is a good place for social disclosure as it is widely available, well-known and allows comparability.

Option 1

Legislative reform could require the disclosure of social and environmental information as part of the director's report (ie. insertion of a new section 299(1)(g) in the *Corporations Act 2001* (Cth)).

Option 2

The ASX could require the inclusion of social and environmental information similar to what is required under the ASX Principles of Good Corporate Governance and Best Practice Recommendations ('ASX Corporate Governance Guidelines'). This could be done either through: (a) addition to the current guidelines, or (b) the release of a new set of guidelines and

[245] There are of course other conceivable avenues for mandating disclosure such as in takeover documents. However, the focus of these documents is the evaluation of the offer, the prospect of receiving a higher offer, etc and not to give information about the social and environmental performance of the company. Hence, they will not be considered in this paper. This is not to say, however, that such documents could not, in the future, require disclosure of social information.

the insertion of a new requirement to the Listing Rules similar to 4.10.3. It is proposed by this paper that the new Listing Rule could state:

> companies must provide social and environmental information in the annual report or on the company website using the Guide to Reporting Against Environmental Indicators and the Guide to Reporting Against Social Indicators. Any departure from the Guides must be explained. If a company chooses not to provide all or any of this information, it must provide an explanation of that decision.

9.2 Prospectus disclosure

When a corporation intends to list on the ASX, or issues additional securities, it must lodge a prospectus document with ASIC which is then made available to the public. Section 710 of the *Corporations Act 2001* (Cth) stipulates that prospectuses must contain 'all information that investors and their professional advisers would reasonably require to make an informed assessment of' the relevant issues, including the 'financial position and performance, profits and losses and prospects of the body'.

Option 3

Legislative amendment of the *Corporations Act 2001* (Cth) could require the disclosure of social and environmental information as part of the prospectus document.

Option 4

Arguably, s 710 could be interpreted to require the inclusion of social and environmental information as information required by investors to make investment decisions. This would be achieved through judicial re-interpretation of section 710 or by ASIC. While ASIC does not have the power to prescribe the content of the prospectuses, [246] it can give views on what should be included in them by indicating the basis on which it would exercise its stop order powers.[247]

9.3 Continuous disclosure

Corporations are required under ASX Listing Rule 3.1 to *immediately* disclose any information that a reasonable person would expect to have a *material effect* on the price.[248]

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[246] ASIC, *ASIC Policy Statement 56 Prospectuses*, [56.17]), see www.asic.gov.au

[247] see: Robert Baxt et al, *Securities and Financial Services Law,* (6th Ed. Butterworths 2003), 100.

[248] ASX Listing Rule 3.1:

The market materiality test for this Listing Rule tracks the statutory definition.[249] Section 677 of the *Corporations Act 2001* (Cth) states that information is material if it 'would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose'[250] of that company's securities.[251]

Option 5

Similar to the proposal of Cynthia Williams, the definition of materiality could be interpreted to now include relevant social and environmental information.

9.4 Proposed regulatory approach – ASX guidelines

While all the options have merit, and could be considered in the future, Option 2 (ASX guidelines) is the approach proposed by this paper. The type of disclosure outlined in the Appendices is obviously best suited to being provided in annual reports, or separate sustainability reports. This is what the Guides are designed for. This type of information could not be disclosed on a continual basis, and the provision of such information in prospectuses would be a logical 'next step' if disclosure in the annual report was successful.

This 'soft law' approach is hard enough to be effective, but avoids many of the disadvantages and difficulties that a traditional hard law solution would encounter in this field. Introducing new legislation is difficult due to the inertia of government and lobbying by powerful business groups. The treatment of the *Corporate Code of Conduct Bill* highlighted some of these problems as the Parliamentary Joint Statutory Committee on Corporations and Securities believed that inroads into this area need to be made 'carefully, slowly and incrementally'.[252] Other advantages commonly associated with this type of regime include: a perceived increase in the legitimacy of the regulation as it is closer to the market; it is

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> Once a person or entity is or becomes aware of any information concerning it that a reasonable person would expect to have a *material effect* on the price or value of the entity's securities, the entity must immediately tell ASX that information.

[249] Ford, above n 13, 505.

[250] s 677 of the *Corporations Act 2001* (Cth):

> A reasonable person would be taken to expect information to have a *material effect* on the price or the value of ED securities of a disclosing entity if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the ED securities.

[251] *Fords Corporations Law*, above n 13, states that section 677 seems to be based on US law in *TSC Industries Inc v Northway, Inc.* 426 U.S. 438 (1976). In that case, the Supreme Court rejected 'all facts which a reasonable shareholder might consider important', and held materiality is satisfied by 'a showing of a substantial likelihood that, under the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder': at 449

[252] Parliamentary Joint Statutory Committee on Corporations and Securities, above n 67, 46.

cheaper for the State; and avoids the legalism and over-regulation that "command and control" legislation tends to bring.[253]

The introduction of a similar system by the Johannesburg Securities Exchange in 2002 (discussed in 6.1.2) provides us with a unique precedent in this field which can be used in setting up such a system here.[254] The ASX would also be able to draw on lessons learnt in the implementation and supervision of the ASX Corporate Governance Guidelines.

The "if not, why not" compliance mechanism allows companies which are reluctant or opposed to social and environmental disclosure to not disclose. This is the approach used in both the ASX Corporate Governance Guidelines and by the JSE. According to Dimity Kingsford Smith, the exact legal effect of such a system has not yet become clear.[255] The Listing Rules are part of the binding contract between the ASX and the Company.[256] Hence, the ASX has various tools of enforcement and coercion it can use against a company not complying with the Listing Rules. These range from drastic remedies such as suspending or delisting the company, to "soft" tools such as query letters and dialogue with companies.[257] In practice, the 'ASX is adopting techniques of negotiation, persuasion and market education in the supervision and enforcement'[258] of the ASX Corporate Governance Guidelines. The ASX could also introduce a SRI or CSR index (similar to the JSE SRI Index) to further encourage compliance. While the system in not perfect, and arguably suffers from uncertainty, the flexibility that the ASX has in enforcement and supervision is a great advantage.

The flexibility afforded is needed in the area of social and environmental disclosure as this is a new idea for corporations, the market and regulators. The ability to require corporations to follow a common set of reporting guidelines allows certainty as well as ensuring comparability of information. Australia has the advantage that the Guides to Reporting Against Social and Environmental Indicators are tailor-made for the Australian context. The ability to consult the stakeholders involved (corporations, members, community) and amend the guidelines with ease is a great benefit, and one that is necessary. A recent example of this

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[253] See Dimity Kingsford Smith, *If Not, Why Not? Hybrid Approaches to Corporate Governance Standards*, (forthcoming manuscript in file of the author), Monash University, Melbourne, August 2004, 17-18.
[254] Unfortunately, at the time of writing, there has been no feedback from the JSE on the regime, its effectiveness or issues encountered in implementation. However, this dialogue could easily be established by the ASX.
[255] For an extensive discussion of the possible legal effects and advantages and disadvantages of the ASX Corporate Governance Guidelines see: Kingsford Smith, above n 253.
[256] Baxt, above n 247, 313.
[257] see: Kingsford Smith, above n 253, and Baxt et al, above n 247, 306-330.
[258] see: Kingsford Smith, above n 253, 28.

is the amendment of the audit committee requirements under the ASX Corporate Governance Guidelines.[259]

259 Following the recommendation of the ASX Corporate Governance Council Implementation Review Group (IRG), as of 3 May 2004, the recommendations for the composition of the audit committee apply only to the top 300 companies, rather than to the top 500 companies (which the ASX Corporate Governance Guidelines generally apply to). See: Australian Stock Exchange Corporate Governance Council Implementation Review Group, *Principles of Good Corporate Governance and Best Practice Recommendations: Report to the ASX Corporate Governance Council* (31 March 2004), and the ASX response at http://www.asx.com.au/about/13/CorporateGovernanceReporting_AA3.shtm

Chapter 10

THE WAY FORWARD – A PLURALIST APPROACH

Zappala argues governments can also take a 'non-regulatory activist approach' which involves the government supporting, developing and encouraging CSR practices. [260] The UK government is cited by Zappala an example, having measures such as a Minister for Corporate Social Responsibility and specifically encouraging CSR practices. Governments can act as demonstrators of best practice as government agencies adopt TBL reporting,[261] and can use ethical criteria in tendering processes.[262] Governments can also choose to conduct business with socially responsible actors where there is a choice.[263] Zappala endorses the following statement from Richard Lambert on the role of the British Government:

> Government has a clear interest in helping to encourage notions of social responsibility among companies … supportive policies could help to nudge companies and investors in the right direction, to encourage the spread of best practices, and to provide a sound framework for social and environmental reporting.[264]

Julian Blanchard correctly argues that mandatory disclosure rules have their part to play in the 'arsenal of weapons' to tackle social and environmental problems.[265]

In addition to the necessary step of mandating social disclosure, the Australian government undeniably has a role in educating companies and the public about CSR issues, assisting companies to embrace CSR initiatives and providing funding for research and consultation for the advancement of CSR. The Guides to Reporting, and the Prime Minister's Community Business Partnership, are the only current examples of such activist approaches by the Government. In the future further initiatives need to be taken, which could include such things as appointing a Minister for Corporate Social Responsibility, introducing CSR policies

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[260] Dr Gianni Zappala categorises the approach as designing a framework to: (i) ensure coordination of CSR and corporate citizenship policies and activities across the whole government, (ii) raise the profile of CSR and corporate citizenship, (iii) promote the link between corporate citizenship and productivity, (iv) assist in the development of CSR and corporate citizenship skills, (v) assist smaller and medium sized firms apply corporate citizenship practices, (vi) fund research into corporate citizenship, and (vii) enact a range of 'soft' or 'enabling' legislation of relevance to corporate citizenship. Zappala, above n 2, 16-17.

[261] Zappala, above n 2, 17.

[262] Zappala, above n 2, 7. In Britain, for example, tendering for public-private partnership contracts requires:

> 'all bidders for government contracts to demonstrate a commitment to sustainable development, especially on smaller companies which are often not touched by other activity and are less exposed to consumer and investor pressure'

[263] For example, in March 2000, the United States police forces decided to purchase Smith and Wesson firearms exclusively for the reason this company publicly announced they were taking extra steps to make their firearms safer. See Rick Sarre, 'Responding to Corporate Collapses: Is There a Role for Corporate Social Responsibility' (2002) 11 *Deakin Law Review* 9.

[264] See Zappala, above n 2, 19.

[265] Blanchard, above n 48, 172.

in government agencies and entities, and creating a Corporate Social Responsibility Unit as part of a government department.[266]

[266] Zappala suggests the Department of Industry, Tourism and Resources as a suitable location for such a new unit. Zappala, above n 2, 18.

CONCLUSION

Corporate social responsibility is a term unfamiliar to many, and fully understood by even fewer. Such was the case with corporate governance not so long ago. Today corporate governance is of central importance in corporate regulation, and corporate governance disclosure is universally mandated. There is little doubt that CSR will follow a similar path, the only question is how long it will take.[267] Rather than acting slowly and reactively, Australia should seize the opportunity to become a world leader by embracing the concept and mandating social disclosure.

Currently the level of social and environmental disclosure provided by Australian companies is inadequate, and the quality of what is disclosed is poor. The reality is that the levels of disclosure are far poorer in Australia than in most other countries including most of Europe, the US and Canada. We are also lagging behind our economic contemporaries in terms of initiatives to increase and regulate its provision. Mandating social disclosure is both necessary, and desirable. There is sufficient interest in social and environmental issues, and demand for comparable information, to warrant regulatory intervention to make its provision mandatory. Additionally, such a step would increase and protect Australia's national competitiveness, and ensure our company's have optimum access to international capital.

The best approach would be for the ASX to mandate social disclosure in the annual report in a manner similar to the disclosure requirements of the ASX Principles of Good Corporate Governance and Best Practice Recommendations. This should be achieved, along with other 'non-regulatory activist' initiatives, in order to provide a pluralist framework for encouraging CSR practices and delivering social and environmental information to the investing public.

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[267] For interesting examination of the interrelation between corporate governance and corporate social responsibility see: Bryan Horrigan, 'Fault Lines in the Intersection Between Corporate Governance and Social Responsibility' (2002) 25 *UNSW Law Journal* 515.

APPENDIX A

Guide to Reporting Against Environmental Indicators

The following is the authors summary of the reporting requirements outlined in *Triple Bottom Line Reporting: A Guide to Reporting Against Environmental Indicators.*[268]

1. Environmental Management Indicators

Core Indicator 1	Details of any Environmental Management Systems (EMS), audit programs and conformance with relevant industry standards or codes
Core Indicator 2	Details of processes for identifying and assessing environmental risks and opportunities; objects and targets relating to environmental issues; and progress with commitments outlined in previous reports
Core Indicator 3	Details of integration of EMS with other business management systems, including organisational and board structures, and details of how the EMS is built into core business practices and decision-making
Additional Indicator 4	Summaries of material environmental risk issues arising in due diligence processes from any mergers and acquisitions
Additional Indicator 5	Details of known material liabilities, and details of environmental issues with the potential to result in material liabilities

2. Environmental Performance Indicators

Energy	Direct Energy Use (kJ)
	Indirect Energy Use (kJ) – ie. energy used by suppliers to provide the amount of direct energy used
	Initiative to use renewable energy sources and increase energy efficiency
Greenhouse	Total greenhouse gas emissions (tonnes CO_2 equivalent)
	Initiatives to reduce greenhouse gas emissions
Water	Total water use (m^3)
	Total water reused (m^3)
	Initiatives to decrease water consumption and/or increase water reuse
Materials	Total material use (tonnes) – ie. steel, aluminium, plastic, etc, reported by type

[268] Environment Australia, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Environmental Indicators,* Department of the Environment and Heritage, June 2003.

	Initiatives aimed at using post-consumer recycled material and waste from industrial sources
Waste	Total amount of solid waste by type and destination
	Total amount of hazardous waste product (tonnes)
	Initiatives and improvements to waste management
Emissions to air, land and water.	Significant emissions to air and land (tonnes)
	Significant discharges to water by discharge type (tonnes)
	Initiatives to reduce discharges and emissions.
Biodiversity	Location and size of land owned, leased or managed in biodiversity-rich or ecologically significant areas (hectares)
	Major impacts on land owned associated with the company's activities, products and services.
	Initiatives and improvements to biodiversity management
Ozone depleting substances	Ozone-Depleting Substance (ODS) emissions
Products and Services	Describe major environmental impacts at each stage of the life cycle of principal products and services
	Products and services initiatives to reduce environmental impacts
Compliance	Incidence of, and penalties for, non-compliance with applicable laws
	Significant spills of chemicals, oils and fuels in terms of total number and total volume

APPENDIX B

Guide to Reporting Against Social Indicators

The following is the authors summary of the reporting requirements outlined in *Triple Bottom Line Reporting in Australia – A Guide to Reporting Against Social Indicators.*[269]

Employment	Breakdown of workforce where possible by country, employee type (full time/part time), and employment contract (contract/permanent)
	Employment net creation and average turnover segmented by geographical area
	Employee benefits beyond those legally mandated (e.g. contributions to healthcare, disability, maternity, education and retirement)
Health and Safety	Standard injury, lost day and absentee rates, and number of work related fatalities
Training and Education	Average hours of training per year per employee category of employee (e.g. senior management / middle management / etc. and professional/technical/ administrative/etc.)
	Description of programs to support the continued employability of employees and to manage career endings
Diversity and Opportunity	Description of equal opportunity programs and policies, as well as monitoring systems, and the results of monitoring
	Composition of senior management and corporate governance bodies (including board), including female/male ratio and other indicators of diversity
Human rights	Description of policies, guidelines, structure and procedures to deal with all aspects of human rights, including monitoring mechanisms and results
	State how policies relate to existing standards such as Universal Declaration and Fundamental Human Rights Conventions of the ILO
	Evidence of consideration of human rights impacts as part of investment and procurement decisions, including selections of suppliers/contractors.
	Description of freedom of association policy
	Description of policies, guidelines, structures and procedures to deal with the needs of indigenous people, including indigenous people in the workforce and communities where the organisation currently operates or intends to operate.
Community	Description of policies to manage impacts on communities in areas affected by

[269] Department of Family and Community Services, *Triple Bottom Line Reporting in Australia: A Guide to Reporting Against Social Indicators*, Draft in Discussion, July 2004.

	company activities, including explanation of procedures for identifying and engaging in dialogue with community stakeholders.
	Amount of money paid to political parties and related institutions
Product Responsibility	Description of policy for preserving customer health and safety during use of products and services; extent to which this policy is visibly stated and applied; and explanation of multiple standards in the marketing and sales of products.

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