

How many of you believe that government can adequately protect the environment, our communities and other elements of the public interest from corporate behavior? How many do not? These are questions I recently asked a group of about 125 Australians at a forum hosted by the New South Wales Young Lawyers. One person held up her hand to indicate that she believed government could. More than 100 raised their hands to indicate they believed government could not.

Australia is about to host a discussion on what can be done to make corporations more socially responsible. Two inquiries are currently pending. One before the Parliamentary Joint Committee on Corporations and Financial Services. The other before the Corporations and Market Advisory Committee of the Australian Government. The outcome of these inquiries is vitally important to all Australians and possibly all mankind. My hope is that all Australians will participate in them.

The Origin of the Problem

Corporations exist only because laws have been enacted that provide for their creation and give them a license to operate. When these laws were enacted, no attempt was made to give corporations characteristics or traits that would make them good citizens. At that time, most corporations were small and their impact on society was insignificant. Then, it was not as important that they be socially responsible. This is no longer true.

The corporate law establishes a structure under which all corporations operate. The key element of this structure is the duty of directors to act in the best interest of the corporation --to try to make money for shareholders. This duty of directors, in turn, becomes the marching orders for all of the corporation's officers, managers, employees, counsel and other advisors.

The consequence of this structure is that all corporate action is taken in the pursuit of profit. Literally hundreds of decisions are made every day by employees who have little incentive to promote corporate citizenship or social responsibility unless such promotion can be shown to improve (short term) profitability. Nothing in this structure encourages (let alone requires) corporations to be socially responsible (i.e. be a good citizen). Indeed, it is clear that the structure discourages

corporate citizenship and results in significant harm being done to the public interest.

This is not to say that there are not corporations that sometimes behave in a manner that makes them appear to be good citizens. However, good marketing should not be confused with good citizenship and a company's citizenship should not be dependent upon the size of its marketing budget.

There are also corporations that have managers who manage their companies to be good corporate citizens as well as make money. However, this tends to last only as long as the individual(s) responsible. In a world of global competition, hostile takeovers, merger and acquisitions, and fast moving corporate executives, it can be extremely short lived.

To the extent there is any restraint on the pursuit of profit at the expense of the public interest, it comes in the form of government regulation. This presents corporate managers with a basic conflict of interest: how to comply with the regulation (which can increase their costs) while at the same time remaining primarily responsive to their duty to make money (which requires reduced costs).

Though companies must comply with government regulation, quite often that is not enough to protect the public interest. One need only look at the harms caused by corporate generated pollution, the corporate manufacture and distribution of tobacco and by companies moving to take advantage of cheap labor in third world countries to realize that complying with the law does not necessarily guarantee protection of the public interest.

Moreover, the line between legal and illegal behavior can be moved to allow for even more damage of the public interest. When compliance with the law becomes too costly, the corporate structure encourages managers to try to reduce these costs by changing the law. This can be accomplished by lobbying our elected representatives, playing governments off against each other and other tactics designed to follow the letter of the law but not necessarily its spirit.

We must recognize that the tendency of corporations to abuse the environment and other elements of the public interest is not the fault of corporate directors, managers and other personnel. They work in a system designed to achieve a certain result in which there is tremendous pressure to conform. I believe something must be done to ease that pressure.

Similarly, we must not blame people in government for failing to adequately protect us from irresponsible corporate behavior. The system in which they work was designed long before the rise of the modern corporation. It was designed to protect the public interest from people not corporations.

People have only a limited capacity and almost no inclination to do serious harm to the public interest. They act locally (in only one place at any one time). Most do not have the financial resources necessary to engage in behavior that would cause serious damage. Unlike big companies, they don't hire lawyers to tell them exactly what the law is so they can fashion their behavior to be just in compliance.

Furthermore, people have consciences. They want to be thought of as good citizens. They are capable of being shamed when their behavior damages the public interest. Each of these things causes them to largely self-regulate their behavior and keeps them from doing serious harm to the environment and our communities.

Our government was designed to take advantage of these traits and characteristics. The way it works is that it presumes people will behave as good

citizens. It only passes laws restricting personal behavior after sufficient evidence has been presented to the people's elected representatives to indicate a new law further restricting personal freedom is necessary.

Prior to the rise of the modern corporation, this system was capable of protecting the public interest just fine. There was little chance that individual behavior could seriously harm the environment, our communities or other elements of the public interest. If harm was caused, a law could be quickly passed prohibiting such behavior in the future.

Unfortunately the modern corporation has both the capacity to damage the public interest and the inclination. It has the ability to act in many places at once (indeed, globally) through the collective action of hundreds and sometimes thousands of employees. These actions are backed by millions and sometimes billions of dollars of capital. As a consequence, it has the capacity to do more damage to the public interest - legally - in a single afternoon than the average human being can do in a lifetime.

This new entrant into our society also has much much greater inclination to damage the public interest than people do. Our corporate law (Section 181 of the

Australian Corporations Act) directs that the corporation is to be managed to pursue its own interest. The law backs up this directive by giving the corporation's shareholders the right to sue management if these instructions are not followed. Too often this section of the law is interpreted to justify the pursuit of profit that comes at the expense of the public interest.

The modern corporation came along after our system of government was already in place. The situation we now find ourselves in is that a government designed to protect the public interest from people who have almost no capacity or inclination to harm the public interest is being asked to also protect it from large businesses that have plenty of both.

Government can't do it. Not only can't government do it, but as evidenced by the response I got at the Young Lawyers forum, people are beginning to catch on that government cannot do it.

We cannot continue to live with this situation indefinitely. As large companies and socially irresponsible industries get bigger, so do the problems they create. People will not put up with this forever. At some point their patience will run out. A change will be made somewhere at sometime. The only questions

remaining are what change will be made and will it be made as the result of a major catastrophe or before one that can be averted?

One of two things must be done to remedy the problem. Either government has to be made more robust in its ability to protect the public interest from corporate behavior *or* corporations have to be changed to make them more respectful of the public interest.

In the United States there are groups on the far left that say government has to be given greater powers to control corporate behavior. They advocate taking away the corporation's right to due process (including the right to a fair trial) and equal protection. I believe that changing government in this way is unnecessary. It would also be unjust.

It makes much more sense to change the corporation.

Changing the Corporate System

W Edwards Deming, the late American management guru, was fond of saying that 94% of all business problems are systems problems and only 6% are people problems. This is because the lack of performance is usually not a problem

caused by the people working within the system. It is caused by the design of the system itself. Most of the time the people cannot overcome the system, no matter how well they are educated and no matter how many times they are admonished to do better.

Lack of corporate citizenship is not a people problem. It is a systems problem. It cannot be solved by the education or regulation of the people in the corporation. It can only be solved by changing the corporate structure.

Peter Senge of Massachusetts Institute of Technology and the author of the best selling management text, *The Fifth Discipline*, has said that the best way to change a system is to change it at its point of highest leverage. This is the point where you can make the smallest change and have the greatest effect. The importance of making the smallest change is that small changes are easier to understand. This lowers the resistance to implementing the change and increases participation rates in affecting it.

The point of highest leverage in the corporation is the duty of directors to act in the best interests of the company. This duty gives the corporation purpose and drives all corporate action. If corporations are to be made more socially and

environmentally responsible, It is here (in Australia, in Section 181 of the Corporations Act) where the change must be made. It is here where the focus on making money starts for all corporate personnel. Until some change is made here, companies will continue to find ways to make money at the expense of the public interest.

This section of the law must be changed to recognize that the pursuit of profit need not come at the expense of the public interest. The two goals (making money and protecting the public interest) should no longer be thought of as mutually exclusive. The duty of directors should be changed so that directors are required to manage their companies to achieve both. When this happens, the corporation, capitalism and indeed mankind, will all evolve.

We must realize that it is impractical to expect a change in the law of this magnitude to be implemented immediately. Corporations have operated in ways that are socially irresponsible for too long to expect them to change their ways overnight. Billions of dollars are now invested in operations that damage the public interest. Companies will need time to write-off these investments and to invest in the development of new technologies and processes that safeguard the public interest.

Any proposed change must include a provision for a substantial transition period from the old to the new, to give responsible capitalism the time it needs to take hold. Government should do all it can to facilitate this transition through tax incentives, research and development grants and other subsidies.

Furthermore, consideration should be given to exemptions for small businesses. Small companies do not do nearly the damage that large ones do. If the changes imposed on large companies are also imposed on small companies, the burden will be disproportionately greater.

Imposing new social and environmental obligations on large companies will create a boom in investment in new technologies and processes designed to meet these needs. In addition to providing much of the entrepreneurial skill necessary to develop these technologies and processes, smaller companies will adopt them. If they do not, and small companies are later found to be doing material damage, the exemption can be reduced or eliminated at that time.

A Code for Corporate Citizenship

I have suggested that Section 181 of the Corporations Act should be amended by adding a 28 word Code for Corporate Citizenship. These 28 words would leave in place the obligation of directors to act in the best interest of the corporation, but modify it by adding these words:

"but not at the expense of the environment, human rights, public health and safety, the dignity of employees, or the welfare of the communities in which the corporation operates."

The Code for Corporate Citizenship will make it clear to company directors and all other corporate personnel that the corporation has a duty to safeguard the public interest in the pursuit of profit. It will undermine the idea that company directors have an obligation to shareholders that overrides everything else. It will also free every employee to do the right thing with regard to the public interest while still doing his or her job. Indeed, it will make it their job to do what is socially and environmentally responsible.

I have suggested that the Code be implemented with a 15-year transition period. This does not mean that things will be at a standstill for 15 years. Companies will recognize that they have a limited amount of time to change their

ways. In a sense, the new law will give them a goal and a finite time in which to achieve it. Failure to make progress towards this goal will have an adverse effect on their public relations. Recalcitrant companies will also find their access to capital begin to dry up.

Conclusion

Today, at the beginning of the 21st century, corporations have become our most powerful citizens. It is no longer tenable that they be entitled to all the benefits of citizenship, but bear none of the responsibilities.

When the modern corporation was introduced into our society, it was not readily apparent that this would result in abuse of the public interest that governments were not equipped to stop. As generations passed and corporations increased in size, the problems they were able to create became more serious. Many people are now beginning to realize that government can no longer protect the public interest from the pursuit of corporate profit. This is not the fault of people in corporations or people in government. It is a systems problem.

Our generation's task is to solve this problem. We will not solve it by hoping corporations will change their behavior voluntarily. The best, possibly only, way to solve the problem is to eliminate it at its source. This means changing the duty of directors to require them to manage their companies in ways that safeguard the public interest.