Faculty of Business,
Queensland University of Technology
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Committee Secretary,
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate

re: Inquiry into corporate responsibility

Please accept this submission entitled "Corporate Social Responsibility: The Good, the Bad, the Ugly?" to the above committee. The spirit behind this submission is that of management scholars seeking to contribute some empirical evidence relevant to the terms of reference of the committee, in particular: "The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community".

Our submission is based on the application of a novel and powerful methodology for assessing the beliefs, attitudes, and concerns of firms and their managers through studying their own words and quantifying and exploring patterns in their words; the technique is broadly known as content or text analysis. The "words" we typically study are those in firms' annual reports that are an important medium of communication for listed firms with both shareholders and other stakeholders. Our approach makes it possible to study reports from large numbers of firms and to compare the amount of attention they give to a variety of issues over time, in this case their attention to corporate social responsibility issues. This information in turn can be related to factors such as firms' financial performance, which we do in a simple but, we hope informative way in our submission.

We are advocates neither for nor against CSR but we believe that empirically-based findings relevant to this issue can be useful to the deliberations of the Committee. The submission is succinct and draws on a minimum of technical and statistical terminology.

We hope that the Committee finds our submission useful for its deliberations.

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● Corporate social responsibility: The good, the bad, the ugly?

Corporate social responsibility (CSR) is receiving considerable attention from a varied group of players, including politicians, social activists, academics, business commentators, investors, and businesses and their managers. It's importance to business leaders is indicated by an article in the July, 2005 issue of Company Director, a publication of the Australian Institute of Company Directors which observed that company directors are coming under increasing pressure to become accountable for the "non-financial performance" as well as the financial performance of their firms. So the pressure is certainly on both managers and boards to do something about, or at the very least to be seen to be concerned with CSR. Whether this is a good thing is also being debated. CSR has been variously described as: simply good business that ensures that the communities and environments that business depends upon are "healthy" and provide the resources, human and otherwise that businesses depend on; a bit of "wishy-washy", PR-inspired, image-building that business chiefs can usefully hide behind when their firms' performance is less than impressive, or, rather more ominously as the latest expression of a politically correct ideology that seeks to undermine the legitimacy of the profit motive.

We aren't going to throw more petrol on these flames but we do hope to cast some empirical light on how Australian businesses perceive or attend to the CSR issue. We do this by examining the amount of attention that a large sample of listed Australian firms give to CSR in one of their major communications with their shareholders and broader stakeholders – their annual reports. Specifically we examine two questions: has the amount of attention that Australian firms give to CSR in their annual reports increased over the last decade and, second, is the level of attention that firms give to CSR related to their level of financial performance? There has been vigorous, largely data-free debate about whether firms can be high performers both financially and as good corporate citizens, or whether the two outcomes have no or only coincidental association, or, in the worst case, are negatively related. Some data can usefully inform such speculations.

● What we measured:

The annual report is an important communication medium for listed companies. Clearly there are legal requirements that govern what financial data are reported but there are also expectations that senior managers use the annual report as a way of communicating some important things about the direction, character and values of the company, including the firm's attitude to CSR. So our guiding assumption is that the importance that is attached to the CSR issue is reflected in the amount of attention that this topic receives in annual reports, in particular the amount of attention it receives in the relatively small, valuable space that makes up the CEO's or Managing Director's Report. The more sentences and words, or "space" that is given to the CSR issue in the CEO's report the more important it is. The fact that we have analysed only a part rather than the entire annual report could be seen as a limitation but the advantages are that this ensures more comparability across firms since firms produce annual reports that differ vastly in length and it is possible to give attention to any and every issue and topic if a report is long enough. We assume that if it is really viewed as important by the top-team it will appear in the CEO's letter.

Our approach invites another question – is the attention given in annual reports an indicator of real concern, or PR "spin? Our answer to this is that it is likely to be a combination of both– firms will certainly present themselves as favourably as possible, but it is also risky for firms to present a picture that is too far removed from reality – firms' annual reports are scrutinised too closely to permit excessive spin-doctoring. So while discussing CSR is not the same as acting upon CSR it does give us some idea of whether the level of attention it receives from the top has changed over time.

The method used to assess CSR and Financial Performance themes within annual reports was a form of computer aided text analysis. First, random samples of annual report sections were analysed manually by trained coders. These sections were then used to train analysis software to find and rate similar sections of text. The final determination of the amount of CSR and Financial Performance themes in each annual report was made by the trained software.

Firms that were included were listed on the Australian Stock Exchange between 1993-2003 and had produced at least one annual report in that time(average per firm was 3.8 reports). The total number of firms exceeded 1,000 and included reports from all members of the ASX 200, that is, Australia's largest listed firms. We measured the relative space (i.e. words and sentences) in annual reports that was spent on several themes. One of these was what can be considered traditional annual report content -discussion of the firm's Financial Performance, such as references to revenues, profits, sales, costs, and so on; we did not differentiate between positive and negative views. As there is no single definition of CSR we adopted three themes that are generally considered to reflect core elements of CSR – the attention paid to community, employees, and governance and management. We found that these three themes clustered together naturally in annual reports – that is, firms that gave more attention to any one of these three themes also gave more space to the other two, suggesting there was an underlying CSR-like dimension; we combined these three themes to reflect the total amount of attention to CSR in annual reports -

i.e. **CSR= Total references to [Community + Employees + Governance]/Management**.

• What We Found:

The first interesting thing we noticed about the themes measured, was that the amount of attention CSR received was negatively related to the amount of attention given to Financial Performance; that is, traditional financial discussion in a sense, “competes for space” in the annual report with discussion of CSR, and vice versa. This meant we were able to graph the relative amount of attention firms paid to CSR and Financial Performance over the time period as a single line (the mean line in Figure 1) with higher positive scores indicating relatively more attention to CSR, and higher negative scores indicating relatively more attention to Financial Performance. This scoring system reflects the relative amount of space allocated to CSR and Financial Performance in any year relative to their levels over the time period as a whole, so that in most cases there will be some attention paid to both issues in annual reports. Scoring the two themes as ‘positive’ and ‘negative’ is, incidentally a statistical convenience and not driven by any value judgment about their relative merit.

It is evident that for the sample as a whole there is no simple pattern of either increase or decrease in the amount of attention given to CSR in annual reports – space devoted to CSR is somewhat higher between 1993-1997 then declines relative to the attention paid to Financial Performance issues between 1998-2002 before returning to a stronger CSR focus in 2003. Is there a way to explain this pattern? We believe there is – differences in firms’ overall level of performance over this period. In each year we identified the top and bottom 33% of performers in each industry based on their ROE (return on equity) and plotted the amount of space firms in these two groups gave to the “CSR vs Financial Performance” theme in their reports. The results in the graph are quite striking. It is evident that the high performers (top line) consistently give more attention to CSR than the low performers (bottom line) who consistently focus more on discussing Financial Performance. This effect neatly explains the variations in the amount of attention given to CSR by all firms represented by the mean line – when more firms on average are doing better, the balance swings away from discussing Financial Performance towards a greater focus on CSR, and vice versa when things are tougher financially.

• What Does This Mean?

As is usually the case, there is no single, unequivocal interpretation of the results. One straightforward interpretation consistent with the findings is that when senior managers feel shielded by firm performance from investors’ “blowtorch to the belly”, they are able to give more attention to issues such as CSR. Another interpretation that may be favoured by CSR advocates is that firms that give greater prominence to CSR issues perform better as a result of doing so. This implies the potential for the existence of a virtuous cycle – good performance means more attention to CSR which then leads to good performance, and so on. A rather more cynical interpretation of this whole pattern is that

it is revealing a simple pattern of spin-doctoring: when investors are jumping up and down about under-performance, senior managers try to reassure them that they have got their eye well and firmly on the "financial ball", whereas when the money is rolling the firm is keen to not be seen as " a greedy corporate that is only concerned with raking in as much as it can".
Both interpretations are plausible and it is not easy to answer which is more or less correct.

To determine what causes what (i.e. Performance -->CSR or CSR--> Performance) is not easy in any complex system. However it is possible for us to have an initial examination of this question by examining the correlations (i.e. association) between CSR and Performance over time. To the extent that firms' level of CSR tends to precede their level of Financial Performance we can argue that the pattern of association is at least consistent with one in which CSR is a potential cause of Financial Performance because the level of CSR precedes the level of Financial Performance. On the other hand if we find that the level of Financial Performance tends to precede the level of CSR then it is more plausible to argue that the former is more likely to be a cause of the latter. To test these possibilities we carried out a series of correlations which assessed whether firms' level of CSR preceded or followed their level of Financial Performance for spans of 1, 2 and 3 years.

The broadest analysis possible used the entire sample, correlating lagged, contemporary and leading ROE with the attention to CSR measure wherever data was available. The sample used for each correlation differed, since not all companies had complete data for the range of times required. Nevertheless, the correlations between ROE and CSR v FP were small and significant whether lagged, leading or contemporaneous, with higher industry adjusted ROE associated with a tendency toward higher CSR content (and vice versa for lower ROE and higher Financial Performance content).

A more focussed analysis used only those companies with ROE data for all seven time points. Using this more restricted sample which included around 350 observations based on about 120 companies, only the contemporaneous and single year leading ROE correlations were significant, with the leading correlation stronger. This suggests a modest association between CSR content in any year and current year's performance, and a slightly stronger association between current CSR level, and ROE in the following year.

● Conclusion:

While we cannot eliminate the "spin doctoring" explanation on balance these results suggest that, the amount of attention that senior managers express towards CSR is related to the level of firm performance – the better the performance the more they express interest in CSR, and vice versa. In terms of which is the more likely cause of which, while tentative, our results suggest that Performance and CSR are related bi-directionally, suggesting that good performance can be a precursor to senior managerial interest in CSR, and that a focus on CSR can in turn be associated with slightly higher performance in the short term. In other words, these results are not inconsistent with the existence of a virtuous cycle in which high performance facilitates an interest in CSR which in turn sustains or enhances future performance. It would be premature to conclude we have shown that an emphasis on CSR is a cause of superior performance since our analyses can be viewed as fairly simple and preliminary on this issue. Our results suggest there are both challenges and opportunities for the advocates of CSR and Australian firms and managers.

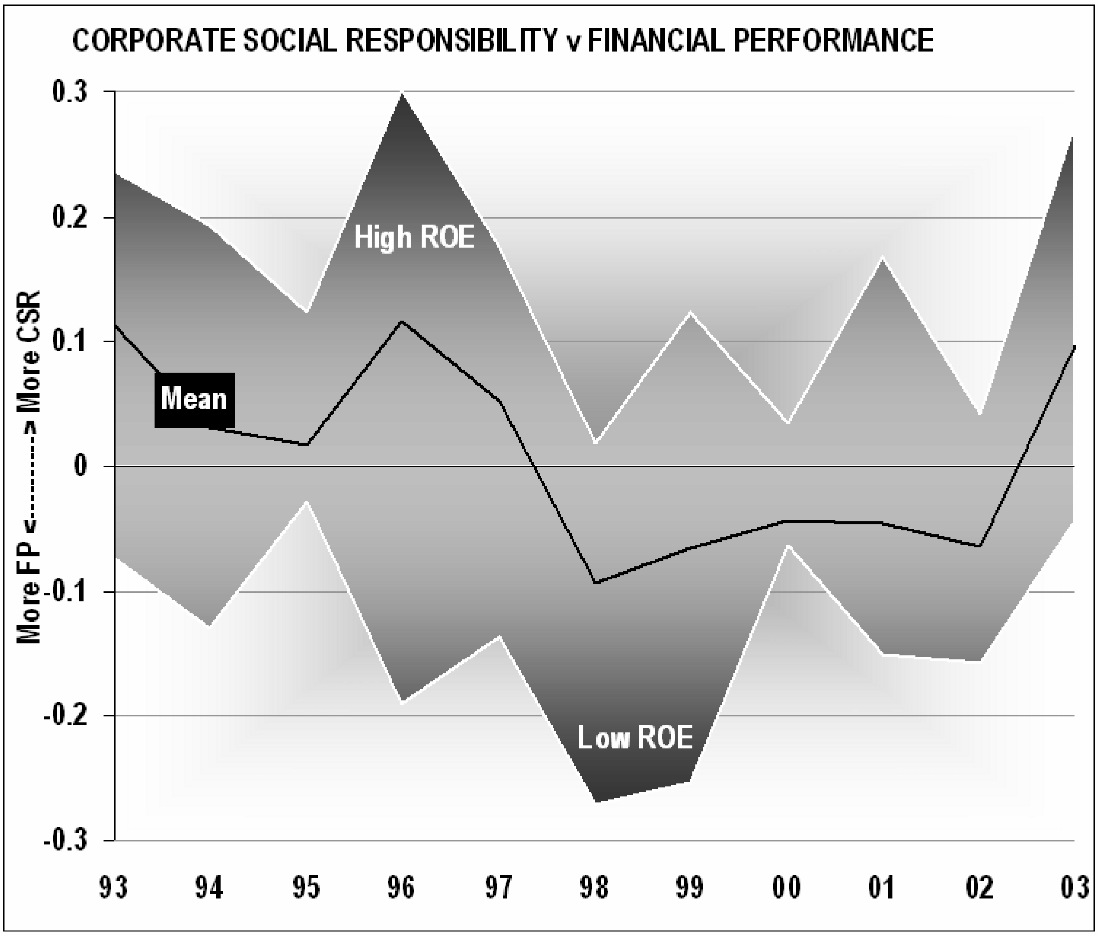

Figure 1
Corporate Social Responsibility V Financial Performance Factor for High ROE and Low ROE groups, and all companies(Mean), over time