CORPORATE RESPONSIBILITY

SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

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Introduction

A noteworthy feature of the Committee's terms of reference is the use throughout of *corporate responsibility* (**CR**) instead of the more usual expression *corporate social responsibility* (**CSR**). Perhaps that is because the Committee shares the perception that the word *social* sucks out of the words *corporate responsibility* any objective meaning that they might otherwise have: see the first of the general submissions below.

It does, however, suggest a simple way of summarizing the essential thrust of this submission by making a distinction between:

- *corporate responsibility* (**CR**), which requires corporate decision-makers to ensure that their company complies with its legal obligations to "stakeholders" other than shareholders, whether imposed by law or assumed by contract or in any other way, and permits them to have regard to the interests of such "stakeholders" beyond the extent of legal obligation, so long as they believe reasonably and in good faith that it is in the interests of the company and the general body of its shareholders to do so; and

- *corporate social responsibility* (**CSR**), which would require or allow corporate decision-makers to direct their company to operate in the interests of "stakeholders" other than shareholders beyond the requirements of law, even when to do so is **not** in the interests of the company and the general body of its shareholders, thereby subordinating the interests of shareholders to those of other "stakeholders".

The essential thrust of this submission is that:

- subject to the point made below on *Corporations* Act 2001 (**CA**) s181(1), CR, understood in the above sense, is perfectly consistent with the present framework of statute and general law; and

- the adoption of CSR, understood in the above sense, would:

    - require the present legal framework to be changed to allow corporate decision-makers to subordinate the interests of their company and the general body of its shareholders to those of non-shareholder "stakeholders"; and

    - lead inevitably to a decline in the profitability and competitiveness of Australian corporations to the detriment of Australians generally.

This submission commences with an outline of the present state of the law, after which are set out submissions on the Committee's specific terms of reference. The final part of the submission, dealing with the meaning – or lack of meaning – of CSR, and the implications and origin of CSR, are substantially reproduced from the writer's contribution to a debate on CSR with Dr Bill Beerworth, which was published in the December 2004 issue of *Company Director*.

The present position

Any discussion about CR or CSR is apt to go astray if it does not take as its starting point the incalculable debt owed by society to corporations. It is no exaggeration to attribute the unprecedently high standard of living and prosperity that most societies enjoy today above all to the development of the limited company over the last 150 years.

We must also remind ourselves that a limited company exists to pursue a business with the object of generating as high a return as business exigencies permit for its shareholders, who have contributed the capital without which the company would not exist. They are encouraged to contribute what is essentially risk capital by the risk-limiting principle of limited liability.

In pursuing that object, the company will also generate wealth for its employees, lenders, suppliers and other parties in meeting the demands of its customers. Ultimate responsibility for the success or otherwise of the company's business lies with its directors and managers, who can be seen as stewards for the capital-providing shareholders. The extensive fiduciary and other duties imposed on directors under the general law, and increasingly enlarged or supplemented by statute, are in general owed to the company as representing the general body of its shareholders.

It is important at this point to keep in mind that the shareholders, far from being in any position of privilege, are the most at risk should the company fail. In its liquidation, all they are entitled to is such of the company's wealth, if any, as remains after the company's liabilities to its creditors, be they employees, lenders, suppliers or other outside parties, have been meet. While a company remains in operation, the shareholders' return on their capital depends entirely on the profits earned by the company: no profits, no dividends.

It follows that the company's business under stewardship of its directors should be directed towards maximizing the return to its shareholders. That is the basis of company law as we know it. In pursuing that objective, the company must comply with its obligations to outside parties, whether assumed by contract or imposed by law. That is not to say that the company may not impose it upon itself obligations, such as for employee benefits, OH&S, product safety, the environment etc, over and above those imposed by law. On the contrary, the company is free to do so, but in doing so, the law requires its directors to be satisfied that it is in the interests of the company and its shareholders.

The importance of corporate profitability cannot be over-emphasized: on it depends the well-being not only of the outside parties already mentioned, but also of shareholders, whose number includes indirectly a vast number of superannuation fund members, life and general insurance policy holders, and the community generally through the generation of corporate tax revenue. The limited company is the instrument for converting the savings of a given community into the capital that generates the corporate investment that secures the general well-being of that community as nothing else can.

Submissions on the Committee's specific terms of reference

In the light of those observations, I venture to make the following submissions to the Committee on the issues specified in the Committee's terms of reference.

(a) *The extent to which organizational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.*

From the inception of the limited company a century and a half ago, the directors and others involved in the management of a company have been under the duty at law to act in good faith in the interests of the company as representing the interests of the general body of the shareholders who contributed the risk capital without which the company would not exist.

Fundamental to the performance of that duty, corporate decision-makers must exercise due care to ensure that the business of their company is carried on in accordance with or applicable requirements of law. In the context of non-shareholder interests, labelled – perhaps not altogether appropriately – as "stakeholders", in a company, that includes compliance with the requirements of laws and regulations governing such matters as workplace relations, occupational health and safety and environmental impacts.

If it is thought that those requirements are inadequate, it is the function of Parliament to amend the relevant legislation appropriately, as they are requirements which should apply equally to all business operations, whether carried on through an incorporated entity or not.

In short, corporate decision-makers must have regard for the interests of "stakeholders" at least to the extent that the law applicable to their company's business so requires. As will be seen from the submission on terms of reference (b), the present law gives corporate decision-makers a fair measure of leeway in having regard for the interests of "stakeholders" beyond that extent.

(b) *The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.*

A prevalent misconception, one which is probably the mainspring of the corporate social responsibility (CSR) industry, is that the duty to act in the interests of their company implies that corporate decision-makers need do no more for the benefit of non-shareholder interests than the letter of the law requires.

That has never been the law. As long ago as 1883, the correct principle was explained – in the characteristically trenchant language of the time – by Bowen LJ in *Hutton v. West Corp Railway Co* (1883) 23 Ch D at pp 672-3 thus:

"It seems to me you cannot say the company has only got power to spend the money which is bound to pay according to law, otherwise the wheels of business would stop, nor can you say that directors who have got all the powers of the company given to them by sect. 90 of the Companies Clauses Consolidation Act, are always to be limited to the strictest possible view of what the obligations of the company are. They are not to keep their pockets buttoned up and defy the world unless they are liable in a way which could be enforced at law or in equity. Most businesses require liberal dealings. The test there again is not whether it is bona fide, but whether, as well as being done bona fide, it is done within the ordinary scope of the company's business, and whether it is reasonably incidental to the carrying on of the company's business for the company's benefit. Take this sort of instance. A railway company, or the directors of the company, might send down of the porters at a railway station to have tea in the country at the expense of the company. Why should they not? It is for the directors to judge, provided it is a matter which is reasonably incidental to the carrying on of the business of the company, and a company which always treated its employees with Draconian severity, and never allowed them a single inch more than the strict letter of the bond, would soon find itself deserted – at all events, unless labour was very much more easy to obtain in the market than it often is. The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company."

The legal principle is expressed in Ford's *Principles of Australian Corporations Law* [8.130] in the following more contemporary terms:

"The decided cases in this area indicate that management may implement a policy of enlightened self-interest on the part of the company but may not be generous with company resources where there is no prospect of commercial advantage to the company."

That formulation might conceivably be too generous when considered in the light of CA s181(1): see submission on term of reference (c).

(c) The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.

The ability of corporate decision-makers to treat non-shareholder parties and interests more generously than required by the strict letter of the law, so long as to do so is in the interests of their company, was further enhanced by the general law doctrine that directors must act "bona fide in what they consider – not what the court may consider – is in the interests of the company.": *re Smith & Fawcett Ltd* [1942] Ch 304 at 306 per Lord Greene MR. In other words, even if a particular decision by the directors of a company turned out, as events unfolded, not to be in the best interests of their company, the directors could not be rendered liable for making it unless the decision were one that no reasonable board of directors would make.

That general law principle was, however, overturned in Australia by the enactment in 1999 of *Corporations Act 2001* (CA) s 181(1) in the Bill for the *Corporate Law Economic Reform Program Act 1999*.

As introduced into the Parliament s 181(1) provided:

(1) A director or other officer of a corporation must exercise their powers and discharge their duties:

(a) in good faith **in what they believe to be** in the interests of the corporation; and

(b) for a proper purpose

(emphasis added)

At the behest of the opposition parties in the Senate, the words "in what they believe to be" were deleted from s 181(1) as enacted.

The effect of deleting it "in what they believe to be" is to make a director's or other officer's belief as to what is objectively in the best interests of the relevant company inevitably the subject of review in hindsight by the court. That gives rise to the fundamental problem that every act or omission amounts to a choice, whether made consciously or otherwise, between at least two courses: to act or not to act; or to choose between two or more alternative actions, each of which might be in the interests of the relevant company. The choice can be made only on a subjective basis at the time of making it. Whether the choice made was in the best interests of the company in the objective sense required by the amendment can be determined only afterwards in the light of hindsight; and even then, it would be more a matter of opinion than fact.

It is perhaps unlikely that the momentous implications of that change were present to the minds of the politicians who made it, one of which is that the change could only reduce the ability of company decision-makers to confer benefits on "stakeholder" parties and interests beyond the strict requirements of the law. And the very making of the change almost certainly makes it impossible for a court to interpret s 181(1) as if the change had not been made.

Whatever else its consequences, the change made to s. 181(1) can operate only to make company directors and officers more cautious about conferring unmandated benefits on parties other than shareholders than they would have been had the change not been made.

(d) *Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community.*

It follows that, if the Committee believes that the ability of company decision-makers to act in the interests of non-shareholder parties beyond the requirements of law should be clarified or enlarged, the most obviously expedient way of doing so would be to amend s 181(1) by restoring the words "in what they believe to be".

That amendment would not only re-align s181(1) to the corresponding general duty, but would also make it run parallel with clause B.3(1) of the draft *Company Law Reform Bill* included in the *Company Law Reform White Paper* issued in March 2005 by the UK Department of Trade and Industry, under which:

> *(1) As a director of a company you must act in the way **you consider**, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.* (Emphasis added.)

As noted in section (a) above, if it is thought that the obligations of businesses in relation to – for example – the environment should be enlarged, the appropriate way to do so is by amending relevant environmental legislation applicable equally to all business operations, whether carried on through an incorporate or unincorporated entities.

(e) *Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.*

In view of the present state of the law, if CA s 181(1) were amended as submitted in section (d) there is in my submission ample ability or part of incorporated entities and their directors to advance "stakeholders" interests whenever it is in the interests of the relevant entity to do so.

(f) *The appropriateness of reporting requirements associated with these issues.*

The CA should not impose reporting requirements in relation to non-financial matters, but should leave it open to reporting entities to report on those matters to the extent and in the manner thought appropriate by their directors and management.

It has become more common than not for listed companies, particularly the larger ones, to include in their annual financial reports a section reporting on the company's self-perceived performance on so-called sustainability issues. Indeed, as the Committee would know, The Global Reporting Initiative (**GRI**) has produced its *Sustainability Reporting Guidelines* as "a common framework for sustainability reporting".

The GRI Sustainability Report sets out at great length and in great detail "indicators" for environmental and social "performance", compliance with which would, in the case of most companies at least, be very expensive. The incurring of such a cost – like any other expenditure of a company's funds – is justified only if it is in the interest of the relevant company to incur it. The main factor that would be raised in justification in the case of a sustainability report would be the belief that it will serve to deflect claims by non-shareholder interests which would or might have adverse effect on the company's business with even greater cost to the company.

In a real sense, therefore, a sustainability report amounts to self-serving propaganda, and is increasingly seen to be so by the constituencies to whom it is primarily addressed.

For example, in the context of the G8 Summit in July 2005, Meena Raman, Chair of Friends of the Earth International, was reported as saying:

"The [corporations] speak of what they have done by way of corporate social responsibility, which is voluntary and non-binding. But we find these claims are "green washing", and much more of a public relations exercise."

That is a view which is taking hold in environmental and other groups in the sustainability industry. It may even be that a company would be less likely to attract the unfavourable attention of the sustainability industry by not producing a sustainability report at all. If, however, the directors of a company believe the best interests of the company would be served by making a sustainability report, they are, and should remain, free to do so.

At the same time, there can certainly be no justification at all to require by legislation or regulation any form of sustainability report.

(g) *Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.*

I am not aware of any regulatory, legislative or other policy approaches in any other country that could be usefully adopted or adapted for Australia.

General submissions

The meaning of corporate social responsibility

The threshold problem with CSR is working out what exactly it means. The difficulty lies with the word *social* which, as Hayek memorably observed, "can be used to describe almost any action as publicly desirable and has at the same time the effect of depriving any terms with which it is combined of clear meaning.": the perfect example of a weasel word, sucking out from the word it qualifies any real meaning, just as a weasel is said to suck out the contents of an egg. The problem would perhaps not matter if all that CSR is generally intended and understood to mean that a company's operations should be conducted in accordance with the requirements of law, and beyond those requirements where it is in the interests of shareholders to do so.

That, however, does not appear to be the intention of the promoters of CSR. For example, the World Business Council for Sustainable Development (WBCSD), an influential body whose 175 members include many of the largest MNE's, and a significant proponent of CSR, defines CSR as *business' commitment to contribute to sustainable economic development, working with employees, their families, the local community, and society at large to improve their quality of life*, an example of defining a meaningless term in meaningless terms, the word *sustainable* being as much a weasel word as *social*. It doesn't look like a party to which shareholders are invited.

As WBCSD itself acknowledges, "CSR means very different things to different people, depending on a range of local factors, including culture, religion, and governmental or legal conditions. There can be no universal standard." Seen in that light, CSR is scarcely a sure foundation on which company directors and managers could develop corporate policy or legislators could develop corporate law. Perhaps the essential meaninglessness of CSR is the cement that keeps together the strange coalition of its advocates. If that were all that were to it, CSR would come quickly to be seen as no more than a passing fad. That, however, is not all that there is to it. Whatever CSR is supposed to mean, we should be alert to what it is seen to imply.

The dangerous implications of CSR

The principal implication is that company directors and managers should direct their company to operate in the interests of parties other than shareholders beyond the requirements of law, whether or

not to do so is in the interests of its shareholders. That implication arises from attaching to those other parties the misleading label of *stakeholders*: misleading in so far as it suggests that those other parties have as legitimate a claim on the company's ultimate wealth, after the company's legal obligations to them have been met, as shareholders.

What flows from that implication is that company directors and managers would face the insoluble dilemma of defining and weighing the interests of the various "stakeholders" and judging whose are to be preferred to others, and how they are to be variously weighed against the interests of shareholders. The touchstone that seems to be emerging to guide them through the dilemma is the notion of "society's" or "community" expectations. On examination, the notion seems worse than useless: *society's* is a cognate of the weasel word *social*, and *community* in this context is itself another weasel word, sucking out any real meaning from the word *expectations*.

The fact is that the application of those weasel words is a matter of politics, not business; and if CSR takes hold, we shall surely find the operations of companies increasingly directed not by the directors and managers as stewards for the capital-contributing shareholders in accordance with their general duties to the company, but by them towards the requirements of the State in its ever-changing assessment of community expectations. Company directors and managers will, inevitably, find themselves beholden in the conduct of their company's business not to the company and its shareholders, with all the consequent benefits to outside parties and to the community generally, but to the State and its politicians and bureaucrats. In the meantime, the countless citizens whose welfare depends on corporate profitability will find their welfare diminishing as the process proceeds.

The origin of CSR

As noted, prominent among the members of the WBCSD, and also no doubt other like bodies, are leading multi-national enterprises (MNE's). For all the great benefits they bring to the world at large, and to the advancement of less developed countries in particular, MNE's have for years laboured under attack from bodies purporting to represent the various interests of labour, women, children, consumers, the environment and other special interests, almost all of which bodies are imbued with an anti-capitalist mentality. CSR, and at least the pretence of implementing its nostrums is seen by its corporate proponents as a means of appeasing sectional activists; and by sectional activists as a means of quarrying more and more from the corporate sector. On both sides, the interests of a company's shareholders are seen as expendable in favour of outside sectional interests.

Corporate advocates of CSR, in seeking to appease sectional interest groups, seem not to be aware of, or to be content to ignore, three fairly obvious points. First, the single issue activist body is concerned solely about the supposed interest it purports to represent, and not about the interests of the community at large. Secondly, the wish-list of the single issue activist body can never be satisfied: satisfy one wish, and another bobs up. Thirdly, it has regrettably to be said that leaders in the corporate sector have on the whole been less than whole-hearted in reminding the pubic generally of how much it owes for its welfare to free market capitalism in general, and to the limited company in particular. Those of their number who seek to live by weasel words and buzz-words run the risk of dying by them.

At the other spectrum of the CSR coalition, those imbued with the anti-capitalist mentality, at a time when the failure of socialist regimes – particularly Marxist regimes – has become generally recognized, CSR can be seen as another means of knee-capping capitalism, in much the same way – albeit widely unperceived – as the German National- *Socialists* (the latter half of their label needs due emphasis) did, and under slogans pre-echoing those of CSR..

Conclusion

Were CSR to be understood as meaning no more than that company directors and managers should meet their duties under the law, and do what they reasonably can to ensure that their company does

likewise, it can, and should, be seen as creating the unnecessary confusion that comes from, to borrow from a great English judge, well-meaning sloppiness of thought.

That, however, does not seem to be what proponents of CSR for the most part have in mind. The essential meaninglessness of the expression CSR has proved remarkably successful as a cloak under which to smuggle into the uncritical consciousness of businesspeople, lawyers – academic and practising – politicians, bureaucrats and the public generally, ideas that are potentially at least subversive of the institution of the limited company as it has evolved in the English-speaking world over the last 150 years. Once we grasp the essential meaninglessness of CSR, we are in a surer position to defend an institution to which, above all others, we owe the highest standard of living in all history. And let's also not forget Aesop's fable of the Goose and the Golden Egg.

Bibliography

A Google search on CSR reveals about 35,800,000 entries, so it cannot scarcely be said to be a subject on which literature is lacking. The writer would, however, comment to the Committee's attention:

The Company – A Short History of a Revolutionary Idea by John Micklethwaite and Adrian Wooldridge (The Modern Library, New York 2003). A concise, informative and entertaining history of limited company and its contribution to human progress by two editors of *The Economist.*

Misguided Virtue – False Notions of Corporate Social Responsibility by David Henderson (New Zealand Business Roundtable 2001). A concise but comprehensive critique of the nostrums of CSR and their potential to do real harm by undermining the market economy, thereby reducing community well-being world-wide. The monograph is useful also for bringing out the roles of MNE's and NGO's in the CSR movement.

The Art of Corporate Governance – A Return to First Principles by Samuel Gregg (The Centre for Independent Studies – 2001). This monograph by a young Australian moral philosopher, now attached to the Acton Institute for Religion and Liberty in USA, includes a critical analysis of stakeholder theory, the concept of triple bottom line and the notion of CSR.

The Economist. The issue dated 20 January 2005 contains a five article supplement on CSR. The supplement was reproduced in Australia in a subsequent issue of *Company Director*.

The writer

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