

## **Parliamentary Joint Committee on Corporations & Financial Services**

### **Inquiry into Corporate Responsibility & Triple-Bottom-Line reporting**

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#### **INTRODUCTION**

The focus of this submission is on enhancing the opportunity for corporations to engage in more socially responsible practices. To achieve this aim, it is necessary to create an expectation that gives directors of corporate entities explicit authorisation to take into account corporate social responsibility (CSR) principles without feeling they would be neglecting their fiduciary duties. This expectation is created by recognising that in the *Corporations Act 2001 (Cth) (Corporations Act)*, adherence to CSR principles does not constitute a breach of corporate duties required at law. Refining the regulatory provisions of corporate conduct in the Australian jurisdiction requires more than legislative amendment. The imposition of sanctions for conduct that contravenes legislation and prescriptive requirements for behaviour are not likely to be readily adopted by members of the corporate world. Instead, the likely outcome of a purely prescriptive and sanction based approach is that office holders of corporate entities will focus on where the loop holes lie and in effect circumvent the intention of the legislation. In practical terms, adherence to a strict imposition of regulation on corporate activity is likely to require further inquiries into the issue of CSR as problems similar to the ones in

the current context continue impacting significantly on the Australian corporate landscape. Focussing purely on the legality of corporate actions encourages the further development of a corporate culture of compliance, where companies recognise the need to adhere to legal requirements and professional standards but go no further than the letter of the law – the legal minimum requirement.

The use of values is important when considering measures aimed at addressing issues that arise in relation to CSR. Importantly, such issues are of significance not only to stakeholders but also to the corporations themselves. The call for corporations to take social and environmental considerations into account continues. There are sound financial reasons for companies to take values other than shareholder value seriously. A company with an appreciation of its responsibilities in a broader sense are likely to be better managed and therefore have better returns and investment results over the medium to long term. Showing investors that the returns on their investment are more likely to be sustainable if the companies they invest in are sustainable will surely impact on corporate strategy. However, there is concern to ensure that non-financial considerations are not merely incorporated into a company's economic activity. Instead, they must become an integral part of a company's conduct.<sup>1</sup> At present, there remains a marked absence of formal, widely applicable measures that allow organisational decision makers to act with regard to the interests of stakeholders *other than* shareholders.

Fiduciary duties of directors are viewed in terms of duties owed to shareholders and the importance of financial returns to them. As a result, actions that take into account other interests may be viewed as reducing the likelihood of shareholder wealth maximisation. There seems to be a process of changing perceptions occurring in the current Australian corporate environment which is increasingly realising that long term wealth maximisation will not be jeopardised by considering other non-financial stakeholder interests, and that shareholders value more than just the monetary price for which their shares can be sold.<sup>2</sup> This is, at least in part, recognition of the need for longer-term sustainability and protection and development of corporate reputation.

While we applaud the corporate reporting requirements that are currently in operation, we nevertheless believe that there exists a degree of ineffectiveness in the current piecemeal approach of legislation, regulation, codes and guidelines. We therefore recommend that a code of ethics be developed that informs the *Corporations Act*, combined with legislative reform to permit CSR to be seriously considered in the corporate decision making process. The process of drafting a coherent regulatory framework would involve various representatives from the corporate spectrum (e.g. legislators, directors and relevant NGOs). The appeal of such an approach is that interested parties will be more likely to adhere to the principles of the code if it reflects the underlying values of the entities affected by its creation and implementation. Imposing a code of ethics on corporations would be less likely to achieve the goal of a more coherent approach to CSR precisely because it becomes a regulation imposed from 'without' rather than developed from 'within' the corporate business context.

## **DEFINING CORPORATE SOCIAL RESPONSIBILITY**

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<sup>1</sup> For a recent analysis of Australian attitudes to corporate practice see Batten, J.A. & Birch, D. "Defining Corporate Citizenship: Evidence from Australia", *Asia Pacific Business Review*, vol. 11, no. 1, September 2005, pp. 293-308.

<sup>2</sup> Sampford, C. & Berry, V. "Shareholder Values not Shareholder Value" *Griffith University Law Review*, vol. 13, no. 1, 2004, pp. 115-121.

CSR and triple bottom line<sup>3</sup> (TBL) reporting have been variously defined and interpreted. At the very least, both terms attempt to define the nature of business in society.<sup>4</sup> TBL is the catchphrase response to calls for greater transparency and accountability of corporate activities and refers to the three elements of social, environmental and financial accountability. The aim of TBL, in broad terms, is the extension of decision making considerations to include interests beyond that of short term shareholder wealth maximisation. The Prime Minister's *Community Business Partnership* defines CSR as a corporate entity's commitment to operating in ways that consider the impacts of business decisions beyond financial implications to social, environmental and economic impacts.<sup>5</sup> Here, the term refers to interests that go beyond the short term gains of shareholders.

### Identification of stakeholders

The term 'stakeholder' covers a wide array of interest holders depending on the definition used. It is important to recognise that the stakeholder definition used impacts on what is required of corporations to meet CSR demands. Early stakeholder theory focused on the managerial model of an entity and, as a result, narrowly defined 'stakeholder' as a group that impacts on the success of the organisation in terms of production outcomes and transactions.<sup>6</sup> The broader definition of the stakeholder view of the firm includes those who may affect or be affected by the organisation – employees, customers, local community, management, owners and suppliers and so on.<sup>7</sup> A corporation will cease to exist if any group is removed since "all the parts are necessary for the whole".<sup>8</sup> The narrow definition restricts the responsibility of an organisation to be accountable for its actions to a limited number of stakeholders. In contrast, the broader definition recognises the considerable and varied impacts the conduct of a corporation may have on an extended number of people by taking into account relationships with external groups.

Both definitions bring with them the issue of conflicting interests of stakeholders, regardless of the size of the population that they cover. It is important to be aware of such conflict and resist the temptation to place all interest holders under the same banner without recognition of the different agendas each stakeholder or stakeholder group brings to the debate. Recognition of the competing interests serves to highlight the balancing task corporations have, regardless of the types of reform implemented when it comes to balancing financial interests of the company and its shareholders, and the interests of other stakeholders.

One critical issue in CSR concerns which stakeholders are recognised and valued and the how such recognition and valuing should affect the governance of corporations. The community as a whole has an interest in the very broadest sense in that they have been persuaded that the creation and maintenance of joint stock companies (as the institutional vehicles through which most economic activity is pursued) is of benefit to the community as a whole – it enhances overall welfare, offers generally enhanced freedom and opportunity, and considers the values important to the community. This is (at least part of) the justification for having corporations in the first place, and many accept some version of it. Most directors and managers would genuinely believe that corporations as a whole add to the welfare of society rather than secure

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<sup>3</sup> First proposed by Elkington, J. "Towards the Sustainable Corporation: Win-Win-Win Business Strategies for Sustainable Development" *California Management Review*, vol. 36, no. 2, 1994, pp. 90-100.

<sup>4</sup> Brenkert, G. "The Need for Corporate Integrity", in G. Brenkert (ed) *Corporate Integrity and Accountability*, California: Sage Publications, 2004, p. 2.

<sup>5</sup> [http://www.partnerships.gov.au/csr/corporate\\_csr\\_defined.shtml](http://www.partnerships.gov.au/csr/corporate_csr_defined.shtml) (accessed 12 September 2005).

<sup>6</sup> Freeman, R.E. *Strategic Management: A Stakeholder Approach*, Boston: Pitman, 1984, p. 6.

<sup>7</sup> *ibid.* p. 25. See also Freeman, R.E. "A Stakeholder Theory of the Modern Corporation", in T. Beauchamp & N. Bowie (eds) *Ethical Theory and Business*, 6<sup>th</sup> edn, Upper Saddle River, N.J.: Prentice Hall, 1997.

<sup>8</sup> Brown, M.T. *Corporate Integrity: Rethinking Organizational Ethics and Leadership*, Cambridge: Cambridge University Press, 2005, pp. 18-19.

advantage at the overall expense of the community. It is important that corporations live up to that justification and their collective and individual codes of ethics reflect that for a variety of reasons.<sup>9</sup> The community is involved in the regulation of corporations and therefore must be considered by directors and managers when deciding whose interests must be taken into account. Preserving and enhancing the long term self interests of the corporation and the values that shareholders place on their communities is likely to be one of the first considerations (particularly if they are thinking of the ways in which corporations may further the shareholders' values beyond the monetary value of shares).

While valuing the community in which a corporation must thrive should be shared among all corporations, the valuing of other stakeholders' interests will naturally vary and will be based on those that the community mandates through legislation.

## HOW THE CURRENT REGULATORY SYSTEM WORKS

The following is a brief overview of the current Australian system of corporate regulation in terms of CSR. The overview describes specific corporate governance provisions relating to CSR to highlight the piecemeal approach currently in operation. While not explicitly discussed here, it is important to note that the impact of corporate activities on stakeholders other than shareholders are regulated in Australia by other general legislation in the areas of, for example, environmental protection, trade practices provisions and employment and workplace legislation.<sup>10</sup>

### Legislation

Disclosure provisions that are aimed at encouraging corporate governance are focussed mainly on ensuring financial accountability of corporate decision makers to shareholders rather than on improving stakeholder access to information regarding the actions of corporations. However, the following are examples of current legislative provisions specifically applicable to corporate entities and stakeholder interests.

Section 1013D(1)(l) *Corporations Act* applies to socially responsible investment (SRI) and states that a product disclosure statement in relation to a financial product that has an investment component must include a statement highlighting "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."

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9) amended the *Corporations Act* to require that an operating and financial review be included as part of an entity's annual report. Prior to the inclusion of this provision, the legislative requirements had only asked for the inclusion of general operational information.<sup>11</sup> The implemented reforms were aimed at providing members with information from the perspective of the Directors that impact on members' ability to make informed decisions.<sup>12</sup>

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<sup>9</sup> See Sampford and Wood "The Future of Business Ethics: Legal Regulation, Ethical Standard Setting and Institutional Design", in C. Sampford & T. Coady (eds) *Ethics, Law and Business*, Sydney: Federation Press, 1993.

<sup>10</sup> For example, *Environmental Protection Act 1994* (Qld); *Trade Practices Act 1974* (Cth); *Workplace Relations Act 1996* (Cth); *Industrial Relations Act 1999*.

<sup>11</sup> s299(1) *Corporations Act 2001*(Cth).

<sup>12</sup> CLERP 9 (Audit Reform and Corporate Disclosure Bill) p. 82.

In terms of the environmental regulatory disclosure section 299(1)(f) of the *Corporations Act*, a directors' report must give details of the entity's performance in relation to environmental regulation if the entity's operations are subject to any particular and significant environmental regulation.

### **Policy and Guidelines**

ASIC Policy Statement 175 considers the application of the conduct and disclosure obligations under Part 7.7 of the *Corporations Act* and how they apply to the provision of financial product advice to retail clients. In relation to environmental, social or ethical considerations entities should form their own view about how far to inquire into the client's attitude. However, it is considered best practice in the Policy Statement to determine whether such considerations are of importance to the client regardless of any current legal requirement.<sup>13</sup>

Under the ASX Listing Rules, companies are required to review their operations and activities in their annual report and provide 'continuous disclosure'.<sup>14</sup> Companies are also required under the listing rules to include a commentary on the results for the reporting period in the preliminary final report submitted to the Exchange.<sup>15</sup> Further to this, the ASX *Principles of Good Corporate Governance and Best Practice Recommendations* aim to provide a practical governance framework.<sup>16</sup> The Principles articulate ten core elements of good corporate governance. Under ASX Listing Rule 4.10 listed companies are required to state in their annual report the extent to which the best practice recommendations have been followed and provide reasons for any departure from the best practice guidelines.<sup>17</sup> Of particular relevance here is *Principle 10: Recognise the Legitimate Interest of Stakeholders* which states "companies have a number of legal and other obligations to non-shareholder stakeholders such as employees, clients/customers and the community as a whole."<sup>18</sup>

Standards Australia has issued a five-part series of standards on corporate governance which, unlike the ASX *Principles of Good Corporate Governance and Best Practice Recommendations*, apply to non-listed companies.<sup>19</sup> Two of the standards are of particular significance to stakeholder interests. AS 8002-2003 *Corporate Governance – Organisational Codes of Conduct* recommends code drafting to be carried out in consultation with employees and other relevant stakeholders. The standards list 'responsibility for dealing with stakeholders' as an issue that should be included in a code of conduct.<sup>20</sup> Specifically in relation to CSR, AS 8003-2003: *Corporate Governance – Corporate Social Responsibility* has the objective of providing guidance for "establishing, implementing and managing effective CSR programs within an entity and provides guidance in using these elements."<sup>21</sup>

The description of the Australian regulatory corporate landscape highlights the varied approaches currently in effect. Corporate governance regulation exists in terms of the legal provisions in the *Corporations Act*,

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<sup>13</sup> ASIC Policy Statement 175 Licensing: Financial product advisers – Conduct and disclosure Chapter 7 – Financial services and markets, p. 35. The Policy Statement makes specific reference to Section 945A Corporations Act 2001 (Cth) which requires a reasonable basis for the advice.

<sup>14</sup> Listing Rules 4.10.17 and 3.1.

<sup>15</sup> Listing Rule 4.3A in Corporate Law Economic Reform Program No. 9 (CLERP 9) (Audit Reform and Corporate Disclosure Bill) p. 81.

<sup>16</sup> ASX Corporate Governance Council, *Principles of Good Corporate Governance and Best Practice Recommendations*, March 2003. Available at <http://www.asx.com.au/about/pdf/ASXRecommendations.pdf> (accessed 13 September 2005).

<sup>17</sup> *ibid.*, p. 5.

<sup>18</sup> *ibid.*, p. 62.

<sup>19</sup> The five corporate governance standards are: AS 8000-2003: Corporate Governance – Good Governance Principles; AS 8001-2003: Corporate Governance – Fraud and Corruption Control; AS 8002-2003: Corporate Governance – Organisational Codes of conduct; AS 8003-2003: Corporate Governance – Corporate Social Responsibility; AS 8004-2003: Corporate Governance – Whistleblower Protection Programs for Entities.

<sup>20</sup> Standards Australia AS 8002-2003 *Australian Standard Organisational Codes of Conduct*, p. 7.

<sup>21</sup> *ibid.*, p. 2.

more generally in other legislation, through standards bodies and ASX reporting guidelines. However, there is little coherence and uniformity across the regulator bodies and this is a fundamental element of any effective strategy aimed at encouraging accountability for actions regardless of the mechanism adopted to achieve this end.

## INTERNATIONAL JURISDICTIONAL APPROACHES

Of interest for this inquiry generally, and our submission in particular, is the implementation of 'constituency statutes', which permit and in some instances require corporate consideration of non-shareholder interests, in the majority of states in the United States (US). While the regulation of corporate activity in the US is primarily an issue left to state legislatures, the US experience provides a useful example of legislative permission to consider interests apart from those of shareholders.

It is important to note that the majority of the legislative responses in terms of non-shareholder constituencies were the result of the prevalence of hostile takeovers in the 1980s. Such measures were ultimately implemented to give directors additional grounds on which to oppose such takeover attempts.<sup>22</sup> The majority of the 'constituency statutes' permit, rather than require, a director to take into account the interests of stakeholders when considering what is in the best interests of the corporation. In some instances, the statutes also permit directors to consider factors that are more general in nature, such as social considerations, and local and national economies.<sup>23</sup> While the majority of states have enacted permissive provisions in relation to considering additional stakeholder interests without restricting them to matters purely associated with takeovers, the *Connecticut Business Corporation Act* provides an example of the mandatory position on considering non-shareholder interests in relation to issues associated with mergers and sales.<sup>24</sup>

In the US context, there is some concern about the absence of guidance regarding the weight to be assigned to the different (and often conflicting) interests.<sup>25</sup> This raises an interesting issue in relation to permissive provisions that is important for reformers of the Australian corporate framework to consider. Likewise, the lack of determinants for what 'may consider' might mean or even how directors of corporations are to consider the competing interests of non-shareholder stakeholders provide significant factors for consideration.

A review of the *Corporations Act* to permit office holders to take into account other stakeholder interests is similar in nature to the permissive provisions found in company law in certain US states. As such, provisions in the US were prompted by a series of hostile takeover issues. To date there is little evidence of case law beyond this application. As the proposed revision of the *Corporations Act* in Australia relates to issues associated with CSR, the absence of case law (beyond hostile takeovers) detailing the application of the provisions in US state jurisdictions should not negatively impact on the ability of permissive provisions to be effectively implemented in the Australian context given that their primary objective differs considerably.

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<sup>22</sup> Hanks, J. Jr. "Playing with Fire: Non-shareholder Constituency Statutes in the 1990s", *Stetson Law Review*, vol. 21 1991, p. 103.

<sup>23</sup> *ibid.*, p. 103 citing Minn.Stat. § 302A.251(5) (1990): "In discharging the duties of the position of director, a director may, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation."

<sup>24</sup> Sec. 33-756, General standards for directors.

<sup>25</sup> Hanks, *op. cit.* p. 103.

In the United Kingdom (UK) legislative amendments to the Pensions Act came into effect in mid 2001 to require pension fund trustees to disclose the extent to which social, environmental and ethical factors were considered in decision making.<sup>26</sup> The Company Law Review Steering Group and Government White Paper *Modernising Company Law* called for companies of a certain size to report on social and environmental impacts where it is 'material' to the company's operations to publish annual Operating and Financial Reviews (OFR).<sup>27</sup> However, in 2003 the Department of Trade and Industry announced that the OFR requirements would be implemented through regulation rather than legislation despite endorsing the concept of mandatory requirements.<sup>28</sup> The regulations require reporting of corporate business objectives, strategies and the risk that may affect their achievement. Where it is necessary for understanding the business, other matters, including employees, the environment and social issues are required in the report. If they are not included, the report must state the information and analysis it does *not* contain.<sup>29</sup> Like Australia, the UK also has a variety of guidelines. For example the government has issued guidance on environmental reporting,<sup>30</sup> the Association of British Insurers (ABI) detail environmental and social factors that investors expect to see in corporate annual reports,<sup>31</sup> and the ACCA UK Awards for Sustainability Reporting recognise and encourage disclosure and reporting by UK companies<sup>32</sup>.

The adoption of voluntary standards continues to increase globally. Examples include the United Nations Global Compact, OECD Guidelines for Multinational Enterprises, and the Global Reporting Initiative (GRI) to name only a few of the most widely adopted standards.<sup>33</sup> The GRI, an independent organisation since 2002 and currently related to the United Nations Environment Program (UNEP), is the most prominent development in terms of sustainability reporting. The aim of the GRI is to develop globally applicable sustainability guidelines for reporting on the economic, social and environmental impacts of corporate activities.<sup>34</sup> As its name indicates, GRI's focus is on reporting, however it does provide insight into the processes necessary for implementing a CSR initiative.<sup>35</sup> GRI incorporates the active participation of representatives from various organisational groups and through this process is developing a globally applicable sustainability reporting framework. The framework contains reporting principles for organisations to (voluntarily) use to guide the preparation of sustainability reports in relation to the economic, environmental and social impacts of the entity's activities.<sup>36</sup>

## RECOMMENDATION FOR REFORM

The above descriptive component of this submission highlights the Australian corporate environment and attempts to show the varied approaches that are currently in operation in Australia, the US and UK, and

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<sup>26</sup> Department of Trade and Industry <http://www.csr.gov.uk/ukpolicy.shtml> (accessed 12 September 2005). See also Sparkes, R. *Socially Responsible Investment: A Global Revolution*, Chichester, West Sussex: John Wiley & Sons Ltd, 2002, pp. 3-20.

<sup>27</sup> Doane, D. "Good Intentions – Bad Outcomes? The Broken Promise of CSR Reporting", in A. Henriques & J. Richardson (eds) *The Triple Bottom Line – Does It All Add Up?* London: Earthscan Publications Ltd., 2004, p. 85.

<sup>28</sup> Cooper, B. & Hill, S. 'Quality of Life' 390 ICSA International *Keeping Good Companies*, August 2004, p. 393.

<sup>29</sup> Statutory Instrument 2005 No. 1011 *The Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005* came into effect on 22 March 2005. See particularly PART 3 Operating and financial reviews with reference to Schedule 7ZA.

See also Department of Trade and Industry <http://www.csr.gov.uk/ukpolicy.shtml> (accessed 12 September 2005).

<sup>30</sup> Department of Trade and Industry <http://www.csr.gov.uk/ukpolicy.shtml> (accessed 12 September 2005).

<sup>31</sup> Monaghan, P. "Put Up or Shut Up" in Henriques & Richardson, *op. cit.*, p. 147.

<sup>32</sup> <http://www.acca.co.uk/sustainability/awards> (accessed 12 September 2005).

<sup>33</sup> Oakley, R. & Buckland, I. 'What if Business as Usual Won't Work?', in Henriques & Richardson, *op. cit.*, pp. 134-135.

<sup>34</sup> *Global Reporting Initiative* <http://www.globalreporting.org/guidelines/framework.asp> (accessed 12 September 2005).

<sup>35</sup> Dent, G. "A 'Real Time' World: Why Corporate Social Responsibility is a Must Have for Businesses", *Keeping Good Companies*, May 2003, p. 233.

<sup>36</sup> *Global Reporting Initiative*, *op. cit.*

some key global initiatives. In this section we offer a reform mechanism that takes into consideration the competing and often conflicting interests that regulators, legislators and corporate entities bring to the debate. Its starting point is that shareholders and unit holders have values beyond the narrow economic issue of the long term return on their shares and superannuation accounts and that capitalism is enriched rather than impoverished if mechanisms exist to allow investment decisions to link those values to investment decisions.

Setting uniform minimum legal standards will not be sufficient to regulate corporate activity in terms of CSR. A regulatory framework based on sanctions, by virtue of its reactive nature, is weak in terms of imposing penalties after an event that contravenes a provision has occurred. Calls for changes to corporate culture as the most effective mechanism to alter corporate behaviour without outside regulation regularly refer to chief executive and board leadership, corporate frameworks that permit employees to act ethically, and reduce the fear of employees to speak up. Using such terms places the onus of recognising wider duties to stakeholders, and 'creating' values and conditions conducive to this recognition, on the board. Proponents of such a method of encouraging CSR may be concerned that regulation hampers the ability of companies to set themselves apart and differentiate their product from others competing in the same market.

The central dynamic of CSR is that responsible directors, managers, shareholders and unit holders do recognise the importance of values other than the long term value of the shares and units involved. This should be encouraged and facilitated –impediments should be removed in some cases, and difficulties put in the way of those who would seek to profit by pretending to further environmental and other values. Our suggested approach recommends revision of the *Corporations Act* as it currently exists to explicitly authorise directors and office holders to take into account values other than financial returns to shareholders. Our submission attempts to balance the need for regulation of the corporate environment while recognising the need to encourage competition and product differentiation.

Our suggested model would incorporate:

1. Developing a code of corporate ethics which reflects the purposes for which joint stock companies are created and sustained
2. Amending legislation to make it absolutely clear that directors may take into account values and interests other than long term shareholder return
3. Providing mechanisms by which corporations may make claims about values to attract investment – either in prospectuses seeking funds or by endorsement of existing shareholders. The *Corporations Act* can be amended to give an indicative list of the matters on which such claims may be made
4. Requiring that any such claims must be reported on in the annual report
5. Providing mechanisms for the independent assessment of claims – including internal and external auditing, monitoring and rating.
6. Encouraging the development of flexible investment products that allow shareholders to weight investments according to their values (including concentrating on those that promote certain values or exclude those which further others)
7. Encourage investment advisors to ask if investors want to consider other values in choosing their investments

## 1. Corporate Ethics



The Corporations law that allows and encourages joint stock companies is put in place for a wider community purpose. These should be explicitly reflected in Corporations Law and in the ethics of corporations. Our submission recommends a new 'chapter one' of the *Corporations Act* which sets out a set of principles for guiding the legal regulation and ethical standard setting of corporations. This would provide a very clear statement of the purposes of the legislation that would guide its interpretation and future amendment.

While it would have to be passed through parliament, it would be drafted by government and business with inputs from relevant stakeholders. Corporations would then have a common starting point in framing their own codes of ethics and internal integrity systems through which they seek to realise the values set out in the ethics codes. Corporations following such a code will find compliance much easier because they are operating under the same principles that guide the law and its interpretation.

## **2. Amending legislation to explicitly authorise and legitimate CSR**

We do not assert that current legislation should be interpreted to mean that corporations cannot take into account values of importance to their shareholders and unit holders other than those which can be immediately and clearly justified as enhancing the monetary value of their investment. However, that interpretation is often offered as an excuse for ignoring issues of CSR by corporations.

The amendments should make it clear that taking into account other values which the Board believes are likely to increase the long term shareholder/unit holder value is not only legal, but specifically permitted and falls within the responsibilities of directors. However, a Board should minute their reasons to show that they have thought through the issue and have good reasons for taking the position they do.

The amendments should also permit the Board to take into account other values held by shareholders and unit holders – such as environmental sustainability (generally or specifically, e.g. water use or carbon emissions), involvement in specific morally contested industries (e.g. gambling, sex industry, alcohol, nuclear industry, armaments), non-exploitative labour relations, use of local product/services, non-investment in dictatorships and so on. This list is merely illustrative of the kinds of issues that shareholders and unit holders might take value positions on (and in some cases, like nuclear energy, some will choose to invest in areas that others shun). However, corporations making such claims would have to be able to justify those claims. We seek to promote the integrity of claims, not their substance.

## **3. Making claims about values**

The emphasis of the reform process should be on permitting CSR, endorsing and encouraging it by listing the areas under which to make claims regarding CSR actions. Corporations then may make claims under such headings. The listed areas should not be exhaustive in nature as there is a need to ensure legislative responsiveness to contextual change.

## **4. Annual reporting**

Corporations do not have to make claims that they are furthering other values at the same time as long-term shareholder returns. However, if they do so to differentiate themselves from others and to attract capital (or avoid shareholder motions for reform) they should report on the achievement of those claims and the means by which they can substantiate them.

## **5. Assessment of claims**

Corporations holding themselves out as conducting their activities in a certain manner need to have supporting documentation that may be subjected to thorough scrutiny. The claims of social responsibility should be as testable and contestable as those of financial responsibility. This might mean that claims about environmental or other considerations be moderated to reflect the *realities* of how businesses currently operate.

The means by which corporations internally justify their claims will vary, and the diversity of other matters reported on will lead to even more variation. While such internally generated processes should be at the core of assessment (as they are in financial audits), there should be an independent assessment process to address the issue of 'pretended goodness'. A requirement for the justification of a corporation's actions means increased and improved access to information and knowledge about the activities of the corporate sector. The mechanism that permits companies to make claims about their conduct means information is more likely to be informative rather than misleading. The process increases the contestability of claims made by companies.

Central to this submission is that the onus is on business to support any claims made about their conduct. If an interested party is not satisfied that the claims expressed by a corporation are accurate, that interested party may make a submission to the appropriate assessment body detailing specific issues and questions. The assessment body will then request further particulars from the corporation to substantiate the claims. This body could then report that the claim was valid, in need of modification, or unsubstantiated. Where the assessment body considered that the claim had been misleading or deceptive, it could refer the matter to the ACCC, the goal being to improve the accuracy of the claims made.

There is a role here for ratings agencies, however it is important that there is not a single ratings agency and that corporations are rated on the values that they claim to further rather than the value preferences of the agency.

## **6. Development of flexible investment products**

It is not easy for an individual looking to invest in shares and superannuation funds that seek to make money by furthering certain kinds of values. In theory such an investor may invest in corporations that pursue those values or vote shares to make existing companies alter their values – but it is not easy. They could join ethical funds, however it is difficult for individuals to have a significant impact, and further, ethical funds tend to package values based on their origins, the values of the Board or those who rate ethical funds. The more explicit corporations or trustees are about the values they seek to further in trying to enhance the interests and values of their shareholders/unit holders, the easier it is to tailor products to investors who wish to take into account such values and the particular mix of values that individual investors may hold.

## **7. Investment advice**

If some investors want to achieve more with their investment than a monetary return, then investment advisors may have a very important role to play in assisting them to find the right funds and shares. They should be encouraged to do so.

## DISCUSSION

Incorporating a values based model into the regulation of corporate behaviour need not be viewed as the antithesis of maximising shareholder interests and ensuring the longevity of the success of a given company. By permitting corporations to make claims about their operations and the values that underpin the decisions made, corporations are able to justify their actions while providing information to both shareholders and stakeholders to make informed decisions about how to react to such actions. Reporting on corporate activities allows investors and potential investors to formulate decisions based on the 'values' information the corporate entity has claimed. In this way, would-be investors are given the opportunity to ask values questions of themselves when making decisions.<sup>37</sup> Further, the wide ranging interest of corporate entities and stakeholders are not limited to a fiction of there being one commonly held set of values.

While we recognise that the process may result in an increase in effort for the genuine, it is also a mechanism of protection that enables companies to avoid being labelled a 'Greenwash' by only making claims that it has the information to support.<sup>38</sup> There may be more initial support for such a process from larger companies that have the resources to make claims, however it is important to emphasise that the amount of information required to support a claim will depend on the size of a company. Further, it is up to the company to decide which claims are made at any given time. Directors, therefore, need to be aware of what information they are disclosing and whether they have the relevant data to support the claim being asserted.

This reporting mechanism aims to ensure that directors and officers of companies think carefully about their actions and the claims that they make about their business conduct and that supporting documentation to justify their position is available should it be required. Ultimately, this means that companies that make claims can provide reasonable supporting documentation to interest holders that is more effective than the traditional unsophisticated 'tick the box' approach to CSR.

Our submission encourages a move away from a compliance focussed approach to CSR, where guidelines and measurements are adhered to purely in accordance with the letter of the law, to one that adheres more to the spirit of the applicable regulation. This is achievable by permitting corporations to act in ways that recognise the impact they have on the broader society. Permitting directors to make decisions about the future of a given corporation that consider more than shareholder returns limits the opportunity to merely aim for compliance because it encourages corporations to voluntarily disclose how it takes broader issues into account. Such a mechanism protects market-based competition since it is the directors of corporations electing to make claims about the corporation's activities and being prepared to support such claims if they are contested. Likewise, this mechanism provides to other interested parties (as well as shareholders) information upon which to make more informed decisions about their individual or collective interaction with a given corporation, whether that be in terms of purchasing or selling shares, or as a prospective consumer.

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<sup>37</sup> Sampford & Berry, 2004, p. 121.

<sup>38</sup> While some companies are attempting to reduce negative environmental impacts, others have found that reputations can be made rather than earned. One problem with 'greenwash' (i.e. disseminating disinformation about one's activities in an effort to present publicly an environmentally responsible image) is that it threatens the progress of corporate sustainability. This will result, for example, in consumers being suspicious of *any* environmental claims, and it threatens to undermine the efforts of companies attempting to make real progress on sustainability issues.

A perception exists that corporations must always get it 'right'. This method of encouraging and measuring CSR is not focused on encouraging companies to always be 'right' but is offering mechanisms by which companies can make claims about CSR. Provision for corporations to consider interests other than shareholder interests and make statements about activities in relation to those interests may also include making claims about risk factors to ensure a balanced perspective. In terms of this approach, CSR is also about managing risk (in relation to other relevant factors) in addition to shareholder interests. Having said this, the focus on risk is not merely about avoiding negatives. The aim is to further positive activities in relation to CSR so that questions of risk come to focus on risk outside of the corporation which will ultimately encourage socially responsible awareness of risks to external stakeholders.

Our proposal focuses on the need for business to reduce the impact of risk while allowing for business activities to be improved to enhance business success. It achieves this by encouraging market based competition and permitting office holders of corporations to make decisions about what is in the long term best interests of the company, and being able to make such claims and support them if required. This process brings to the forefront of corporate governance corporate reputation and the potential negative impacts of making misleading claims to the public.

The focus of this submission is about providing accurate information about CSR. There is a legitimate interest in the corporations that are invested in, and this process provides a contestable method for the provision of information and its receipt. The process overcomes the issue of legislative obstacles to doing the 'right thing' in terms of directors' fiduciary duties conflicting with taking into account other stakeholder interests. This integrated approach attempts to address issues associated with perception of the driving forces behind corporate decisions and what the community can reasonably expect from corporations.