Submission by Corporate ResponseAbility Pty Ltd to the Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Responsibility.

1. Introduction:

This inquiry is both timely and constructive for the development of an enhanced understanding on Corporate Responsibility (CR) issues. This clarity will follow, from the development of shared understanding and articulation by Australian companies, civil society, public agencies and individuals finding common ground on the extent to which organisational decision – makers have an existing ability to consider other stakeholders under the current Corporations Act.

I note that this inquiry has coincided with the release of the House of Representatives Standing Committee on Environment and Heritage's report "Sustainable Cities". The opening Foreword by the Chair of the committee Dr. Mal Washer states:

> *This committee's vision is for Australian cities that are vibrant and healthy – environmentally, socially and economically. It is the responsibility of all Australians and must be a priority for all Australians*[1]

This statement is relevant to all regions and communities of Australia – not just our urban cities.

The statement recognises that society as a whole bears the responsibility for our sustainable future. This responsibility is no less applicable to Australian companies - large and small, or, for that matter, foreign owned - operating in Australia, as they are integral to the Australian fabric.

Though there is much debate, too often centred around a diverse array of definitions and terminology, the practical objectives of CR are to advance the specific desired outcomes of sustainable businesses (and therefore a sustainable society) through;

- engaging the communities of external and internal stakeholders;
- delivering improved corporate governance, environment, social and economic outcomes through enhanced business management practices; and
- informing investors through transparent and credible reporting, an improved understanding of and therefore confidence in, companies they invest in.

[1] Sustainable Cities , House of Representatives Standing Committee on Environment and Heritage, August 2005, Canberra, p ix

This concept is evident in the statement made by Chris O'Donnell the CEO of Investa Property Group in their 2004 Sustainability Report

> *Specifically, Investa enhances shareholder value by integrating long term sustainability practices as part of our business platform. These practices are measurable, accountable and enduring. They allow us both to embrace the opportunities and manage the risk arising from environmental, social and economic trends. Over the past three years Investa has proved that sustainability can be a pathway to efficiency, innovation and profitability.*[2]

The achievements of companies with business practices that reflect embedded CR thinking and management attitudes demonstrate enhanced profitability. Yet a common fear is that such considerations would make a company less profitable.

There are many instances of companies that have experienced greater profitability by pioneering the shift from CR business theory into CR business practice.

There are no published case studies that demonstrate the opposite, that companies who embrace a CR philosophy are less profitable. The Dow Jones Sustainability Index specifically tracks the performance of stocks using CR criteria.

> *By seizing the opportunities and managing the risks deriving from economic, environmental and societal developments, companies enhance their competitive position. Therefore, sustainable companies are better positioned to create more shareholder value than their peers.*[3]

This occurs through improved business efficiency in decision making and has the potential to eliminate waste in management systems.

This is often expressed as 'enlightened self interest' and is clearly reflected in the following statement that was made in the 2004 HSBC Corporate Social Responsibility Report.

> *We are clear about where our priority lies. Our number one objective is to ensure that our shareholders get a better return from HSBC than they would from investing in our financial services peers. To achieve financial success over the longer tem requires a sustainable approach and our strategy seeks to address the expectations of our customers, colleagues and those who represent the interests of various communities, the wider society and the environment. Our strategic objectives include making HSBC one of the world's leading brands for customer experience and corporate social responsibility…..*
>
> *While our strategy involves growing revenues by meeting customer needs, our goal is not, and never has been, profit at any cost. We know that tomorrow's success depends on the trust we build today.*[4]

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2 Investa Property Group , 2004 Investa Sustainability Report, p 1
3 The Sustainability Yearbook 2005, Sustainable Asset Management, Zurich, p 7
4 HSBC Corporate Social Responsibility Report 2004, London , p4

Corporate Responsibility, stakeholder engagement, transparent and accountable business practices are not in opposition to profitability, but fundamental to the achievement of sustainable environment, social and economic outcomes for all.

2. Stakeholder Engagement.

b) The extent to which organisational decision makers should have regard for the interest of stakeholders other than shareholders.

Companies no longer exist in ‘boardroom or senior management isolation’, where decisions remain unchallenged and senior management are presumed to hold the only correct view of what is in the best interest of the company. Companies are accountable to society for their direct and indirect impacts on the communities in which they operate.

More importantly, in today’s rapidly changing and rapidly communicating world, there is an advantage for organisations that can harness the collective intelligence of all their stakeholders.

In particular, over the last 5 to 10 years, in Australia, those companies that have begun casting the stakeholder net wider, by engaging the broader community through Stakeholder Forums as a regular part of the companies’ intelligence gathering process, have enjoyed the benefits of an increase in community, employee and shareholder trust.

They recognise that:

- Adversaries often bring views that, though confronting, can be timely and beneficial where respectful relationships exist and both parties are committed to constructive outcomes.

- Great business ideas can originate from any part of society, not just those areas with the greatest financial proximity to an organisation.

- The active management of external and internal stakeholders is a prerequisite to good risk management and risk mitigation practice that:

    - can create opportunities to help an organisation identify emerging trends for customers that will put them ahead of their competitors; and
    - will allow a company to focus its priorities and resources on areas that will make the biggest contribution to releasing innovation inside the organisation.

These benefits are being experienced globally:

> *Stakeholder engagement is increasingly being recognised as more than just a defensive response to criticism or imminent conflicts. In some companies it has transcended into an integrated part of systematic risk management. Furthermore, effective stakeholder engagement is increasingly contributing to organisational resilience and flexibility, to learning and innovation, to the identification of new opportunities, and ultimately to the improvement of sustainable performance. Good engagement however can be more than a contribution to the organisations' performance, but also has the potential to inform the adequate integration of social, environmental and economic issues into core strategies and business models.*[5]

Unfortunately, global and Australian corporate history is littered with many examples where the singular pursuit of shareholder profit in the short term has led to the inevitable demise of the organisation. Such examples include WorldCom, Enron, HIH, Parmalaat, and Ansett to name just a few.

Enlightened self interest will compel senior management and the Board of Directors to a more inclusive approach to the collective intelligence of society that will enhance the creation of long term shareholder value.

Therefore organisational decision makers should have regard for the interest of stakeholders other than shareholders where consideration of those views will benefit the company in the long term.

3. Sustainability and Disclosure.

e) Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interest by incorporated entities:

Three alternative mechanisms to enhance consideration of stakeholder interests by incorporated entities are:

1. The ASX Corporate Governance Principles which could be modified to include Social and Environmental disclosure.
2. Management Discussion and Analysis documents by large companies at the release of their annual results which could be expanded to include reporting on what they are currently regulated on relating to social and environmental sustainability issues.

[5] From Words to Actions, The Stakeholder Engagement manual Vol 1, The guide to practitioner's perspectives on stakeholder engagement., Stakeholder Research Associates, United Nations Environment Programme, AccountAbility. 2005, p3

3. Transparent and Accountable Reporting to stakeholders – which will be discussed later under the heading of the appropriateness of reporting requirements.

ASX Corporate Governance Principles.

In 2003, the ASX Corporate Governance Council published a series of best practice principles in regard to good corporate governance. Under ASX Listing Rule 4.10 companies are required to provide a statement in their annual report, disclosing the extent to which they have followed the best practice recommendations in the reporting period. Where a company has not followed a best practice recommendation it must disclose why it has failed to do so.

In March 2004 the ASX Corporate Governance Council responded to the Implementation Review Group's report on the progress that these guidelines had made:

> *The Council is pleased to note that feedback to the IRG shows that the business community has embraced the opportunity to review and improve current governance practices and provide enhanced disclosure about them….*[6]

The strength of these guidelines is that they give both a high level overview and clear direction without being overly prescriptive. i.e. they avoid the need for prescriptive detailed regulation.

While good corporate governance has certain fundamental characteristics, one size does not fit all. Companies need to be able to develop higher levels of sophistication if their business model requires it.

> *The council stresses that 'best practice' evolves over time. It will require different approaches by different companies at different times and according to different sets of variables. A prescriptive interpretation of the recommendations will not best serve the business and investor community in Australia. Such an interpretation will be as disincentive to companies to continually evolve and improve their practices having regard to changing market needs and their own growth path and changing circumstances.*[7]

The first round of reporting by Australian listed companies using these guidelines has already demonstrated that this approach is preferable to prescriptive legislation.

Strengthening these guidelines - in particular ASX Corporate Governance Councils' Good Corporate Governance Principles 3, 4, 7 and 10, would enhance the current disclosure by listed companies of the many non - financial risks and opportunities that can impact the overall profitability of a company. Investors have a right to understand

[6] ASX Corporate Governance Council response to the Implementation Review Group Report 31st March 2004. p1

[7] Ib id p2

these non financial risks and the way in which a company is approaching the management of these issues as a business imperative.

These Principles currently cover only the intangible issue of corporate governance. They could be appropriately modified to include disclosure on social and environmental intangibles that are relevant to a company's operation.

Shareholders are looking for improved disclosure on issues that may only be emerging issues for society and a company, but are vital to future sustainability and profitability. An example of this is the recent publication of the 'Carbon Disclosure Project 2005 – on behalf of 155 investors with assets of $21 trillion.' This project examined the climate change risk management practices of the FT 500.

> *The Carbon Disclosure Project (CDP) is a co-ordinating secretariat for institutional investor collaboration regarding climate change. Its aim is twofold: to inform investors regarding the significant risks and opportunities presented by climate change; and to inform company management regarding the serious concerns of shareholders regarding the impact of these issues on company value.*[8]

In the current global drive for transparency on intangible or latent risk in business, it is not surprising that 71% of companies responded to the request for information. What is surprising is that some companies did not respond at all even though signatory investors held more than 20% of their outstanding shares.

Investors may well ask whether or not these companies are good investments in light of their disrespect for genuine requests on important business strategy information.

Management Discussion and Analysis:

Many listed companies use the Management Discussion and Analysis document attached to the half yearly and annual results to disclose the underlying policies and management practices that may be driving the financial outcomes of the company. For instance the disclosure of OH&S or environmental management systems, managing the human capital of employees for the benefit of the company, the consideration of supply chain vulnerability or the development of strategies on offshoring.

This document could be much more useful to investors if, as a minimum, companies were encouraged to use it to discuss material items for which they are already regulated or licensed, such as OH&S, environmental impacts requiring licensing, anti discrimination, competition policy, industry ombudsmen and industry regulatory requirements. This document, together with a CSR Report, would improve the transparency and therefore accountability of companies to all their stakeholders. They should not be required to disclose competitive information.

[8] Carbon Dsclusre Project 20005 , Innovest Strategic Value Advisors, 2005, p9.

4. The Global Reporting Initiative

f) The appropriateness of reporting requirements associated with these issues

Many leading companies in Australia and globally, are demonstrating their commitment to sustainable business practices through transparency and accountability to their shareholders and broader stakeholders, with the production of a Corporate Social Responsibility Report more commonly referred to as a triple bottom line report.

The reports are records of the non-financial business performance of companies. These strategies, business practices and outcomes of intangible assets on an organisation, have the potential to ultimately impact the financial bottom line of companies.

A triple bottom line report that takes a marketing or 'tick the box' approach will not ensure sustainability. What drives sustainability is good business practices that are executed in such a way as to guarantee success of those business strategies.

Systems thinking is vital to the success of any strategy – it is what moves a company from a good idea into good practice. Too often, companies talk about their aspirations from year to year in their annual reports – but never measure progress towards achieving measurable outcomes.

But the reality is that what gets measured in companies – gets done. Without performance criteria that can be reported on and tracked for incremental improvement, how can analysts or shareholders know whether or not a company is achieving its objectives?

While we in Australia may prefer a voluntary approach to reporting, globally the picture is quite different.

> *The burden of corporate reporting seems to grow heavier by the day. Regulatory agencies around the globe have been issuing new and more stringent requirements, their efforts in part spurred on by the public outcry over corporate scandals and wrong doing………The Goal of much of the new regulation – is on reporting that is clear, comprehensible and complete: in a word - transparent. The underlying concepts are… focused on investor's need to view performance as seen through the eyes of management.*[9]

The best CSR reports record the management practices and policies inside an organisation and give valuable insights for the community, employees, customers and suppliers, regarding the extent to which a company is involved in good management or corporate marketing.

[9] Sustainability Yearbook 2005, SAM, p20

With the level of disclosure required overseas, careful consideration should be given as to whether, if it is not replicated in some form here in Australia, this may lead to the unintended consequence that foreign shareholder confidence in Australian companies may be influenced and therefore affect investment flows.

When CSR reports use the Global Reporting Initiative (GRI) guidelines, qualitative and quantitative information can assist shareholders and stakeholders to understand the extent to which systems thinking is embedded in the organisation.

The GRI guidelines are a globally recognised reporting framework that is developed and continually reviewed using a multi-stakeholder process that is robust and transparent. Input from companies and investors into the development of these guidelines, ensures that they are relevant and applicable. This process has included significant input from Australians.

The GRI Guidelines are very flexible. From 2006, the new GRI Guidelines will recommend 4 tiers of reporting. Each tier recognises that good corporate disclosure is a journey. As companies improve their stakeholder dialogue and develop their internal business systems, they will increase the level of sophistication of their reports and the extent of disclosure. A first-time reporter may only report on some indicators and direct impacts, while other more experienced reporters will report on the direct and indirect impacts in more than one country.

The following 2004 Sustainability reports are recommended as best practice examples of Australian sustainability reporting that demonstrate the amount of flexibility available to those companies using the GRI guidelines:

1. IAG – who are a first time reporter.
2. BHP Billiton – who have been reporting for many years.

At this stage, it would be premature to require mandatory reporting by Australian listed companies as the appropriate accounting and auditing procedures are still in development.

However, it is reasonable for all listed ASX 100 companies to be encouraged to produce their first CSR report by 2007, and all ASX 200 companies by 2009. To facilitate the comparability of data within industry sectors in Australia and globally, companies should be encouraged to use the GRI guidelines as the base reporting framework.

Where companies are not in a position to have their Corporate Responsibility reports audited, it is recommended that, just as Directors must attest to the accuracy of their reports on the ASX Good Governance Principles, they should also attest that their sustainability reports are a fair and accurate record of the organisation's business practices.

While this may appear to primarily place the burden of transparency and accountability only on large listed companies, there would be a 'trickle down effect' of sustainability thinking and reporting through the larger companies' supply chain.

5. Conclusion:

Corporate Responsibility is not an ill-defined trend or business management 'flavour of the month'

It is fundamental, integrated thinking on:

- What a company does every day,
- How the company behaves every day towards their customers, shareholders, employees, suppliers and the greater community,
- How the company's products and services affect the communities and individuals within their wider sphere of influence
- How the company creates shareholder value as a consequence of good business practices and careful management of resources.

Although corporate responsibility terminology may be reasonably new (a decade or so) these have always been the hallmarks of successful companies.

Australian companies are already affected by many pieces of legislation that mandate and prescribe their behaviour in regard to their business behaviour. This legislation includes competition law, corporations' law, OH&S, environmental and employment law to name but a few.

When it comes to good business practice, enlightened companies are always looking for the next strategic advantage over their competitors. This search for differentiation leads companies to innovate and think outside the square.

Sustainable solutions for sustainable business profitability and the society require leading, rather than lagging approaches.

The development of legislation is a lagging response to inappropriate business behaviour. Where companies continually fail to meet the needs of the society then regulation is required.

While there are many companies that will wait for the imposition of legislation to respond to changing society's expectations, these companies will go out of business as they fail to compete with more flexible thinking organisations. No company has ever complied its way to greatness.

It is however, very important that companies that have a natural tendency to respond to society's expectations from a voluntary perspective, are not disadvantaged by a playing field that is tipped too far in favour of the laggards.

Companies that consider and engage the broader stakeholder community will enhance the profitability of shareholder value in the long term.

Shareholders deserve to be fully informed on the business management practices of an organisation. An extension of the ASX Corporate Governance Principles to include disclosure on environmental and social issues with the potential to have a material impact on its future, would begin to address the current imbalance on disclosure of important information and the resulting loss of trust in corporations by their stakeholders

Corporate Responsibility reporting that is responsive to stakeholder concerns, credible and comparable, is an important window into the strategy, thinking and business outcomes of companies. It will assist companies to demonstrate the ability of their organisations to more than comply with the minimum requirements of a legislative base line and meet the challenges of a competitive and demanding future.

Linda Funnell-Milner
Corporate ResponseAbility Pty Ltd
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