COrporatE reSpOnsiBiLiTy: MorAL Or MaNDatory?

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Decisions made by directors and management can affect the interrelations and reputation of a company with the general community. It is these interrelations that make up who the company is, and what it stands for.

Increasingly, the community expects companies and their decision makers to show respect for environmental and social issues in their quest for economic performance and growth. Many companies have voluntarily adapted to meet this challenge and become accountable for their conduct. Others have not, so governments have identified an obligation to respond to these values with a variety of regulatory impositions, and the promise of more to come.

One of the enabling functions of regulation is the opportunity to provide incentives, and thereby alter or influence the behaviour of individual decision makers, and consequently the companies with which they are associated. Apparently, regulators still consider more needs to done to induce accountability in those individuals who impose the outcomes of unsound business on society. The purpose of this article is to examine the current trends toward mandatory sustainability reporting, in both national and international arenas, and discuss the issues and values that are central to corporate responsibility, and a company’s reputation.

The movement to mandatory sustainability reporting

There are a number of current developments.

1. The request by the Parliamentary Secretary to the Treasurer to the Companies Markets and Advisory Committee (CAMAC) to examine whether the liability of directors under the Corporations Act should include social responsibility.

2. The same issue is included in the terms of reference for submissions to the inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into corporate
3 The suggestion by company director Bill Beerworth that the 'business judgment rule' be extended to include protection for directors and officers from personal liability against claims relating to corporate social responsibility issues. Importantly, the imposition will reside with the individual, not just the firm.

4 Mr David Boymal, Chairman of the Australian Accounting Standards Board (AASB), recently foreshadowed mandatory triple bottom reporting (TBL) requirements that will require firms to disclose their social and environmental policies.

5 Senator Ian Campbell, federal Minister for Environment and Heritage, met with the ASX Corporate Governance Council to discuss whether the Council could develop a standard for sustainability reporting. Senator Campbell said that an agreed framework would ensure that the reporting on environmental and social performance by listed companies would allow comparability between companies and across borders. His suggestion was that any such standard could be modelled on the international reporting framework Global Reporting Initiative (GRI).

The focus on sustainability reporting is consistent with the requirements of the Operating and Financial Review (OFR) which now forms part of the UK Regulations Statutory Instrument 2005, No. 1011.5. Directors need to consider whether it is necessary to provide information on a range of factors that may be relevant to the understanding of the business, including environment, employee and social and community issues. The report:

- is aimed at assisting investors to determine and evaluate a company's strategies
- is a principles-based standard
- reflects the directors' view of the business operation
- includes key performance indicators.

Specifically, the OFR will include:

5 (a) information about persons with whom the company has contractual or other arrangements which are essential to the business of the company; and

(b) information about receipts from, and returns to, members of the company in respect of shares held by them.

6 (1) The review must include analysis using financial and, where appropriate, other key performance indicators, including information relating to environmental matters and employee matters.

(2) In sub-paragraph (1), 'key performance indicators' means factors by reference to which the development, performance or position of the business of the company can be measured effectively.

As evident, this mandatory requirement links the company’s policies with key financial and non-financial performance indicators for environmental and employee matters. Commentators also highlight the increasing importance of linking environmental and financial performance, identifying the association with accounting: 'This linkage gains greater importance as concern about the environmental effects of
business operations becomes more acute within the investor, regulatory and public interest arenas.15

However, this reporting aspect is not new. Forty years ago, in 1966, the American Accounting Association (AAA)6 emphasised a concern for what it termed the 'quality of life' issues which combined the use of limited natural resources and the welfare of society. The AAA viewpoint placed everyone in the community in the role of a stakeholder and/or a user of information. So why did it take forty years and government intervention for the issue to arise again?

Reporting issues

Business managers have been considered to be rational utility maximisers. They only disclose information that relates to their public image, rather than information on decisions, activities or the company’s stewardship role. This viewpoint is consistent with research findings that:

- voluntary reporting disclosures did not appear consistent with sound internal environmental and social management systems that cope with all regulatory compliance, and
- disclosure and reporting strategies have been more directed towards improving the public image of companies7 and highlighting proactive corporate behaviour, that is, ‘good deeds’, not ‘bad deeds’.8

In a report on a member of the chemical industry, research9 compared the ethical, social and environmental performance with information obtained from other sources, and found an ‘incompleteness’.

The findings of this research supported a call for mandatory reporting on social and environmental issues. Paradoxically, an overview10 of the European Union Eco-Management and Audit Scheme suggests that mandatory environmental reporting in Europe has had mixed results. Specifically, it can expand disclosure and increase the number of companies actually preparing reports; however, the content may not be meaningful or useful to decision makers although it may add to its reliability.

Fundamentally, it appears voluntary reporting is not keeping pace with the interrelationships between stakeholder values and information needs. Although continually changing, stakeholder values underpin the company’s licence to operate — the central plank of legitimacy theory. A company can convince society its activities and transactions are required and, as part of this process, it enlists society’s approval by meeting with accepted standards and codes of conduct and demonstrates its compliance with regulations and standards. The community imposes penalties and sanctions for failure to meet such regulations and standards. If voluntary performance is not forthcoming, regulations increase the standards necessary to maintain the community licence to operate.

Voluntary reporting guidelines

Voluntary reporting guidelines and frameworks have been formulated, of which the most well-known is the international Global Reporting Initiative (GRI). The GRI reports are based on stakeholder engagement, a consultative process to ascertain and provide specific stakeholder information needs. For example, the signalling of information to specific stakeholders underpins the eight-page leaflet currently provided in Lloyds TSB branches,
that briefly looks at the bank’s important relations, including employees, communities and investors. One advantage of this practice is that appropriate updates can replace irrelevant or old information.

The International Organisation for Standardisation (ISO), which devised the ISO 1400 environmental management standards, announced in July 2004 that it is developing an international standard for corporate social responsibility, aimed at providing guidance on implementing a system to address social and environmental issues. Standards Australia also has a standard specifically directed towards Corporate Social Reporting (AS 8003–2003).

The format for these is the triple bottom line (TBL) approach. This form of communication signals information on the firm’s social and environmental ‘bottom lines’.

Both the GRI in their 2002 Sustainability Reporting Guidelines and the list of sub-criteria in the 2005 summary of voluntary reporting trends and rankings in Germany include a section disclosing ‘vision and strategy’. In completing this section a company provides insights on its future expectations, and its relationship to citizenship issues in the journey to achieving its goals.

Next step: ecological footprints?

Disclosure that allows insights into the potential consequences of business activities is strengthening the TBL approach. This is apparent in the 2003 Guide to Reporting against Environmental Indicators prepared by Environment Australia, and is also highlighted in the launch of the World Wildlife Fund (WWF) and Global Footprint Network European report The Ecological Footprint. This report shows that Europe uses 20% of the biosphere’s services to serve only seven per cent of the world’s population, a 70% increase from 1961.

The report marks the first time Europe has ever tracked and studied its ecological spending in relation to planetary limits, only to find that its use of ecosystem services — such as food, fibre, energy, and land — has created an ecological deficit for the entire region. The result: Europe’s consumption levels can continue to grow only by importing more natural resources, such as wood, metals or fish, from other countries and dumping more of its CO2 waste into the global atmosphere.

Justice and equity

Not all members of the community, including businesses, operate with a consideration of justice and equity for others. The rate of global warming is surmised to be increasingly evident in our changing weather patterns, the intensity of storms, tsunamis and hurricanes, and the disruption of agricultural activities. It has been accepted that business plays a role in global warming, and that it is not solely the responsibility of individuals or governments. The CSIRO conference on International Climate Change, held in November 2005, included information on Australian conditions and mixed the expertise of businesses, government and science to respond to these issues. However, to overcome climate change incurs a social cost.

Considerable legislative inroads have been made to incorporate the social costs within the framework of the market economy and the financial accounts of corporations that cause the damage — the ‘polluter pays
principle’. However, unlike cigarette smoking, there is no causative link between particular companies and an individual’s ill health. Therefore, in the longer term, the cost of ill health is an ‘externality’ — a community rather than a private cost. To cover such costs, there have been suggestions of a ‘social dividend’, payable by the ‘super prosperous’.17

There are arguments in favour of determining and measuring the benefits or costs associated with social issues. However, the maximisation of personal utility, while consistent with consumerism, is inconsistent with utilitarian theory. Under utilitarian theory, decisions are judged in terms of the overall good for the greatest number, that is, if it maximises the good for the majority, it is ethically right. Concepts of justice are founded on the notion that we respect the rights of others.18

The issue is how to demonstrate that making decisions for the overall good can be beneficial to business. A company that fosters goodwill through benevolent actions, such as donations to tsunami victims, and/or by adopting corporate responsibility for its impact on the environment can advance a reputation that avoids self-interest and actually promotes the common interest. Practices of this type define what management and the company stand for, that is, a moral agent replacing self-interest with mutual goodwill. Such intrinsic values can reduce antagonism and strengthens ties with members of the community in which both management and the company continue to operate.19

Obviously shareholders already appreciate corporate citizenship values, as ‘more than one out of every nine dollars professionally managed in the US today is involved in socially responsible investing’ (SRI).20 This equates to $2.16 trillion invested in professionally managed portfolios in the US, with $21.5 billion invested in Australian SRI funds.21 There are sustainability ratings for investment funds supporting investor choices, allowing them to identify funds with those companies with positive, sustainable performance.22 It has been suggested that ethics is one of the ‘missing pieces’ in investors’ perception of risk management23, and that Generation Y investors in Australia will want companies to be ‘clean and green, considering sustainability and ethical issues before investing in any company’.24

While a company can choose to simply communicate ‘good deeds’ and disclose information sufficient to promote an image of corporate responsibility, if the disclosure is not consistent with the company’s performance, it poses a reputational risk. The call now is for companies to report information as a foundation for users to determine:

- the perspectives of the company and its managers on social justice and the moral principles underpinning business decisions. Are duties and obligations fulfilled only when there are beneficial consequences to the company? Put simply, can the community trust the company and its management to ‘do the right thing’ by the environment, its employees, and other interrelated parties?

- the extent to which plans and policies translate into actual performance.

### Inconsistency with profit objectives

Nevertheless, some may view corporate responsibility as inconsistent with the conventional perspective on business
objectives, which is that it is the responsibility of management to maximise shareholder value — to make as much money as possible — while conforming to the rules of society, embodied in law and ethical customs. From this perspective, social responsibility is a form of penalty payment, which in shareholder terms can be seen as an uneconomical use of financial resources.

Recent research efforts have found a positive association between social performance and corporate financial performance. Some of the research explicitly rejected Milton Friedman’s view that corporate social responsibility was inconsistent with shareholder value, including a meta-analysis, integrating 30 years of prior research studies on the relationship between corporate social performance and financial performance.

Nevertheless, from the financial perspective of a business, regulatory requirements impose compliance costs. These may be direct, indirect or even hidden. Costs incurred without corresponding benefits are detrimental to shareholder value. In addition, certain compliance costs may involve activities that can currently be ascertained while others may be based on uncertain outcomes. Stringent regulations may impose future fines and penalties, so that compliance today may not diminish tomorrow’s risk.

Therefore, faced with a myriad of conflicting organisational (and individual) values and goals, managers in a global system of exchange are faced with both risk and uncertainty, and the problem of adeptly balancing a variety of social and environmental objectives with economic objectives.

Central to practicalities

For dynamic companies with good management and investment opportunities, the intrinsic values associated with corporate responsibility support a proactive stance — an ‘open system’ of management. This requires a holistic approach, or a Gestalt perspective to management decisions which, when working effectively, can also assist in:

- reducing financial risk associated with uncertainties
- providing benefits to offset regulatory costs, and
- reducing the potential for personal liability of directors and officers.

By channelling a ‘set of values that differentiates between the good for the community and the bad’ into organisational policies and procedures, economic targets can be harmonised with social, environmental and ethical goals, along the lines suggested in ISO 14000. Incorporating the goals of justice and equity into the company’s internal information system and decision-making processes will also benefit the company’s culture, and set employee relationships.

System implementation will commence with executive management and flow through the key performance indicators of the firm down to the control and reward systems of individual personnel. These goals and systems are then reflected in the process of screening and filtering information and the evaluation of alternatives, flowing into the use of all resources, including the recruitment of staff and their associated performance and rewards. Underpinning this is maintenance of the utilitarianism perspective mentioned earlier, that is, that any changes should not be undertaken.
simply to satisfy management needs
purely on the basis of the benefits
returned to the company, its directors or
officers. 50

Conclusion

The propensity to place private capital in
SRI investment funds; the protection of the
company’s dividend yield and its ability to
sustain and grow its share price in the long
term all prompt a morally pluralistic and
contextual approach to corporate decision
making and resource management. The
interconnectedness of the business with the
widening sphere of corporate responsibility
is an obligation that is increasingly
unavoidable in terms of long-term
shareholder value. Therefore, for some
companies, a fundamental shift in what the
company stands for, what it does, and how it
performs in the long term is the challenge.
This is a cultural challenge, but one that
contends that ‘environmental accounting
also holds the potential to inform broader
public interest discourse by linking financial
reporting to environmental performance,
while also serving the traditional ends of
information that is relevant for
investor/creditor decision-making’. 51

A responsible corporation is perceived to be
well managed and engenders public trust.
Ultimately, the challenge for business
management is to build public trust, which
‘requires integrity to deliver its potential’. 52

The challenge for reporting professionals is
to provide communication tools that can
signal public trust and connect the financial,
economic and social information in both the
short and long term.

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