REFINING THE ROLE OF THE CORPORATION: THE IMPACT OF CORPORATE SOCIAL RESPONSIBILITY ON SHAREHOLDER PRIMACY THEORY

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[*Evidence indicates that we may be witnessing a redefinition of traditional theories of the role of the corporation. Traditional shareholder primacy theory contends that a corporation is primarily responsible to its shareholders to maximise wealth, consequently social factors should not interfere in a corporation's business operations. In the modern business setting however, a company's core objective of profit maximisation must be underpinned by a proactive approach to corporate social responsibility in order to manage and mitigate a broader array of risk factors. Managing risk via community engagement and the implementation of socially responsible strategies is increasingly linked to business success and stakeholder confidence. Intangibles such as trust, ethics, corporate culture, employee satisfaction, environmental behaviour and community responsibility are increasingly relevant to consumers, business partners, governments, special interest groups, existing and potential employees and investors*.]

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I INTRODUCTION

Shareholder primacy theory is outdated as it fails to acknowledge the business case for adopting socially responsible practices. Given that social factors now play a major role in the quest for profit maximisation, the hypothesis that social engagement should be considered *ultra vires* from business activities is contradictory. Part one of this paper outlines the theoretical debate between Berle and Dodd regarding the proper purpose of the corporation and the role of social factors in decision making. Discussion focuses on what should be the primary motivation for a corporation, and leads to an outline of the legal position in Australia with respect to directors' duties and statutory obligations. Part two of the paper considers the development of the corporate social responsibility (CSR) movement in the community and the factors which have shaped stakeholder expectations. Consideration is given to the impact of the culture of ruthless profit maximisation in the 1980s, the development of "insincere" CSR and recent governance crises such as corporate collapses and substantial increases in directors' remuneration.

Part three of the paper argues that a misunderstanding of CSR concepts by commentators has led to confusion as to what amounts to social responsibility. An accurate definition of CSR is presented based on risk management principles associated with governance, environment, social and workplace issues. In line with this definition, examples such as occupational health and safety and corporate philanthropy are evidence of socially responsible strategies which afford financial benefit or increased goodwill for a corporation. Part four of the paper reviews proposed amendments to corporations law in Australia and outlines the preferred approach to CSR management. Discussion also focuses on the impact of the business judgement rule and ultimately concludes that the interconnectedness of social and financial performance is challenging the legitimacy of shareholder primacy theory.

II THE THEORETICAL DEBATE

Debate regarding the role of the corporation has historically taken place between shareholder primacy and social welfare theorists. The views of each school are best conveyed by Adolph Berle and Merrick Dodd, whose public debate in the post-Depression era spawned widespread controversy regarding the potential regulation of industry. The theory of shareholder primacy, endorsed by Berle, contends that a corporation is primarily responsible to its shareholders to maximise profits; as a result social factors which sacrifice shareholder wealth should not be taken into account.[1] Berle contends that the managers of an entity owe a fiduciary responsibility to its shareholders based on an application of the law of trusts. He proposes that an equitable limitation exists on the exercise of all corporate powers and that such powers "…are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears."[2]

[1] Adolph Berle, *Corporate Powers as Powers in Trust*, HARV. L. REV. Vol. 44, 1049 (1931).
[2] *Id.*, at 1049.

Under this model the sole purpose of the enterprise must be to maximise shareholder wealth and avoid succumbing to social influences which serve to sacrifice profit. Silverstein notes that this philosophy evolves from Adam Smith's "invisible hands" doctrine which argues that individuals, and by implication businesses, cannot be "do-gooders" as they lack the knowledge required to make social decisions. Instead corporations will benefit society by creating wealth for individuals, which will in turn lead to a more dynamic community. Silverstein notes, "Individuals should simply seek to maximise profits, profit seeking frees us from having to make controversial value judgements. The "invisible hand" doctrine assures us that profit seeking will invariably lead to the most economically efficient allocation of resources which, in turn, will produce the greatest utility for the world taken as a whole."[3] Accordingly social welfare is best served through the "invisible hand" of the market, as society as a whole will benefit from strong industrial performance.

Berle's theory of shareholder primacy has been most famously endorsed by eminent free market economist Milton Friedman who suggests that external factors such as social responsibilities must be considered *ultra vires* and illegal if they do not result in increased shareholder wealth.[4] In defence of Friedman, his article, "The social responsibility of business is to increase its profits", has received much scrutiny yet was not intended as an academic paper. As Sparkes notes, the article was written in 1970, amidst a different set of market conditions. He states, the article came "…in response to a particular set of circumstances, i.e. the climate of big business in the 1960s…a time when large companies seemed to be dominated by managerial elites with little interest in shareholder returns."[5] Despite this, Friedman has subsequently endorsed the position articulated in this article in a recent series of interviews with Joel Bakan.[6]

Friedman questions how "business", an inanimate object, can be constrained by social responsibilities.[7] Corporations, according to Friedman, possess neither the authority nor the moral right to divert shareholders' profits for the welfare of the general public. He writes, "Managers are merely agents of the stockholders, and thus have no right to spend or give away corporate monies except in the interests of increasing shareholder wealth…any stockholder is free to use his dividends to support any worthy causes he may choose, but the choice should not be made for him by a company president who may not share either his values or priorities."[8]

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[3] David Silverstein, *Managing Corporate Social Responsibility in a Changing Legal Environment*, AMERICAN B.L.J, Vol. 25, 525 (1987).
[4] Milton Friedman, *The Social Responsibility of Business is to Increase Profits*, NY Times, Sept. 1970 (Magazine) at 33.
[5] Russell Sparkes, *A Pragmatic Approach to Corporate Social Responsibility*, (Address given to The School of Management, the London School of Economics, 19 May 2003), *available at* <http://cep.lse.ac.uk/seminarpapers/19-05-03-SPA.pdf>
[6] JOEL BAKAN, THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER (2004).
[7] Friedman, *supra* note 4, at 33.
[8] *Id.*, at 33.

Instead the responsibility of managers, as agents appointed by shareholders, is to maximise shareholder wealth. Friedman notes, "There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits."[9] Henderson also adopts shareholder primacy theory and offers contemporary criticism of the commercial application of CSR. Henderson characterises CSR as misguided virtue, stating, "CSR involves the voluntary adoption by business of broader objectives, more complex procedures and more exacting standards. To this extent it would tend to impair enterprise performance, with effects on both costs and revenues, short run and long run…the system effects of CSR, as well as the enterprise effects, will tend to make people in general worse off."[10] As a result, both Friedman and Henderson contend that social temptations inevitably erode corporate profits, and must therefore be considered *ultra vires* of the business activities of directors.

Conversely Dodd argues for the expansion of directors' fiduciary duties to protect the interests of society, not just shareholders. He contends that "Business must provide a social service, even at the expense of profits, in order to serve the best interests of employees, creditors, customers, and the broader community."[11] While Dodd does not question Berle's application of fiduciary concepts to the exercise of corporate powers, he does reject the assertion that corporate entities exist solely for the purpose of maximising shareholder wealth. As authority for his view Dodd notes, "Public opinion, which ultimately makes law, views the business corporation as an economic institution which has a social service as well as a profit making function."[12] In a modern setting, social welfare advocates argue that "big business" controls a disproportionate amount of wealth and wields a degree of political power today which is unprecedented. Silverstein suggests that, "In the United States we recognise the enormous impact of highly paid lobbyists, political action committees, campaign contributions, and media advertising by large corporations. Furthermore, ownership of these giant corporations is so dispersed that the shareholders, in reality, exercise very little control over management."[13] As such, corporations owe an obligation to society to act in a socially responsible manner even if such actions are not legally mandated. Although strict interpretation of Dodd's theory suggests that a corporation should engage in social welfare even if it leads to profit sacrifice, in the modern business setting it appears that social and financial performance are interconnected. Therefore in order to truly maximise profits a company must engage with social interests.

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[9] *Id.*, at 126.
[10]David Henderson, *Misguided Virtue: False Notions of Corporate Social Responsibility*, NEW ZEALAND BUSINESS ROUNDTABLE (June 2001).
[11] E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, HARV. L. REV. Vol. 45, 1148, 1150 (1932).
[12] *Id., at* 1148.
[13] Silverstein, *supra* note 3, at 538.

III THE LEGAL POSITION

Corporations law in Australia provides no provisions for social welfare but determinately adopts Berle's shareholder primacy norm. Corcoran notes that corporations law is essentially founded on the principles of the *Companies Act 1862* (UK). She states, "It is a *laissez-faire* statute which promotes a strict rule of profit maximisation. It actively discourages corporate concern for social welfare when social welfare must be purchased at a cost to profit maximisation, even when the social welfare is that of its own employees."[14] The primary statutory directors' duties are found in sections 180, 181, 182 and 183 of the *Corporations Act 2001* (Cth). These duties are: to use due care and diligence,[15] act in good faith,[16] not make improper use of position[17] and not make improper use of information.[18] In addition to statutory duties, common law imposes the duty to use skill, care and diligence, and the duty to act *bona fide* in the best interests of the company as a whole.

Directors enjoy broad authority to conduct the management of a corporation, yet are required to exercise their powers in a manner which the directors honestly believe to be in the best interests of the company. Given that the fiduciary duty is owed to the company, any actions which foster profitability appear to be in the company's best interests. As a result, the traditional legal position provides that the role of a corporation is to maximise profits. In undertaking the obligation to maximise profits a director has broad discretion. The subjective nature of the Australian position is best outlined by Lord Greene in *Re Smith & Fawcett*. [19] He states, "Directors must exercise their discretion *bona fide* in what they consider – not what a court may consider – is in the best interests of the company, and not for any collateral purpose."[20] Only in extreme circumstances, for example where a company has ceased to carry on business, or where there is absolutely no conceivable benefit, will it be possible to convince the court that directors did not honestly believe their actions were in the best interests of the company. Pennycuick J in *Charterbridge Corp Ltd v Lloyds Bank Ltd* [21] provides a degree of objectivity in the test despite the *prima facie* subjective base. His test asks, "…whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company."[22]

[14] Suzanne Corcoran, *The Corporation as Citizen and as Government: Social Responsibility and Corporate Morality*, FLINDERS J.L.R, Vol. 2, 53, 54 (1997).
[15] Corporations Act, 2001, s180(1) (Cth).
[16] Corporations Act, 2001, s180(1) (Cth).
[17] Corporations Act, 2001, s180(1) (Cth).
[18] Corporations Act, 2001, s180(1) (Cth).
[19] Re Smith & Fawcett, (1942) Ch 304, 306.
[20] Re Smith & Fawcett (1942) Ch 304, 306.
[21] Charterbridge Corp Ltd v Lloyds Bank Ltd (1970) 1 Ch 62, 74.
[22] Charterbridge Corp Ltd v Lloyds Bank Ltd (1970) 1 Ch 62, 74.

Directors are required to believe that their actions will maximise the company's profits in the short or long term. Langton and Trotman note the difficulties associated with such a vague time period. They state, "…exactly how long remains unspecified. For that reason it is submitted that the phrase 'best interests of the company' should be equated in Australia with ruthless profit maximisation over some unspecified period."[23] As a result, strict interpretation of the law suggests that Australian directors must give exclusive consideration to advancing the financial, not social or moral interests of shareholders.

IV DEVELOPMENT OF THE CSR MOVEMENT

Although the law does not impose specific boundaries, external pressures have played an important role in developing the culture of "short term profit at any cost". Managers have traditionally pursued short term profit maximisation by providing quick returns in order to justify their worth to shareholders. The outcome of more expensive long term profiteering has often been considered more speculative, yet can be legally justified due to the broad scope of power granted to directors.

Traditionally, managers who seek to act in a socially responsible manner by adopting a long term approach to profit maximisation have encountered financial pressures from impatient stockholders. Drucker notes, this long standing problem "…has been exacerbated by the growing concentration of publicly held stock in the hands of a few large, and demanding, institutional investors."[24] The culture of profit maximisation has traditionally been driven by the pressures of financial markets and the obligation to increase personal and client wealth. This developed in the United States in the mid-1970s where business bankruptcies hit their highest level since the Depression, due largely to the rise of international competition from Japan and Germany, and the decline of older more stable industries. High level investors saw opportunity in the crisis and purchased undervalued stocks for quick turnaround. Vulnerable companies were absorbed via hostile takeovers and leveraged buyouts, shrewd financiers made hostile bids on companies in order to be paid to go away. The new industrial state has therefore prioritised personal wealth and profit maximisation over social issues.

The rise of the culture of profit at any cost has been significant in shaping public opinion against big business. The emergence of "crash and bash" CEOs such as Sunbeam's "Chainsaw" Al Dunlap, whilst beneficial for short term profits, drastically lowered public confidence in the corporate world to deliver social wealth. Dunlap and other CEOs built their reputations on ruthless layoffs and became much sought after entities for multinational corporations which sought short term profit maximisation regardless of the social consequences. As chairman of Scott Paper Company, Dunlap fired 11,200 employees and consequently drove the company's stock price up 225%. Upon the sale of the company Dunlap received a $100 million

[23] Robert Langton & Lindsay Trotman, *Defining The Best Interests of the Corporation: Some Australian Reform Proposals*, FLINDERS J.L.R, Vol.3, 163, 176 (1999).
[24] Peter Drucker, *A Crisis of Capitalism*, WALL STREET JOURNAL, Sept. 30, 1986 (Editorial).

bonus. When Dunlap joined Sunbeam, the company's stock rose 60% in twenty-four hours on expectation alone as the stock market routinely rewarded layoffs with lofty stock prices.[25] Dunlap subsequently downsized Sunbeam by firing half of the company's 12,000 employees and eliminating 87% of its products. On the back of the ruthless profit climate the Dow Jones moved from 1000 to 3000 and turned CEOs such as Dunlap into heroes of the capitalist movement.[26] Bakan states, "Dunlap, who once posed on a magazine cover wielding a machine gun to symbolise his take no prisoners approach to management, was cheered as a hero and fearless knight of the bottom line."[27] The effect of the cutthroat managerial style was damaging to the national workforce. Byrne notes, "Over the past two decades, more than 45 million Americans have been laid off from their jobs."[28] Therefore whilst high level individuals have profited from ruthless profit maximisation, the social costs have been considerable.

Recent corporate scandals in Australia have also led to increased public cynicism of corporate motives. A report titled *Eye on Australia*, which appeared in *Business Review Weekly* in 2004, suggests that Australian corporations are severely alienating consumers and employees. Statistics demonstrate that 84% of consumers consider corporations to be overly profit motivated and 75% disagree with the notion that Australian corporations are "caring".[29] It is not difficult to comprehend the background for the anger directed towards corporate Australia.

Since 2001 consumers have witnessed the collapse of Ansett, FAI, Harris Scarfe, HIH and One.Tel as well as Enron and World.Com in the United States. In 1999 the "cash for comments" scandal implicated the banking sector and Australian corporate icons Qantas and Telstra. This event raised community scepticism and portrayed corporations as deceptive and immoral. At a time of unprecedented profit, resulting partly from massive downsizing of staff and branch closures, the scandal perfectly illustrated the lack of sensitivity corporate Australia had developed towards its community. Considerable media coverage has subsequently been afforded to corporate mishaps which has led to increased scepticism. Since 1999 Coles Myer has undergone a battle of proxy votes in order to remove Solomon Lew from its board, AMP has undergone dramatic restructuring and suffered large financial loss, James Hardie has attempted to avoid asbestos compensation payments by relocating the principal component of its company offshore, NRMA has undergone a demutualisation process, Newmont has come under fire for damaging environmental activities in Indonesia, ASIC has alleged possible breaches of competition law by Amcor and there has been considerable press given to "corporate criminals" Ray Williams, Rodney Adler, Rene Rifkin and Steve Vizard. Furthermore directors' payouts have

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[25] JOHN BYRNE, CHAINSAW: THE NOTORIOUS CAREER OF AL DUNLAP IN THE ERA OF PROFIT-AT-ANY-PRICE 44 (2003).
[26] *Id.*, at 44.
[27] BAKAN, *supra* note 6, at 31.
[28] BYRNE, *supra* note 25, at 120.
[29] Simon Lloyd, *Greedy Dishonesty Boring Faceless,* BUSINESS REVIEW WEEKLY, April 22, 2004 at 32.

exponentially risen at the same time, highlighting the extravagant lifestyle of senior managers and further isolating business from the community. BHP Billiton's Brian Gilbertson reportedly received $30 million upon leaving the company after only 6 months; previous BHP-Billiton CEO Paul Anderson received $18 million while Steve Jones received $30 million from Suncorp-Metway. George Trumbull, remembered for the disastrous acquisition of GIO, left AMP with $13.2 million whilst Frank Cicutto received a $3.27 million resignation payment after the crisis at NAB.[30] Departing Commonwealth Bank CEO David Murray is expected to receive approximately $40 million plus reward shares over the next three years if the bank achieves its performance targets.[31]

Although executives may be entitled to such payouts as a result of strong leadership and financial performance, at community level such figures are implausible. As Lloyd suggests, "…at a time when 73% of consumers say that paying off their mortgage is their biggest worry in life, it is little wonder they [consumers] bridle at the excesses of the corporate world."[32]

Corporate Response - Implementation of Insincere CSR

The impact of recent corporate scandals and the entrenched culture of profit maximisation has resulted in the development of a hostile social movement against big business. Consequently, corporations, in response to increased public scrutiny and heightened stakeholder expectations, have sought to modify internal strategies and engage with the community in order to avoid consumer backlash and continue to maximise profits.

For many companies there is a considerable gap between corporate rhetoric and the reality of doing business in a more socially alert and sustainable manner. In line with shareholder primacy theory and in response to community cynicism, many corporations have elected to adopt strategic or "insincere" CSR practices in an attempt to "cash in" on the social movement. As Bakan suggests, insincere CSR began as no more than a means for directors to exploit the community by appearing responsible in order to maximise profits. He states, "Corporate social responsibility is their new creed, a self conscious corrective to earlier greed-inspired visions of the corporation. Despite this "shift" the corporation itself has not changed. It remains…a legally designated person, designed to valorise self-interest and invalidate moral concern."[33] Shareholder primacy theory therefore contends that CSR is best used as a marketing tool to increase profits; executives should not be motivated by social responsibilities unless they are used as a "cloak" for legitimate business decisions. By extension shareholder theorists consider "sincere" CSR to be illegal due to the cost associated with adopting a responsible framework and the perceived lack of financial benefit gained.

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[30] David Campbell, *Corporate excesses cost faith as well as dollars* THE AGE, Jan. 10, 2003 at 11; and Jennifer Hewett, *Betrayal of Trust*, THE SYDNEY MORNING HERALD, Jan. 18, 2003 at 34.
[31]Asia Pulse, *David Murray ends his career at Commonwealth Bank of Australia*, June 14, 2005, available at <http://au.biz.yahoo.com/050614/17/4qu4.html>
[32] Lloyd, *supra* note 29, at 32.
[33] BAKAN, *supra* note 6, at 28.

Australian corporations law supports this position by compelling directors to maximise profits. Therefore any activity which interferes with this process is *prima facie* illegal. As a result, shareholder primacy theory contends that CSR should translate only into window-dressing. Friedman notes, “The executive who treats social responsibility and environmental values as a means to maximise shareholders” wealth – not as ends in themselves – commits no wrong…it’s like putting a good looking girl in front of an automobile …that’s not in order to promote pulchritude, that’s in order to sell cars.”[34]

In practice however the implementation of insincere or strategic CSR is unlikely to lead to profit maximisation. It is more likely that such practices will result in increased risk and structural stress resulting from a range of potential failures. The inherent nature of insincere CSR highlights the growing isolation of some boards from the communities in which they operate. Implementation of insincere practices reveals a corporate culture which seeks to evade personal or professional responsibility and ultimately increases financial volatility. In reality the public is likely to catch onto such deceptive practices. Whilst initially most organisations attempted to adopt established public relations and brand management strategies to ensure that the organisation was seen as a worthy corporate citizen by investors and customers, ultimately this approach was greeted with increased scepticism due to the lack of credo associated with the campaigns. In 2000 the Enron Annual Report led investors and employees to believe that the company was pursuing a range of activities which protected their interests, in the spirit of “Respect, integrity, communication and excellence”.[35] As Coates states however, the insincerity of the Board’s implementation of such systems, and their quest to maximise profits ultimately deceived investors. He notes, “In truth none of the executives adhered to these high minded principles, whereas rank and file employees took them seriously and practised them.”[36]

The collapse of Enron due to the criminal actions of executives and the provision of misinformation to the market demonstrates the hypocrisy of the notion that insincere CSR may be beneficial. In practice the desire to maximise profit at any cost is likely to lead to a culture of corruption whereby management systems fail as a result of executive or employee irresponsibility. As Velasquez notes, the insincere nature of such actions is likely to create an unsustainable corporate culture. He states, “Unethical practices arise when corporations fail to pay explicit attention to the ethical risks that are created by their own systems and practices.”[37] In Australia the recent National Australia Bank (NAB) scandal revealed the inherent risk associated with internal systems built on financial pressure. Trader Luke Duffy falsely

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[34] *Id.*, at 34.
[35] *Enron Annual Report* (2000), *available at* <http://www.enron.com/corp/investors/annuals/>
[36] Breena Coates, *Rogue Corporations, Corporate Rogues & Ethics Compliance: The Sarbanes-Oxley Act, 2002*, PUBLIC A.M.I.J, Vol. 8, No.3 (2003) at 184.
[37] Manuel Velasquez, *Corporate Ethics*: *Losing It, Having It, Getting It*, in ESSENTIALS OF BUSINESS ETHICS 134 (Peter Madsen& Jay Shafritz eds., 1990).

claimed a $37 million profit in an attempt to cover a $5 million loss to avoid scrutiny. Chettle J, in sentencing Duffy stated, "The mixture of personal ambition, arrogance and corporate culture made you forget the legal responsibilities you had to the NAB, its management and its shareholders…You and your team saw yourselves as invincible and justified in your criminal conduct by asserting that your principal motives were to make money for the bank."[38] Defence lawyer John Dickenson noted that traders had to take risks to achieve the targets the bank had set. He claimed, "The bank had put them in a situation where they had to gamble, and gamble hard."[39] Coates argues that in unethical systems, "…the culture is so structured that management finds it easy to provide rationalisations for deviant demands. Lower functionaries feel pressured into doing things (in the name of business) that they would not otherwise do."[40] Likewise Roddick claims that the religion of profit maximisation makes decent people do indecent things. He notes, "…because it has to maximise profits, everything is legitimate in the pursuit of that goal, everything…"[41] As a result, the Enron and NAB scandals demonstrate how wide a gap can exist between a company's cleverly crafted do-gooder image and its actual operations.

V THE MOVEMENT TOWARDS SINCERE CSR

A *Mistaken Concepts of Shareholder Primacy and The Benefits of a CSR Management Framework*

Misinterpretation of CSR principles by shareholder primacy theorists has cast a shadow over the perceived illegality of "sincere" CSR. Commentators have failed to appreciate the foundation of CSR in risk management and instead erroneously view "social welfare" as the only component of sincere engagement. As a result shareholder primacy theorists have failed to appreciate the business case for adopting CSR as a means to reduce risk.

Parkinson defines "sincere" social responsibility, which he terms "profit sacrificing social responsibility" as "…behaviour that involves voluntarily sacrificing profits, either by incurring additional costs in the course of the company's production processes, or by making transfers to non-shareholder groups out of the surplus thereby generated, in the belief that such behaviour will have consequences superior to those flowing from a policy of pure profit maximisation."[42] Likewise Lantos contends that "…firms practising altruistic CSR help to alleviate various social ills

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[38] Daniella Miletic, *16 months' jail for NAB forex dealer over $360m scandal*, THE AGE, June 16 2005, Business Section p .1

[39] Daniella Miletic, *NAB man's $5m losing bet*, THE AGE, June 15, 2005, Business Section, p.1.

[40] Breena Coates, *Hard Choices and Dirty Hands Dilemmas: The Implications of the USA Patriot Act of 2001*, THE JURIST, January 2002, at 167.

[41] BAKAN, *supra* note 6, at 55.

[42] JOHN PARKINSON, CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW 261 (1994).

within a community or society, such as lack of sufficient funding for educational institutions, inadequate monies for the arts, chronic unemployment, urban blight, drug and alcohol problems, and illiteracy, among others."[43] In practice however, the adoption of sincere CSR is more appropriately defined as the implementation of sound management structures aimed at minimising risk in areas such as governance, environmental impact, social impact and workplace practices. Shareholder primacy theorists are therefore mistaken in their belief that CSR is merely the departure of profits from the company in order to engage in social welfare.

Australian social responsibility ratings agency RepuTex, best identifies the elements of "sincere" CSR. It states, "An organisation should, as part of its core operating activities, display a commitment to exemplary conduct and the highest standards of ethical practice in the diverse areas of environmental sustainability, workplace practices and community wellbeing. Transparent and accountable governance structures should incorporate the highest standards of ethics that result in a genuine capacity to self govern and be trusted by the community. Value should be added to the organisation's understanding of social responsibility through a process of active and responsive engagement with a broad range of stakeholder groups."[44] As a result social welfare constitutes only one component of a strategy designed to minimise exposure to social risk. Minimising risk ultimately places a company in a stronger, more sustainable market position than an unengaged competitor who is likely to be exposed to a greater number of external variables. As Black argues, the adoption of such practices positions a corporation to effectively manage potential risk. He notes, "Social risk management procedures impose clear disciplines upon an organisation and its stakeholders which should result in improved relationships with stakeholders and a better understanding of the environment in which it operates. Such management procedures should better equip an organisation to anticipate the inclinations of those who prescribe regulations and performance expectations upon it, and will sharpen its response to third party pressures."[45]

Companies are increasingly recognising that they need to act with regard to sincere CSR in order to attract increased business, customer and investor support. Resource companies, such as Rio Tinto, BHP Billiton and BP, due to the high impact nature of their operations, have invested a considerable amount of energy in order to meet the high expectations of environmental and social stakeholders. In doing so companies also seek to increase goodwill and reverse public mistrust of big business. BP Chairman Sir John Browne, believes that people's angst about corporations – the "…quiet monster living in the public mood", can be tamed by sincere CSR engagement. "If we're going to win back public acceptance and trust, we have to be

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[43] Geoffrey Lantos, *The Ethicality of Altruistic Corporate Social Responsibility*, JOURNAL C.M, Vol. 19 No. 3, 206 (2002).

[44] RepuTex website *at* <http://www.reputex.com.au>

[45] Peter Black, *Social Responsibility Ratings and Their Relevance to Mainstream Investment Analysis*, REPUTEX BACKGROUNDER, Vol. 1, 1 (2005).

progressive."[46] As a result companies are taking a proactive and transparent approach to CSR reporting. In the BBC's Reith Lectures in 2000, Browne noted, "Companies are radically altering their annual reports to include detailed information about environmental and social performance alongside their financial accounts. Performance is now measured on many dimensions and success is defined in a holistic way. One of the great gains from the connected economy is transparency, because that is the key to confidence and trust, and for the granting of permission by society for companies to pursue their activities and continue to make progress."[47] In light of the insincere approach to CSR undertaken by companies such as Enron, Browne's comments demonstrate the importance of sincere engagement and the potential for financial gain as a result. BP is, for example, more likely to secure future access to government controlled oil deposits and therefore more likely to achieve superior profit maximisation due to its social and environmental engagement and sustainability programs.

At policy level, BP has adopted a comprehensive program aimed at ensuring sustainable business practices. As noted, the long term effect of such strategies is at the least likely to separate the company from its competitors. BP has undertaken to reduce its emissions of greenhouse gasses by 10% by the year 2010. To help reach the announced goals BP has established an in-house carbon dioxide trading program that requires business units to buy and sell credits in order to meet their allowed emission levels. In Australia BP is also the first participant in the "greenhouse friendly – greenhouse free" initiative in which revenue from sales of its cleaner fuel is specifically directed by the Commonwealth Bank into cleaner energy projects.[48] Under Browne, BP marketing campaigns have capitalised on the company's responsible practices by painting the company in a green, environmentally friendly light. The company subsequently appears more attractive to responsible investors, and consumers who prefer "clean" brands. BP has also changed its name from British Petroleum to Beyond Petroleum in an attempt to reduce the emphasis on unsustainable fuel products and imply a social vision. Sincere engagement and leadership on climate change is ultimately undertaken as a mechanism to ensure that the company is well placed to overcome potential environmental risk exposures, and to give the company a distinctive edge in the eyes of government officials and community groups. This is also likely to lead to innovation and long term shareholder wealth.

B *Impact of CSR Policies & Strategy*

The advantages associated with adopting CSR policy may be identified by examining the benefits of specific programs such as those relating to Occupational Health and Safety (OH&S) and philanthropy. Although considered a profit sacrifice by shareholder primacy theorists, the relationship of such programs to a company's

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[46] BAKAN, *supra* note 6, at 144.
[47] BBC Radio 4, Reith Series Lectures 2000, *available at* <http://news.bbc.co.uk/hi/english/static/events/reith_2000/lecture3.stm 20/6/05>
[48] *See*: <www.bp.com.au> (last visited May 16, 2005).

bottom line is evidence of the interconnectedness of social and financial performance.

C *Occupational Health & Safety*

The implementation of OH&S strategies by a corporation demonstrates the financial benefit of CSR engagement and reduced risk exposure. Sincere implementation of safety measures by a company goes beyond Friedman's concept of mere window dressing and suggests that profit sacrifice for sincere CSR purposes may be financially rewarding. From the shareholder primacy perspective, the belief that an unsafe workplace will result in increased shareholder wealth due to reduced cost demonstrates the contradictory nature of both primacy theory and insincere CSR. Concern regarding directors breaching their primary duties to shareholders by sacrificing profits is negated when a company's performance is measured by non-economic factors such as employee satisfaction and corporate reputation. As Horrigan notes, "Compliance with anti-pollution and workplace safety laws to prevent harm to employees and the environment unquestionably increases the costs of business but nobody seriously frames this in terms of unjustified distraction from the financial bottom line or something which compromises the primary directive to satisfy shareholder interests."[49]

Companies in high impact sectors such as BHP Billiton and Rio Tinto have traditionally adopted rigorous OH&S policies in order to protect staff and manage the inherent risk in the nature of their work. Rio Tinto for example has implemented performance standards to cover typical occupational exposures in the industry. These include strategies to protect employees from gas vapour exposure, high noise levels, manual handling and vibration, hazardous substances, radiation, thermal stress and fitness for working.[50] These programs are supported by the adoption of a health and safety management system which sets out specific requirements of risk assessment, workplace monitoring and medical surveillance.[51] Of note however is the extension of OH&S policy into industries which have typically been indifferent to safety due to their perceived low impact operations. Companies such as Hewlett-Packard and NAB, which *prima facie* appear to have little need for strict OH&S policy, provide a good example of the modern approach to safety management. NAB for example has adopted a health and safety management system which is integrated with organisational activities. The company has adopted strategies such as safety targets and accountabilities for all employees, dissemination of safety information via employee forum groups, safety training and rehabilitation programs.[52] Such programs ultimately reduce potential exposure to workplace risk and

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[49] Brian Horrigan, *Fault Lines in the Intersection Between Corporate Governance and Social Responsibility*, 25 UNIVERSITY N.S.W.L REV. 515, 539 (2002).
[50] <http://www.riotinto.com/community/occHealth.aspx> (accessed on May 10, 2005).
[51] *Id.*
[52] <http://www.nabgroup.com/0,,48934,00.html> (accessed on May 20, 2005).

therefore reduce the likelihood of financial outlay. The willingness of corporations such as Rio Tinto and the NAB to adopt OH&S programs demonstrates the benefit to be gained from observing a safe workplace.

In the modern business setting, a proactive approach to health and safety, regardless of the perceived operational impact of the company, will have significant benefit to a corporation. It has long been recognised that effective management of health and safety can deliver a wide range of benefits to a company via reduced risk exposure. As Grammeno notes, while zero injury targets are the primary goal, improvements may also result in increased productivity, product and service improvements and increased morale and job satisfaction. This may also result in reduced absenteeism and lower staff turnover.[53] Employee identification in company goals and objectives is valued as a means to maximise profit. Strategies such as OH&S, which increase morale and employee confidence in the corporation may therefore lead to financial benefit.

The 2003 Bertelsmann CSR Report clearly supports this notion. It states, "Leadership through partnership strengthens employee identification with their company; identification meanwhile promotes business success. The top one quarter of all companies, whose employees identify most strongly with their companies, generated a high return on sales on average, while the bottom one quarter, whose employees felt least identification, averaged return on sales close to zero. In other words: Leading through partnership results in a better bottom line."[54] Companies which engage in insincere OH&S practices are unlikely to foster such employee identification, and are therefore likely to miss the associated financial benefits. As a result of a less stringent safety culture, such corporations are also likely to face increased risk exposures. Poor OH&S performance is likely to have a negative financial impact on a corporation via increased costs associated with employee lost time due to injury, equipment damage, accident investigation and documentation, and waste of product.[55] In cases where employer negligence is to blame, penalties and compensation for breaches of health and safety laws will directly impact on a company's bottom line. In 2000 the State Rail Authority of New South Wales was fined $420,000 for a single breach of the Occupational Health and Safety Act 1983 (NSW). As a result it is difficult to conclude that the implementation of OH&S strategies is a distraction from maximising company profitability. Conversely OH&S policy will be advantageous to a company's bottom line and corporate reputation as the correlation between risk, financial volatility and CSR performance is increasingly relevant.

[53] GABRIELLE GRAMMENO, *Managing Business Risks: Risk Management and Corporate Culture*, MASTER OHS AND ENVIRONMENT GUIDE, CCH, 2002, AT 238.

[54] 2003 Bertelsmann CSR Report, at 3, *available at* <http://www.bertelsmann.com/bertelsmann_corp/wms/bertelsmann/index.php?ci=132&language=2>

[55] GRAMMENO, *supra* note 53, at 238.

D *Corporate Philanthropy*

Shareholder primacy theorists contend that corporate philanthropy and social welfare is a means of profit sacrifice and illegal unless it is in the service of corporate self- interest. In the modern business setting, however, it appears that the scope for philanthropic acts may have expanded to include pure social welfare, due to the tangible and intangible benefits associated with such engagement. Therefore all forms of corporate philanthropy may now be considered in the service of self-interest.

The traditional legal position regarding corporate philanthropy endorses shareholder primacy theory. In 1883 Bowen LJ in *Hutton v West Cork Railway* stated, “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…charity has no business to sit at Boards of directors qua charity. There is however a kind of charitable dealing which is for the interest of those who practice it, and to that extent…charity may sit at the Board, but for no other purpose.”[56] In line with corporations law and directors’ duties, companies are provided limited flexibility and protection with regard to charitable dealings. Part 2D.1 of the *Corporations Act* sets out the duties and powers of company officers. These statutory duties sit alongside the common law and equitable duties which require directors to act “*bona fide* for the benefit of the company as a whole”.[57] Directors are protected under the business judgement rule where a legitimate business decision has been made.[58] The business judgement rule in Australia apples only to the duty of due care and diligence under s.180(1), which states that “A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise…”[59] To satisfy the rule the judgement must be in good faith, for a proper purpose and the director must rationally believe that the decision is in the best interests of the company. The director must be informed and must not have a material personal interest in the decision.[60] Therefore the charitable dealing must be in the interest of the corporation and its shareholders. This is likely to be the approach taken by the court if a reasonable corporate donation were ever challenged in Australia.

Difficulty defining the phrase “best interests of the corporation” has led to uncertainty regarding what constitutes a reasonable philanthropic act. The Australian Shareholders Association (ASA) contends that directors should not engage in any form of corporate philanthropy. They state, “The directors of companies are appointed by shareholders to look after the interests of the shareholders. They are there to make money for shareholders, not donate it to other people. Companies

[56] Hutton v. West Cork Railway, (1883) 23 Ch D 654, 673.
[57] Mills v Mills, (1938) 60 CLR 150, 188.
[58] Corporations Act 2001 s180(2) (Cth).
[59] Corporations Act 2001 s180(1) (Cth).
[60] Corporations Act 2001 s180(2)(a), (b), (c), (d) (Cth).

should not be deciding what to do with shareholders' money…The shareholder may well want to be philanthropic; but that's their choice and it should come out of the income which has been delivered to them by the companies in which they invest."[61]

In Australia however, shareholders have very little direct control over management decisions which are made in the "best interests of the company". According to *NRMA v Parker*[62] shareholders are unable to directly instruct management on how to exercise the powers vested in them, yet are able to indirectly influence decisions by passing a resolution at an AGM to alter the company's constitution or by seeking a directors' removal. Shareholder primacy theorists argue that any donation for purely philanthropic or social welfare purposes is illegal. Friedman contends that corporate philanthropy may be tolerated only when it serves the financial interests of the company which in turn benefits shareholders[63] – apathetic social welfare must be deemed illegal. While the law *prima facie* agrees, given the intangible benefits associated with philanthropy, in practice it is difficult for the courts to set clear parameters of when philanthropy may or may not constitute a "benefit". The intangible benefits granted to a company have made the courts reluctant to interfere in matters that involve the exercise of commercial judgement. Philanthropy may result in increased goodwill to the business, improved reputation, employee loyalty or a long term shift in the wellbeing of the community where the business operates. If a decision has been made to donate to a charity for these reasons, the court will be cautious in second guessing the business decision of the directors.

The courts' reluctance to set parameters as to what constitutes a benefit may have resulted in a broadening of the powers indirectly granted to officers via directors' duties. Intangible benefits, for example goodwill, may now be considered to have a direct impact on a company's bottom line; as a result, actions which increase goodwill such as pure social welfare may be *intra vires*. The link between goodwill and profit maximisation has previously been considered ambiguous by the courts. The 1953 US case *A.P Smith Manufacturing Co v Barlow*[64] suggests that goodwill has no impact on the bottom line; as a result corporate philanthropy may be unjustified. Obiter from the case states, "Corporate giving appears to be remote from the company's visible business needs…That those expenditures may also result in an enhanced receptivity for the enterprises' products or services or loyalty from employees is a happy additional benefit, but does not appear to be at the core of the drive to donate. The benefit may reflect managerial long-term strategic conceptions, but they need not be arranged by management to mesh with the daily or short term operations of the enterprise. In short, such goodwill expenditures are not functionally integrated with any particular corporation's business operations and are considerably more remote from the bottom line."[65] Despite this, the date of the judgement may be indicative of the shift in business practices in recent years. In the modern era, corporations have shown a strong desire to capitalise on the goodwill associ-

[61] Quoted in Denis Tracey, *Giving It Away: In Praise of Philanthropy*, SCRIBE (2003) at 11.
[62] NRMA v. Parker, (1986) 6 NSWLR 517, 522.
[63] Friedman, *supra* note 4, at 35.
[64] A.P. Smith Manufacturing Co v. Barlow 98 A2d 581 (NJ 1953).
[65] *Id.*, at 583-86.

ated with charity by trading on the notion of the "halo effect". Harvey and McCrohan define the "halo effect" as follows: "Increasingly corporate giving is seen not solely as philanthropic but rather as an established part of doing business, being present in the community and acting in the corporation's own self-interest. An additional benefit of corporate giving, regardless of the efficiency level of the philanthropy supported, is that perceptions of corporate social responsibility are higher for firms with greater levels of giving, even for those that had earlier violated the antitrust statues. This finding supports the notion that corporate giving provides a halo effect that can overcome prior transgressions."[66]

More recently philanthropy has become a significant component of advertising and marketing campaigns via brand association with a particular cause or non-profit event. For example, Australian supermarket chain Ritchie's proudly publicises its philanthropic activities on television commercials and on the company's website in order to increase goodwill and ultimately profits. Their branding as a "community" store is evidence of the business case for philanthropic activities. As Brudney notes, "By publicly and visibly connecting to those activities the corporation seeks to attract the approval of customers of its goods, products or services and the loyalty of its employees."[67]

As alluded to by Harvey and McCrohan, goodwill may also enable a corporation to mitigate potential brand damage in the event of a corporate mishap. McDonalds, for example, has effectively promoted itself as a responsible corporate citizen by sponsoring over 160 Ronald McDonald Houses around the world which care for young cancer patients. Negative publicity as a result of the McLibel proceedings in the United Kingdom threatened to seriously damage the company's philanthropic image. The scandal, where two Greenpeace activists were sued for handing out libellous information, ultimately forced disclosure of the company's poor social and environmental practices, and portrayed an inequitable mismatch of corporate power versus members of the community. McDonald's image was further tainted by claims that spies had infiltrated London Greenpeace in an attempt to gain evidence to use at trial. However as Compton notes, McDonald's track record and association with charities reduced the impact of the scandal. He states, "McDonalds is widely accepted as a responsible corporate citizen, so much so that when it got into trouble with environmentalists, the community instantly forgave it. The company had built up a bank of goodwill, which it can draw upon when necessary."[68] Likewise Telstra, which received negative publicity in February of this year after seeking to withdraw its sponsorship of the Lifeline program, may have reduced reputational damage as a result of the activities of its Telstra Foundation. The Foundation, which focuses on indigenous and childhood development, is likely to have reduced major

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[66] James Harvey & Kevin McCrohan, *Changing Conditions for Fund Raising and Philanthropy* in CRITICAL ISSUES IN AMERICAN PHILANTHROPY 59 (1990).
[67] Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV., 1192 (2002).
[68] Everald Compton, *Community Partnerships*, IPA REVIEW, Vol. 48/4 (1996) at 45.

brand damage as a result of Telstra's standing as a good corporate citizen. McColl also notes, "…it could be argued that its work helps deflect criticism of Telstra over claims of anti-competitive pricing tactics and inadequate rural and regional services."[69] As such, goodwill may have a significant impact on the bottom line, albeit indirectly.

E *Legal Acceptance of Pure Philanthropy & Social Welfare*

Recent tsunami donations indicate that corporations may be legally authorised to engage in acts of pure social welfare previously considered *ultra vires*. Intangible benefits of philanthropy such as goodwill may indirectly advantage a company's bottom line, therefore acts of social welfare and pure philanthropy may be legal under the guise of enhancing goodwill. As noted above, shareholder primacy theorists consider acts of pure social welfare to be *ultra vires*. Defined by Parkinson, social activism "…refers to conduct which is putatively beneficial to society or particular interest groups, but falls outside the scope of the company's ordinary commercial operations."[70] With regard to the tsunami, the ASA openly criticised corporations which donated money expecting nothing in return. According to ASA spokesman Stephen Matthews, "Donations should only be made in situations that are likely to benefit the company through greater market exposure...there is a role for business to make a contribution in relation to the tsunami, particularly those businesses who have activities in South East Asia. Companies like Bluescope Steel come to mind."[71] However many companies, despite ASA criticism, engaged in "illegal" acts of philanthropy by "sacrificing profit". National Australia Bank, Telstra, Commonwealth Bank, Foster's Group, Visy Industries, Westfield Group, Travelex and News Corporation all donated at least $1 million to aid tsunami victims and in the eyes of the ASA gained no benefit for shareholders.[72]

The ASA's comments demonstrate the organisation's, and shareholder primacy theory's lack of acknowledgement of the business case for charitable dealings. Many corporations gained substantial media attention as a result of donations and therefore indirectly enhanced goodwill. A tactful approach to advertising charitable contributions will most likely result in gains due to the perceived sincere nature of the company. Elliott notes, "How advertising addresses the relief efforts is important partly because of the increasing popularity of cause related marketing, as a growing number of consumers look to spend money with companies they perceive are contributing to the greater good. But doing well by doing good, particularly post 9-11, usually works the best when the public considers the attempt to be altruistic rather than self-promotional."[73] Furthermore, given the community reaction to the

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[69] Gina McColl, *Corporate Philanthropy*, BUSINESS REVIEW WEEKLY, July 7, 2005, at 78.

[70] Parkinson, *supra* note 42, at 261.

[71] ABC Online, *Shareholders' group clarifies tsunami donation stance*, ABC ONLINE, Jan. 7, 2005 *available at* <www.abc.net.au/news/newsitems/200501/s1278362.htm>

[72] Therese Wilson, *The Best Interests of the Company and Corporate Social Responsibility*, CLTA Conference, Feb. 7, 2005, at 8, *available at* <http://www.law.usyd.edu.au/~parsons/CLTA/WilsonPaper.pdf>

[73] Stuart Elliott, *The Media Business: Advertising; The delicate task of showing corporate concern for the tsunami victims, without seeming promotional*, THE NEW YORK TIMES, Jan. 4, 2005.

tsunami disaster, many corporations were morally obliged to donate in order to avoid employee and consumer backlash. Donations were therefore used as a means to reduce business risk. This notion demonstrates the contemporary application of corporate philanthropy.

In the modern era, acts of pure social welfare outside the scope of business operations and interests, are likely to benefit a corporation by enhancing goodwill, employee morale and reducing external risks such as consumer backlash. Indicative of the enhanced role of philanthropy as a means to manage risk was the public reaction to the ASA's comments against pure philanthropic acts by corporations. One letter to the *Sydney Morning Herald* stated, "As a shareholder I am proud that companies are reflecting the community feeling and making a significant difference. It is a chance for leaders in all sectors to inspire. The picture of greed and self interest painted by the response of the ASA fills me with disgust."[74] As a result it appears that a large section of the population expects corporate philanthropy, and now perhaps even pure social welfare. Wilson notes, "It seems that the community expectation is that corporations, as legal entities, should exhibit the same generosity and compassion in the event of such a tragedy as natural persons."[75] As a result shareholder theory, supported by the ASA, appears to be outdated and inflexible in light of changing stakeholder expectations. In the modern era it appears that all forms of philanthropy may indirectly benefit a company's bottom line under the guise of goodwill and the management of potential risk exposures. Many stakeholders appear to be increasingly aware that charitable giving is good for business. Therefore restricting unselfish activity may operate to the detriment of a company in terms of damage to goodwill, reputation and risk exposure.

F *Tangible Benefits of Sincere Social Responsibility*

Given the evolving science of the CSR paradigm, hard evidence of ensuing financial benefit is difficult to collate. However, as noted above with regard to OH&S and philanthropy, corporate case studies have demonstrated considerable benefit from adopting socially responsible projects. The UK Department of Trade and Industry has published several case studies from leading companies such as BP, British Telecom, J Sainsbury, Laing Group, Royal Dutch Shell, Unilever and TXU Europe, which illustrate the various benefits that can emerge from socially responsible strategies. Benefits achieved included:

- Increased staff morale and a better ability to recruit and retain staff;
- Increased reputational standing within communities leading to increased potential for customers;

[74] Editorial, *Even shareholders can give without expecting a return*, SYDNEY MORNING HERALD, January 8, 2005.
[75] Wilson, *supra* note 72, at 9.

- Improved relationships and higher approval rating with local area decision makers (councils and local community organisations);
- Demonstrable cost savings and cuts in waste from new sustainable management strategies;
- Increased customer confidence;
- Improved communication channels to local community and more durable social licence to operate;
- Protection of local supply chains, mitigation of disruption to operations, better risk management;
- Improved partnership with suppliers leading to higher sales;
- Increased business from clients who want a development partner that can deliver effective social and economic programmes.[76]

Furthermore, it appears that organisations with a positive CSR profile offer a better return for investors. The increasing number of socially responsible investment (SRI) funds and CSR products reflects the interconnectivity of financial and social performance. The popularity of SRIs is due largely to the reactive nature of investors who are keen to invest in sustainable companies as a means to punish "dirty" brands. As investors increasingly look to social and environmental issues when making investment decisions, the benefits of an outwardly sustainable business strategy are enhanced. The Ethical Investment Association states that SRI funds in Australia are now worth $21.5 billion, up 41% since June 30, 2004, with religious bodies and employer superannuation funds being the largest investors on SRI criteria.[77] In the US, 13% of the US$16.6 trillion invested, is done so in a socially responsible manner.[78] Research suggests that SRI funds are outperforming traditional investment vehicles. The Dow Jones Sustainability Group Index (DJSGI) in the US measures the CSR performance of companies which represent the top 10% of sustainable companies over 64 sectors. According to the DJSGI website, the top 200 corporations on the Index have outperformed the Dow Jones Global Index by approximately 10% since its inception in October 1999.[79] Likewise, research undertaken by AMP Capital's Sustainable Funds Transfer Team has found that "…companies with a higher CSR rating outperformed [other stocks in the investable universe] by more than 3% per annum over 4 and 10 year periods."[80] As a result the majority of investment managers worldwide anticipate a move into the global financial mainstream within the next decade.[81]

In Australia the extension of CSR into traditional financial products is evident via the release by ABN AMRO of a Collateralised Debt Obligation (CDO) based on

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[76] *Available at* <http://www.societyandbusiness.gov.uk> (accessed on June 10, 2005).
[77] Liam Egan, *Investors warm to SRI*, *available at* <ww.moneymanagement.com.au/articles/c8/0c0281c8.asp>
[78] John Arbouw, *Corporate Citizenship: More than a good idea*, COMPANY DIRECTOR, Vol. 17(4), May, 2001, at 19.
[79] *Available at* <http://indexcs.dowjones.com> (accessed on May 8, 2005).
[80] AMP Capital Investors, *Financial payback from social and environmental factors* in INSIGHTS, Mar. 30, 2005, at 2.
[81] Mercer IC, *Fearless forecast survey 2005, available at* <http://www.mercerhr.co.uk>

corporate debt issues of sustainable companies. The product is the first in the world to have both a credit rating and CSR rating attached to it in order deliver investors a more comprehensive appraisal of current and future risk exposures which might impact on a company's capacity to maintain a sustainable financial position.[82] Mainstream uptake of the CSR agenda ultimately reflects the growing significance of social responsibility as an indicator of financial prosperity.

VI POTENTIAL LEGISLATIVE DEVELOPMENTS

Reform of Australian corporations law via the entrenchment of ethical standards has been proposed by commentators as a means to ensure companies act not only in the best interests of shareholders, but for the community as a whole. Corcoran contends that stakeholder interests should be expressly acknowledged by Australian courts. She states that: "An ethical standard phrased in general terms would promote high ethical standards while maintaining wide discretion. It would recognise the powerful position of corporations within the fabric of our social and political arrangements. A general standard would be flexible and adaptable to changing circumstances. It would assist in closing the expectation gap that exists between the way people think corporations should act and the legal rules with which corporate managers must comply."[83]

Corcoran identifies the American Law Institute's *Principles of Corporate Governance* as an example of a general standard which may be entrenched in statute. Principle 2.01(b)(3) states that a corporation "…may devote a reasonable amount of resources to public welfare, humanitarian, educational, and philanthropic purposes."[84] Accordingly the pursuit of economic objective must be constrained by social imperatives and may be qualified by social needs.[85] In Australia the Australian Stock Exchange (ASX) has developed a set of guidelines, the *Principles of Good Governance and Best Practice Recommendations*, designed as a reference point for companies to understand stakeholder expectations and promote investor confidence.[86] Recommendation 10 proposes that companies "…recognise legal and other obligations to all legitimate stakeholders."[87] This entails the adoption of a company code of conduct in order to guide compliance with legal and other obligations. The guideline for the content of the code of conduct suggests that companies outline responsibilities to shareholders and the financial community in general, responsibilities to clients and consumers, responsibilities of employment practices

[82] Available at <http://www.reputex.com.au/7-home.asp> (accessed on June 16, 2005).
[83] Corcoran, *supra* note 14, at 63.
[84] American Law Institute, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATION (1994).
[85] *Id.*
[86] ASX, *Principles of Good Governance and Best Practice Recommendations*, available at <http://www.asx.com.au/supervision/governance> (accessed on June 20, 2005).
[87] *Id.*, at R.10.1.

such as OH&S, responsibilities to the community, and how the company complies with relevant legislation.[88] Adoption of the recommendations is voluntary, as such a corporation may chose to adopt only part of the framework, or part of a specific recommendation. The impact of voluntary codes is difficult to assess. *Prima facie* such guidelines are unlikely to persuade rogue corporations to adopt socially responsible strategies; however they will ultimately serve as a means to advance the CSR agenda.

Current Australian and British Governments have to varying degrees shown some desire to enhance the legal standing of CSR. In the UK legislative reform has been proposed via the *Company Law Reform Bill*, which seeks to place a positive burden on directors to take stakeholder interests into account. The Bill is currently "in progress" in the House of Commons. Part B3(1) of the Bill outlines the duty of a director to promote the success of the company for the benefit of its members. Subsection (3) of the duty states that "In fulfilling the duty, a director must take account the likely consequences of any decision in both the short and long term and have regard to the interests of employees, foster its business relationships with suppliers, customers and others, and consider the impact of its operations on the community and the environment."[89] Although yet to be passed by the House of Commons, the Bill represents a positive step forward with regard to recognising the interests of stakeholders and the wider community. The Bill also questions the validity of shareholder primacy theory in law as it implies that "ruthless" profit maximisation may now be toned down if it is inconsistent with stakeholder interests.

In 2001, the French Government adopted a more prescriptive approach by mandating social disclosure as part of its Nouvelles Régulations Économiques (NRE). Article 116 of the NRE requires all listed French corporations to report on the social and environmental impact of their activities. Proponents have praised the commitment as a baseline mechanism to implement sustainable reporting standards and foster openness and transparency. More importantly, the Decree places CSR squarely on the agenda of every publicly listed French corporation, effectively institutionalising triple bottom line reporting concepts, and providing French corporations with a competitive advantage over their European and international competitors. The NRE imposes a legal obligation for corporations to publicly disclose against a limited set of qualitative and quantitative indicators relating to the social and environmental impacts of their activities. The regulations make it mandatory for corporations to report on: Employees (equity, diversity, OH&S, training, remuneration); Community (impacts, local development initiatives, stakeholder engagement); Environment (data on air, water and ground emissions, energy consumption, water and raw materials, management systems); and International Labour Standards (how the company and any subsidiaries/contractors promote conventions). Whilst the NRE has received criticism for not establishing specific indicators and methodologies, the Decree is nonetheless evidence of the emerging importance of sustainability issues in mainstream international governance.

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[88] *Id.*, at R.10.1.

[89] Company Law Reform Bill Part B(3) s3(a) & (b).

In Australia the Commonwealth Government has shown a willingness to explore possible amendments to directors' duties, yet has taken no steps to actively promote or recognise sustainability concerns. In March 2005 the Corporations and Markets Advisory Committee (CAMAC) was asked to advise the Parliament on the extent to which the *Corporations Act* should include CSR or explicit obligations to force directors to take into account the interests of certain classes of stakeholders other than shareholders.[90] The exploration of legislative reform demonstrates that the government acknowledges the importance of stakeholder interests, and recognises the need to improve business standards to meet enhanced community expectations.

VII CONCLUSION

Calls to reform Australian corporations law in order to entrench CSR principles may be unwarranted in light of the broad scope afforded by the current system. Meredith Hellicar, Chairman of James Hardie recently suggested that directors' duties should be expanded to include responsibilities to the interests of all stakeholders, enabling company boards to be more generous with company funds. She noted, "What one needs is a safe harbour for directors to be able to integrate corporate social responsibility into their decision making without fear that they are going to be sued both personally and as a company by their shareholders."[91] Whilst Hellicar's comments may appear to be self-serving in light of the recent James Hardie asbestos scandal, the perceived illegality of altruistic CSR demonstrates a lack of understanding of CSR concepts and a failure to appreciate the substantial benefits associated with the effective management of non-financial risk. In practice current directors' duties provide safe harbour for corporate officers who engage in activities which maximise profits. Given the relationship between financial and social performance, directors may rely on the knowledge that CSR activity should be held to be in the best interests of the company. As such any perceived illegality of CSR is unwarranted.

Bartholomeuz notes than in business practice directors may consider a broad range of stakeholders. He writes, "CSR Pty Ltd has been making voluntary payments to asbestos victims for decades. Australian resource companies have become world leaders in adding a social responsibility dimension to their interaction with the communities within which they operate. Australian companies provided a torrent of cash for the tsunami appeals…"[92] The link between social engagement and financial performance ultimately suggests that companies will be motivated to self regulate and implement socially responsible strategies regardless of legislative reform.

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[90] Letter of referral from the Hon Chris Pearce MP, Parliamentary Secretary to the Commonwealth Treasurer, *available at* <http://www.camac.gov.au> (accessed on May 20, 2005).
[91] Stephen Bartholomeuz, *New Director plans could backfire*, THE AGE ONLINE, Apr. 6, 2005, *available at* <www.theage.com.au>
[92] *Id.*

Furthermore, as Wenzel states, self regulation may prove to be more effective than legislation. He notes, "Allowing time for a corporate culture to develop within companies, in which consideration of stakeholder interests is respected as a legitimate and central component of the decision making process…is preferable to the imposition of black letter law."[93] The current framework provides legal protection for directors who engage in CSR activities, and, in combination with public pressure, should serve to adequately protect and entrench CSR. It should be acknowledged however, that legislative reform and an expansion of directors' duties may at the least raise the bar for CSR performance, and ensure public accountability and transparency is taken seriously by corporate boards and business leaders.

In light of the tangible benefits of CSR engagement, shareholder primacy theory appears to be no longer relevant to the current business environment. Whilst shareholder theory contends that social factors should not interfere in business operations, in the modern setting, a company's core objective of profit maximisation must be underpinned by a proactive approach to CSR in order to manage and mitigate a broader array of risk factors. Companies which engage with the community and adopt a sincere CSR management approach gain an advantage from an enhanced capacity to be aware of and control risk associated with new or altered demands from government regulators, employees, community stakeholders, shareholder activists and consumers. Risk management therefore reduces unexpected crises and strengthens the company's overall presence and stability. By contrast companies adopting a non-integrated or insincere approach to CSR are more likely to be subject to stress resulting from the diverse range of issues relevant to external parties. Therefore the possibility of corporate risk failure and potential financial volatility is increased.

As Davis argues, in the current setting, shareholder primacy theory may in fact diminish profits. He notes, "Paradoxically, the language of shareholder value may hinder companies from maximising shareholder value in this respect. Practiced as an unthinking mantra, it can lead managers to focus excessively on improving short term performance of their business, neglecting important longer-term opportunities and issues. The latter would include not just societal pressures, but also the trust of customers, investment in innovation and other growth prospects."[94] Given the influence of social factors and the direct link to profit maximisation, shareholder primacy theory which asserts that social engagement should be *ultra vires* is contradictory. Companies which incorporate CSR systems into their core objectives and reporting mechanisms ensure that the generation of profit remains the primary goal, yet do so in a socially responsible manner. Therefore whilst Berle and Dodd have traditionally been in conflict, in the modern setting it appears that companies must engage with Dodd's theory of social welfare in order to truly achieve Berle's concept of profit maximisation. CSR will be advantageous to a company's bottom line and corporate reputation as the correlation between risk, financial volatility and CSR performance is increasingly relevant. Intangible benefits, for example good-

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[93] Michael Wenzel, *The social side of sanctions: Personal and Social Norms as moderators of deterrence*, 28 LAW AND HUMAN BEHAVIOUR 547, 549 (2004).
[94] Ian Davis, *Business and Society: The Biggest Contract*, THE ECONOMIST, May 26, 2005.

will, may now be considered to have a direct impact on a company's bottom line; as a result, actions which increase goodwill such as pure social welfare may be *intra vires*. Therefore shareholder theory appears to be outdated and inflexible in light of changing stakeholder expectations.

The failure of shareholder theory to acknowledge the benefits of social engagement demonstrates that the market may have moved beyond pure profit maximisation as the definitive role of the corporation, and instead embraced social engagement and CSR as a means to benefit both the community and increase shareholder wealth.