ETHICS, VALUES AND CORPORATE GOVERNANCE

Thomas Clarke

Business decision-making is a moral exercise

INTRODUCTION

Since the origin of commerce, the ethical basis of business has been in question. In the ancient Greek civilisation Aristotle could readily distinguish between the basic trade required for an economy to function, and trade for profit which could descend into unproductive usury (Solomon 1992, 321). Most major world religions cast a sceptical eye on business, including Christianity, Islam and Confucianism. Shakespeare immortalised the potential venality of business in The Merchant of Venice, “All that glisters is not gold.” Frentrop (2003) graphically records how greed, speculation, deceit and frequent bankruptcy punctuated the fortunes of the earliest of the great trading companies, beginning with the Dutch East India Company. Adam Smith in 1776 in The Wealth of Nations made a withering comment on company management that would echo through the ages: “Being managers of other people’s money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private co-partner frequently watch over their own ... Negligence and profusion, therefore, must always prevail more or less in the management of the affairs of a joint-stock company” (Smith 1976, 264–265).
As technological change advanced with the industrial revolution, there occurred a wider diffusion of ownership of many large companies as no individual, family or group of managers could provide sufficient capital to sustain growth. Berle and Means chronicled the profound implications of this separation of ownership and control: “the dissolution of the old atom of ownership into its component parts, control and beneficial ownership” (1933, 8). Berle and Means expressed hope that with this different concept of a corporation there might develop a much wider accountability to the community, recognising the significance of the diffusion of ownership and the concentration of control in the modern corporation: “The economic power in the hands of the few persons who control a giant corporation is a tremendous force which can harm or benefit a multitude of individuals, affect whole districts, shift the currents of trade, bring ruin to one community and prosperity to another (Berle and Means 1933, 46).

However any hope of a wider sense of fiduciary duty in corporations was eroded away in the later decades of the twentieth century in the Anglo-American world, as capital markets became more aggressive and unstable, and executive compensation was propelled upwards by stock options. A succession of cycles of booming economies, followed by market collapse and recession, culminated in 2007–2008 in the first global financial crisis, which was also a crisis in governance and regulation. The most severe financial disaster since the Great Depression of the 1930s exposed the dangers of unregulated markets, nominal corporate governance, and neglected risk management. What also appeared in stark relief were an economic system and corporations and managers singularly lacking in any moral compass.

It has been argued that the dominant logic in this era, in both finance and law of agency theory, had reduced managers to mere agents of shareholder principles. Agency theory asserts that shareholder value is
the ultimate corporate objective which managers are incentivised and impelled to pursue: “The crisis has shown that managers are often incapable of resisting pressure from shareholders. In their management decisions, the short-term market value counts more than the long-term health of the firm” (Segrestin and Hatchuel 2011, 484; Jordi 2010). Agency theory has become “a cornerstone of ... corporate governance” (Lan and Heracleous 2010, 294). As governments, regulators, and financial institutions examined what had gone wrong during the crisis, a new sense of the importance of robust regulation, alert corporate governance, and stronger ethical guidelines became widespread. In effect what is now emerging is an integration of corporate governance, corporate social responsibility and corporate sustainability which potentially offers a new framework for ethical business.

This newly-emerging ethical framework for business provides a stronger base for the exercise of moral values and ethical reasoning. “People in business are ultimately responsible as individuals, but they are responsible as individuals in a corporate setting where their responsibilities are at least in part defined by their roles and duties in the company ... businesses in turn are defined by their role(s) and responsibilities in the larger community ...” (Solomon 1992, 320). This suggests an ethical alignment of individuals, corporations, and the economic system, which is captured in the definition of corporate governance offered by Cadbury, and adopted by the World Bank:

Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society.
This definition highlights the importance of corporate governance in providing the incentives and performance measures to achieve business success, and secondly in providing the accountability and transparency to ensure the equitable distribution of the resulting wealth. Finally the significance of corporate governance in enhancing the stability and equity of society recognises a more positive and proactive role for business. Rather than corporate governance and regulation being inherently restrictive, they can be a means of enabling corporations to achieve the highest goals of corporate achievement. Equally a more positive approach to business ethics can be imagined (Solomon 1992, 330):

Business ethics is too often conceived as a set of impositions and constraints, obstacles to business behavior rather than the motivating force of that behavior ... properly understood, ethics does not and should not consist of a set of prohibitive principles or rules, and it is the virtue of an ethics of virtue to be rather an intrinsic part and the driving force of a successful life well lived. Its motivation need not depend on elaborate soul-searching and deliberation but in the best companies moves along with the easy flow of interpersonal relations and a mutual sense of mission and accomplishment.

HISTORICAL DEVELOPMENT OF CORPORATE GOVERNANCE AND ACCOUNTABILITY

The balance of pursuing market opportunities while maintaining accountability has proved a defining challenge for business enterprise since the arrival of the joint-stock company in the early years of industrialism. The accountability and responsibility of business enterprise was constantly subject to question, and historically failed this test—often in the view of the public. Maurice Clark deplored how business “inherited
an economics of irresponsibility” from the laissez-faire beliefs and practices of early industrialism (1916). He argued that business transactions do not occur in isolation, but have wider social and economic consequences which need to be considered, impacting directly on employment, health and the environment. He insisted that legal regulation may be required to ensure protection from abuses, but that this could never replace a general sense of responsibility in business that goes beyond the letter of the law, preventing competitive forces from leading to a race to the bottom. Hence the periodic outbreak of destructive competition needed to be restrained in Clark’s view by “an economics of responsibility, developed and embodied in our working business ethics” (1916).

The debate concerning the true extent of the accountability and responsibility of business enterprise has continued to the present day, punctuated by occasional public outrage at business transgressions, and calls for greater recognition of the social obligations of business. At the height of the economic depression in the United States in 1932, Dodd made a dramatic plea in the pages of the Harvard Law Review: “There is in fact a growing feeling not only that business has responsibilities to the community but that our corporate managers who control business should voluntarily and without waiting for legal compulsion manage it in such a way as to fulfill these responsibilities.” This resonated with Berle and Means’ insistence that large corporations “serve not alone the owners or the control, but all society.” Though Berle subsequently commenced a prolonged debate with Dodd on the subject of For Whom Are Corporate Managers Trustees, he (Berle) (1955) later conceded to Dodd’s argument that management powers were held in trust for the entire community (Wedderburn 1985, 6).

Such forthright views did not remain at the level of academic speculation, but often were translated into legal, policy and business interpretations
and practice. For example in *Teck Corp Ltd v. Millar*, the Supreme Court of British Columbia, while retaining the identification of company interests with those of shareholders, nonetheless was prepared to grant directors a licence under their fiduciary duties to take into account wider stakeholder interests (*Teck Corp Ltd v. Millar* 1973, 313–314):

The classical theory is that the directors’ duty is to the company. The company’s shareholders are the company ... and therefore no interests outside those of the shareholders can legitimately be considered by the directors. But even accepting that, what comes within the definition of the interests of the shareholders? By what standards are the shareholders’ interests to be measured? A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting bona fide in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders.

Wedderburn (1985, 12) documents an equivalent deep-seated and practical commitment of corporate responsibility to a wide constituency in the post-war beliefs of leaders of the British business community. A lively debate continues world-wide concerning the scope of directors’ duties. In Australia, the Corporations Act Section 181 obliges directors and other corporate officers to exercise their powers and discharge their duties:
– in good faith and in the best interests of the corporation;
– for a proper purpose.
Under common law directors are obliged to act in the interests of “the company as a whole.” Traditionally this phrase has been interpreted to mean the financial well-being of the shareholders as a general body (though directors are obliged to consider the financial interests of creditors when the firm is insolvent or near-insolvent). A recent generation of financial economists helped to translate this broad shareholder primacy principle into a narrow pursuit of shareholder value. This restrictive definition of shareholder value has often been associated with short-termism and a neglect of wider corporate responsibilities in the interests of immediate profit maximisation. Concerns have arisen that directors who do wish to take account of other stakeholder interests may be exposed. However there is a wider interpretation of shareholder value which suggests that only when all of the other constituent relationships of the corporation— with customers, employees, suppliers, distributors and the wider community—are fully recognised and developed, can long-term shareholder value be released.

In 2007–2008 the first global financial crisis exposed the dangers of unregulated markets, nominal corporate governance, and neglected risk management

Traditionally, commercial law in many European countries has supported a sense of the wider social and environmental obligations of companies, which continues despite a recent enthusiasm for the principle of shareholder value as some large European companies for the first time seek the support of international investors. The United Kingdom has stood apart from Europe as an influential exponent of the Anglo-American market-based approach to corporate governance. However, in an effort to jettison the company-law rhetoric instituted in the 19th century, and to make the law more accessible, a Company Law Review (CLR) steering group was
established. The ensuing consultative document Modern Company Law for a Competitive Economy: Developing the Framework (2000) proposed for the first time that there should be a statutory statement of directors’ duties (in the past the core components of those duties was found in case law), and made a significant step in the direction of endorsing fuller corporate social and environmental reporting (CLR 2000, 180–181):

Current accounting and reporting fail to provide adequate transparency of qualitative and forward-looking information which is of vital importance in assessing performance and potential for shareholders, investors, creditors and others. This is particularly so in the modern environment of technical change, and with the growing importance of “soft,” or intangible assets, brands, know-how and business relationships. The full annual report must be effective in covering these, both as a stewardship report and as a medium of communication to wider markets and the public … we believe the time has come to require larger companies to provide an operating and financial review, which will cover the qualitative, or “soft,” or intangible, and forward-looking information which the modern market and modern business decision-making require, converting the practice of the best-run companies into a requirement for all.

These issues were extensively considered in the United Kingdom for several years in the deliberations of the Modern Company Law Review. Two approaches were considered:
– a pluralist approach under which directors’ duties would be reformulated to permit directors to further the interests of other stakeholders even if they were to the detriment of shareholders;
– an enlightened shareholder-value approach allowing directors greater flexibility to take into account longer-term considerations and interests of various stakeholders in advancing shareholder value.
In considering these approaches, the essential questions of what is the corporation, and what interests it should represent are exposed to light, as Davies eloquently argues (2005, 4):

The crucial question is what the statutory statement says about the interests which the directors should promote when exercising their discretionary powers. The common law mantra that the duties of directors are owed to the company has long obscured the answer to this question. Although that is a statement of the utmost importance when it comes to the enforcement of duties and their associated remedies, it tells one nothing about the answer to our question, whose interests should the directors promote? This is because the company, as an artificial person, can have no interests separate from the interests of those who are associated with it, whether as shareholders, creditors, employers, suppliers, customers or in some other way. So, the crucial question is, when we refer to the company, to the interests of which of those sets of natural persons are we referring?

As a member of the Corporate Law Review Steering Group, Davies goes on to defend the enlightened shareholder-value view suggesting that the pluralist approach produces a formula which is unenforceable, and paradoxically gives management more freedom of action than they previously enjoyed. An Australian legal expert, Redmond, endorses this critique of widening the scope of directors’ duties too greatly (Redmond 2005, 27):

The pluralist or multifiduciary model rests on a social, not a property, view of the corporation. It identifies the corporate purpose with maximizing total constituency utility. This is an indeterminate outcome measure which poses particular difficulties in translation into a legally enforceable duty. The
indeterminacy of the criteria for decision and performance measurement also points to a probable loss of accountability for directors since it offers broad scope to justify most decisions. It is difficult to resist the conclusion of the British review that either it confers a broad unpoliceable policy discretion on managers themselves or just gives a broad jurisdiction to the courts. The model needs either practical rehabilitation or a superior performance metric. It is not clear where either might be found.

In the resulting British Company Law Reform Bill (2005) the enlightened shareholder-value view has prevailed in clause 156, which defines the essential directoral duty as:

Duty to promote the success of the company

1. A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

2. Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, his duty is to act in the way he considers, in good faith, would be most likely to achieve those purposes.

3. In fulfilling the duty imposed by this section a director must (so far as reasonably practicable) have regard to:
   a. the likely consequences of any decision in the long term,
   b. the interests of the company’s employees,
   c. the need to foster the company’s business relationships with suppliers, customers and others,
   d. the impact of the company’s operations on the community and the environment,
e. the desirability of the company maintaining a reputation for high standards of business conduct, and
f. the need to act fairly as between members of the company.

4. The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

This clause replaces the discretion of directors to have regard for stakeholder interests with a duty for directors to do this (Davies 2005, 5):

As far as directors’ duties are concerned, this is the heart of the enlightened shareholder-value approach. The aim is to make it clear that although shareholder interests are predominant (promotion of the success of the company for the benefit of its members), the promotion of shareholder interests does not require riding roughshod over the interests of other groups upon whose activities the business of the company is dependent for its success. In fact, the promotion of the interests of the shareholders will normally require the interests of other groups of people to be fostered. The interests of non-shareholder groups thus need to be considered by the directors, but, of course, in this shareholder-centred approach, only to the extent that the protection of those other interests promotes the interests of the shareholders. The statutory formulation can be said to express the insight that the shareholders are not likely to do well out of a company whose workforce is constantly on strike, whose customers don’t like its products and whose suppliers would rather deal with its competitors.

In this way the Company Law Reform Bill treads a fine legal line between a sense of “enlightened shareholder value” which is becoming best practice in many leading companies, and more radical claims for company law to
adopt a more “pluralist” sense of the ultimate objectives of the enterprise and the interests to be served. The reform manages this balancing act by suggesting that the pluralist objectives of maximizing company performance to the benefit of all stakeholders can best be served by professional directors pursuing commercial opportunities within a framework of standards and accountability:

The overall objective should be pluralist in the sense that companies should be run in a way which maximizes overall competitiveness and wealth and welfare for all. But the means which company law deploys for achieving this objective must be to take account of the realities and dynamics which operate in practice in the running of a commercial enterprise. It should not be done at the expense of turning company directors from business decision-makers into moral, political or economic arbiters, but by harnessing focused, comprehensive, competitive decision-making within robust, objective professional standards and flexible, but pertinent accountability (CLR 2000, 14).

The reform supports the ultimate power of shareholders to appoint or dismiss directors for whatever reasons they choose, and to intervene in management to the extent the constitution permits, and confesses: “There is clearly an inconsistency between leaving these powers of shareholders intact and enabling or requiring directors to have regard to wider interests ... the effect will be to make smaller transactions within the powers of directors subject to the broad pluralist approach, but larger ones which are for shareholders subject only to the minimal constraints which apply to them” (CLR 2000, 26).

It is likely that the modern company law proposals will over time facilitate the wider and more conscious adoption by British companies of social and environmental commitments, and the willingness to report fully on
them. In time it is possible that such social and environmental commitments will become part of widespread company and management best practice, in the way that the commitment to quality in the production of goods and services has become universal. Moreover, just as the United Kingdom in the publication of the Cadbury code of corporate governance ultimately influenced a considerable number of other countries to adopt a similar code, it is possible that other countries, particularly those that share a common law tradition with the United Kingdom, will begin to review their company law with similar objectives in mind.

Moral liability occurs when corporations violate stakeholder expectations of ethical behaviour in ways that put business value at risk

One reason why the agenda of corporate responsibility is increasingly irresistible is that while legal liability of corporations is deepening, what has been described as an emerging and hardening moral liability is exerting increasing influence. In this respect the legislative process lags behind what society thinks, values and respects. Moral liability occurs when corporations violate stakeholder expectations of ethical behaviour in ways that put business value at risk. There is an increasing convergence between these two forms of liability, as corporations come under scrutiny both by the law and—often more immediately and pointedly—by public opinion (SustainAbility 2004, 5).

CORPORATE SOCIAL RESPONSIBILITY

The narrow focus of corporate governance exclusively upon the internal control of the firm and simply complying with regulation is no longer tenable. In the past this has allowed corporations to act in extremely
irresponsible ways by externalising social and environmental costs. Corporate objectives described as “wealth generating” too frequently have resulted in the loss of well-being to communities and the ecology. But increasingly in the future the license to operate will not be given so readily to corporations and other entities. A license to operate will depend on maintaining the highest standards of integrity and practice in corporate behavior. Corporate governance essentially will involve sustained and responsible monitoring of not just the financial health of the company, but the social and environmental impact of the company.

A substantial increase in the range, significance and impact of corporate social and environmental initiatives in recent years suggests the growing materiality of sustainability. Once regarded as a concern of a few philanthropic individuals and companies, corporate social and environmental responsibility appears to be becoming established in many corporations as a critical element of strategic direction, and one of the main drivers of business development, as well as an essential component of risk management. Corporate social and environmental responsibility (CSR) seems to be rapidly moving from the margins to the mainstream of corporate activity, with greater recognition of a direct and inescapable relationship between corporate governance, corporate responsibility, and sustainable development.

The burgeoning importance of this newly revived movement is demonstrated by the current frequency and scale of activity at every level (Calder and Culverwell 2005, 43). Among international organizations the United Nations is coordinating a public-private partnership between UNEP and 170 banks, insurers and asset managers world-wide including Deutsche Bank, Dresdner Kleinwort Wasserstein, Goldman Sachs, HSBC and UBS to explore the financial materiality of environmental, social and governance (ESG) issues to securities valuation (UNEP 2004). Early in 2005 the UN convened a group of 20 of the world’s largest institutional
investors to negotiate a set of Principles for Responsible Investment, and published a *Working Capital* report in early 2006 as a guide to the investment community on how to incorporate environmental, social and governance issues into their investment decision-making and ownership processes. This builds on the work of the UN Global Compact with more than 1,500 corporate signatories, which is working with the world’s leading stock exchanges and the World Federation of Exchanges to advance the principles of corporate responsibility in capital markets and with public corporations (UN 2000).

In 2005 institutional investors representing US$21 trillion in assets came together for the third Carbon Disclosure Project meeting, collectively requesting the world’s largest corporations to disclose information on greenhouse-gas emissions and their approach to the management of carbon risks (UNEP FI 2005). Finally, 36 of the world’s largest banks, representing more than 80% of the global project finance market, have adopted the Equator Principles, a set of voluntary principles outlining environmental, social and human rights disciplines associated with project finance above US$50 million (Freshfields Bruckhaus Deringer 2005). The principles originally were developed by the International Finance Corporation (IFC), the private sector investment arm of the World Bank. The OECD also is active in the promotion of CSR in its guidelines for the operations of multinational corporations; and the European Union is actively encouraging CSR as the business contribution to sustainable development (OECD 2000; European Commission 2003, 2004). At the national level a growing number of governments in Europe, and across the globe, have identified strongly with the call for corporate social and environmental responsibility, even with the evident difficulties in applying the Kyoto Protocol and creating an effective international climate-policy regime.

At the corporate level the World Business Council for Sustainable Development, and World Economic Forum Global Corporate Citizenship
Initiative have projected corporate responsibility in the minds of the international business elite (WBCSD 2002, 2004; WEF 2005). Other business organizations active in promoting CSR include the Business Leaders’ Initiative on Human Rights, the Conference Board, Business in the Community, and Business for Social Responsibility. A large number of leading corporations have signed up for the Global Reporting Initiative and more than 2,000 international corporations now publish reports on their CSR performance (many accessible on www.csrwire.com). In 2011 the GRI published new guidelines on materiality, stakeholder inclusiveness, sustainability context, and completeness of reporting (GRI 2011). Reinforcing the new-found willingness on the part of corporate executives to disclose their commitments to CSR are the new indices including the Dow Jones Sustainability Index and FTSE4Good. Finally, there are a proliferating number of consultancies, NGOs and campaign groups offering guidance and actively monitoring CSR activities along the entire length of the global value chain (World Bank 2003).

**Corporate governance essentially will involve sustained and responsible monitoring of not just the financial health of the company, but the social and environmental impact of the company**

Questions are often addressed regarding the sincerity of corporate social and environmental initiatives; the legality of company directors engaging in these concerns; equally, the legality of the trustees of investment institutions attending to these interests; and the verifiability of CSR activities and outcomes. It is important to clarify the continuing and emerging legal and commercial basis for corporations to pursue corporate social and environmental responsibility; the ongoing legal and material support for institutional trustees to prioritize socially and environmentally responsible investments; to examine developments in verification on
corporate reporting of CSR performance; and to consider some illustrations of current best practice.

THE INTEGRITY OF CORPORATE SOCIAL RESPONSIBILITY

Despite the recent burst of enthusiasm for corporate social and environmental responsibility in some quarters of the business community, the concept and practice still provoke a degree of understandable scepticism (partly due to CSR's record of lapsing into amoral apologetics for unacceptable corporate behavior) (Najam 2000; Christian Aid 2004; Corporate Responsibility Coalition 2005; OECD Watch 2005). David Vogel in a review conducted for the Brookings Institute, *The Market for Virtue: The Potential and Limits of Corporate Social Responsibility* (2005), contends there are many reasons why companies may choose to behave more responsibly in the absence of legal requirements to do so, including strategic, defensive, altruistic or public-spirited motivations. However despite pressure from consumers for responsibly-made products, the influence of socially-responsible investors, and the insistent call for companies to be accountable to a broader community of stakeholders, there are important limits to the market for virtue:

CSR is best understood as a niche rather than a generic strategy: it makes sense for some firms in some areas under some circumstances. Many of the proponents of corporate social responsibility mistakenly assume that because some companies are behaving more responsibly in some areas, some firms can be expected to behave more responsibly in more areas. This assumption is misinformed. There is a place in the market economy for responsible firms. But there is also a large place for their less responsible competitors ... Precisely because
CSR is voluntary and market-driven, companies will engage in CSR only to the extent that it makes business sense for them to do so. Civil regulation has proven capable of forcing some companies to internalize some of the negative externalities associated with some of their economic activities. But CSR can reduce only some market failures (2005, 3–4).

Vogel concludes that CSR has a multidimensional nature, and that companies, like individuals, do not always exhibit consistent moral or social behaviour, and may behave better in some countries than others depending on the social and environmental policies existing there. Since the origins of capitalism, there have always been more or less responsible firms, and it is heartening that executives in many highly visible firms may be becoming more responsive (if only as a result of external stakeholder pressures). However the reality is that the amounts wasted on losses due to financial fraud, the very substantial—and some would argue unwarranted—increases in executive compensation in corporations, and the huge losses in the global financial crisis, in recent years far exceed any resources companies have devoted to CSR.

In a similar vein Deborah Doane who is Chair of the Corporate Responsibility Coalition in the United Kingdom, is sceptical regarding optimism about the power of market mechanisms to deliver social and environmental change, referring to the key myths informing the CSR movement as follows:

– The market can deliver both short-term financial returns and long-term social benefits.
– The ethical consumer will drive change.
– There will be a competitive “race to the top” over ethics amongst businesses.
– In the global economy countries will compete to have the best ethical practices.
In support of her argument that these are largely mythological trends, she highlights the insistence of stock markets upon short-term results and the failure of companies to invest in long-term benefits; the considerable gap between green consciousness expressed by consumers and their consumer behavior; the inconsistency between companies’ alignment to CSR schemes, and their successful efforts to bring about the sustained fall in corporate taxation in the United States and other jurisdictions in recent decades; and finally the evidence emerging in developing countries of governments competing to reduce their insistence on the observance of social and environmental standards to attract international investment (Doane 2005).

It may well be the case that further legislative and regulatory intervention will be required to ensure all corporations fully respond to the growing public demand that they recognize their wider social and environmental responsibilities. However, it is useful to examine how far CSR objectives can be achieved within existing law and regulation. If there is substantial evidence of leading corporations demonstrating that it is possible to voluntarily commit to social and environmental performance and to achieve commercial success—perhaps because of, rather than in spite of, ethical commitments—then it will be more straightforward to press for the legislative changes necessary to deal with corporations that refuse to acknowledge their wider responsibilities, as well as find appropriate legislative support for companies that wish to develop further their CSR commitments.

In the meantime, the practical fact is that corporations and governments currently are struggling with an “almost bewildering array of international CSR initiatives” (Calder and Culverwell 2005, 7; McKague and Cragg 2005). Reviewing the efforts to develop CSR following the World Summit on Sustainable Development, a survey by the Royal Institute for International Affairs of stakeholders from governments, businesses and
civil society groups identified a range of significant weaknesses in current approaches to promoting CSR which governments should seek to address:

– an over-proliferation of CSR initiatives at the international level and lack of clarity about how these initiatives relate to each other in a coherent way;
– an excessive focus on getting businesses to make commitments to CSR and not enough focus on enabling them to implement them effectively;
– an absence of credible monitoring and verification processes of CSR initiatives;
– a lack of effective mechanisms of redress for communities affected by companies that flout national or international norms on sustainable development or human rights;
– a lack of engagement with developing-country governments and their sustainable development priorities (e.g. economic development and poverty reduction);
– a failure to bridge the governance gap created by weak public-sector governance of the private sector in many developing countries; the limited impact on national and international sustainable-development goals;
– a lack of government involvement and/or investment in international CSR initiatives, which is contributing significantly to their underperformance (Calder and Culverwell 2005, 7).

DEFINING CORPORATE SOCIAL RESPONSIBILITY AND SUSTAINABILITY

The rapidly developing interest in CSR and sustainability has resulted in a plethora of definitions and interpretations of the two concepts from international agencies, consultancies and practitioners (Calder and Culverwell 2005; McKague and Cragg 2005). A first difficulty is that the most commonly employed acronym, CSR, refers to corporate social
responsibility, though in most interpretations it is meant to include environmental responsibility also. The use of the simpler term corporate responsibility and acronym CR is not in widespread use, though it would more readily embrace all corporate responsibilities. The UN’s recent adoption of the environmental, social and governance (ESG) acronym may become influential, since it explicitly links governance to social and environmental responsibility.

**Corporate sustainability is a critical issue because of the economic scale and significance of these entities and their growing impact on the economy, society and environment**

More confusingly still, in some definitions sustainability is included within CSR, while in others CSR is subsumed under sustainability. One source of this confusion is that often different levels of analysis are being addressed. At the highest level the sustainability of the planet is at issue, and at lower levels the sustainability of economies and societies, industries and organisations. Corporate sustainability is a critical issue because of the economic scale and significance of these entities and their growing impact on the economy, society and environment. “Corporations have magnified capacities relative to individuals, in their financial resources, scale of operations, organizational capacity and capacity for social and individual harm” (Redmond 2005, 1). Once the primary (in some cases sole) concern was to produce goods and services that might generate the profits to achieve the financial sustainability of the corporation (everything else was written off as externalities). “Defining limited liability is simple. It means that no matter how much environmental damage a corporation causes, no matter how much debt it defaults on, no matter how many Malibus explode or tires burst or workers or consumers die of asbestosis, no matter how many people it puts out of work without their pension benefits or other
protections; in short, no matter how much pain it causes, the corporation is responsible for paying damages (if at all) only in the amount of assets it has” (Mitchell 2001).

Increasingly today the social and environmental impact of the corporation will be assessed in deciding whether it is viable or not, by governments, regulators, or other stakeholders, even if the corporation’s management is reluctant to make this assessment. The license to operate can no longer be readily assumed for any corporation, and in an increasing number of contexts needs to be earned with verifiable evidence of the social and environmental responsibility of the corporation.

Definitions of CSR and sustainability range from the basic to the most demanding, from a specific reference to a number of necessary activities to demonstrate responsibility, to a general call for a comprehensive, integrated and committed pursuit of social and environmental sustainability. The following representative range of definitions of CSR is in ascending order from the least to the most demanding:

– the integration of stakeholders’ social, environmental and other concerns into a company’s business operations (EIU 2005, 2);
– the commitment of businesses to contribute to sustainable economic development by working with their employees, their families, the local community and society at large to improve their lives in ways which are good for business and for development (World Business Council for Sustainable Development 2002, 2011).
– Corporate social responsibility is at heart a process of managing the costs and benefits of business activity to both internal (for example, workers, shareholders, investors) and external (institutions of public governance, community members, civil society groups, other enterprises) stakeholders. Setting the boundaries for how those costs and benefits are managed is partly a question of business policy and strategy and partly a question of public governance (World Bank 2002, 1).
– a concept whereby companies integrate social and environmental concerns into their business operations and their interaction with their stakeholders on a voluntary basis (European Commission 2001, 2009);
– a company’s commitment to operating in an economically, socially, and environmentally sustainable manner, while recognizing the interests of its stakeholders, including investors, customers, employees, business partners, local communities, the environment, and society at large (Certified General Accountants Association of Canada 2005, 20).
– CSR is essentially about how the company makes its profits, not only what it does with them afterwards. CSR is about how the company manages, first its core business operations—in the board room, in the workplace, in the marketplace, and along the supply chain; second, its community investment and philanthropic activities; and third, its engagement in public policy dialogue and institution building (Kennedy School of Government Corporate Responsibility Initiative 2004, 33).
– a business approach embodying open and transparent business practices, ethical behavior, respect for stakeholders and a commitment to add economic, social and environmental value (SustainAbility 2011);
– Sustainability performance refers to an organization’s total performance, which might include its policies, decisions, and actions that create social, environmental and/or economic (including financial) outcomes (AccountAbility 2005, 10).

Sustainability as a whole (planet, environment, species) is an altogether more ambitious project with more expansive definitions than CSR. Corporations have a vital role to play in this also, beginning with a modest recognition of their necessary subordination to the interests of maintaining a balanced ecosystem. Sustainability is defined as:
– meeting the needs of the present generation without compromising the ability of future generations to meet their needs (Bruntland Commission 1987);
Sustainable development, sustainable growth, and sustainable use have been used interchangeably, as if their meanings were the same. They are not. Sustainable growth is a contradiction in terms: nothing physical can grow indefinitely. Sustainable use is only applicable to renewable resources. Sustainable development is used in this strategy to mean: improving the quality of human life whilst living within the carrying capacity of the ecosystems (IUCN, UNEP, WWF 1991).

Putting the entire field into perspective, according to the Global Reporting Initiative (GRI) 2011 Sustainability Reporting Guidelines:
- Environmental impact means an organization’s impact on living and non-living natural systems, including ecosystems, land, air and water. Examples include energy use and greenhouse gas emissions.
- Social impact means an organization’s impact on the social system within which it operates. This includes labor practices, human rights and other social issues.
- Economic impact means an organization’s impact both direct and indirect on the economic resources of its stakeholders and on economic systems at the local, national and global levels.

FROM THE MARGINS TO THE MAINSTREAM?

However challenging the prospects, there are growing indications of large corporations taking their social and environmental responsibilities more seriously, and of these issues becoming more critical in the business agenda. KPMG since 1993 has conducted an international survey of corporate responsibility every three years which has revealed the developing prevalence of this commitment. Surveying the largest 100 companies in a sample of advanced industrial OECD countries (with the addition of the Global 250 companies from 1999), KPMG (2008) finds a steadily rising trend in companies issuing separate corporate-responsibility
annual reports. From 13% of national 100 companies reporting on corporate responsibility matters in 1993, by 2008 this had risen to 43% (up to 80% if including information in annual reports). A more substantial increase in the Global 250 reporting occurred with 35% reporting in 1999, 52% in 2005, and 79% by 2008. In addition some companies have integrated their corporate responsibility report with their main financial report. Publication of corporate responsibility reports as part of the annual financial reports of companies sometimes implies the issue is regarded as of greater salience, and companies often progress from separate to integrated CSR and financial reports.

**Large corporations are taking their social and environmental responsibilities more seriously, and these issues are becoming more critical in the business agenda**

More importantly, the substance of company reports is changing, from purely environmental reporting up until 1999, to sustainability reporting (social, environmental and economic), which has become the mainstream approach of the G250 companies and is becoming so among the national 100 companies. The two leading countries in terms of separate corporate responsibility reporting are Japan (88% of top 100 companies) and the UK (84% of top 100 companies) in 2008.

Finally the KPMG survey reveals a balanced range of business drivers for CSR reporting, beginning with ethical considerations (69% of companies); economic considerations (68%); innovation and learning (55%); reputation or brand (55%); employee motivation (52%); risk management (35%) and access to capital (29%). The survey suggests there were solid reasons for acting and reporting on CSR: “As in previous years, the overall drivers for reporting are ethical and economic considerations. Although
these responses are fairly broad, they indicate that companies realize they operate in a context where they play key roles in contributing to healthy societies, ecosystems, and economies—and that it is in their best interest to maintain and improve these spheres” (KPMG 2005, 18).

In a further international survey of 136 corporate executives and 65 executives of institutional investors on the importance of corporate responsibility (CR) the Economist Intelligence Unit (EIU) discovered a similar growth in interest:

A total of 88% of executives said that CR is a “central” or “important” consideration in decision-making. This compares with 54% of executives who said it was a “central” or “important” consideration five years ago. The biggest percentage change between now and five years ago was among European executives. A total of 46% said CR was “central” or “important” five years ago compared with 84% at the present time. In Asia, the proportion rose from 49% to 82% and in North America from 66% to 88%. The survey of professional investors reveals a sharper trend. Eighty-one percent of those surveyed said CR was currently a “central” or “important” consideration in their investment decisions, compared with 34% who said it was “central” or “important” five years ago. In fact, 14% of them said CR was not a consideration at all five years ago. Now, not a single investor said it was not a consideration (EIU 2005, 5).

As with the gap noticed earlier between consumer consciousness and behavior, it is likely there will be a mighty gulf between the expressed concerns of executives for corporate responsibility and their actual behavior in different circumstances and in the exigencies of difficult situations; however, simply expressing concerns is an advance over stony-faced refusals to even acknowledge responsibilities that may have
occurred in the past. “Corporate responsibility is really about ensuring that the company can grow on a sustainable basis, while ensuring fairness to all stakeholders,” says N. R. Murthy, the chairman of an Indian IT firm, Infosys (EIU 2005, 2). Though some of the expressed concern may be part of the discourse of political correctness, there do appear to be grounds for a significant shifting of opinion among executives, as the EIU comments:

Until recently, board members often regarded corporate responsibility as a piece of rhetoric intended to placate environmentalists and human rights campaigners. But now, companies are beginning to regard corporate responsibility as a normal facet of business and are thinking about ways to develop internal structures and processes that will emphasize it more heavily. In the not-too-distant future, companies that are not focusing on corporate responsibility may come to be seen as outliers. As companies focus on non-financial performance, an important yardstick of corporate responsibility, the measurement of intangibles, such as customer satisfaction and employee morale, are likely to become less vague and more credible (EIU 2005, 3).

One of the surprising results of the EIU survey was that after more than a decade of the exhortation of the primacy in all circumstances of shareholder value, the executives surveyed still possessed a balanced appreciation of the relative importance of key stakeholders to the company, identifying customers, employees and shareholders in that order. The EIU compiled some of the contextual highlights for these changes in executive views in the emerging evidence that corporate social and environmental responsibility is moving substantially from the margins to the mainstream of economic activity:

– The New York-based GovernanceMetrics International (GMI), which covers corporate governance and CR, now produces in-depth rating
reports on 2,000 companies around the world and has a growing client base including TIAA-CREF, State Street Bank and ABP, the largest pension fund in Europe.

- More than 10,000 individuals and 3,000 listed companies have helped to develop the standards of the Global Reporting Initiative (GRI), an organization based in Amsterdam, trying to create a single global measure for CR performance. Among its corporate clients implementing GRI standards are Bayer, Canon, Deutsche Bank, General Motors, Heineken and Shell.

- A group of five major European institutional investors, including the second-largest pension fund in the United Kingdom and the largest pension fund in the Netherlands, jointly stated in October 2004 that they would allocate 5% of their budgets for the purchase of non-financial research analysis of such topics as corporate governance, labor management and environmental practices.

- One in every nine investment dollars under professional management in the United States is now invested in socially responsible funds. This amounts to US$2 trillion out of a total of US$19 trillion in investible funds, according to the 2003 report on socially-responsible investing (SRI) produced by the Social Investment Forum, the national trade body for the SRI industry (EIU 2005, 4–5).

A final promising development is the new Manifesto for a “Global Economic Ethic” encompassing consequences for global businesses, which was declared at a business-ethics symposium held at the UN headquarters in New York. The Global Economic Ethic Manifesto is a self-regulatory moral framework/code of conduct “which is both interactive and interdependent with the economic function of the main institutions of the economic system: markets, governments, civil society, and supranational organizations” (Kung 2009). The manifesto includes five universally-accepted principles and values: the principle of humanity; the basic values of non-violence and respect for life; the basic values of
justice and humanity; the basis values of honesty and tolerance; and the basic values of mutual esteem and partnership. This is intended as an ethical complement to the UN Global Compact, with the manifesto providing a framework for ethical values to meet the moral dilemmas confronting boards and directors of multinational corporations, in the way in which the Compact is designed to address market and institutional failures (Hemphill and Lillevik 2011, 213).

The Global Economic Ethic Manifesto is a self-regulatory moral framework. It includes five principles and values: humanity; non-violence and respect for life; justice and humanity; honesty and tolerance; and mutual esteem and partnership.

At the confluence of these multiple emerging initiatives and trends towards greater corporate social and environmental responsibility there is emerging a dynamic stakeholder model for driving enlightened shareholder value. At many leading corporations the pieces of what is admittedly a very large and demanding puzzle are beginning to come together. The wider commitments to building engaged and inclusive relationships with employees, economic partners, the community and the environment become a means of achieving enlightened shareholder value through access to a lower cost of capital, enhanced reputation, minimised risks and new business opportunities.

The impact of the adoption of corporate commitments to wider forms of social and environmental engagement and reporting will be determined essentially by initiatives of leading companies and, in turn, this will be influenced by the insistent pressures companies encounter from the market, investors and stakeholders, and the perceived commercial benefit of assuming a broader accountability. However, the role of the law and of
accounting standards in establishing a framework of accountability and management discipline is a significant factor. Historical analysis of the perception of company directors’ duties, including legal interpretations, reveals much greater sympathy for corporations adopting a wider view of their responsibilities than the recently-imposed tenets of shareholder value would suggest.

CONCLUSIONS

The effective integration of corporate social and environmental responsibilities could potentially release greater value for both shareholders and wider stakeholders: moving beyond compliance, to creating new value through new products and services that meet societal needs; and collaborating to solve the complex and demanding social and environmental problems that threaten to grow beyond our control. This would provide a more vital context in which people would have greater opportunity to exercise moral values and ethical commitments. However corporations capable of working in investors’, stakeholders’, and society’s interests in a collaborative, creative and productive way would require a further fundamental redesign of the concept of the corporation and the institution of the market. It is possible that confronting the dilemmas of social, economic and ecological survival which governments, business and communities face, will force the rethinking of corporate objectives, structures, and activities that is necessary.
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>> The balance of pursuing market opportunities while maintaining accountability and ethical integrity has proved a defining challenge for business enterprise since the arrival of the joint-stock company in the early years of industrialism. The accountability and responsibility of business enterprise is constantly subject to question. The manifest failures of corporate governance and business ethics in the global financial crisis has increased the urgency of the search for a better ethical framework and governance for business. A substantial increase in the range, significance and impact of corporate social and environmental initiatives in recent years suggests the growing materiality of a more ethically-informed approach. However challenging the prospects, there are growing indications of large corporations taking their social and environmental responsibilities more seriously, and of these issues becoming more critical in the business agenda.

THOMAS CLARKE

University of Technology, Sydney