

EMBARGOED UNTIL 12.00 PM WEDNESDAY 21 APRIL 2004

BRIGHTSTAR CFO SUMMIT 2004

MAKING SENSE OF CORPORATE CITIZENSHIP

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AUCKLAND
21 APRIL 2004

MAKING SENSE OF CORPORATE CITIZENSHIP

Making sense of debates about corporate citizenship or the social responsibilities of business can be like trying to nail jelly. We hear much talk of 'putting people before profits' and 'promoting sustainable development', but what does it all mean? The language certainly has a 'feel good' ring to it but is often vague or vacuous. Substance and spin can be hard to disentangle.

Consider the following statements from people interviewed for this month's cover story on the topic in *Management* magazine. "Definitions [of sustainability] are difficult and not everyone has the same understanding of it." Very true. "[T]here's a growing sense [among companies] that looking after their people, the community they work in and the environment around them are all relevant to long-term business survival." Tell us something we didn't know. Sustainability means "ensuring the company is really smart when it comes to dealing with the big impacts it can have on the environment and making the best possible use of existing resources." Hardly revolutionary either. "There's also an increasing realisation that 'people matter' and that is now a major driver." Since when hasn't it been? "Some of those shouting the loudest about their corporate virtues are also among those inflicting continuing damage on communities." Quite perceptive. "After four years we've come to the conclusion that the crucial breakthrough issue is less about sustainability with a big 'S' and more about leadership with a big 'L'. Wow!

Finally, a return to commonsense from Chris Morrison, chair of the Sustainability Business Network: "Sustainability has become an overused catchphrase." What the SBN is promoting is "the concept of companies that are profitable and also taking into consideration their impact on society and the environment." Hear, hear.

Let me state upfront my position, which is that businesses have a range of social responsibilities. The Statement of Purpose of the Business Roundtable, drawn up in 1986, reads:

The NZBR endorses the concepts of corporate responsibility, integrity, self-reliance and open and fair conduct in business practices.

Its members aim to promote, at the enterprise level, a sense of cooperation and mutual respect between management and individual employees, effective use of human skills, equal opportunities and other social goals in order to maximise employee satisfaction and improve economic performance.

A former vice-chairman, Roderick Deane, elaborated on these statements as follows:

That businesses have social roles and responsibilities is not at issue ... In this regard companies are no different from other organisations such as partnerships, cooperatives, clubs, trade unions, universities, charities and churches in which people join together voluntarily to pursue common goals. All have social roles and responsibilities.¹

The particular role of business, Dr Deane went on to say, is to produce the goods and services that people as consumers need in their daily lives. In doing so, business provides jobs, generates returns on the savings that people have invested in firms, and raises living standards through innovating and finding ways of using resources more productively. These are hugely important and demanding roles. Material well-being isn't everything but it matters to people.

The Business Roundtable has also affirmed the need for businesses to act lawfully and ethically, to treat stakeholders such as suppliers and customers well, to be environmentally responsible and to be sensitive to the interests and values of communities in which they operate. All these factors are consistent with – indeed prerequisites for – commercial success.

Over the years, however, there have been many proposals to impose other responsibilities on business and direct how firms should operate.

In the 1970s there was a push for 'industrial democracy', involving worker representation on company boards, and for the formation of worker cooperatives. People should be free to try such arrangements, but these experiments died a natural death – experience showed they didn't work.

¹ Roderick Deane, in foreword to David Henderson (2001) *Misguided Virtue: False Notions of Corporate Social Responsibility*, New Zealand Business Roundtable, Wellington.

An allied idea was stakeholder theory, which argued that managers should make decisions so as to weigh up and balance the interests of all the stakeholders in a firm. But as Michael Jensen of the Harvard Business School has pointed out, it is logically impossible to maximise in more than one direction.² A firm cannot maximise value if it ignores the interests of its stakeholders, but it is ultimately accountable to those who have entrusted risk capital to the firm, its shareholders. Stakeholder theory can be attractive to managers and directors since, with no way to keep score, they are unaccountable for their actions. Moreover, as Jensen points out, in competitive markets and the absence of externalities, the welfare of society is maximised when each firm in the economy maximises its total market value.

On occasions, companies have attempted to run themselves on stakeholder lines. Under CEO Bob Haas, Levi Strauss set out to prove that a company driven by social values could outperform one driven by profits. It did all the politically correct things – involved everybody in decision-making, set up 80 task forces to make the company more ‘aspirational’, promoted diversity, vetted contractors for labour practices and so on – and took its eye off the ball of profitability. Its costs blew out, its market share plummeted, it was forced to lay off 16,000 workers and its market value shrank from US\$14 billion to US\$8 billion before it was forced to abandon “its failed utopian management experiment.”³ Was this socially responsible behaviour? Hardly.

A similar case is Anita Roddick’s Body Shop. Once hailed as the ‘Mother Teresa of capitalism’, Roddick was a champion of human rights, environmental concerns, indigenous people and triple bottom line reporting. But two years ago the company’s shares had fallen from 372 pence to around 70 pence, a loss of more than £500 million; it was being called “sleazy” and “no more ethical than a heap of beans” by a former partner; and Roddick herself was calling the business a “dysfunctional coffin.”⁴

² Michael Jensen (2000) ‘Value Maximization, Stakeholder Theory, and the Corporate Objective Function’, Harvard Business School Working Paper #00-058.

³ Nina Munk, ‘How Levi’s Trashed a Great American Brand’, *Fortune*, April 12, 1999.

⁴ Jon Entine, ‘Body Shop’s packaging starts to unravel’, *Australian Financial Review*, 18 December, 2002.

In the last decade or so, particularly since the United Nations 1987 Brundtland Report and the Rio Earth Summit of 1992, the accent in the 'social responsibility' movement has been on 'sustainable development'. But here the track record of several leading promoters of the concept has been no better. It is hard to escape the conclusion that much of the activity has been more about public relations than anything else.

One firm boldly announced: "We will ... integrate ... social and environmental considerations into our internal management and value system" ... and that it had "enhanced our efforts to engage external stakeholders on human rights, biodiversity, indigenous rights, transparency and performance measurement."

That was Enron in its corporate responsibility report.

A few years ago, the oil company British Petroleum made a big thing of rebranding itself: it said BP really meant 'Beyond Petroleum'. Yet last year BP took a huge stake in the Russian oil industry and has become the world's second largest oil and gas producer. The joke now is that BP stands for 'Beyond Plausibility'.

This year a major corporate scandal has been unveiled at Shell, another company that went out of its way to promote corporate social responsibility (CSR) and its green credentials. It has been forced twice to restate its reserves, its chairman has resigned and five separate authorities in the United States and Europe are investigating its affairs.

Other prominent promoters of CSR that have been enmeshed in scandals include ABB, a Swiss-Swedish firm, the Swedish company Skandia, a loyal member of the World Business Council for Sustainable Development, and Ahold in the Netherlands.

Counterparts in New Zealand have not escaped similar embarrassment. Fletcher Challenge, a founding member of the New Zealand Business Council for Sustainable Development, destroyed some \$9 billion in shareholder value and had to be broken up. Nuplex, another Council member, was fined last year for a string of illegal air discharges. The judge

said he was concerned that the company presented itself as an environmentally responsible corporate citizen but did not back that up with actions.

There seems to be something of a pattern here. Holier-than-thou behaviour should not be taken at face value. As Adam Smith put it long ago, "I have never known much good done by those who affected to trade for the public good."⁵ George Orwell was rather more blunt. "Saints", he said, "should always be judged guilty until proven innocent."

'Sustainable development' is now itself understood to be a term with only limited content. No one is for 'unsustainable development'. But the idea that future generations are at risk because the world is running out of resources is simply wrong. So too is the idea that economic growth is the antithesis of sustainable development. Growth typically leads to improved environmental quality by raising the demand for it and providing the wherewithal to meet that demand. In his book, *The Skeptical Environmentalist*, Bjorn Lomborg correlates the World Bank's environmental sustainability index with per capita gross domestic product across 117 countries and concludes that "higher income in general is correlated with higher environmental sustainability."⁶ Sustainable development can most sensibly be defined as a call to maximise human welfare over time, and is thus consistent with standard economic ideas of optimisation and growth. As one writer has put it, Adam Smith's *The Wealth of Nations* could be called "the world's first blueprint for sustainable development."⁷

In all the writing about CSR over recent years, it is possible to identify at least five strands, most of which I believe are dubious or wrong.

The first concerns philanthropy. Being socially responsible as a business is said to require giving to charity. My response is that sponsorship activities and other community programmes that benefit firms and hence their

⁵ Adam Smith (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*, edited by Edwin Cannan, University of Chicago Press, Chicago.

⁶ Bjorn Lomborg (2001) *The Skeptical Environmentalist*, New York, Cambridge University Press, p 32.

⁷ Jerry Taylor (2003) 'Natural Resources', http://www.sdnetwork-net/natural_resources.htm

owners are proper business roles. It is not just legitimate for directors and managers to spend money on them; it is their duty to do so if it benefits shareholders. However, activities of a purely charitable nature that do not benefit shareholders are not legitimate. Shareholders Association chairman Bruce Sheppard has rightly challenged boards on this account. When a CEO builds a lavish corporate headquarters as a personal indulgence it is wrong. It is just as wrong to spend money on a pet charity of the CEO's spouse, unless shareholders have agreed. I am all for charitable activity and would like to see more of it in New Zealand, but it is the business of individuals or privately owned firms, not public companies. As Elaine Sternberg, author of a book on business ethics, has written:

Managers who employ business funds for anything other than the legitimate business objective are simply embezzling: in using other people's money for their own purposes, they are depriving owners of their property as surely as if they had dipped their hands into the till.⁸

A second proposition is that firms should trade off profits for other goals. That idea is inherent in stakeholder theory, which is mistaken for this reason, and in any literal interpretation of the triple bottom line. Consider what would happen if New Zealand firms decided to accept a return of, say, 10 percent less than their cost of capital on an ongoing basis, in the interests of some so-called social or environmental bottom line. Clearly, both local and overseas investors would flee the country in droves in search of better returns. There would be a giant sucking sound as businesses and jobs moved offshore. Would that be a socially responsible strategy?

A third argument is that being socially responsible will benefit shareholders and the economy. In the form espoused by Roderick Deane that I quoted earlier, this argument is correct. But in other forms it is not. An example is so-called 'ethical investing'. Many ethical funds promote themselves on the basis that they offer better returns to investors (which in turn would benefit the economy). Leaving aside the serious problem of deciding which investments are ethical, this claim is simply wrong. Of course, some ethical funds may outperform any market benchmark for a period but so too may

⁸ Elaine Sternberg (1994) *Just Business: Business Ethics in Action*, Little, Brown and Company, London, p41.

'unethical' funds investing in, say, alcohol, arms, gambling and tobacco. Indeed *The Economist* reported a few months ago that a company in the United States calling itself Vice Funds and investing in such industries had outperformed market indexes last year.⁹ The point, however, as any first-year finance student would know, is that so-called ethical funds "will generally under-perform when compared with the market because they restrict their choice to a narrow, and therefore riskier, range of investments."¹⁰ I have no objection at all to those who wish to put their money into ethical funds, or to promote them. But to promote them on the basis that they offer generally higher returns is implausible to the point of being unethical.

A fourth variant is the wider CSR doctrine that firms should embrace 'corporate citizenship' and pursue aims such as sustainable development and social justice. In part this doctrine is based on the false assumption that globalisation has shifted power from governments to corporations, thus imposing large new responsibilities on them. By pursuing CSR, it is also argued, the result will be greater public support for business, higher profitability and increased economic welfare.

Insofar as this approach differs from that outlined by Roderick Deane, it is in fact likely to have few of these benefits. It carries dangers of raising costs and impairing efficient firm operation. Managers are expected to involve themselves in time-consuming consultation and negotiations with an array of outside groups such as non-governmental organisations (NGOs). Such organisations have little incentive to limit their demands for ever greater sacrifices of shareholder value, and are often hostile to business. New systems of recording and reporting on firm performance against a range of environmental goals are called for. Firms that embrace CSR are expected to adopt more exacting environmental and social norms. They are also obliged to ensure that their suppliers, partners and contractors conform to its precepts. All things considered, these additional cost burdens are likely to mean lower shareholder value creation and reduced national income.

⁹ 'Socially irresponsible investment: Virtues of Vice', *The Economist*, November 1, 2003 pp 71-72.

¹⁰ Jim Hoggett and Mike Nahan, 'Ethical investment – Deconstructing the Myth', *Institute of Public Affairs Review*, September 2002, p 6.

The only way to offset this burden on businesses pursuing CSR is to bring other firms into line. Thus the fifth variant, as proposed by the World Business Council for Sustainable Development, is “to encourage whole market segments to change so that supportive companies are not doomed to unfair competitive disadvantage”.¹¹ This might be achieved by public pressure, for example by NGOs. Hugh Morgan, currently president of our counterpart organisation, the Business Council of Australia, and formerly the head of the Australian mining company WMC Resources, reports a conversation with the CEO of “a very large resources-based corporation” who had said to him:

Hugh, don't you understand? My organisation is run by Greenpeace today, and it is my job to ensure that Greenpeace is running yours tomorrow.¹²

Alternatively, all firms in an industry could be forced to adopt CSR practices by government regulations. The end result might be a normal level of profitability in a smaller-sized industry, but harm to the community as a whole through lower wages and higher prices.

In addition, there are wider dangers in the radical redefinition of corporate objectives involved in this version of corporate social responsibility. The economic editor of the *Financial Times*, Martin Wolf (who is delivering this year's Sir Ronald Trotter Lecture for the Business Roundtable), has criticised CSR as follows:

... it accepts a false critique of the market economy; it endorses an equally mistaken view of the powers of multinational businesses; it risks spreading costly regulations worldwide; it is more likely to slow the reduction of global poverty than to accelerate it; it requires companies to make highly debatable political judgments; and it threatens a form of global neo-corporatism, in which unaccountable power is shared between companies, activist groups, some international organisations and a few governments.¹³

Business should not be held hostage by uninformed critics. There is a perfectly sound and respectable case to be made for profit-oriented business. In competitive markets, profits are a signal that society's resources are being put to good use. No less an authority than Pope Jean

¹¹ Charles O Holliday, Stephan Schmidheiny and Philip Watts (2002) *Walking the Talk: The Business Case for Sustainable Development*, World Business Council for Sustainable Development, Greenleaf.

¹² Quoted in David Henderson, *op cit*, p 79.

¹³ Martin Wolf, 'Sleep-walking with the enemy: Corporate social responsibility distorts the market by deflecting business from its primary role of profit generation', *Financial Times*, May 17, 2001.

Paul has pointed out that “When a firm makes a profit this means that productive factors have been properly employed and corresponding human needs have been duly satisfied.” To a first approximation, profits reflect the difference between what consumers are willing to pay for goods and services and the costs of producing them. Hence, as David Henderson has written, profits are a *prima facie* indicator of the good that a business is doing for people in general. Profits promote environmental stewardship: the same incentives that lead to better, cheaper products also lead to reduced resource use and less pollution per unit of production. Henderson adds:

Of the many anti-market slogans that are now in vogue, the most misleading, and potentially the most damaging in its effects, is that of ‘people before profits’. In a competitive market economy, profits can only be made through serving the wishes and interests of people.¹⁴

Moreover, businesses are the main vehicles for raising productivity and prosperity. As Henderson puts it:

Past history, especially of the past half-century or so, offers clear evidence of rapid, sustained and increasingly widespread improvements in material welfare, and there is good reason to think that profit-oriented ‘capitalist’ businesses, operating within the framework of competitive market economies, have played, and are continuing to play, a large part in making such achievements possible. *From an economy-wide perspective, as distinct from that of the individual firm, this is the primary role of business.*¹⁵

The reputation of business has taken a battering around the world in recent years as companies like Enron and Shell that proclaimed virtue were found to have feet of clay. Fortunately, New Zealand business seems to have escaped these excesses. What *The Economist* has called “[o]ne of the biggest corporate fads of the 1990s ... the flowering of ‘corporate social responsibility’ (CSR)”¹⁶ has not taken deep root here. The article reported that disenchanted NGOs are coming to regard CSR as a sham, and suggested it would be no bad thing if it had finally peaked. Green Party co-leader Jeanette Fitzsimons has recently acknowledged that recycling was often a con in terms of the environmental benefit it actually delivered. As in other countries, the focus has come back on to corporate governance and the responsibility of company officers to their shareholders.

¹⁴ David Henderson (2004) *Progress, Pressures and Profits: The Role of Business and the Status of Capitalism Today*, New Zealand Business Roundtable, forthcoming.

¹⁵ *Ibid.* Emphasis in original.

¹⁶ ‘Corporate social responsibility: Two-faced capitalism’, *The Economist*, January 24, 2004.

Companies, like Shell, that claimed to be promoting the interests of “People, Planet and Profits” turned out not to be promoting the interests of any of them.

Business should stick to its role and do it well and ethically. In a democracy, collective decisions on matters of social policy are not for business and NGOs to make; they are for voters and elected politicians. I think Klaus Schwab, president of the Geneva-based World Economic Forum, had it about right when he said recently:

Like many people, we at the World Economic Forum welcome some aspects of the corporate responsibility movement ... But I worry, sometimes, that the trend to saddling companies with social responsibilities may have gone too far. After all, economic growth is the business of business ... Isn't it time to get back to basics here? Shouldn't the men and women of business once again serve as ambassadors for economic growth? ... Business can and does play a positive role in our society. We should not be so shy about recognising and expressing this.¹⁷

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Klaus Schwab, 'Time for business to get back to basics', *New Zealand Herald*, May 5, 2003.