

Parliamentary Joint Committee on Corporations and Financial Services

**Submission to Inquiry into corporate responsibility**

**Systemic and Governance Changes to Corporations are needed for Ecologically and Socially Sustainable Development**

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**Summary of Critical Issue for Inquiry**

In the course of human events, seminal moments arise when it becomes imperative to redesign major social institutions. We face such a moment in the case of the corporation. Conceived in the era of kings, refashioned in the industrial era, corporations now wield dominant power over the lives of people and the quality of the environment. We face a moment of both urgency and opportunity to begin a transformation of this powerful institution, redesigning it to stand on a foundation of service to the public interest.

To advance this vital process, Corporation 2020 proposes these New Principles for Corporate Design for consideration by this Inquiry.

1. The purpose of the corporation is to harness private interests in service to the public interest.
2. Corporations shall accrue fair returns for shareholders, but not at the expense of the legitimate interests of other stakeholders.
3. Corporations shall operate sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs.
4. Corporations shall distribute their wealth equitably among those who contribute to its creation.
5. Corporations shall be governed in a manner that is participatory, transparent, ethical, and accountable.
6. Corporations shall not infringe on the right of natural persons to govern themselves, nor infringe on other universal human rights.

The Principles were drafted by the participants of Corporation 2020, a global project in which I am participant to create the vision and chart the course for the future corporation. More details of Corporation 2020 are available at <http://forums.seib.org/corporation2020/>

The following research paper gives more detail why these new principles for Corporate Design are urgently needed to address critical issues in Australia and other countries.

# **Unsustainable Business: Systemic and Governance Changes needed for Ecologically and Socially Sustainable Development**

## **Abstract**

The concept of Ecologically Sustainable Development has emerged from a recognition that all terrestrial systems, be they natural or human, are interconnected. Ecologically Sustainable Development therefore requires that all our social, economic and business systems must operate in a way that sustains the earth's ecosystems for future generations.

Australian and most other societies continue to be ecologically unsustainable. One major reason is the strong and continuing societal focus on economic growth and business corporations' focus on profit growth. These increasing profits are achieved through growth in revenues, usually with increased resource use and often with increased pollution and waste. The paper, therefore, proposes that this Inquiry should recommend major governance changes that are required to ensure all businesses, particularly corporations, be re-oriented to contribute towards Ecologically and Socially Sustainable Development for all of society.

## **Introduction**

This paper argues that the corporate-led globalisation and development currently being pursued in Australia, New Zealand and globally is unsustainable and represents a major barrier to Ecologically and Socially Sustainable Development (ESSD). It also contends that the reason for this is systemic as it relates to the system within which businesses, particularly corporations, operate. These corporations have increasing power and influence on how the world and national economies, political systems and governance operate and this is reinforcing the barrier to ESSD. Significant progress towards ESSD is not going to be achieved without major systemic and governance changes globally, nationally and regionally. Given the powerful position of the business sector, particularly global corporations, in contemporary society, the required major systemic change will not be easy to achieve. It therefore concludes by proposing changes to how governance, society, governments and businesses operate, in order to successfully move towards an ecologically and socially sustainable corporations, business sector and society.

## **Why not Business as Usual?**

Businesses were central to the creation of the technology and wealth that has totally transformed society in the last two centuries. They provide most of the products and services that people consume. Businesses invent, design, develop and market those products and services, so that they shape market demand and the environmental impacts of consumption. The business community, along with the mass media (mainly owned by business) and governments, has also helped to promote and affirm a culture that emphasises the core values of economic rationalism and consumerism: economic growth, markets, material prosperity, individual success, technological progress, and consumer choice. If this approach has been so successful over the last two centuries, the critical question is why can it not continue?

The major problem lies in the inability of the current system to recognise and remain within ecological limits. Wackernagel (2002) and his colleagues' recent work published on Humanity's Global Ecological Footprint indicates that with current human consumption patterns we reached the ecological carrying capacity of the earth in the 1970's and by 1999 exceeded its carrying capacity by 20%, a critically unsustainable level. Further economic growth driven by business as usual is therefore currently making the situation even more unsustainable, as there is no significant evidence of any substantial decoupling between economic growth and energy and resource use and sink use for waste and emissions (OECD, 2002b). Resource and energy use, waste and greenhouse gas emissions are still increasing in most OECD countries, including Australia, albeit at a slightly slower rate than overall economic growth (OECD, 2002a). We are moving towards a global tragedy of the commons (International Forum on Globalization, 2002) - eg global warming due to greenhouse gas emissions (Hickman & Bartlett, 2001) - where markets and businesses operate within a system that fails to constrain economic activities within ecological limits.

## **Can Business become Ecologically and Socially Sustainable?**

As business is such a major part of the modern world, the scenario if business does not become ecologically and socially sustainable could be cataclysmic and one possible version of this dystopian scenario is described in Susan George's Lugano Report (1999). The critical questions therefore are:

- Will business change quickly enough towards ESSD to avoid a cataclysmic scenario?
- What can be done to make it more likely that business and societies change quickly enough towards ESSD to avoid a cataclysmic scenario?

These are far from easy questions to answer and in reality nobody really knows the answer. The next part of the paper focuses on some key aspects of the current system within which business, particularly business corporations currently operate that act as barriers to progress towards ESSD. Corporations are defined for the purpose of this research as business corporations whose shares are traded on a sharemarket in Australia or in other countries.

## **Why the Current Corporate-led Globalisation and Development is Unsustainable?**

*“Anyone who believes exponential (economic) growth can go on forever in a finite world is either a madman or an economist.”* - Kenneth Boulding (1965)

The predominant focus of corporations and of national economies is growth. In the case of corporations - the focus is long-term growth of profits; and for nations - national economic growth. Without continuing economic growth, it would be much harder for corporations to achieve long term profit growth and therefore the national and increasingly global focus on economic growth is strongly supported by the corporate sector. The value of the shares of these sharemarket listed corporations assumes that profits on average will continue to grow by the expected long-term economic growth rate (2-3%pa) (Weston & Brigham, 1975).

### **Why the Growth Paradigm is a Major Barrier to Progress Towards ESSD**

Economic growth is an increase in the real value of production and consumption of goods and services produced and sold in a country or region. Economic growth occurs when there is an increase in the multiplied product of population and per capita consumption. The Australian and most other economies grow as an integrated whole consisting of agricultural, extractive, manufacturing and services sectors that require physical inputs and produce wastes. Economic growth is usually indicated by increases in the real (prices adjusted for inflation) gross domestic product (GDP) or real gross national product (GNP). Economic growth has been a primary, and remains perennial goal of

Australian and New Zealand and most other societies and governments despite the fact that it is ecologically unsustainable (Daly & Farley, 2004).

Based upon established principles of physics and ecology, there is a limit to economic growth, because there is limited sources of energy and materials and limits to absorption capacity of the atmosphere (eg greenhouse gases) and other sinks which the economy uses to absorb waste. As documented by Wackernagel et al (2002), our current level economic activities are already above the level of the ecological resource constraints, using too much of the sources that provide the inputs (particularly non-renewable and many renewable resources) and the sinks (rivers, lakes, oceans, atmospheres) that absorb the outputs. Despite this, businesses and nations seek to grow the level of economic activities, without currently giving any serious consideration to imposing conditions on this economic growth that would ensure that the economy is ecologically (and socially) sustainable.

For example, there is strong and increasing evidence that Australian and global economic growth (with increased greenhouse gas emissions) is causing substantial and in the short to medium-term irreparable ecological damage to the atmospheric ecosystem and the welfare of future generations in Australia, our Pacific Island neighbours in particular and the rest of the world. There has been an increase of global temperatures due to greenhouse gas emissions to levels above those prevalent on earth for 120,000 years (Intergovernmental Panel on Climate Change (IPCC), 2003). The US and Australian Governments, however, both still refuse to ratify the Kyoto Protocol despite both countries having among highest levels of per capita greenhouse gas emissions of any country. There is also strong evidence that corporations from the fossil fuel industry have had a strong influence on the Governments' decision not to sign the Kyoto Protocol in both the US (Gelbspan, 2004) and Australia (Bulkeley, 2000) and many have been actively involved in trying to slow or stop other countries becoming part of Kyoto Agreement to reduce greenhouse gas emissions (Gelbspan, 2004). Fossil fuel corporations through their, lobbying of national governments, funding of lobby groups, think-tanks and research by climate change sceptics have also sought to limit or weaken Global Agreements on climate change, such as the Kyoto Agreement (Bulkeley, 2000; Gelbspan, 2004). This represents a clear illustration of how the interests of powerful corporations have ceased to align with the interests of people and the planet.

In addition, there is strong evidence from Australia (Australia, 2002; Hamilton, 2003) and most other developed countries (Daly, Accessed February 2004) that increasing GNP has ceased to be a good measure of increasing human welfare for all developed countries since about 1980. It also does not increase happiness (Hamilton, 2003; Layard, 2003).

Daly and Farley (2004) have recognized the problem of “Uneconomic Growth”—where the environmental and social costs of economic growth are more than the benefits of increased output. In Australia and many developed countries, the evidence indicates that we are pursuing uneconomic growth or, put another way, unsustainable economic growth. We need to move to an ecologically socially sustainable society that meets the Natural Step system conditions outlined in a later section, with an economy in sustainable development. Daly has described this economy as follows:

“An economy in sustainable development adapts and improves in knowledge, organization, technical efficiency, and wisdom; and it does this without assimilating or accreting, beyond some point, an ever greater percentage of the matter-energy of the ecosystem into itself, but rather stops at a scale at which the remaining ecosystem (the environment) can continue to function and renew itself year after year. The non-growing economy is not static—it is being continually maintained and renewed as with the environment” (Daly & Townsend, 1993).

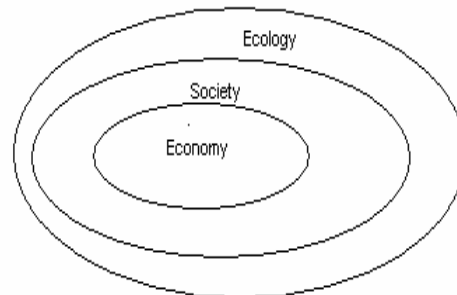
## **Different Triple Bottom Lines**

Many corporations around the world have adopted some form of triple bottom line reporting of varying depth and quality (UNEP/SustainAbility, 2002). The triple bottom line approach involves incorporating economic, environmental and social performance indicators into an entity’s management, measurement and reporting processes. However, as John Elkington(1997) who developed the term and concept of “triple bottom line” noted *“the three lines represent society, the economy and the environment. Society depends on the economy – and the economy depends on the global ecosystem, whose health represents the ultimate bottom line.”*

Carrying capacity is the bottom line of ecological accounting and as noted previously humanity’s ecological footprint is already exceeding the carrying capacity of the planet (Wackernagel et al,

2002). For ecologically sustainable development to be achieved we need to recognise that human society and the economy are nested systems within the earth's ecosystem as illustrated in Figure 1:

**Figure 1: Nested System Model of Ecologically Sustainable Development**



The *1996 Australia: State of Environment Report* describes the nested system model as:

*“the decision making model needed for an ecologically sustainable future for Australia. It recognises that the economy is a sub-set of society, since many important aspects of society do not involve economic activity. Similarly, it acknowledges that human society is totally constrained by the natural ecology of our planet. It requires integration of ecological thinking into all social and economic planning”* (State of the Environment Advisory Council, 1996).

In order to move towards an ecologically sustainable future for Australia and the planet, we therefore need to move to a decision making models that recognise at all levels (global, national, regional and business) the limits of the natural ecology. We also need to make systemic changes that ensure that societies, economies and corporations recognise the predominant importance of the ecological bottom line. It will require major changes in the system within which business operates in order that all businesses give higher priority to operating within ecological limits than generating profits. If any business is unable to operate within ecological limits, the business should not be allowed to continue to operate. Otherwise it will be competing unfairly as it is avoiding the costs of the ecological damage it is creating. The Natural Step model discussed later in the paper can provide a basis for setting these ecological limits.

Under the current system within which corporations operate, considerations of these other stakeholders and other broader issues, such as ecologically and socially sustainable development however, will always tend to be a secondary issue for businesses due to the way the system currently

operates requiring the directors and senior management of businesses, particularly publicly traded corporations, to have their ultimate bottom line focus on growing profits over the long term in order to survive and thrive.

One of the other major reasons for this is that the most intense and continuous scrutiny of the publicly traded corporation almost always comes from the financial market, through stockbroker and fund manager analysts. The primary focus of these analysts is on current and future corporate profits. As they can (and do) have a significant influence on the major shareholders of the corporation, they reinforce the primacy of profits as an objective within any triple bottom line. A recent report on financial analysts by the World Business Council for Sustainable Development (2005) stated “Young analysts appear unconvinced over the materiality of most environmental, social, and governance issues to business”

It is therefore clear that under the system that business corporations currently operate, a decision to be ecologically sustainable (eg - by using only renewable energy sources) is likely to reduce the corporation’s competitiveness in the global marketplace due to the higher cost of renewable energy and of many of the other more ecologically and socially sustainable production methods - eg cradle-to-cradle (McDonough & Braungart, 2002). Some business corporations may manage, measure and report a triple bottom line but operate within a system which ensures that the economic bottom line representing the current and future profits of the corporation, which is continually assessed by sharemarket analysts and fund managers is given much higher priority than the environmental and social bottom lines, which normally receive much less intense scrutiny.

Based on the reasons outlined, it is argued that the current system and constraints under which business operates are far from sufficient to ensure that business changes quickly enough towards ESSD in order to avoid risking a cataclysmic scenario. This leads to the second question posed earlier:

- What can be done to make it more likely that business and societies change quickly enough towards ESSD to avoid a cataclysmic scenario?



## System Conditions for an Ecologically Sustainable Society

*“At every level the greatest obstacle to transforming the world is that we lack the clarity and imagination to conceive that it could be different”* – Roberto Unger (Smolin, 1997)

The Natural Step framework, which specifies four system conditions for ecological and social sustainability:

1. There is no increase in concentrations of substances extracted from the Earth’s crust.
2. There is no increase in concentrations of substances produced by society.
3. There is no physical impoverishment by over-harvesting or other forms of ecosystem manipulation.
4. Resources are used fairly and efficiently in order to meet basic human needs worldwide.

These have been accepted by at least some of the scientific community as a reasonable basis for the ecological limits to sustainability (Robèrt, 1997). There are criticisms of the Natural Step model in regard to its different levels of generality and the limited treatment of the social and economic aspects of sustainable development (Diesendorf, 1998). Diesendorf, in that paper however, accepts that the model provides a strong focus for business and government in controlling flows into the environment and developing measurable indicators of ecological sustainability. The focus of the remainder of this paper is on how can we change our governance systems to better ensure progress towards ecologically sustainable development, as there is strong evidence that we are already significantly breaching all of the first three ecological system conditions in a way that is seriously detrimental to earth’s ecosystems and the welfare of future generations.

The fourth system condition relating to social sustainability is broad and general. Globally, however it is clear that our current development path is also socially unsustainable, with the wealth and income of the mega-rich business leaders in many countries contrasting with 200 million children under five who are underweight due to lack of food, 14 million children who die each year from hunger related diseases and 800 million people who go to bed hungry each night (International Forum on Globalization, 2002). Corporate-led globalisation and development is clearly failing to meet human needs and provide even a tolerable existence for millions of people across world and another model for governance and development is urgently needed.

# Governance Changes to Facilitate Transition to an Ecologically and Socially Sustainable Society

## Why Governance Changes are needed to move towards ESSD?

The World Humanity Action Trust(2000) defines governance as “the framework of social and economic systems and legal and political structures through which humanity manages itself”.

Governance, society, governments and businesses all have to change substantially in order to enable significant progress to be made towards ESSD. Governance comprises the institutions, processes and traditions, which determine how power is exercised, how decisions are taken and how citizens have their say.

The OECD Public Management program (OECD PUMA, 2004) focuses in particular on the principal elements of good governance at a government level, namely:

***“Accountability:** government is able and willing to show the extent to which its actions and decisions are consistent with clearly-defined and agreed-upon objectives.*

***Transparency:** government actions, decisions and decision-making processes are open to an appropriate level of scrutiny by others parts of government, civil society and, in some instances, outside institutions and governments.*

***Efficiency and effectiveness:** government strives to produce quality public outputs, including services delivered to citizens, at the best cost, and ensures that outputs meet the original intentions of policymakers.*

***Responsiveness:** government has the capacity and flexibility to respond rapidly to societal changes, takes into account the expectations of civil society in identifying the general public interest, and is willing to critically re-examine the role of government.*

***Forward vision:** government is able to anticipate future problems and issues based on current data and trends and develop policies that take into account future costs and anticipated changes (e.g. demographic, economic, environmental, etc.).*

***Rule of law:** government enforces equally transparent laws, regulations and codes.”*

Good governance may assist the societal and business transition to Ecologically Sustainable Development but there needs to be a re-direction of the focus what international, national and regional governance is trying to achieve at a societal level in order to make significant progress.

One of the major problems in achieving this re-direction is the ever-increasing influence corporations have over the governance process at a regional, national and international level. Corporations do not only contribute significantly to political campaigns but also are a powerful force lobbying government on policy, legislation and other issues (Derber, 1998; International Forum on Globalization, 2002; Korten, 2001; Monbiot, 2000; Ritz, 2001; The Group of Lisbon, 1996). Large corporations have much more significant resources for lobbying government than individual citizens or other Non-Governmental Organisations(NGOs). Large corporations often cooperate to lobby on specific issues giving them even more power and resources to lobby and influence governments and government bureaucrats (Bulkeley, 2000; Gelbspan, 2004; The Group of Lisbon, 1996).

The largest multinational corporations have revenues larger than the total GDP (money spent on goods and services etc) of Australia (Anderson & Cavanagh, 2000). In many cases, the corporate power is such that they can negotiate special deals with national governments for tax holidays, other concessions, particularly if they are proposing a major investment and it can be feasibly be located in more than one country. They can even relocate the parent company. Ericsson, the Swedish Electronics company is reported to have threatened to relocate its world headquarters from Sweden due to the high tax rates in that country and more recently if Sweden rejected joining the Euro currency system (AFP, 2003). James Hardie, relocated the legal domicile of the parent company and the world headquarters away from Australia for tax and other reasons (Hardie, 2001). It has recently become clear that trying to avoid the future potential liabilities to Australian victims of its asbestos activities was one of the major reasons for James Hardie's relocation (Sydney Morning Herald, 2004).

Large multinational corporations are probably even more powerful in relations to global governance and global agreements, especially when a number of them have common interests. They can individually and jointly via lobbying groups, think-tanks and lobbyists seek to influence many governments participating in the negotiations (Gelbspan, 2004; International Forum on Globalization, 2002; The Group of Lisbon, 1996). Any individual citizen is likely to have minimal influence on their own national government and NGO's and other lobby groups may have some influence, but are usually much less well resourced for lobbying. Some international NGO's such as Greenpeace and

WWF clearly seek to exert influence on a number of governments in relation to global agreements such as Kyoto but do not have the lobbying power of the think-tanks and lobby groups funded by the large multinational corporations (Gelbspan, 2004; Korten, 2001).

### **Governance Changes Needed for ESSD**

As businesses, particularly corporations represent a barrier to ESSD and also have a strong influence on governments and governance (globally, nationally and regionally), it will be necessary to possibly eliminate or at least significantly reduce business's influence on governments and governance to make progress towards ESSD. This is because, as discussed in the paper, we have passed the stage of development where the interests of business and of society were largely aligned. Businesses, particularly corporations, are constrained within a system that focuses its strategies on ever-increasing profitability, usually achieved through increasing revenues and reducing costs. Societies need to address the problem of providing a sustainable and meaningful livelihood for all of earth's 6.5 billion people within the ecological limits of the planet. This represents an enormous challenge as the world's population continues to increase and we are already breaching the ecological limits (Wackernagel et al, 2002).

There are a wide range of possible government policies to encourage ecologically sustainable behaviour by society, business and consumers. These could include business and product licensing, restrictions on use of non-renewable resources, policies to ensure that renewable resources are only harvested at or below their replenishment rate, ecological tax systems, work-time reduction, income guarantees and international agreements on environmental governance measures (McGregor, 2003). Many of these will have an adverse impact on some powerful corporations whose resistance under our current governance systems is extremely difficult currently to overcome. This has been demonstrated by the powerful resistance mounted to greenhouse gas emission reduction policies by fossil fuel based corporations (Gelbspan, 2004), discussed previously in the paper.

Moving from corporate-led globalisation and development to a people based democracy that recognises ecological limits will not be easy but it is necessary to progress towards ESSD (Drutman & Cray, 2004; George, 2004; Madron & Jopling, 2003). As this move to an ecologically and socially sustainable model of development will involve massive societal change, it is going to be hard to achieve. It will be particularly difficult as it involves overcoming the extremely powerful business interests that are strongly entrenched in the currently unsustainable system of business.

## Conclusion

The Design Principles for Corporation proposed by Corporation 2020 represent a sound basis for developing public policy to ensure corporate responsibility. I would urge the Inquiry to seriously consider these principles for Corporate Design:

1. The purpose of the corporation is to harness private interests in service to the public interest.
2. Corporations shall accrue fair returns for shareholders, but not at the expense of the legitimate interests of other stakeholders.
3. Corporations shall operate sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs.
4. Corporations shall distribute their wealth equitably among those who contribute to its creation.
5. Corporations shall be governed in a manner that is participatory, transparent, ethical, and accountable.
6. Corporations shall not infringe on the right of natural persons to govern themselves, nor infringe on other universal human rights.

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## **Ian McGregor – resume and related research (some with links)**

Ian McGregor commenced his PhD research at UTS' Institute for Sustainable Futures in relation to Australia and Ecologically Sustainable Development in 2002. Ian's previous experience was in Strategy Consulting in Sydney and London and in Marketing and Strategic Planning with the Australian Stock Exchange, ANZ and Westpac. In 2003, he was appointed to the position of Lecturer

in the School of Management in the Faculty of Business at UTS. His areas of expertise include strategic planning, marketing, feasibility studies, cost-benefit analysis and ecological economics.

Ian presented on Australian National Indicators of Sustainable Development at the Indo-Pacific Ecosystem Health Conference in November 2002 and the Australian and New Zealand Society for Ecological Economic Conference in December 2002. A paper based on these presentations entitled "Is Australia Progressing towards Ecologically Sustainable Development?" was published in the Australian Journal of Environmental Health in 2003. Can be downloaded from: <http://www.business.uts.edu.au/management/research/CCG/PDF/IMcG2002.pdf>

He also presented 'An Ecologically Sustainable Business Sector within an Ecologically Sustainable Society' at the Ecological Economics Think Tank, Auckland, 16 November 2003. Can be downloaded from: <http://www.business.uts.edu.au/management/research/CCG/PDF/IMcG2003.pdf>. He has a strong interest in the research area of the links between Ecologically Sustainable Development and Corporate Governance.

### **Refereed Publications:**

**Is Australia Progressing Towards Ecologically Sustainable Development** - Journal of Environmental Health, Vol 3, Issue 1, p31-45, 2003

**The Corporate Sector – A Major Barrier to Moving to Ecological Rationalism from Economic Rationalism** – Proceedings of the Ecopolitics XV Conference, 12-14<sup>th</sup> November 2004

**An Integral Ecology of Commerce to Avoid Dystopia** - Refereed Papers: Australian and New Zealand Academy of Management Conference – 8-11<sup>th</sup> December 2004

**Sustainable organisational procurement - a progressive approach towards sustainable development** – International Journal of Environment, Workplace and Employment, Vol. 1, Nos. 3/4 with Grob, S 2005

### **Conference Papers – Abstract Refereed:**

**The Ecopolitics of Global Warming** - Ecopolitics XVI Conference, 4<sup>th</sup>-6<sup>th</sup> July 2005

**Corporate Capitalist Hegemony: Why it is a major barrier to Ecological and Social**

**Alternatives** - Other Worlds Conference: Social movements and the making of alternatives, 28<sup>th</sup>-29<sup>th</sup> April 2005

**Moving to Ecological Rationalism from Economic Rationalism - A necessary transition for Ecologically Sustainable Development** Association of Pacific Rim Universities Doctoral Students Conference Aug, 2004

**Ecologically Sustainable Development and Ecologically Sustainable Business Models** – Paper and Presentation – New Zealand Sustainable Business Conference - 17<sup>th</sup>-19<sup>th</sup> November, 2003

**An Ecologically Sustainable Business Sector in an Ecologically Sustainable Society** - Australian and New Zealand Society for Ecological Economics - Ecological Economics Workshop – 16<sup>th</sup> November 2003

### **Academic Qualifications:**

**MSc (London Business School) - Business Administration**

(Awarded GKN Prize for Achievement and selected for International Exchange Program)

**BA (Honours) in Marketing from University of Strathclyde** (Awarded Institute of Marketing Prize)