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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL  
SERVICES

**Reference: Corporate responsibility**

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SYDNEY

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**JOINT STATUTORY COMMITTEE ON  
CORPORATIONS AND FINANCIAL SERVICES**

**Wednesday, 23 November 2005**

**Members:** Senator Chapman (*Chairman*), Ms Burke (*Deputy Chair*), Senators Brandis, Murray, Sherry and Wong and Mr Baker, Mr Bartlett, Mr Bowen and Mr McArthur

**Members in attendance:** Senators Brandis, Chapman and Wong and Mr Baker, Mr Bartlett, Mr Bowen and Ms Burke

**Terms of reference for the inquiry:**

To inquire into and report on:

Corporate Responsibility and Triple-Bottom-Line reporting, for incorporated entities in Australia, with particular reference to:

- a. The extent to which organisational decision-makers have an existing regard for the interests of stakeholders other than shareholders, and the broader community.
- b. The extent to which organisational decision-makers should have regard for the interests of stakeholders other than shareholders, and the broader community.
- c. The extent to which the current legal framework governing directors' duties encourages or discourages them from having regard for the interests of stakeholders other than shareholders, and the broader community.
- d. Whether revisions to the legal framework, particularly to the Corporations Act, are required to enable or encourage incorporated entities or directors to have regard for the interests of stakeholders other than shareholders, and the broader community. In considering this matter, the Committee will also have regard to obligations that exist in laws other than the Corporations Act.
- e. Any alternative mechanisms, including voluntary measures that may enhance consideration of stakeholder interests by incorporated entities and/or their directors.
- f. The appropriateness of reporting requirements associated with these issues.
- g. Whether regulatory, legislative or other policy approaches in other countries could be adopted or adapted for Australia.

In inquiring into these matters, the Committee will consider both for profit and not-for-profit incorporated entities under the Corporations Act.

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**Committee met at 8.35 am**

**CHAIRMAN (Senator Chapman)**—I call the committee to order. Today the committee will hear evidence regarding its inquiry into corporate responsibility and relevant and related matters. The committee expresses its gratitude to the contributors to this inquiry, including those who will appear before us as witnesses today. Before we start taking evidence, may I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to the evidence they provide. Parliamentary privilege refers to special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person that operates to the disadvantage of a witness on account of evidence given by him or her before the parliament or any of its committees is treated as a breach of privilege. I also state that, unless the committee should decide otherwise, this is a public hearing and all members of the public are welcome to attend. Today is the first time the committee will hear evidence on this reference. There will be further hearings in Melbourne, Sydney and Canberra, at least, in early 2006, and maybe further afield.

**ARMSTRONG, Mr Daren Mark, Secretary, Legislative Review Task Force, Commercial Law Association of Australia Limited**

**DREISE, Mr Anthony (Tony) John, Director, Deputy Chair, Legislative Review Task Force, Commercial Law Association of Australia Limited**

**DURIE, Mrs Anne, Member, Legislative Review Task Force, Commercial Law Association of Australia Limited**

**FINNANE, Mr Edmund Thomas, Member, Legislative Review Task Force, Commercial Law Association of Australia Limited**

**CHAIRMAN**—Welcome. The committee has before it your submission, which we have numbered 33. Are there any alterations or additions you wish to make to your written submission?

**Mr Finnane**—Yes. On the second line of the submission the numbers 2, 3 and 4 appear. Those numbers should be (b), (c) and (d), respectively. Those are the only alterations.

**CHAIRMAN**—Thank you. I now invite you to make an opening statement.

**Mr Dreise**—Thank you again for the opportunity for the Commercial Law Association to appear before the committee. The CLA has for over 40 years now provided a bridge between commerce and the law. The Legislative Review Task Force of the CLA was specifically formed by the CLA to consider legislative issues and to make submissions about them. The president of the CLA, Dr John Keogh, was unfortunately unable to come today and sends his apologies. Mr Finnane will address the principal submissions of the task force, as contained in our submissions to the committee. On that note, I will hand over to Mr Finnane.

**Mr Finnane**—Thank you. If it is in order, I would like to make our substantive submission on that point. We thank the committee for the opportunity to expand on our submissions today. We have provided written submissions which focus on paragraph (d) of the terms of reference. We address the question of whether directors' duties should be extended in the interest of corporate responsibility or corporate social responsibility. In our view, they should not be. In our view, it is appropriate that directors' duties are to the corporation and nobody else, but there are a couple of points that should be made about this issue. Firstly, 'corporation' for these purposes includes creditors when a corporation is insolvent or on the verge of insolvency. Secondly, the interests of the corporation are not to be understood in narrow terms. In our written submission we make the point that public perception and relationships are important in business, and that giving to charity, contributing to a better environment or engaging in ethical business can normally be justified in the long-term interests of a corporation, within limits of course. The business judgment rule, which we also address in our written submission, gives directors a broad scope to do what they consider to be in the best interests of the corporation provided that they act honestly.



I will now deal with the reasons for our opposition to expanding directors' duties in the interests of corporate responsibility. In our written submission we point out that directors and corporations are already subject to the law, and there is no need to expand directors' duties for these purposes. We also point out that governments rather than corporations have broad social responsibilities and the power to make laws to address them. A further point I would like to make is that directors' duties are by definition legal obligations. A director must not use his or her position for personal advantage. A director must use his or her power in good faith for a proper purpose. A director must avoid insolvent trading. If a director breaches these obligations there are serious civil and criminal consequences or potentially both. Because there are consequences, it is important that directors, lawyers, prosecutors and courts know what it is that constitutes a breach.

The concept of corporate responsibility or corporate social responsibility exists in a different realm from legal duties. The World Business Council for Sustainable Development defines corporate social responsibility as:

... the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

There are other definitions that are promulgated by others. These aspirations are properly understood as a combination of moral and ethical rather than legal obligations. They are not matters which are readily stated as legal duties for breach of which there are to be serious legal consequences.

We do not think that directors' duties are a good mechanism for achieving such aspirations. In our view, if there is an area of commercial, environmental or other activity where changes are needed, parliament not corporations should address this by enacting general laws. Having said all of this, we do not dispute that corporate social responsibility is important, given the power and role in society of corporations, particularly large corporations. But the concept of corporate responsibility is concerned with ethical, moral and social obligations as opposed to legal obligations. We take the view that the forum of public opinion rather than the courts is the appropriate place for enforcing and measuring compliance with obligations of that type. We would also point out that the content of corporate social responsibility is by no means fixed, and ongoing public discussion of what corporations ought to do as opposed to what they must or must not do is something to be encouraged.

**CHAIRMAN**—Thank you for that introduction. In your submission you refer to the flexibility that the business judgment rule gives to directors in determining where their companies' interests lie. Our next witnesses will be representing St James Ethics Centre. They have proposed an ethical judgment rule which would allow company directors to make decisions based on bona fide ethical considerations and protect them from liability when a reasonable person would judge those considerations to be well founded. What are your views on that proposal?

**Mr Finnane**—My understanding is that essentially when one talks about the possibility of amending directors' duties in the interests of corporate social responsibility, there are two general types of reforms that people talk about. One is reforms whereby additional duties are placed on directors to consider interests which may be foreign to the interests which they are

currently required by law to uphold and pursue. The other type of amendment or enhancement of directors' duties that is suggested gives directors an out effectively and an excuse to do that which would otherwise constitute a breach of directors' duties.

In our view there is a problem with both forms of amendment. The St James Ethics Centre proposal, as you have outlined—although I have not read their submission in detail—falls into the latter category. It needs to be looked at very cautiously. It needs to be borne in mind that what such an amendment does is give a director an excuse to do what would otherwise be a breach of directors' duties.

**Senator WONG**—Why do you say that?

**Mr Finnane**—Either the requirement to act ethically is something that falls within directors' duties—normally it will, in which case there is no need to amend the directors' duties because it already falls within the current law—or it is an entitlement that a director has to pursue some ethical interest which would otherwise breach the directors' duties. If it is needed, it is needed because it would otherwise constitute a breach of directors' duties by definition.

**Mr BOWEN**—Some people interpret the duty to act in the best interests of the corporation as being narrowly defined in the interests of shareholders. Other people say that it can be defined broadly as the best interests of the corporation in the long term, which can take into account sustainability issues and the general wellbeing of society which therefore puts the company in a good position to continue. What would be the problem with an amendment that simply avoided doubt and said that the duties of directors are to the corporation or the company and, to avoid doubt, that this can be taken to include the long-term sustainability of the community and society that that company is operating in? That puts no, if you like, specific obligations but simply avoids doubt and says that it does not need to be narrowly defined to be in the best interests of the shareholders of today and not necessarily the shareholders of tomorrow as well.

**Mr Finnane**—I suppose that suggests that there is some doubt in the first place. I am suggesting that there is not the need for that.

**Senator WONG**—I suppose, Mr Finnane, that it is a legal argument, which quite a number of people have put to us—at least in discussions, although we have not had the formal inquiry. There still is, even in the business community, I would suggest, a view promulgated that there is a conflict between taking into account longer term sustainability issues and the interests of the shareholders. In the *Fin Review* today you would have seen James Hardie continuing to put that view, or at least being reported as doing that. I would have to say that most of the legal submissions that we have seen would probably concur with what you are suggesting. If you are right, from our perspective as policymakers, how do we inculcate that kind of understanding of what the best interests of the company means? If you are saying, 'Don't change the law,' what else do we do?

**Mr Finnane**—Mr Dreise or Mr Armstrong can probably say some more about this.

**Mr Armstrong**—If the question is educative, with respect to the existing law, then education ought to happen. If the government wishes to promote such education, there are many means by which it could do that. Another point in relation to specifying certain matters—this being a non-

exhaustive list—is that you give those a certain prominence and that may, from a policy perspective, be considered by the government to be helpful in those particular areas. That might be the policy concern of the day or in the near term.

**Senator WONG**—Is the way you see good faith and the best interests of the company operating—the terms Mr Finnane has outlined—a view you put to your clients and in broader policy discussions? Why I am asking relates to some aspects of the business community—I will refer back to James Hardie and this concept. I am not suggesting government should regulate for such high profile events as the only way in which you look at regulation, but they have put a view to the community that their actions were necessary because it would have been a breach of their directors' duties not to have gone down this path. What you are putting to us would suggest a view that would be contrary to that approach.

**Mr Armstrong**—I am not fully aware of the James Hardie circumstances but as I understand it, in part, their argument is based on the separation of two companies in a group, and there might be group considerations that one could work in here as well. They may not promote such an argument if all of these operations and liabilities are in the same company.

**Ms BURKE**—They could also argue about compensation exposure to shareholders and what path you take. Part of their main argument has been that it would be a breach of their responsibility to shareholders to go down the compensation route. So you have to juggle those competing interests, surely, and that is the whole argument. Who are the people you are looking after—the broader stakeholders, your employees or the shareholders of the community you expose?

**Mr Dreise**—Some companies—and I am not speaking here specifically of James Hardie—have taken a pretty narrow view of directors' duties.

**Ms BURKE**—Thank you.

**Mr Dreise**—If I were advising a company board, I would encourage them to take a broader view, one which took account of the spirit of the law, and also a longer term view than the short-term share price. So I think there is room for a broader view to be taken by boards—and a number of them obviously do. As Mr Finnane was saying, that can be seen as being in the long-term interests of the company and not at all in conflict with the current duties of the directors.

**Mr Finnane**—We should be a little cautious in talking about the James Hardie situation, particularly as we do not necessarily know all of the facts. It is still being played out. The James Hardie directors would perceive that their brand name is being badly damaged by the publicity they are suffering. They would be acutely conscious, I would suggest, of the long-term and broader interests of the corporation, which they need to pursue if they were not aware of that earlier, which I do not want to get into.

**CHAIRMAN**—Does the James Hardie case indicate some inherent conflict of interest in the discharge of directors' duties? On the one hand, it could be argued that the directors were limited in what they could do with regard to employees because of their liability or duty to shareholders and they could not be seen to be overstepping the mark and perhaps being overgenerous to

employees. On the other hand, there is the issue of the asbestos victims they had to concern themselves with. Is there a conflict there?

**Mr Finnane**—In discharging their current duties they have to weigh up competing considerations. Whenever there is a broad or a longer term type issue like this issue, where there is not an immediate increment to the bottom line, and there is potentially an immediate expense to the corporation, then directors need to weigh up their long-term interests and act in the best interests of the corporation. In a sense that will involve considering competing claims on the corporation's long-term interests. There are always going to be difficult issues for directors of corporations to consider.

**CHAIRMAN**—The business judgment rule was adequate in dealing with that.

**Mr Finnane**—We think it is—yes.

**Mr Armstrong**—To add to Mr Finnane's submission in that regard, the list of potential factors that a well-performing warden might need to bring to bear or at least bring to mind before making a decision could in a particular matter be three items long or 33 items long. To mandate that, you must always take into account item 17 in the list of 33. It could, depending on what that item is, be something which from a policy perspective you wish to promote at this particular point in time, but it is not to say that the law at the moment does not permit directors or restrict directors from acting properly and considering the complete list of appropriate variables to consider at the particular time.

**Senator BARTLETT**—Mr Finnane, in your introductory comments you said there is a distinction between what companies ought to do and what they must do—that is, between their social obligations and their legal obligations. Isn't this the real question then: who is it in the corporation who decides what they ought to do—what they must do is clear—and, if evidence shows that that is not happening in a way that is consistent with community expectations, isn't there a place for the government to legislate to make those oughts become what must happen?

**Mr Finnane**—If there is something that ought to happen in some respect—in respect of the environment or whatever—why should that be restricted to corporations or to directors in particular?

**Senator BARTLETT**—It should not, but they are one player within the community. Isn't there a role then for the government to legislate to require that they fulfil those obligations as well as other members of the community?

**Mr Dreise**—We would definitely agree with that. What we are saying is that, as in the environment, if the government has a view that certain obligations should be placed on companies, it is for the parliament to lay those down and, obviously, for the companies to comply with that. The distinction we make is that it is not for the board of the company to turn its mind to broad social issues; it is for the parliament and the government.

**Mr Finnane**—We object to putting it in terms of directors' duties. It is not a question of whether social objectives—

**Senator BARTLETT**—So you see a corporate responsibility rather than a director's responsibility.

**Senator WONG**—As I understand your submission on the issue Mr Bartlett is raising, you are saying that general regulation that applies to legal persons, corporations or individuals is how we should be dealing with environmental and other social issues. Directors' duties is not the place for it. Is that a reasonable summary?

**Mr Finnane**—Yes, that is right.

**Senator WONG**—I understand your position on director's duties. I am trying to move a bit beyond that. I accept that is your view, and I accept there is a fairly strong view about the points you raise. What I want to look at is the question of, if not that, then what? It seems to me, notwithstanding what you say as a matter of law, there are still companies which clearly and quite publicly—and we do not have to talk about individuals—have a view that casts a very narrow construction of what acting in good faith and in the best interests of the company means. If everybody thought the way Mr Dreise has just articulated about how you would advise a country, I doubt we would be as concerned about the issues that have led to the initiation of this inquiry. I am saying to you—and I understand you are a legal practitioner, so it is a bit of a different role—that if changing the law for the reasons you outlined is not what we should do then what should we do? How do we get to a point where the common understanding of directors in Australia is the sort of understanding that you outlined, Mr Dreise—that is, that it is appropriate and entirely within their powers for directors to have regard to these broader issues when considering the best interests of the company?

**Mr Dreise**—We would certainly support any educative approaches. I know that the St James Ethics Centre has suggested a number of voluntary schemes and codes of conduct which might assist. The difficulty is that, no matter how much law you write, it is not going to change the culture or ethics of the board if that is not the way they look at things. It has to be from the point of view, as Mr Finnane says, of the public. That has to be brought to bear. There obviously have to be some educative programs. Perhaps the sorts of concepts we are talking about here should be built into the documents that, say, ASIC puts out to directors, which at the moment probably tend to concentrate on the law.

**Senator WONG**—You might characterise them as compliance first.

**Mr Dreise**—Certainly a number of things can be brought to the attention of directors. Obviously, there are a number of recent instances of the way some directors have approached their duties resulting in negative consequences. If those instances do not bring to the attention of directors the need to take a broader view of how they approach matters, then I am at a loss to know what will. But, obviously, the more we can provide education, voluntary codes of conduct and a mechanism for advisers of boards to bring to the boards' attention these sorts of issues, then the better. Again, we do not see the way to approach that being through the legal definition of directors' duties.

**Ms BURKE**—Is the current crop of board directors and members up to the standards we require, considering the plethora of boards that exist out there, from tiny not-for-profit corporations to massive corporations? Do you think one of the biggest underlying factors of a lot

of things that have happened recently is that there are a lot of people sitting on boards who do not read their papers and who do not do get the education but who turn up at these meetings? Some of them are not paid, so I am not having a go just at people getting whacking great amounts of money for turning up at meetings and not reading their papers. But we have not emphasised the role and the responsibility of being a member of a board. You keep mentioning education; we have not. That has been your terminology. Do we need to go back to basics with a whole lot of people going onto boards?

**Mr Finnane**—You have mentioned companies large and small. Directors represent if not a cross-section of the community then certainly a cross-section of the business community, from the small suburban motor mechanic to the largest boards in the country. I have no doubt that there are different levels of understanding of what directors' duties entail amongst that range of directors. There is no doubt about it all. One of the mechanisms for informing directors of their duties is the documents that get sent out to all directors when they form a company. That is a good point Mr Dreise made. There may be others. It is important.

**Ms BURKE**—The Fairfax board awarded a massive parting salary at the same time they announced they were going to axe a couple of hundred staff. What stakeholder interest were they representing there? That is a fairly senior board level. We are not talking individuals who should not understand their responsibilities. Again, you would have thought by now that the public attention says to these boards, 'You can't go around paying out millions at the same time as you are about to retrench a whole of staff.' But they seem to do it. I sat through that recent one and thought, 'Haven't we all learnt?' I understand the legalities and that he was entitled to it, but should he have been given that payout, given that it was at the board's discretion to pay it?

**Mr Dreise**—We should recognise that there is quite an onus on board directors. There is a tremendous amount of law they have to take account of. Obviously, in many cases, they have to take the advice of company executives and so on. The question of remuneration and so on is vexed. How do you determine that? What is reasonable and what is not? You have to have some sympathy for the individual board member who has to take account of the law, the views of his colleagues and the material put to him by executives. It is not an easy job. Perhaps boards need to be encouraged to step back a little from the detail of the law or the particular council sometimes and say, 'Is this approach right?' Perhaps that is where ethics come in. It is the sort of thing I am sure the St James Ethics Centre will address.

Somehow or other we have to persuade directors to take that next step—to avoid being just bound up in what the recommendations are, what the remuneration committee is suggesting, and step back and ask, 'Is this right?' That may not be a legal issue, as Mr Finnane says, but perhaps it is an ethical issue. It is certainly one that has been canvassed well and truly in the public domain, and directors, I would have thought, should be aware of it. At the end of the day, they have to take into account matters such as what other people are doing and what other people are paying their executives, and the need to attract the right people to run their companies.

**Mrs Durie**—I am not exactly sure if these figures are correct, but I read some figures recently that said that, of the top 200 ASX listed companies in Australia, the board members are taken from a pool of approximately 250 people. I think, really, this is the big problem and one of the big issues that we are looking at and having to deal with. In a way that ties in with the CLA submission in that, if you clamp down further on directors' duties, you are going to narrow down

that pool even further and then those directors are going to be pushed into making decisions more quickly, without correctly reading their papers, without correctly understanding all of the issues involved. I think that is probably one of the major problems in Australia at the moment.

**CHAIRMAN**—And the duties are too onerous and therefore the positions are unattractive.

**Mrs Durie**—Arguably, the positions are becoming more unattractive as legal duties are increasingly being imposed upon directors. As that pool narrows, there is going to be a greater risk of directors making decisions without being fully informed. I think being fully informed is probably one of the most vital aspects of directors being able to correctly address their duties.

**Mr BOWEN**—I think that is a very good point. But, just to put it in a slightly different way: isn't it equally arguable that, by having a requirement to act in the corporation's best interests, which have been narrowly defined by some companies and by some judges, you are in fact increasing the onus on directors because they are leaving themselves liable to action from a group of shareholders if they act in a way which that group of shareholders does not think fits within that narrow definition of the best interests of the corporation? We talked before about doubt, and I suggested an amendment which would remove doubt. That would be beneficial to directors, I would suggest. For instance, Mr Dreise said some companies interpret the Corporations Law this way while others interpret it that way, saying, 'I would advise them to interpret it this way.' But they are taking a risk whenever they do that, are they not? They are leaving themselves open to that liability. Would it not be better to remove that doubt and remove that potential liability by acting in the broader interests of society instead of that narrow definition of the best interests of their shareholders?

**Mr Armstrong**—I think this also relates to a point Senator Wong made earlier as to what, apart from education, could be done. One of the strands that I hear being presented here is people's excuses for not properly considering the breadth of their duties. So it may be better, particularly if there are good policy considerations that are of concern presently, to say, 'You may take into account the following things'—not necessarily 'must' but 'you may, as part of your director's duties'. We have had a quick look at the CAMAC report just released this month; in that they have extracted proposed clause 156 of the Company Law Reform Bill 2005 of the UK. There are a number of factors listed under subclause 156(3) for directors to take into consideration. There, though, it is presented in the words 'you must'. I think that there is great benefit in perhaps listing those matters and saying 'you may'.

**Senator WONG**—And an indication that they are not intended to exclude any other matters. You would have to say 'would include', 'not exclusively' or something.

**Mr Armstrong**—In a non-exhaustive way, 'you may'. For the record, and having quickly looked at the clause, the matters that are in here are:

... the likely consequences of any decision in the long term ...

I would have thought one would put 'the short, medium and long term' there.

**Senator WONG**—I do not think we need to worry about short and medium.

**Mr Armstrong**—Lawyers tend to read these things that, if they are not in there, there is a reason they are not in there. Companies, employees and contractors are in there as well. They have:

... relationships with suppliers, customers

... ..

the desirability of the company maintaining a reputation for high standards of business conduct ...

but query whether that should be ‘community accepted standards of business conduct’ and contrast that to getting down to enforcement. Directors only have to do what is reasonable of directors. Not every director in Australia is a director who uses high standards of business conduct. There is a spectrum of ability in any walk of life. The last matter they put there is:

... act fairly as between members of the company ...

and one could add to that ‘classes of those members’. That is already a very clear matter that is within well established case law on directors’ duties.

Another educative or practical effect might be the triple bottom line reporting. Directors are there at the pleasure of their shareholders. It is the shareholders’ money that they are looking after. They are not looking after the community generally; they are looking after the shareholders’ money, plus everyone else who is involved in the company as a whole. Clearly, at the moment our annual reporting is done on the basis of dollars and cents. There is no annual reporting at the moment, apart from the recent good corporate governance disclosure requirements of the Stock Exchange, on other matters. It may be for good policy reasons at this time that you wish to require directors to inform the shareholders and, within an ASX context, they are answerable to them. Every three years they are up; they must submit themselves to re-election. It may be that you wish to promote certain areas to be additional matters to be included in annual reports.

The annual reports under part 2M.3 of the Corporations Act are not just financial statements but also directors’ reports. Within that part, there are sections—300 and 300A—that are quite wide in their terms as to the operations of the company on which they have to report and in respect of the financial year the subject of the report. One is seeing companies reporting within that context on wider matters. If there are particular matters that as a matter of policy it is desired the directors must report on then I think that is quite open for this committee to recommend.

**CHAIRMAN**—You would be aware, I assume, of the recent decision in the ASIC case against Rich where it was held that the standard of care expected from a chairman be determined by community expectations. How do you see this within the context of the terms of degree of care and diligence expected under section 181 of the Corporations Act and principle 10 of the Stock Exchange’s corporate governance principles, which requires directors to ‘recognise legal and other obligations to all legitimate stakeholders’? Do you think there is any significance in that particular judgment?

**Mr Finnane**—Are you talking about the reference to community expectations?



**CHAIRMAN**—Yes.

**Mrs Durie**—May I suggest something? The process of triple bottom line reporting, and the stakeholder connection and the stakeholder discussion that results from that, by definition will mean that directors are fully informed with regard to what the community expectations are. It is possible that triple bottom line reporting could actually be used to enable directors to fall easily and clearly into the categories required under section 180, subsection (2), the business judgment rule. One of the major requirements of the business judgment rule is to ensure that a director is fully informed. Triple bottom line reporting will ensure that directors are fully informed about the impacts of their decision upon all stakeholders and, as a consequence, will actually provide a protection. That business judgment rule could provide a protection as long as directors do engage in triple bottom line reporting and can show that they have actually considered all of the matters involved and have made a fully informed decision.

**Mr Finnane**—On the ASIC and Rich point that you asked about, Senator Chapman, I would need an opportunity to address that as a legal question. ASIC and Rich is not a case that involves questions of directors' duties looked at in the broad sense that we have been discussing in part this morning, but I would need to look at that further. Perhaps we could provide a supplementary submission.

**Senator WONG**—You can take that on notice.

**CHAIRMAN**—In relation to your references to triple bottom line reporting, if that is done only on a voluntary basis, where is the consistency between different corporations and different directors?

**Mrs Durie**—We as a task force have not discussed that particular issue, so I can only speak personally with regard to that. Perhaps the direction to take would be more along the line of reporting requirements as opposed to directors' duties with regard to legislative reform or policy consideration. It would be really focusing more on the reporting requirements rather than on actual directors' duties. That is just my personal viewpoint.

**Mr BAKER**—The public perception out there is that total emphasis is placed on profit, as in dollar driven companies. Let me put to you a suggestion that, whether or not it is called an impact study of some of the decisions that some of the companies make, that some of the directors make, as far as a profit perspective is concerned, absolutely, it looks great. But from a social impact perspective, it might be a different outcome. I apologise for being a few minutes late. It is all very well to say: more education, more education, more education. That is wonderful. Now let us have some reality about some actual outcomes. That is from a point of view that social impact studies will channel some of these directors down a line where they actually have to declare and illustrate both sides of the argument, purely from a profit driven perspective. What has changed? I want to jump back a bit to the late 1990s and use AMP as a classic example. You talk about directors' responsibilities. What a debacle is George Trumbull—\$13 million et cetera. We have not really moved on from that perspective.

**Mr Armstrong**—In terms of social impact statements, I would just like to say that many people in relatively humble circumstances in service industries are now directors of their own

companies. I would not like to see a recommendation that they issue social impact statements to themselves as the sole director and sole shareholder in the company.

**Mr BAKER**—I understand that. I am talking about the major corporations.

**Mr Dreise**—Presumably you are talking about major decisions which will affect the company.

**Mr BAKER**—Exactly, yes. We can go around with a legal argument all day and end up nowhere.

**Mr Finnane**—But you are essentially talking about entities that are required to make disclosures under the provisions that Mr Armstrong was talking about earlier, I assume—public companies and other disclosing entities.

**Mr Armstrong**—In that regard, if it is the committee's recommendation to leave it to the ASX to include additional matters in listed public company reports, I would suggest that that is not a preferred outcome. If that is the recommendation that this committee takes forward, it ought to be as a result of the legislature's decision as to what are the matters that are the subject of the report, so that it is a matter of law, not the ASX's discretion in this area.

**Ms BURKE**—I suppose the bottom line is what role government should play in encouraging CSR and what role you as advisers play in then encouraging CSR reporting—changing the terminology to triple bottom line or whatever.

**Senator WONG**—Before you answer that, could I just clarify something. Were you just suggesting that we should be mandating in the law?

**Ms BURKE**—That is what I am trying to say, I suppose, yes.

**Senator WONG**—As opposed to leaving it to the discretion of the ASX as to what would be included in the financial reports.

**Mr Armstrong**—These sorts of matters are not matters for the ASX. The ASX is simply a stock market made up of stockbrokers. I do not say that in a pejorative way, but they are not legislators.

**Ms BURKE**—We can say it in a pejorative way. That is all right; leave that to us.

**Senator WONG**—I would not be recommending that.

**Ms BURKE**—I would not be recommending that either in that case. We started out with you saying that it should be up to government to legislate if you wanted to change directors' duties. I am moving away from that to reporting responsibilities. What do you say on that? Call it triple bottom line, CSR, social impact or whatever.

**Mr Armstrong**—Add another section to section 300A. That is the crisp answer.

**Ms BURKE**—So it should be?

**Mr Armstrong**—Yes.

**Mr Finnane**—It is one way in which the government can, in our submission, appropriately involve itself in this issue. The whole point is to bring the broader interests of the corporation, which include matters coming within what is called ‘corporate social responsibility’, into the public forum to a greater extent than they already are—education, disclosure. Government has a role in that. Interest groups, environmental lobby groups and so on have a role in all of that as well.

**Mr Armstrong**—Mr Baker, just for your benefit, 300A deals only with listed companies, so there is already a distinction drawn between section 300, of general application, and section 300A, of application to listed companies.

**CHAIRMAN**—If we are to move to triple bottom line reporting, whether it be mandatory or voluntary, do we need a standardised system of reporting? If so, what elements should be part of that?

**Mrs Durie**—There are a vast number of standardised triple bottom line reporting measures—the global reporting index, for instance.

**CHAIRMAN**—That shows there is no real standard, doesn’t it—if there is a vast number of them?

**Mrs Durie**—Currently that is right. Currently the whole area is in a state of flux. Basically you would have to choose one and choose which is going to have the most disclosure—but from a reasonable point of view; it still has to be weighed up with regard to resources and the input of different stakeholders.

**Mr Armstrong**—May I also make a suggestion. This is just on the run. In terms of requirements for listed companies, one ought not to forget that very material business activities happen through unlisted subsidiaries in Australia—Australian incorporated unlisted companies and also Australian subsidiaries of foreign companies.

**Senator WONG**—And? I am sorry, there seemed to be a pregnant pause at the end of the sentence.

**Mr Armstrong**—Accordingly, if the specification here is for listed companies and they are targeted because they are perceived to be of a certain weight, size, influence and need to be regulated, then please consider two other entities of similar weight, size and influence and need to be regulated.

**Ms BURKE**—To go that far, would there be some economic advantage to unlisted companies?

**Mr Armstrong**—There are benefits and there are debt rights.

**Ms BURKE**—No, if they did not have to report these things.

**Mr Finnane**—That would depend on how onerous the reporting requirement is, I guess. With larger corporations, I am sure they could readily absorb it as a minor expense.

**Mrs Durie**—To overcome that particular issue, perhaps the triple bottom line reporting concept, or the CSR reporting concept, could be brought into play with regard to families of companies, so the family itself has to engage in that form of reporting so that there is no risk of subsidiaries hiding within their unlisted status and not having to report.

**Mr Armstrong**—If one were to regulate foreign companies in this regard, perhaps there would be some benefit in identifying a particular set of guidelines that do have some recognition quite widely.

**Mr BAKER**—To follow up on the point I did not finish about AMP: we had the debacle where the share price went from around \$22, \$23 or \$24 down to \$5 and it has bounced tremendously up to \$7. You talk about corporate responsibilities to shareholders, yet the directors still took their enormous amounts of money.

**Mr Armstrong**—I have two comments on that. Firstly, the AMP board today does not look like it did then. I am not quite sure, but perhaps that is to every man and to every woman. Secondly, there is regulation under the Corporations Act as to excessive retirement benefits. If there is concern in that regard, then they ought to be considered and amended.

**Mr BAKER**—We were talking about social impact. I totally agree that we operate in an open market economy—I have no problems with that—but then you take the McDonald's decision to take half a contract to New Zealand, an open market economy, for the sake of 0.01c per package of French fries.

**Mr Armstrong**—That is a decision they have made. You and I may make that decision.

**Mr BAKER**—I am talking about the social impact. You can go round and round in circles on education, but that is where, if there was a more direct approach from a legal perspective, they had an obligation to disclose and to investigate.

**Mr Finnane**—Could I address—

**Mr BAKER**—We are talking about the public perspective here, not the legal owner.

**Mr Finnane**—I just want to address the issue of termination payments. I think that is a whole separate topic for an inquiry; I do not want to go too much into that. One of the key groups of stakeholders that people often talk about is employees. As I see it, one of the dangers of saying that directors can take into account the interests of stakeholders, including employees, at the expense of the company and in a way that may not promote the interests of the company, is that directors may use that as an excuse where they have paid an excessive termination benefit to an employee, namely, a senior executive—a chief executive officer or whoever. That really is just one example of the sort of danger you get into by making modifications to directors' duties. I realise that we have tried to steer onto another topic, but I thought I would raise that, given that you made reference to that issue.

**Mr Armstrong**—To address the McDonald's matter, people are going to make those decisions one way or another. That does not sound to me to be good for the Australian economy. I would not have done anything if I were sitting in that position, but that is not for me to say. I do not know whether it is for government to say that you must make that decision another way.

**Mr BAKER**—But if they have got some form of obligation as far as social impact studies and that sort—

**Mr Armstrong**—They may lose some custom, I do not know.

**Senator WONG**—On the suggestion that we could apply reporting requirements to families of companies—there are a number of thorny legal issues about how you would go about doing that; I am happy for you to take it on notice—I am not clear what definition you suggest we use or what approach you would use. Would you use the related party provisions? Do you know what I am saying? I am not clear about how that would actually be instructed. It might be a bit more technical than you want to deal with now.

**Mr Armstrong**—I suppose to add to the efficiency of the reporting—because you would not want to have a corporate group for one purpose, for an accountant purpose—it would be the same group.

**Ms BURKE**—What if it is not part of the group and is just an unlisted company? There are some stand-alone policy issues.

**Senator WONG**—That is a different policy issue.

**Ms BURKE**—I know it is a different thing.

**Mr Armstrong**—I understand families can be of one person these days.

**Ms BURKE**—Okay.

**Senator WONG**—Are you able to clarify that? I think there was one other issue you took on notice.

**Mr Finnane**—The other issue was the ASIC and Rich community expectations—

**Senator WONG**—Yes. Can you clarify precisely what you mean?

**Ms BURKE**—We will provide you with a written request, so do not worry about it.

**Mr Armstrong**—I would appreciate that.

**Senator WONG**—Do we do that?

**Ms BURKE**—Yes, we will come down from—

**Senator WONG**—Does Anthony do that?

**Ms BURKE**—Can't we just take it from what we have got? We can give them *Hansard*, can't we?

**Senator WONG**—I was being—

**Ms BURKE**—She is being mean; ignore her.

**Mr Finnane**—I am afraid we cannot.

**Senator WONG**—I have been on committees a lot the last week and a half.

**CHAIRMAN**—Order!

**Senator WONG**—I am asking for a clear suggestion, if you are able, about how you would actually apply it to families of companies.

**Mr Armstrong**—I am happy to clearly suggest that it—

**Senator WONG**—I appreciate that.

**CHAIRMAN**—As there are no further questions, thanks to each of you for appearing before the committee and for your contributions to our inquiry.

[9.33 am]

**LONGSTAFF, Dr Simon Allen, Executive Director, St James Ethics Centre**

**CHAIRMAN**—Welcome. We have before us your submission, which we have numbered 50. Are there any alterations or additions you want to make to the written submission?

**Dr Longstaff**—No.

**CHAIRMAN**—I invite you to make an opening statement.

**Dr Longstaff**—I will be fairly brief. It is fairly self-evident what the submission has to say. The thing I would highlight is that, whatever one thinks about the exact state of the law in relation to directors' duties at present, there are a number of people, including company directors, who have the belief that, even if they were inclined to do something which was ethically required of them, they may nonetheless be bound not to do so because of the way the law operates at present. That is perhaps only a matter of perception; nonetheless, it is true to say that individuals in company boardrooms around Australia find themselves feeling at risk of being sued by shareholders, whether in Australia or overseas, because of the belief that they may have acted in a way which is contrary to the specific interests of shareholders at a particular point in time.

In our submission we try to address that question by looking at some fundamental issues around the privilege of limited liability and what flows from that. It is an extraordinary privilege which I think has been taken for granted now for a considerable amount of time without understanding the proper purposes for which it was enacted. I think we have proposed perhaps the most significant idea within the submission as a whole: that, if there are bona fide ethical reasons for acting in a manner which may be judged by some shareholders to be against their interests, there be some protection afforded by the law, the equivalent of the business judgment rule; an ethical safe harbour—that, if directors had followed a proper process and it was an argument that a reasonable person would recognise as being a genuine ethical position, there be some protection afforded on that basis. That is all I really want to say. The rest of it is fairly straightforward. I would be happy to respond to any questions.

**CHAIRMAN**—In your submission you envisage an ethical judgment rule. Can you characterise the poor corporate conduct to which that would be applicable?

**Dr Longstaff**—I am not sure that I understand the question. Do you mean: can I tell you the sort of thing where an ethical judgment might be inconsistent with what the law is thought to hold at the moment?

**CHAIRMAN**—Yes, let us take a case. You say this rule should afford protection to directors from liability, even when its use has a detrimental effect on the financial interests of the company as a whole.

**Dr Longstaff**—Yes. It could be argued that, in the case of a situation like that faced by James Hardie, there was a clear ethical argument to be made about making early and adequate provision for those persons who had suffered as a result of the company's practices in the past. It also could have been argued that some shareholders would have put the case that for the company to do that at an early stage and to an adequate level would have been against their interests if, instead, they could have taken advantage of some legal provision to avoid the full ethical consequences of what they had done. In other words, if the company had been asked by its shareholders to do no more and no less than the law specifically required of them, they might have done still too little from an ethical perspective. What we have proposed is that, in circumstances where there are bona fide ethical reasons for acting in a particular manner, there should be some protection afforded to directors against claims made by some shareholders that, in acting ethically, they had in some sense deprived the shareholder of a good that they would otherwise have wished to enjoy.

**CHAIRMAN**—Do you believe or not believe that the current provisions of the Corporations Act allow directors to rely on ethical considerations in decision making?

**Dr Longstaff**—I honestly do not know. I am not a lawyer. All I can tell you is that there are plenty of directors out there who think that it does not allow them to take account of ethical considerations if to do so would be inconsistent, at some point, with the interests of the company as a whole, which they often translate as the interests of shareholders. Their concern is not so much about whether or not that is what the law actually allows or does not allow. They stand in some dread of being sued by shareholders who claim that their interests have not been served and therefore I think would benefit from some degree of protection to make it clear that they can bring bona fide ethical considerations to bear in their decision making.

**CHAIRMAN**—Would your proposal draw a clear distinction between decisions made, if you like, on ethical grounds alone and those decisions which were ethical but nevertheless in the long-term or even the short-term financial interests of the company and therefore the shareholders?

**Dr Longstaff**—Yes, I am wanting to make that distinction. It is argued by people that good ethics equal good business and that you can rely upon the fact that companies acting in the interests of the company as a whole will always take into account ethical considerations and will always act in a manner they themselves require by those considerations. But there is absolutely no reason to believe that that is the way the world operates always. There will be times when taking an ethical stance is not in the interests of the company as a whole if you take that to mean the interests of shareholders and particularly their financial interests. On that basis I think you have to make some kind of a distinction in order to allow that extra judgment to be made without fear of being sued for doing so. The main thing you have to do is make sure it is not another thing which is gamed to some degree. It has to be a proper process and there have to be bona fide reasons.

**Ms BURKE**—Do we leave ourselves exposed by the definition of an ethical decision? I know you have written on this at length.

**Dr Longstaff**—Even so, it is a hard thing. A really tough ethical choice is not a right versus wrong, good versus bad sort of thing; it is right versus right or good versus good. When we are



in a genuine dilemma, we always have to balance competing goods of some kind. I do not quite know how to do it. You will have a better idea, if you thought this was an interesting idea, about how to give it legislative effect. It seems to me that two general principles are that, firstly, the process by which the decision making relied upon some kind of ethical consideration would have to be transparent and meet some kind of standard of reasonableness and, secondly, the reasons themselves would have to pass some kind of test of what a reasonable person would recognise as a genuine ethical argument. You would look at the degree of mischief that was involved, the kinds of considerations that were taken into account and the sort of information which was brought to bear. There are frameworks for ethical decision making which are not that difficult to outline or apply. I think you could do it, and I imagine it would be an exceptional circumstance rather than being thought through as part of the day-to-day decision making. If you go back and look at what corporations were initially established to be and some of these extraordinary privileges, it is not unreasonable to expect that decision making to be made and to therefore afford some protection.

**CHAIRMAN**—Some would argue that it is not the role of the Corporations Act to impose legal or other obligations or guidelines on corporations that do not apply equally to individual citizens. What is your view on that?

**Dr Longstaff**—Firstly, what we have just been talking about is not imposing additional obligations; it is providing some kind of protection. With this business about the relative obligations of corporations versus, say, natural persons, it is difficult for me to be absolutely certain what is being said. Sometimes I hear people say that corporations should be treated no differently in the obligations they have from those which would be applied to natural persons. Sometimes I hear exactly the same people saying that some of the obligations applying to natural persons—like in relation to things like manslaughter—should never be applied to corporations. It is very difficult to know what the consistent position is in relation to this. Maybe there is not one; maybe it is a case-by-case situation where you have to say, in particular cases, given the nature of the institutional setting within which corporations operate—including, as I say, the important privileges that shareholders enjoy—there are certain matters where there ought to be a distinction made in how the law applies.

**CHAIRMAN**—Is there a danger that your proposed ethical judgment rule could be used by directors as an excuse or defence against showing poor business judgment?

**Dr Longstaff**—Yes, there is a danger of that, and that is why I think about the development of standards for the process employed by people. I have some faith in the fact that, although you cannot always specify with absolute precision what things are in law, people have a good capacity to tell when something is or is not something. I think a principles based approach often works. There are others who like the absolute certainty that a black-letter law approach with absolute precision can apparently provide. I think it is a bit illusory, to be honest. Often, if you rely on that process, there are points where the law stops and it introduces unhelpful degrees of uncertainty. I think that it invites a certain kind of game playing with it. It is possible to develop principles. I would be happy to rely on the fact that, if somebody was just trying it on and saying, ‘We made a hopeless decision but we are going to pretend it was an ethical decision,’ they would be exposed. One of the things you would want to do is ensure that they were not retrospectively trying to justify it. If such a provision was introduced into law to afford this kind of protection, it would have to be for decisions made at the time, where you could see the

process of decision making going on as the decision was being made, and not something which is introduced after the event.

**Ms BURKE**—Therefore, on top of director's duty—as you go onto in your submission—you would have to be talking about reporting as well so that you have a set of standards of reporting that also go back to the ethical decisions. You would say in the report somewhere that board minutes would indicate that you made this decision, but your reporting would also indicate why you made these decisions and the things you were doing.

**Dr Longstaff**—If you are going to rely on it, yes. It is not going to be every decision. There are going to be a huge number of decisions—in fact, the vast majority of them—where you do not see them sitting down and looking at this. Personally, I think a good principle of governance is that when boards are making decisions and management are creating board papers, as a matter of good practice, they ought to include some statement about the ethical implications of what they do. There are lots of implications in board papers. I do not know if you have ever looked closely at their structure, but there will be something about financial implications, risk management and all the rest. It is a useful practice if management says: 'This is what we say our values and principles are. This is what they actually mean in practice if you make this decision on applying capital or this strategic decision.' Then a board would consider that.

But I would not mandate in law to say that it must happen all the time. All I would say is that, if you reach a critical junction in your decision making and if you have to make a genuine ethical decision, and you feel that it may not actually be particularly in the financial interests of shareholders at that point in time, or even in perpetuity, from the moment you start thinking you should be recording that process and have it available if you rely upon it at some point in the future.

**Mr BOWEN**—Firstly, Mr Longstaff, can I just say that I think your submission is very helpful to the committee and it is very well argued. I just want to be devil's advocate for a moment.

**Dr Longstaff**—Please. I am a philosopher.

**Senator WONG**—It is bread and butter.

**Mr BOWEN**—There is one philosopher in the room! The committee put to the people who made the last submission that it might be helpful to remove doubt and to stop directors being sued if they took a wider view of their obligations as opposed to a narrow view of the shareholders. I want to take you to an example to make my point. As I say, this is a devil's advocate point. If there was an Australian company investing overseas and that overseas nation—Papua New Guinea, for example—had taken a deliberate decision to have very lax environmental rules to encourage foreign investment into it and that Australian company complied with all the laws in Papua New Guinea but was clearly acting in a pretty environmentally reckless way, would your submission—if the committee and the parliament were to adopt it—open them up for liability in Australia so that somebody could take action against them and say, 'Look, you're clearly not complying with the wider interests of society'?

**Dr Longstaff**—No, it would not.

**Mr BOWEN**—Therefore, are we interfering with the sovereign rights of other nations to want to attract foreign investment and therefore to reduce their requirements on environmental and a whole heap of other grounds?

**Dr Longstaff**—No. Our submission would not have that effect. What we have argued, firstly, is that boards of directors should be required to take into account the interests of a wider group of stakeholders. You will see in the submission that we have defined what a stakeholder is in a way that makes it a relevant consideration, because they contribute to the prosperity of the corporation. It is not inconsistent in this definition with the generally accepted purpose of a corporation. But we have not said that directors should be required to decide on that basis. What I find a slightly mischievous situation at the moment is that there are some boardrooms where they will say, ‘Certain groups of people are required to be ethically invisible in our considerations.’ I want them at least to have their voices at the table so that they are making an informed decision rather than pretending they live in an artificial world where the only real people are their shareholders or others who have specified legal rights.

What our submission would do instead is to say that, if a company in those circumstances decided to apply a higher standard on environmental or occupational health and safety standards than would be strictly required by the law in, say, Papua New Guinea, and if they did so on serious ethical grounds, not just because they thought it was a good long-term decision for their business—which it may also be, but not necessarily so—and if they were then sued by some group of shareholders who said, ‘What are you doing applying higher standards than you are strictly required to do?’ then in those circumstances they would be able to rely on a defence for doing so. So it does not cross on that basis against the firm focus of decision making, nor does it cross against the sovereign rights of nations to determine standards if they want to do so.

**Senator WONG**—I will be devil’s advocate again, Dr Longstaff. You made a very good point in your submission—it is a very interesting phrase, actually—when you said:

... an over-reliance on regulation ... can inadvertently weaken the ethical sinews of society.

I have some sympathy for that because I think, in some ways, from a policy maker’s perspective, you have to weigh up the importance of trying to get community standards observed in various areas, which may require compliance with various ‘boxes’ of regulation—people always talk about ‘ticking the box’—but, on the other hand, you are trying to inculcate a culture of a certain ethical approach. I suppose my concern about what you are suggesting—and I understand the distinction you are making about requirement and entitlement to take into account these issues in decision making—is that it may itself lead to a kind of process based compliance approach. In other words, it is saying, ‘We’d better have a look at these issues in terms of the actual deliberations of the board,’ so the focus is on the process of deliberation rather than the outcome. From what I understood, I think Mr Bowen was trying to tease out from you whether we should instead be trying to say: ‘Directors are entitled to look at these issues. They are entitled to take these into account.’

**Dr Longstaff**—I think that is effectively what I have been saying: they are entitled to and they will be afforded some protection against the assumptions of how the law currently operates by making it clear in the legislation that, if they do so, it is not appropriate to sue them for doing

that. But, on your point, if you have a proper understanding of ethical decision making, it is very hard to see how that could be reduced to just ticking a box. There is a certain quality of it.

**Senator WONG**—I agree with you, but I am not sure that that is something one can encapsulate or attain through a legal change.

**Dr Longstaff**—Not by itself, but the law can be permissive in that sense, and it can create the possibility then that better practices can be developed over time. If a court at some point—and I would say that it will be extremely rare—is going to scrutinise what a board have done in relation to this, if they sought to rely upon principle as a defence, then the court will be mindful of the standards that might reasonably be expected of the person. If it has just been a ‘tick the box’ formal response, I do not think that is going to meet the standards a court would apply.

**Senator WONG**—Do you have any additional suggestion about the ‘carrot’ you propose, which is some regulatory relief? You are suggesting that the CRI be utilised. As I understand what you are saying, if you get to a certain point then you might be entitled to some sort of relief as a ‘carrot’ to try and encourage this sort of behaviour. If you do not have any additional suggestion, that is fine; I just wondered if you had anything you wanted to tell me.

**Dr Longstaff**—They are only provisional thoughts. There are other regimes which I understand to operate. For example, in Victoria, the Environment Protection Authority will not be as focused on a particular company’s operations if one of the things it can take notice of is a long record—I think it is something like a five-year record—of achieving a very high standard around environmental audits that it has done. Governments and particularly their regulatory agencies do not have unlimited budgets, and they have to make prudent decisions about where they focus their attention. We are saying that one of the things they might take account of is that, if they have a very high level of performance in an instrument like the Corporate Responsibility Index, it is indicative of there being a safer climate in which they operate.

**Senator WONG**—You make the point that the CRI provides a powerful tool for encouraging a change in culture, and I would agree with you. What role do you see government having in trying to encourage the utilisation of the tool?

**Dr Longstaff**—I think there is a range of things that governments can do. One of the things they can do is to lend their in-principle support to the kind of voluntary tool that this is. There is a whole range of things that they can do. Some people in the commercial sector, for example, link their purchasing decisions to the way in which companies participate and how they perform and things of that kind. It is becoming increasingly common now, within the commercial sector, for the supply chain management process to look not just at price but also at whether or not the suppliers have some kind of alignment when it comes to their ethical commitments and to their performance in a range of conditions. BHP Billiton and Westpac are just two that I know of that do this. It is not just in terms of hard things; they even put these things to providers of services, like law firms—that they try and get an appropriate alignment. So government has a significant place in the marketplace. It can encourage involvement in these things through its purchasing processes. It can do so through the kind of regulatory framework that it brings to bear. I am sure there are other things to be done that are better thought through by others.

**Ms BURKE**—Following on from that, I refer to that bit of reporting, around the time that the 2004 CRI came out, on the gap between the rhetoric and the practicality, the rhetoric and the reality. We came up with the lovely phrase ‘greenwashing’ to describe that. I have dealt with some of these corporations in another life and seen what they put down on paper and what they actually do. Is there a difficulty in matching what they say and what then transpires, especially if people are then making ethical investment choices based on this information? How do you marry that up?

**Mr BOWEN**—Who audits the triple bottom line?

**Ms BURKE**—Yes, who audits the triple bottom line?

**Dr Longstaff**—That is probably one of the strongest things about the process that we have in place. Its great strengths are: it is voluntary, so you make your own choice as to whether you want to do that and secure the benefits, whatever they happen to be; it is international and it uses things like the Global Reporting Initiative as, if you like, the architecture on which it has been built; and it has been designed principally to provide first-rate information to management and to boards so they can improve their performance—that was the genesis of the instrument. But the really important point, which comes to your question, is that it is independently and professionally validated. So a company may make certain claims about what it is doing or what it is not doing, but it is not enough for them merely to assert these things—they have to be able to provide evidence and be subjected to the scrutiny of an assurance process in which people will, in a certain number of cases, go out and, as they say, kick the tyres.

I should say that, at the ethics centre, we do not actually measure or evaluate anyone. We are just a trustee for the process. We have tried to keep clear of all of those things. But in terms of the integrity of the process, I have seen examples where companies have tried to make an assertion which has not been supported by the evidence and they have been marked down. I have also seen cases where companies have underplayed their achievements and they have been marked up, in certain cases. So if this were to develop, as I would hope it might do in time, to be a major instrument that is providing market information on which people rely and which regulators pay attention to—it may have some differential, as I say, in the regulatory approach from a very prescriptive approach for those who do not do these things to a more principle based approach for those who do and do them well—and if this were to grow, then I think this would be a good basis for trying to increase not only the performance of the business world but also the public confidence that might be extended from the community to business.

**Ms BURKE**—So you believe that it should continue, if you go down this reporting route, on a voluntary basis, as opposed to us making a prescriptive legislative requirement for people to do this?

**Dr Longstaff**—Yes, I do. But I would have parliament, on the one hand, and government, on the other—parliament through its legislative framework and government through its other activities—as the executive, providing incentives for doing so. There is a range of things that can be done. But I think that will lead to the most robust outcome that I could hope for in terms of the way that business operates in this area.

**Senator WONG**—What incentives are you talking about?

**Dr Longstaff**—The prospect of some kind of relief is one. There are other things. This is a bit beyond the brief, and people in Treasury would probably not like it, but you could even consider at some point in due course something like a community credit that is paid through the shareholders, much as there are franking credits, on the basis that typically companies that perform at the highest levels in terms of their corporate responsibility tend to be more successful over the longer term—at least, that is what the Australian research shows—and probably represent lower risks to the community and therefore make a net saving. You may even consider a budget neutral situation in which there is some kind of financial benefit that flows to shareholders that support companies of that kind. That is something where it needs a huge amount of work to see whether it would actually operate, but you could contemplate something like that down the track.

**Senator WONG**—Any other incentives?

**Dr Longstaff**—Not that I can think of off the top of my head.

**Ms BURKE**—I think that 26 originally participated and then six withdrew. Were any reasons given for that and has there been a greater take-up rate going forward?

**Dr Longstaff**—In relation to the reason that six withdrew, I know exactly why they did that. When we introduced the first round in Australia, we wanted to give Australian companies an opportunity to participate in this program before they went online on the international scale and started to compete against companies that had done this process for much longer. That meant that, instead of having the usual 12-month cycle, we had to reduce it to six to bring it into alignment with the UK. Those six companies said, ‘We’ve just done it. Why would we want to do it again?’

But you raise a bigger question. The take-up in Australia has been really slow. When you think about it—it was a tool that was initially developed by business for business and it is free—you would ask why. The major reason, we are told, is to do with a resource constraint within companies in the first year in which they do this. It is not actually doing it; it is the data assembly which is costly and time consuming. Although the proportionate capacity of business to do that grows as the company becomes larger, so does the span of issues that it has to deal with. It is a problem there.

The good thing about it is that, under the process, in year 2, year 3 and subsequently, it is also possible to reduce all of that work by around two-thirds, as we have been told by companies that have been doing this for a while, because the data from one year to another are rolled over on the system. Then you only have to deal with any material change that takes place within the index as a result of changes that we put through as a result of a consultative process involving NGOs and business and flowing through with our partners in the UK and Japan.

So it becomes sustainable after that, but it is that first-year hurdle—plus the fact that there are some really silly ideas in some companies in Australia. They say, ‘What’s the point of reporting it? We are just doing it.’ They would never say that about financial reporting. They would never say, ‘Oh, we’re just running a company; we don’t have to make financial accounts.’ They come up with absolute nonsense from time to time.

**Ms BURKE**—Do you think that is because currently, unlike in the UK, there is not shareholder pressure to do it and there is not shareholder activism to look at this as to where to invest.

**Dr Longstaff**—It is growing. Maybe there is not at the moment, but it is changing very significantly in the UK. The Association of British Insurers, which has about 28 per cent of the UK stock market shares, really focuses on this. It has a process in which it has collective engagement with companies so that analysts from large funds pool their questions and focus on these issues. The Ethical Investment Association, which is talking to you later today, will talk about the way in which it is looking at dealing with these issues as well. Mercer recently—in about July this year—released a report in which they predicted, on the basis of the surveys they have done with major fund managers around the world, that within about 10 years there will not be things called ethical investment funds as such. This will become so mainstream that every investor will be looking for it. I would like to think that Australia would be at the leading edge of the curve on this. Our best companies are, but too many of our companies simply do not engage with the issues.

**Senator WONG**—Would you be prepared to take a question on notice? If you have anything to add in terms of more thinking on what incentives parliament could provide, we would be grateful to receive that.

**Dr Longstaff**—Okay.

**Senator BRANDIS**—I am sorry that I came in late. I had to come down from Brisbane this morning.

**Dr Longstaff**—A different time zone.

**Senator BRANDIS**—Yes. I want to ask a practical question about how your proposal would work. As I understand it, you say that, if a board or a company were sued by its shareholders for a particular decision, it could plead in defence to a claim that their interests had not been sufficiently considered, that it had considered the interests of other third parties and made that decision in an ethically supportable manner, and that would be a defence to that action. Is that right?

**Dr Longstaff**—No, that is not quite right.

**Senator BRANDIS**—Is that in practice what you mean?

**Dr Longstaff**—It is not quite that. In cases where they were to make a bona fide ethical decision, it would not be tied to the condition that they had taken into account the interests of others; it would simply be that they had made a bona fide ethical decision. It is almost impossible to consider how that could occur without taking into account the interests of others, but it would not be tied to it.

**Senator BRANDIS**—Given that they have fiduciary obligations to their shareholders, any decision that was not in the interests of their shareholders would presumably have to be a decision that was in the interests of a non-shareholder third party.

**Dr Longstaff**—Absolutely. As a matter of logic, it would, but I would not express it in the law in that sense. That is absolutely right, but I would not legislate it in that way. What I would do is say—

**Senator BRANDIS**—That is how it works.

**Dr Longstaff**—Yes, that is how it works. You are sitting at the board table at the time and you say, ‘We have got a decision to make now where we as a board believe’—if this is what they do believe—‘that we are ethically obliged to do something which we foresee may not be in the interests of the shareholders today and possibly not in the future.’ In practical terms they would be saying, ‘That’s all pretty academic. The fact of the matter is that, whatever we do, there is going to be a group that may sue us today because they say their immediate interests are not being satisfied.’ What I would say in practice—

**Senator BRANDIS**—So it is about ranking third-party interests ahead of shareholders’ interests in certain defined circumstances.

**Dr Longstaff**—But it is particularly looking at ranking them ahead of those shareholders who do not accept that the duty of a director to a company as a whole means a duty to shareholders in perpetuity. Talking of practice now, there are some who say, ‘Look, what you did cost me X dollars today, and I am going to sue you.’ It is to provide protection against that.

**Senator BRANDIS**—In other words, against shareholders who would want to protect their orthodox rights under the law as it now stands.

**Dr Longstaff**—You would know better than I what the law actually says and what it means in relation to the duty of a company as a whole—whether that means shareholders today or the position that Sir John Dunlop put, that it is to shareholders in perpetuity. In practice, though, shareholders can say that it is to them today.

**Senator BRANDIS**—I understand your argument, but I have a difficulty with it. Courts adopt what is called the business judgment rule. Whenever there is a dispute with shareholders in which the shareholders attempt to go behind the board’s decision and say that something was a negligent decision, a decision made in bad faith or otherwise in breach of a fiduciary duty, cognisable under the law at present, the courts will say—I am putting this in loose laymen’s terms—that, unless there is a clearly demonstrated breach of duty, they will not second-guess the board’s business judgment. That is the current law.

**Dr Longstaff**—Yes.

**Senator BRANDIS**—What I am struggling to see is that, if courts will not even second-guess commercial judgments, which presumably can be empirically tested to some level, how on earth are they going to be able to sit in judgment on whether or not a decision is ethically supportable—when ethical propositions, I am sure you would agree with me, are even more contestable than legal propositions?

**Dr Longstaff**—I had in mind, as I put in the submission, that they would first of all have regard to the quality of the process rather than the substance of the decision.



**Senator BRANDIS**—Let us say the process is pure.

**Dr Longstaff**—If the process is pure, I do not see the courts trying to go behind the decision, except to reach a view as to whether or not a reasonable person would recognise this as a bone fide ethical argument as opposed to just a piece of self-interested rationalisation of conduct that they would otherwise have wanted to do for different reasons.

**Senator BRANDIS**—I spent several years of my life practising this sort of stuff before the courts, and now I say that the courts are about the least suitable beasts I can think of to draw a distinction between what is a rationalisation of an ethical argument and what is a bona fide ethical argument. I might have confidence in someone like you to do that, but not the senior lawyers who constitute the courts.

**Dr Longstaff**—I think it would be no bad thing if the senior lawyers who constitute the courts developed that skill set. The trouble with not doing anything about this is that we are left in a situation in which companies and company directors may feel themselves obliged to do great evil—in the objective sense; I am not talking about evil people—

**Senator BRANDIS**—Give me an example.

**Dr Longstaff**—I talked in the press about this, and again I make the distinction as clearly as I can. I am not talking about the individuals who made the decisions being evil, but the thing that they did was objectively evil. To seek to profit knowingly from circumstances in which people were going to be condemned to a possible death of the terrible kind that follows from asbestosis and mesothelioma is objectively evil. I do not believe that any organisation constituted by society, as corporations are under the law, should be operating in a condition in which people feel themselves required to make that decision because they think that, for some reason or other—and you can question their judgment—that is ultimately what shareholders would require them to do, as that is how the duty operates. I think we as a society have to address that issue and face up to the fact that not everything that is profitable, not everything that might generate long-term commercial success, is always going to be ethically appropriate. I want to provide some mechanism—and you guys probably have a better way of doing it than I have come up with—so that, if you are sitting in a boardroom and in all good conscience you think that what you are doing is wrong, you should be able to make that decision and not be sued for doing so.

**Senator BRANDIS**—I understand the argument—

**Dr Longstaff**—If you can come up with a better way, fine; but that is the objective.

**Senator BRANDIS**—but I do fear—and I think somebody may have said this in an earlier question—there is tremendous risk of abuse of that defence to shield ulterior purposes. Do you acknowledge that?

**Dr Longstaff**—I accept that somebody may be inclined to try and do that. I am not a lawyer or a parliamentary draftsman. The question is: is it possible in principle to have a system in which the protection is afforded and somebody can make a reasonable judgment about whether or not it is an abuse? I think it is. I think we are capable within our normal judgment of telling

the difference between these things. How you can then give that some kind of legal effect, I do not know, but I do think it is possible, and therefore it is worth attempting.

**Senator WONG**—Whilst I have some sympathy for the position Senator Brandis just put about the potential for it being misused—

**Dr Longstaff**—I am sympathetic too, but I do not think it is beyond our capacity as a society to address that.

**Senator WONG**—That is an issue for discussion, but the point that you are making is that there is potential for great mischief demonstrably from directors taking and articulating an extremely narrow view of what their current duties are, as evinced in the James Hardie matter.

**Senator BRANDIS**—Is that your point, Dr Longstaff?

**Dr Longstaff**—Yes. I do not want to tie it to that particular case. I see it around talking to all sorts of people, including company directors. They sometimes say, ‘We feel ourselves compelled because of the legal obligation.’ They want to tie it to the long-term interests of the company, and they will try and find a way to do that, but a lot of them also now feel very nervous about the cost and difficulty of being sued.

**Senator BRANDIS**—That is true, and it raises the real risk of what you might call a seamless web of obligations for the entire community. At the moment, company directors are subject to more regulation and legal exposure than has ever been the case before. Courts interpret the general fiduciary duties on the company directors more tightly than has hitherto been the case. There are more stipulations in the Corporations Act itself than was hitherto the case. There are more searching accounting standards. There are more searching environmental requirements, and there are more on the way. There are more stipulations in relation to trading in securities and in relation to market behaviour than was hitherto the case. The courts are developing new doctrines to identify new classes of interest that were never recognised before—famously, fairly recently, was the development of the notion of a duty to creditors. The point I am making to you, Dr Longstaff, is that there has never been a time when directors and senior officers of corporations were exposed to more extensive duties than there are at the minute. These things have externalities, and I do have a concern that your proposal would have the effect of subjecting them to a seamless web of obligations to anyone.

**Dr Longstaff**—I may not have been clear in the submission, but I tried to make it as clear as I could: we are not suggesting the imposition of any new duty.

**Senator BRANDIS**—No, I understand that.

**Dr Longstaff**—What we are saying is that there should not be an extension of an obligation to decide, on the basis of obligations to other groups, that you should take account of them. That is the first thing we have said: you must consider them. But we have said that, if you do, you should be protected. I accept what you are saying. I am deeply sceptical about the effects of too much regulation, not because of the economic costs but because I think it really does weaken the ability of a society to operate on the basis that people and organisations take responsibility for what they do. There are too many people who say, ‘If it’s not illegal, it’s not wrong.’ That is the

absolute standard. They have reduced it to that compliance. You do not want to talk to somebody like Doreen McBarnet, a lawyer and professor from the University of Oxford, who has looked at about 97 per cent of the things that take place in companies like Enron and says they are arguably legal. But you have brilliant people who come together, sometimes from your profession, who are able to generate the most extraordinary mechanisms to defeat the intention of the legislature and others through the use of loopholes. I would much rather have a principles based approach but, in this case, rather than adding to the burden upon directors I am wanting to provide some protection for them.

**Senator BRANDIS**—I understand that, and that is I why I think, if I may say so, the limited focus of your submission is the core of its attraction.

**CHAIRMAN**—As there are no further questions, Dr Longstaff, thank you for your appearance before the committee and for your contribution to our inquiry.

**Dr Longstaff**—Thank you.

**Proceedings suspended from 10.18 am to 10.28 am**

**O'HALLORAN, Ms Louise, Executive Director, Ethical Investment Association**

**CHAIRMAN**—Welcome. We have your written submission, which is numbered 105. Do you wish to make any alterations or amendments to your submission?

**Ms O'Halloran**—No.

**CHAIRMAN**—I now invite you to make an opening statement, at the conclusion of which we will have some questions.

**Ms O'Halloran**—I would like to explain who the Ethical Investment Association is and then frame the importance of corporate social responsibility in that context and from that perspective. The Ethical Investment Association is Australia's peak industry body for professionals working in the area of sustainable responsible investment—and I will use the terminology 'SRI', which is interchangeably used with 'ethical investment'. Like most professional peak organisations, the EIA is involved in research, training, raising awareness about SRI and the establishment and promotion of professional standards.

The EIA assist individuals and organisations to learn more about how they can become sustainable and responsible investors, and we also encourage mainstream analysts to take environmental, social and governance issues into account in the valuation of companies. Our members are the fund managers, the financial advisers, the dealer groups and the superannuation funds that offer sustainable responsible investment products and services.

The EIA believes that organisational decision makers need to adequately balance the interests of shareholders, internal stakeholders and external stakeholders. Equally, the EIA also believes that if directors take a more balanced view of their company's stakeholders, they will be better able to manage the risks, the uncertainties and also the opportunities of their business. A company's ability to manage its risks, its opportunities and uncertainties is one of the most vital elements in the financial valuation of a company. It is this analytical capacity which differentiates one investment firm from another: the ability to value a company with the greatest accuracy possible and hence to determine whether to buy, hold or sell.

At present the disclosure required of corporations is inadequate for the financial markets to determine the entire operational, strategic and managerial capacity of a company. There are two reasons for this, and one is that many issues currently regarded as non-financial are not required to be reported on. I speak here, of course, about the company's environmental impacts, its impact on the health and wellbeing of society, its attitudes and practices regarding industrial relations management and human resource management, its practices in the communities in which it works, its practices in countries to which it outsources, its systems regarding adherence to a code of ethics, its governance procedures and so on.

This information is not currently available in a format that is of use to analysts, unless they are specialised researchers in the area such as fund managers and analysts who specialise in sustainable responsible investment. While it may be plain to many that these issues do and will have an impact on the company's profitability, it is more likely that issues of this nature will take

slightly longer to reach the bottom line than many other operational issues. The current structure of the financial markets and the corporate sector is such that long-term thinking goes unrewarded and is often penalised.

The EIA supports individuals and institutions being able to make investment decisions fully informed of the environmental, social and governance activities of the organisation they are invested in. The EIA also supports individuals and institutions being able to make investment decisions fully informed of the long-term environmental and social implications of present operational decisions. Only in this way will investors be able to garner all of the information required to fully assess the true value of a company.

To this end, the EIA supports corporate triple bottom line reporting, or sustainability reporting. In particular, there is an opportunity to introduce stronger reporting and disclosure requirements of ASX listed companies in principle 7 and principle 10 of the ASX principles of good corporate governance. In this respect, there are two pre-existing frameworks which will be well placed to be adapted in order to augment the current ASX guidelines: the Global Reporting Initiative—the GRI—which is the global standard for triple bottom line reporting, and the operating and financial review and new mandatory disclosure regime introduced into law in the UK this year.

The ASX principles of good corporate governance and best practice recommendations already expect listed companies to ‘recognise the legitimate interests of stakeholders’. Through the ASX Corporate Governance Council process, Australia has been able to develop a process through which the wider business and investor community can address concerns of corporate governance reporting without imposing new or costly regulation. As well, Australia has been in the forefront of fostering sustainability reporting at home, and internationally, through involvement in the Global Reporting Initiative.

The EIA also notes that the Commonwealth government has been promoting sustainability through the Department of the Environment and Heritage, and more recently has been in dialogue with the ASX Corporate Governance Council on the matter of sustainability reporting for listed companies. The EIA would support further advancement of these initiatives, with the intended outcome of widespread availability of sustainability reports by the listed companies. In the event that this is done in such a fashion that avoids overly prescriptive legislation, the move towards triple bottom line or sustainability reporting is useful, and is also consistent with pre-existing initiatives.

The EIA would suggest that the committee—

**Senator WONG**—We do actually have your written submission before us. I do not know if you wanted to read all of it out.

**Ms O’Halloran**—The beginning was not from the original submission.

**Senator WONG**—Yes, I know, but we are into that now. I am happy if you wish to, but I thought you may not be aware that we do have it before us.

**Ms O’Halloran**—I am aware of that. I just needed to conclude with the recommendations, but if you have them then that is fine.

**Senator WONG**—No, please go ahead if that is what you want to do.

**Ms O'Halloran**—No, that is okay.

**CHAIRMAN**—Could you expand on the distinction you draw in your submission between certain financial product issuers and their requirement to disclose their approach to SRI through chapter 7 of the Corporations Act and listed companies?

**Ms O'Halloran**—Could you restate that question?

**CHAIRMAN**—In your submission you refer to:

... the requirement in Chapter 7 of the Corporations Act 2001 (s1013D) that requires certain financial product issuers to disclose their approach to SRI in their Product Disclosure Statement.

You seem to draw a distinction between that and what applies to listed companies. Can you perhaps enlarge on that?

**Ms O'Halloran**—Yes. In 1999 in the United Kingdom there was a law introduced to require all pension funds to disclose on whether they take into account environmental, social or ethical considerations in the purchase of stocks. Australia took that on about three years later, but we took it on in a much broader sense. In Australia now all investment products, including superannuation products, are required to disclose the extent to which they take into account environmental, social and ethical—

**CHAIRMAN**—Managed funds, in effect, you are saying, have—

**Ms O'Halloran**—Managed funds, superannuation funds and any other investment product—so that could be an insurance product, a bond or whatever—are required to do that. If you do take those things into account, you need to explain how you do it and ASIC have prepared a set of guidelines for fund managers to follow when they do that. They omitted to do that in the UK and it resulted in a lot of pension funds saying that they did this but they did not. Perhaps about 80 per cent of the UK's pension funds all of a sudden had taken these issues into account, which clearly was not true. In Australia we learnt that lesson and some guidelines were prepared. That actually has quite a bit of bearing on the conversations in this inquiry.

**CHAIRMAN**—Basically, you are saying that investment products now have to disclose this but other corporations do not?

**Ms O'Halloran**—Yes, exactly. It is an interesting distinction if you look at the investment organisations as corporations as well.

**Senator BRANDIS**—You say all public companies should have to do the same?

**Ms O'Halloran**—There is a logical extension.

**Senator BRANDIS**—Is that your proposition, that all public companies should have the same obligations as providers of financial products?

**Ms O'Halloran**—Yes.

**Senator WONG**—Ms O'Halloran, I thought one point your submission makes about the importance of supporting informed investment decision making was a very good one. That is the basis, I understand, of you saying we should have a broader basis on which companies are required to report. I wanted to go to the issue that has been raised a number of times, which is a lack of consistency in the reporting process when it comes to SRI. You recommend a couple of approaches.

**Ms O'Halloran**—Yes.

**Senator WONG**—Do you think that is an issue? Firstly, you suggested there are two disclosure regimes which we could look at.

**Ms O'Halloran**—Yes.

**Senator WONG**—There are a number of indices in relation to what I suppose you would broadly call SRI matters. First, is some standardisation necessary in order for it to be meaningful and, second, how would we achieve that?

**Ms O'Halloran**—I think so. I think the word 'meaningful' is very accurate. We have only just got to worldwide accounting standards, after however many decades of accounting practices throughout the world.

**Senator WONG**—Some might say it is not any clearer as a result. That has certainly been put to me.

**Ms O'Halloran**—But it is very important, and particularly in the financial markets we live in a global economy where investment works on a global basis. It would be folly to go down any route other than to have a global reporting standard. I just think it would be a waste of time.

**Senator WONG**—To go down a—

**Ms O'Halloran**—To start to create Australian structures and benchmarks which are not comparable with international firms. So much of the investment markets that operate within Australia happen on an international level, so analysts need to be able to compare and contrast between sectors and between companies within sectors on a global basis. They are competing for that investment firm's money with the same risk parameters, the same opportunities and the same uncertainties. They need to be able to compare and contrast on that level.

**Senator WONG**—Is that an argument for the GRI?

**Ms O'Halloran**—It is an argument for the ERI or the OFR. Do not ask me to choose, because I find both of them very compelling. The Global Reporting Initiative has elements in it that are extremely useful for the financial analysts. Those are issues which particularly pertain to risk analysis: the analysis of uncertainties and the analysis of opportunities. These are critical issues that analysts need to be able to obtain information on quickly and with certainty. The Operating and Financial Review reports really do concentrate on that alone. It is elements of both of those

that are extremely important to pass on and to be able to be accessed by financial analysts. As to the Global Reporting Initiative, if you depart from a global standard I think—

**Senator WONG**—You have to have a good reason for that, I suppose.

**Ms O'Halloran**—You have to have good reasons to do it. It has been so entrenched. At every single meeting I go to in any other country the Global Reporting Initiative is fully supported by organisations, by governments and by the financial markets. It seems to be a standard that is absolutely embraced worldwide.

**Senator WONG**—I notice that your association was formed in 1999. Has there been a growth in interest in ethical investment or social responsibility investment in the last six years?

**Ms O'Halloran**—Our funds under management in Australia have grown by 2,348 per cent since we did our first report in 2000, so it is a lot.

**Senator WONG**—That is very impressive.

**Ms O'Halloran**—Funds under management grew by 70 per cent in the last 12 months. There has been significant growth, particularly from the superannuation sector. There is a lot of movement in that area, and I can imagine quite exponential growth in the coming years. I have been in the organisation for four years and in the area for about six years, and over the last year in particular I have seen a dramatic shift in sentiment.

**Senator WONG**—My impression from this end is that the market in many ways has taken this up a bit more quickly than politicians.

**Ms O'Halloran**—The market understands, and I think this was alluded to in the CAMAC report I read over the last couple of days, that issues previously invisible to directors and investors have become issues of critical importance to profitability. We never used to have pressure from civil society. Globalisation has introduced the concept of outsourcing to other nations and to corporations setting up businesses in other communities. The eighties and nineties introduced a whole lot of bad behaviour that is now being redressed. There are issues facing the 21st century corporation that simply were not material 10 years or even five years ago. It has taken a lot of catch-up time for governments and corporations to understand these issues and to learn how to analyse them to find the information they need. But it is still very hard, and that is why most analysts do not consider it. If you set a benchmark for all analysts you find they are all playing on the same field, so it does not matter. It will be short term because that is what the information given is about.

The ones who are ahead of the game are the sustainable responsible investment analysts. They do look at between 100 and 200 extra issues of analysis when they value a company. So they will look at financial analysis but they will also look at all the issues—I would imagine that you are all aware of the particulars in the GRI. When you start comparing and contrasting performance against GRI indicators, you start to get a much broader picture of a company's capability. That is why, when you look at the performance of SRI products and services, you see a slide-out performance or an equalling to the financial markets. Many would argue that there would be underperformance because you are removing stocks and removing a balance.



Generally you try to get some kind of diversification in a portfolio. If you remove sectors and you remove companies, the argument is that you would generally underperform. That has not rung true over decades and over continents. Across the world and across decades all the metastudies of all the studies show that SRI equals or slightly outperforms the benchmark. It is competing with managed funds—that is, its peers in the market. That is because there is an overcompensation for taking out those companies in that your analysis is far more accurate. The evaluation of a company is more accurate.

**Senator WONG**—I have two very brief questions. It seems from your submission that the SRI and the OFR essentially target slightly different issues. The OFR is more, I suppose, a risk-oriented approach. Would you agree with that?

**Ms O'Halloran**—I would say that their concentration on risk is more absolute than the GRI. Of course the GRI is concerned about risk, but it is also concerned to service many markets, whereas the OFR is designed to service the financial markets. It is a stock market style report; it is an annual report. In that sense, it has one audience—I am speaking from the point of view of investors—so the OFR is immensely appealing in that sense. But we also represent so many other bodies interested in the power of the financial markets to effect change in the corporate sector and the GRI is a superb tool for that. So, if you are trying to kill a lot of birds with one stone, the GRI is perfect. But, from the perspective of investment markets, the OFR is where the rubber hits the road.

**Senator WONG**—You keep making the point—and it is certainly something I am aware of—about the equivalence of performance or outperformance. That is not necessarily a view that will be shared by all companies: that there is actually a business case for them, looking to sustainable performance. From an investment perspective, do you have any views about how you might inculcate that sort of thinking? Is it simply a case of saying, 'The market will sort it out because ethical or sustainable investment will grow and—

**Ms O'Halloran**—And 'create that message'. The whole idea of implementing a GRI style program is that it does not just write what it does; it has to start implementing systems and observing its own behaviours and its own performance. There are stories and fables all over the world of companies going through that process and uncovering locked treasures and opportunities. It is about creative thinking and it is about thinking outside the box. So many corporations exist in a framework that is outdated and is no longer serving the 21st century corporation. Corporations are always looking for imaginative ways to find new opportunities.

The GRI is a very good way to do it. So, until a company start measuring and looking at what they do, it is very hard for them to see it. They see it as a cost. Wal King of Leighton Holdings won the first *Sydney Morning Herald* company of the year award for sustainability, which was introduced about three or four years ago. His comment was: 'It was hell going through this, but now I get it. I really get how this brings our company into a new framework of thinking where we can find opportunities that are into the future. They are about the 21st century, the way that companies work and the needs of society and the environment from the corporation.' So the answer is: it is in the process and, unless that process is enforced, I cannot see most corporations naturally gravitating to it.

**Senator WONG**—Thank you. That was very useful.

**CHAIRMAN**—Can you advise the committee of what percentage of Australian managed funds and super funds are currently in the SRI category?

**Ms O'Halloran**—About 1.15 per cent of all funds under management would be screened and analysed in this way. I am not sure about fund managers. Probably about 10 per cent of Australia's fund managers have a product or two in this area. It is growing all the time, though. In the last two weeks, I have met with four what I would call mainstream investment houses who are looking at developing products in this area. The association has just developed the world's first certification system in this area and it has aroused a lot of interest. It is a marketing tool. Those who want to enter the field know that they have some support, a structure and a framework to work with. So it has brought a lot of people out. I suspect in the coming years it will be a fairly basic requirement that there be an offering either from a super fund or from an investment house that covers this area.

I have a further strong view about this going mainstream, and I am sensing that is where some of these questions are coming from. Mercer Investment Consulting, which is the most powerful consultant to superannuation funds in the world, has released a statement that says that, in addition to its four basic judgments of a fund manager, it rates and reviews fund managers, so it can give that information to superannuation funds to guide them in their investments. I am not sure how many of you are aware of this. Its basic judgments are: management of the portfolio, management of the organisation and performance history. There is another one now added to those and that is the capability that analysts have in fund management organisations to analyse sustainability criteria. The largest asset consultant in the world is saying that and it is not only saying it, it is one of its criteria now. It was an absolute blessing for the industry when that happened.

Mercer have been studying this for about five years and they now absolutely believe that this is an issue that is going to affect the long-term value of superannuation funds. Morgan Stanley has also come out with a major report and two other major American investment houses have come out with reports on this. Mercer's report showed that 85 per cent of Australian and Asian fund managers believe that SRI will be mainstreamed in the next 10 years. That is because of the financial implications of the issues we are talking about.

**CHAIRMAN**—How does Australia compare with other countries in terms of percentage currently?

**Ms O'Halloran**—Canada and the UK have between three and four per cent, and our aim is to be at that stage within about four years. Though they are slightly arguable figures, the United States, it is said, have between 11 and 12 per cent. That is because a lot of religious investors screen, and they screen outside the funds management infrastructure.

**CHAIRMAN**—You advocate strengthening and expanding the existing Stock Exchange principles of good corporate governance and best practice recommendations. Can you tell us at this stage how corporations are using the Stock Exchange corporate governance principles to improve or report on governance and social and environmental performance?

**Ms O'Halloran**—Apparently quite well. I have spoken to some of our analysts and the researchers in the area in the last few weeks in the lead-up to this. They believe it has been an

excellent step and that it does provide them with more information. Their whole aim is to get more information and to get it as easily as they can. They believe that some of the reporting is very good. I have also discussed with them what it would mean if there were further requirements, for example, what is the least that somebody could get away with and how much trouble would that take. Most of them believe that some could get away with two or three more pages if you honed down the GRI to, say, six major indicators. I was looking at what is being offered now, what is the standard of it, what extra information does it provide to investors, what illumination does it give on how a company is performing and what extra is needed.

I think that what is missing is a framework. What became important between the introduction of these disclosure requirements for investment products in the UK and here was all of the work Delia Rickard put in at ASIC in developing the guidelines. The guidelines are a superb chart or map. You cannot duck and weave. You really must be fairly explicit about your methodology. If you say you have a screening process for your investments, you really must describe in detail how you do that and what the systems are in your office for managing that. So perhaps what is missing is some kind of guidance for corporations on exactly what is important. A generic request for risks and exposures regarding stakeholders is difficult if you are a corporation that has not looked at what is possible in that area.

**CHAIRMAN**—So you are really envisaging a framework rather than any additional requirements as such in that sense—a framework that spells out in simple terms what is required rather than adding requirements to what is there already?

**Ms O'Halloran**—I would imagine that, if the requirement was there to report on various indicators and there were guidelines behind that which were mandatory, that would become implicitly part of the requirements.

**CHAIRMAN**—Do you have any idea whether, and if so to what extent, that would add an administrative burden on corporations?

**Ms O'Halloran**—That is what I was reflecting on in the last few weeks. The burden of the OFR is considerable. I do not know if you have read the OFR, but there is an awful lot in it. One must accept that we are going into a place where there is going to be a requirement for further investment in this area and that there will be payback for it. The requirement that a company disclose its long-term views—what it probably knows internally or what some of them probably know internally—takes a lot of work. You have to decide what is commercial in confidence and what is going to give others competitive advantage. However, an analyst cannot view what is actually going on with a company without a long-term perspective. They are only guessing. Most of the time, they only guess. So yes, it is going to take extra work. But if you limit it to a certain number of—

**CHAIRMAN**—Do you have a question related to that?

**Mr BOWEN**—I was going to ask the question that you just asked. Perhaps I could follow it through. You mentioned that the OFR is quite onerous. Can you give us idea of just how onerous it is?

**Ms O'Halloran**—My suggestion about the OFR would be to actually isolate issues within the OFR that pertain particularly to stakeholder interests and environmental and social issues. There is a lot of onerous financial reporting in the OFR. That is the part that is onerous that I would actually exclude.

**Mr BOWEN**—You do not think the environmental and social reporting is too onerous?

**Ms O'Halloran**—I do not believe it is too onerous. On balance, the outcomes that the government is looking for and that society is looking for are going to take some more work.

**Mr BOWEN**—Sure, but you would appreciate that governments and parliaments require corporations and companies to do things which are eminently justifiable in isolation but where, when you add them onto each other, you can create a compliance nightmare, particularly for small and medium sized enterprises. Through you, Chair—

**Ms O'Halloran**—May I respond to that?

**Mr BOWEN**—Sure, but my point is—again, I suppose I am playing devil's advocate here—that all these things might be well justified but we need to have cognisance of just what regulatory burden we are placing on companies and whether we are just requiring reporting when we would be better off putting resources into actually doing.

**Ms O'Halloran**—Doing in what manner?

**Mr BOWEN**—Into being environmentally and socially responsible instead of reporting what you are doing.

**Ms O'Halloran**—Reporting requires doing. That needs to be understood. Might I also say that the consequences of not imposing a regulatory regime are always viewed on balance with doing it in any regulation that is imposed.

**Mr BOWEN**—Sure.

**Ms O'Halloran**—I think the consequences are becoming pretty clear in Australia. To invoke James Hardie almost goes without saying: it is the elephant in the room. I have just seen Enron as well.

**Mr BOWEN**—I do not disagree with that, but we need to strike a balance.

**Ms O'Halloran**—I think that a selection of indicators required through the ASX governance laws—selective and pertinent indicators—is a great balance. And it is a great balance to not having onerous new corporation laws and perhaps avoiding the introduction of the entire GRI, which I would also promote, but if you are looking for a balance, that is probably it.

**Senator BRANDIS**—Mr Chairman, can I just throw something in on your point. Didn't you say to me before that you are only calling for this in relation to public companies? Unless I misunderstood you, that would go some way to meeting the problem identified by Mr Bowen in

relation to small and medium enterprises, assuming that most small and medium enterprises are not going to be operated by public companies. Is that right?

**Ms O'Halloran**—Your question is about publicly listed companies. I would also look at companies of a certain size. I think it is a little unfair to—what is the matter?

**Senator BRANDIS**—I am just surprised that you would not appreciate the very plain distinction between the obligations on public companies and on private companies.

**Ms BURKE**—Senator Brandis, if I can help: before you were here this morning, the Commercial law Association made the same point themselves. You will see on the transcript—

**Senator BRANDIS**—That is why I am surprised at the answer. Sorry, Mr Bowen—

**Mr BOWEN**—I understood the distinction. Perhaps I used the wrong terminology. There are medium sized enterprises which are listed.

**Ms O'Halloran**—I am talking about the overarching implications of corporate social responsibility reporting. If you would like me to separate public companies and unlisted companies, then I can have that conversation as well. I am actually speaking about the benefits of corporate social responsibility reporting on lots of different stakeholders—the benefits to society of that, the benefits to investors of that. If you want to talk about whether you feel it should be implemented for listed companies, a certain number of listed and unlisted companies, it is a slightly different conversation.

**Mr BOWEN**—Mr Chairman, while we are on the topic, it might be helpful if committee members could get examples of the OFR reporting from Britain and just how onerous it is and what compliance burdens it does create.

**CHAIRMAN**—We can certainly get that provided. Senator Brandis, do you want to pursue your discussion?

**Senator BRANDIS**—No, I do not want to take it any further.

**CHAIRMAN**—The submission we have received from Chartered Secretaries Australia, who are appearing later today, proposes the inclusion of a replaceable rule in the Corporations Act which would in effect become a default for company constitutions, with corporations retaining the ability to remove such a rule if it is the desire of their shareholders. What is your view on that proposal from the Chartered Secretaries? Would this be an alternative, including, for instance, the GRI guidelines in the Stock Exchange corporate governance principles?

**Ms O'Halloran**—What is the suggestion?

**CHAIRMAN**—That companies have a replaceable rule.

**Ms O'Halloran**—What is the rule?

**CHAIRMAN**—Proposing a replaceable rule which would in effect become a default for their constitutions.

**Ms O’Halloran**—What is the rule that you are referring to?

**CHAIRMAN**—That they report—a replaceable rule in relation to reporting requirements.

**Ms O’Halloran**—Sorry, I was just comparing it to another suggestion about directors’ duties and conclusions in the Corporations Law. I would prefer not to comment on the Corporations Law, because it is not really my skill and my area.

**CHAIRMAN**—If there are no further questions, thank you very much for your appearance before the committee and for your contribution to our inquiry.

[11.04 am]

**FOX, Ms Judith, Director, Policy, Chartered Secretaries Australia**

**SHEEHY, Mr Tim, Chief Executive, Chartered Secretaries Australia**

**CHAIRMAN**—The committee has before it your submission, which we have numbered 28. Are there any alterations or additions you wish to make to the written submission?

**Mr Sheehy**—No.

**CHAIRMAN**—I invite you to make an opening submission, at the conclusion of which I am sure we will have some questions.

**Mr Sheehy**—Thank you very much. Chartered Secretaries Australia are pleased to have, and welcome, the opportunity to comment on issues of corporate responsibility and to appear before the committee today. We are of the view that the principles of corporate responsibility sit at the heart of good governance. Fundamentally, corporate responsibility is about the relationships between a company and those individuals or groups with whom it has a relationship—that is, its stakeholders. Corporate responsibility is about building trust in those relationships. Chartered Secretaries Australia's members are committed to the values of corporate responsibility and support the concept of maximising shareholder value while at the same time acting fairly in the interests of other stakeholders with an interest in the company's affairs. From our perspective there is no debate as to whether or not it is important. Corporate responsibility does not sit outside or alongside the business of business but is fundamental to it.

Coming to matters of substance in our submission. It is our view that a legislative and regulatory framework relating to the individual components of corporate responsibility is already in place. This body of existing federal and state law covers the environment, financial services, human rights, equal opportunity, industrial relations and occupational health and safety et cetera. Much of this legislation requires directors and other officers to take account of interests other than shareholders'. It is also the experience of many of our members that their companies and numerous others already have in place corporate responsibility initiatives under the existing corporate law regime. Such initiatives are not limited to large, listed companies, such as Caltex, BHP Billiton or NAB, as we have outlined in our submission, but extend to unlisted entities such as Zurich Financial Services Australia Ltd or small companies such as Flinders Ports Pty Ltd. In addition, government owned corporations, such as Queensland Rail and Energex, report publicly on their corporate responsibility approaches, as recently cited in the Reputex ratings system.

The information provided by our members suggests that decision makers in many Australian companies already have regard to the interests of stakeholders other than shareholders and see these interests as integral to their business. We are of the view that those companies that ignore the long-term impact of social and environmental issues and refuse to participate in a constant dialogue with their stakeholders are putting their long-term future at risk. Finally, Chartered Secretaries Australia believe that mandatory reporting adds a significant layer of additional compliance costs to the operations of the majority of Australian companies. We strongly believe

in the continuation of voluntary reporting, with education provided to SMEs and other organisations to communicate the value to their businesses of responsible corporate activity. Thank you.

**CHAIRMAN**—Thank you, Mr Sheehy.

**Senator BRANDIS**—Mr Sheehy, let me put a proposition to you. Tell me if you agree with it or if you want to comment on it. When one has regard to the current state of the Corporations Act, the breadth with which the courts interpret the fiduciary duties of directors and senior officers under the Corporations Act and of the general law, the Trade Practices Act, the laws governing marketable securities, environmental regulation and accounting standards, directors and senior officers of corporations in this country are subject to a more extensive regime of regulation and are required as a matter of law to have regard to a greater variety of interests than has ever been the case before. Is that your experience?

**Mr Sheehy**—I think it is fair to say that scrutiny, whether through legislation or otherwise, is constantly increasing. Our members in general are cognisant of the burden but can see merit in it. Yes, I would have to agree that the legislative requirements and requirements under accounting standards are ever increasing and are an ever-increasing focus.

**Senator BRANDIS**—Can I invite you to comment a little further on the cost consequences of each incremental increase in the degree of regulation?

**Mr Sheehy**—Our organisation is on record with regard to cost consequences. We have surveyed our members from time to time. I do not have the numbers off the top of my head. I think that, for example, even the smaller listed companies were experiencing this. The number that was bandied around was \$50,000 just to meet the ASX Corporate Governance Council's guidelines. For smaller organisations that is a significant cost. The cost of meeting compliance requirements is high and is always increasing. There is no question about it, and we are on record as saying so.

**Senator BRANDIS**—We have had the names of a couple of companies which have developed bad reputations tossed around in discussion this morning. James Hardie and Enron are two examples. Am I my right in thinking, Mr Sheehy, that the misbehaviour that was engaged in by senior officers of those companies was prosecuted under existing law in, respectively, Australia and the United States?

**Mr Sheehy**—I have not seen the movie. I do not terribly wish to comment on individual examples, particularly those two, which have attracted too much attention. I think that causes the pendulum to swing wildly. I would prefer to comment on those organisations that have voluntarily embraced what it is we are here to talk about today.

**Ms Fox**—In our submission we did note that, while there has been a lot of comment about the fact that the Corporations Law has been placed under some duress due to some high-profile cases, it has actually survived the duress that it was placed under.

**Senator BRANDIS**—That is a loaded word in this field, Ms Fox—duress.



**Ms Fox**—I was quoting Bruce Cowley on the issue.

**Ms BURKE**—I want to look not at the specifics but at the general, and we were discussing earlier today—and you may have been sitting through some of the discussion—the notion of the actual ability of the directors that we have sitting on boards. Yes, those high-profile cases have gone to court, but I suppose what we would hope is that they had not got there because good governance would have prevailed at a board level. I suppose that with some of these cases the argument is: what is good governance? We are looking at the law for that. Do you think we have, as one of our other witnesses said, too narrow a pool of directors to draw from? Do you think that they are spread very thinly, as these same directors are on every other board, and that they are not paying specific attention, not reading their papers and not going to the meetings? If they are, are they not being fully informed as to the decisions that they are making? Are they not educated enough and not sufficiently informed enough to be actually making good decisions?

**Mr Sheehy**—First of all, we are not here to represent the interests of directors. I believe that Ralph is appearing later on.

**Ms BURKE**—I know that. But you made the point, so I actually want to draw from it.

**Mr Sheehy**—In answer to your question, anecdotally I would be surprised if there were directors in publicly listed companies today who waltzed into board meetings—given all the scrutiny of the last couple of years—without having a thorough understanding of what is in front of them.

**Ms BURKE**—Do you think more education is required for people who are actually taking this on? As you have said yourself, it has now become a fairly onerous task. As you say, as the legislation increases so does the cost. As the individual is actually bearing that, do these people need greater access to information and education assistance when they are taking on these duties?

**Mr Sheehy**—Everyone needs to be educated adequately to take on the duties. Not only is our organisation involved in activities like this but we are primarily a training body. The Institute of Company Directors has a large training role as well. We are experiencing a dramatic and continued rise in demand for the education activities we put on offer. I think that it would be fair to say that no director can take their eye off the ball and no director can get to thinking that they have learned all there is to learn and that they can just coast to the finish line now.

**CHAIRMAN**—Have you floated your proposal for the replaceable rule with the membership? If so, what has been the response?

**Mr Sheehy**—I think it is important for the record that technically we are not calling for this. I think that is an important point to make. We definitely have included it in our submission—and we chose our words carefully—as a notion that has some merit. But we are firmly of the view that the Corporations Act is adequate. We are not calling for an enabling section or anything like that. In honesty, I guess that if we were pressed then this would be something that we think has merit.

**Mr BARTLETT**—It is listed as a recommendation on page 11.

**Mr Sheehy**—In the wording we are saying that it is something that has merit.

**Mr BARTLETT**—It is under the heading ‘Recommendations’.

**Mr Sheehy**—For the record, we are not calling for it.

**Senator BRANDIS**—In the last paragraph of your submission on page 13 you use the word ‘can’, not ‘should’. It says:

CSA believes that companies and stakeholders alike should be reminded that CR can be tailored ...

So you are keeping your options open there.

**Mr Sheehy**—One of the questions that I was asked, or part of the question, was whether we had canvassed that with our members. The answer to the question is yes; otherwise, it would not be in this document. In fact, that particular notion was one of the notions actively discussed by the two policy committees we work with. What would you say the general sentiment was on that?

**Ms Fox**—Our members pride themselves on their practical approach to governance and their practical approach to how issues can be managed within corporations. Within the spirit of seeking to have some ideas that could be practically implemented and looked at, they felt that this was something that they were very happy to put forward for discussion. It was not that they were calling for it, but it was something that they thought merited discussion.

**CHAIRMAN**—Have you thought through the extent to which this would apply? Would it apply to large corporations or public corporations or large private companies?

**Ms Fox**—The feeling was that if it were a replaceable rule the decision then went back to the shareholders. We keep talking about the community within this discussion this morning, and shareholders of course are the community. Therefore, it was a decision for shareholders to make as to whether they wanted it in their constitution and whether they wanted their company to reflect that position. So we did not have a view that it should be constrained to a particular set of companies but that in each instance the shareholders could have a look at it and make a decision whether or not they wished to include it in their constitution.

**CHAIRMAN**—And how flexible would such a rule be? For instance, could shareholders include a replaceable rule that would preclude directors from taking account of interests other than those of shareholders and in fact deny the interests of other stakeholders?

**Ms Fox**—They can currently enter such a clause within their constitution should they so desire.

**Mr Sheehy**—We are not suggesting that. We are suggesting it in a positive vein.

**Mr BARTLETT**—But there is an implication here, surely. If under the current regime directors can consider those things, that is one thing; but, if it became the norm that the

replaceable clause were taken up but some groups of shareholders explicitly rejected that, that would send a different message to directors in the status quo, would it not?

**Mr Sheehy**—Do you mean sending a different message to directors or shareholders?

**Mr BARTLETT**—That shareholders have explicitly rejected the concept of consideration of other stakeholders. Would that not send a different message that says, ‘Look, focus on profits, and shareholders’ rights are paramount,’ more than in the current regime where directors can consider those things and are not explicitly precluded from considering them?

**Mr Sheehy**—Yes, I suppose it would send a message. Replaceable rules are entirely voluntary.

**Mr BARTLETT**—But, if the norm became one where most shareholders did want something stated in there, and that was generally the norm, in the cases where that was not the case that would be sending a different message, wouldn’t it?

**Mr Sheehy**—Most definitely, but we would not think it a terrible healthy message.

**Ms Fox**—Again, it is the shareholders then who are taking responsibility for that decision.

**Ms BURKE**—Don’t we put in this word ‘shareholder’ too much value? The only reason I say that is not all shareholders have equal footing. I have been to a number of AGMs where the floor never carries the day because the big corporations have vast holdings. How do you narrow it down and ask, ‘Which shareholders get to decide this?’ This is the problem all of the time. It is the big corporates in most of these companies who hold all of the cards and that might be in complete conflict with the individual shareholders on the floor on the day, as they often are.

**Mr Sheehy**—Because 400 or 500 people appear at an AGM, it does not and should not drive a decision by a company. We have a fairly equitable method of one share, one vote. This is an age-old argument in a longstanding process of lodging proxies in this country, and one does not have to go to a meeting to exercise their view.

**Ms BURKE**—But the people who have the majority of shares are always going to be large listed companies themselves, aren’t they?

**Mr Sheehy**—No, they are largely institutions.

**Ms BURKE**—Sorry, that is what I meant.

**Mr Sheehy**—There is a vast difference between an institution and a listed company.

**Ms BURKE**—But the institutions are themselves often companies with other interests. If we are talking about social responsibility, we are talking generally about one large corporation having a say over another large corporation, if we are talking about shareholders and investment and all the rest of it. It becomes different nowadays when you put in investment funds and super. I think they have not got up to the plate on this, and that is part of the problem. They have not taken their responsibility to a lot of this actively, but to bandy around this word ‘shareholder’—

**CHAIRMAN**—They are major investors.

**Ms BURKE**—No. You keep using the word ‘shareholder’. I just think it is a misnomer to somehow say it presents shareholders as the people who will have the social responsibility in mind, because it just does not work that way. You know that.

**Mr Sheehy**—For the record, I am not in agreement with your point of view, to be honest. Would you like me to respond?

**Ms BURKE**—No. I just find this notion ridiculous.

**CHAIRMAN**—I would like you to respond, Mr Sheehy.

**Mr BAKER**—I would.

**Ms BURKE**—If you want to, go on. It is not necessary; I just think it is a ridiculous notion. But that is my viewpoint, and I am entitled to it too.

**CHAIRMAN**—We are here to adduce evidence rather than put viewpoints. Do you wish to respond, Mr Sheehy?

**Mr BAKER**—I would like you to.

**Mr Sheehy**—The majority of shares invested in listed companies are owned by investment vehicles—managed funds and so forth. They are not other ASX listed companies.

**Ms BURKE**—I am sorry if I gave that impression. I did not mean to. The terminology is wrong; we are probably at wrong reference points here.

**CHAIRMAN**—They are in fact the aggregation of the savings of a lot of what I call small individuals.

**Mr Sheehy**—Mine, and probably your’s and everybody else in the room.

**Mr BAKER**—Mr Sheehy, can you substantiate that a lot of the major superannuation and investment companies that we touched on before—Bankers Trust, AMP et cetera—have quite substantial SRI funds in wealth creation and superannuation?

**Mr Sheehy**—Can you repeat the question?

**Mr BAKER**—Can you substantiate whether the major investment companies such as AMP, Bankers Trust, Zurich and MLC have been at the forefront of socially responsible investment in capital wealth creation and superannuation funds?

**Mr Sheehy**—Our submission did not touch on the investment industry’s shift to that. The witness who spoke before us was best placed to do that. While I was waiting to give evidence, I jotted down the number she mentioned, which was that there has been a 70 per cent increase in

the last 12 months in socially responsible investments under management. It is a trend that is obviously in place—I think that is indisputable. Probably what some people would like to see is a higher rate of increase, but you cannot argue about the fact that the trend is in place.

**Senator WONG**—Thank you for your submission. I have a number of questions and I will try and get through them efficiently. My first question is about your suggestion—I will not put it higher than that—about a replaceable rule. Do you think there would be a risk—and I think it has been alluded to—that the implication might be at law and, therefore, if it were not in there, the general duties of directors would be more narrowly defined? In other words, would the absence of the replaceable rule in the constitution suggest, or ground, a legal argument or even an ethical argument that the duties of directors, in the best interests of the company, do not extend to looking into stakeholder or longer term issues?

**Ms Fox**—I think we felt that it could inform part of an education program—

**Senator WONG**—I understood that that was the motivation.

**Ms Fox**—rather than necessarily supporting a particular legal perspective—because it would encourage discussion. If it started being a matter of public discussion that some shareholders were electing not to go down that route, there would be a discussion about why. We did not see it as supporting—if you exclude a particular legal perspective—but as encouraging people to consider the issue so that they are actively involved.

**Senator WONG**—I did understand that that was the motivation. Your assertion, which is fundamental to the proposition that the committee should not be looking at an amendment to directors' duties, is that the current legal framework permits such regard being had. I do not particularly want to focus on what are arguably aberrant examples of poor behaviour within the corporate sector in Australia, but there is clearly a view being promulgated within the business community of an understanding of shareholder interests, intrinsic to the current test of the best interests of the company, which is clearly different to that which is put forward in your submission. Both you and the Commercial Law Association have told the committee that we do not need to amend anything because it currently does permit directors to look at stakeholder and community concerns, yet we see in the business pages of a number of our major newspapers companies arguing the opposite position.

**Ms Fox**—I would like to quote from Austin, Ford and Ramsay, a leading text on company directors.

**Senator WONG**—I am familiar with it.

**Ms Fox**—They note that the decided cases indicate that management may implement a policy of enlightened self-interest on the part of the company.

**Senator WONG**—My point is that there are at least two legal interpretations that we are arguing. I think you are probably right but, if the perception and therefore the action dependent on that in the business community include a much narrower construction, what do you say the parliament or government should do?

**Mr Sheehy**—I have no doubt there will be some in the business community that believe that the legislation is, as you said, too narrow and that it constrains them. However, it is the view of our members that that is not the case—that the legislation is adequate as it is—and we support that by citing those organisations that have managed to culturally figure out that they can operate in a socially responsible long-term way under the current legislation. I will pick Westpac only as an example.

**Senator WONG**—I do not disagree with you, Mr Sheehy, but from our perspective parliament is being told by the number of submitters, ‘The law’s okay as it is, you don’t need to change it,’ and sections of the business community demonstrably saying, ‘Actually, it is very narrow and that is why we have had to act the way we have.’

**Mr Sheehy**—That is not our view.

**Senator WONG**—You do not agree with them?

**Mr Sheehy**—No.

**Senator WONG**—I am not trying to set up an oppositional thing here. I am genuinely asking: if the argument is, ‘We don’t want you to change the law,’ how do we deal with the misperception that that exists?

**Mr Sheehy**—I think by highlighting that it is possible and by showing those examples. I know the word ‘education’ is a cosy, feelgood sort of a word—everybody loves it, but what does it mean?—but there are so many examples of organisations that have managed to figure that out that I think it is a cultural change process within the minds of those people who do not think it is possible.

**Senator WONG**—I am probably stealing Mr Bowen’s question because he consistently asks about a permissive amendment. How vehemently would you object to a permissive amendment—not a positive duty, because I think there are some cogent arguments as to the difficulties of a positive obligation being imposed—or would you object to it at all?

**Ms Fox**—Our members did not feel that a permissive clause was required in the directors duties and that is why they made the suggestion that there was more merit in looking at a replaceable rule.

**Senator WONG**—If we are not going down the replaceable rule path, I guess I am asking hypothetically whether you have substantial concerns with the permissive amendment.

**Ms Fox**—There are some difficulties with permissive clauses. A number of arguments have been raised in other submissions. One of them is that directors are responsible for relations with the stakeholders but are accountable to shareholders—and that is not simply a technical point. If you are accountable to stakeholders there is the possibility that you are not effectively accountable to anyone, because there is no clear yardstick for judging performance. That is one of the issues that our members had with the permissive clause.

**Senator WONG**—Mr Bowen might want to follow that up because the sort of suggestion we have been looking at is not intended to set up the kind of conflict you are talking about. I have one last question and that is about reporting. You made reference to the GRI and the accountability AA1000 series et cetera. You also talked about the significant layer of additional costs to SMEs. I accept that. Are you therefore saying that mandated reporting for larger companies is appropriate?

**Mr Sheehy**—No.

**Senator WONG**—What are you saying?

**Mr Sheehy**—We are saying that you should allow the voluntary reporting to continue; and, much the same as the previous person who sat here, we certainly do not believe that a country the size of Australia should be setting up its own reporting standards. We are quite happy with allowing the GRI—or other existing reporting frameworks—to evolve and allow its acceptance to grow. We are very clearly not asking for mandated reporting.

**Senator WONG**—Are you opposed to mandating it?

**Mr Sheehy**—Yes, we are.

**Senator WONG**—On what basis?

**Mr Sheehy**—One, in order to mandate Australia would probably want to set up its own, and we think that is counterproductive.

**Senator WONG**—That is not necessarily a given. Australia could choose to adopt the GRI.

**Mr Sheehy**—It could. Two, each organisation is different and needs to adopt a reporting framework which suits it.

**Senator WONG**—Can I respond as you go?

**Mr Sheehy**—Yes.

**Senator WONG**—Do you say the GRI currently does not have sufficient flexibility to deal with that?

**Mr Sheehy**—I cannot imagine that any one reporting framework would suit absolutely every organisation. Those organisations which play in the big pond will want to be compared with like organisations. It is in their best interests to be and they will therefore adopt a reporting framework which is a comparable reporting framework.

**Senator WONG**—But you could deal with that by allowing their various sectors to alter for that purpose: to compare like with like?

**Mr Sheehy**—Yes.

**Senator WONG**—Go on; we were up to three.

**Mr Sheehy**—Thirdly, mandating has the usual catchphrase of a ‘tick the box’ and we would prefer that companies arrive at the conclusion that there is value for them in adopting reporting against these sorts of things. Even with the Corporate Governance Council guidelines, which, to be honest, were probably fairly benign in many ways, there were a number of companies that changed their practices against their best interests because they just did not want to put up with the flak of explaining why they had not done so. That is a dangerous development.

**Senator WONG**—I understand that argument. Therefore, if you say, ‘We want to change the culture, but parliament should not mandate it,’ what do we do?

**Mr Sheehy**—The trend is already in place; it is already happening. There is a shift of money to funds which value long-term sustainable investment. I have heard comments by Dr Longstaff from the St James Ethics Centre about a circularity of doing business with suppliers and so forth that adopt these sorts of guidelines. Organisations like ours—and there are many, and we have a fairly good penetration—need to continue to put on targeted training or other types of forums to raise the profile of these things. We did that yesterday, for example, and had a fantastic panel discussion on the tug between short-term investment driving certain types of funds and longer term investment growing in attraction to investors.

**Senator WONG**—Essentially, is your argument that government should not do anything?

**Mr Sheehy**—We have clearly stated that we do not support a change to the act.

**Senator WONG**—That was not my question. Governments can do more than change legislation.

**Mr Sheehy**—Then we most definitely think that there would be a role for government in the education and encouragement process, not in the legislative aspect of things.

**Senator WONG**—We are running out of time, and I am sure others have questions, but if you have an indication of what education and encouragement mean in practical terms I would certainly be interested to consider that.

**Mr Sheehy**—Okay.

**Ms BURKE**—As practical examples of leading the way you have cited NAB, Caltex, BHP, Zurich Financial Services and Westpac. We were talking to the ethics centre about the ability to judge the rhetoric on paper versus the practicality and the greenwash—how you deal with that and how corporations and investors are acting. I know that is not your area, but you are dealing with that. If this is the way to go and companies are saying, ‘We’re doing these good things and being judged,’ how do we ensure it is not just rhetoric but the reality?

**Mr Sheehy**—I do think the initiative of the St James Ethics Centre, where they have their responsibility index, is the right way to go. I acknowledge that there have not been a dramatic number of companies that have gone down that pathway. I applaud that particular pathway where companies volunteer to take part, as opposed to an outside ratings body coming in and



just rating everyone, because both sides of the equation have a great degree of validity. When you have independent third-party ratings programs that companies choose to take part in, the quality of the information coming out of them is irrefutable and it is the only way to go.

**Ms BURKE**—Where were the examples you have cited drawn from?

**Ms Fox**—They were drawn from our members. Our members said, ‘We are quite happy for you to put us forward.’

**Ms BURKE**—They have put these into their annual reports, so they have put them out there?

**Ms Fox**—Yes.

**Ms BURKE**—So it is part of their current reporting? They are saying, ‘This is something we would like people in the community, the corporate sector, our investors, our customers and our staff to know about.’

**Ms Fox**—Yes.

**Ms BURKE**—There are no examples here relating to staff and employees. Through most of the submissions everybody says employees are stakeholders, but I have not actually seen anything that says, ‘Here’s a great initiative for our employees.’ Is it something that comes across in discussion? It just struck me that in all of the submissions we have looked at today there is very little mention of what I would have thought was a fairly large stakeholder group.

**Mr Sheehy**—That is a good point. To me it highlights that too much of this corporate responsibility, which is a broad umbrella term, focuses on environmental issues. I think that is unfortunate and it is not how it is meant to be. For example, I believe the ANZ introduced a policy where anyone over 50 or 55 had a right to move to part-time employment, if they wanted to, so that they could look at lifestyle options and so on. That is an example, but I think your point underscores the situation: there is too much focus on the environmental and it attracts too much of the noise.

**CHAIRMAN**—Is that a consequence of the fact that environmental reporting was put into the Company Law Review Act—I think it was—as a mandatory requirement?

**Mr Sheehy**—I do not know what it is a consequence of. It could very well be a consequence of communities focusing on environmental issues and therefore it just gets more airplay.

**Ms Fox**—Also, I think it is partly because some of the reporting stems from GRI. The larger companies—we are talking about multinational enterprises—can have a significant impact on the environment, so the GRI did look quite closely at environmental issues. I think a number of factors have led to that.

**CHAIRMAN**—Given the current lack of a standard reporting framework in Australia in relation to non-financial information—we have the St James Ethics Centre, the GRI and other options—how seriously do you believe that capital markets take the current information that is published by companies that report on non-financial aspects?

**Mr Sheehy**—There are a number of advisory wings to organisations—BT, for example—where that is how they make their living. I think they take it very seriously; otherwise they would not have a client base. A growing number of analyst groups are quantifying this on behalf of their clients who are investors. I think it is taken very seriously.

**CHAIRMAN**—Would you be concerned that changes to the Corporations Act could impact on investor confidence in that investors would then be unsure of their place in the priorities that directors are giving to the various stakeholders?

**Mr Sheehy**—I do not think that is the issue here.

**Ms Fox**—It is not an issue that our members have discussed, so we cannot really report their views on that.

**CHAIRMAN**—Do you have any views on the relevance of the business judgment rule in the James Hardie situation, where there is this argument that the directors may have been personally liable if they were seen to be too generous to the employees as against their responsibilities to the shareholders?

**Mr Sheehy**—I think the jury is still out on that. We do not want to go down the path of commenting on James Hardie.

**Senator BRANDIS**—I think that is very wise since, given the complexity of the facts of the case, most of the public comments about it have been ignorant.

**Mr BOWEN**—I have a different question but along the same line of thought. I know you do not represent directors; you represent other people. But, generally speaking, do you think it is a concern that it is technically possible for directors and maybe others to have action taken against them if they do act in the broader interests of society and not on a narrow definition of shareholder interest in every instance?

It is possible—I know you argue and argue eminently reasonably—that there is room for directors to take a broad view of the best interests of the corporation, but it is also possible for a small group of shareholders to take a much more narrow view and commence an action. Don't you think, to avoid doubt, it would be possible to allow in the legislation a broader, more permissive view to avoid that possibility for action—without using James Hardie as an example?

**Ms Fox**—I can quote Austin, Ford and Ramsay again, where it does say that the decided cases indicate that management may implement a policy of enlightened self-interest on the part of the company. So I am assuming that if you, as a group of shareholders contemplating an action, are going to seek legal advice then that is part of the advice you will receive.

**Mr BOWEN**—There are people who take a different view. There are people around who, I am sure you will agree, take a much more narrow view than that.

**Mr Sheehy**—I come back to our view and the view of our members—that we believe that the act is adequate at the moment.

**Mr BOWEN**—Okay.

**Senator BRANDIS**—Following on from that last point, there is also a danger of losing sight of the fact that public companies as well as private companies are essentially the custodians of people's private property—that is, their shares. If we lose sight of the property rights of shareholders we will also face some very damaging commercial and broader consequences.

**Mr Sheehy**—I cannot argue with that but the decisions are about the sustainability of the entity and its long-term viability. That, for me, is the issue and that would therefore include the property rights, the short-term interest and the long-term interest. But the decisions ought to be made in the best interests of the organisation for it to survive in the longer term.

**Senator WONG**—The AICD has made a suggestion. Have you read its submission?

**Mr Sheehy**—I have not personally, no.

**Ms Fox**—Yes.

**Senator WONG**—Perhaps then, Ms Fox, can you comment on the removal of the word 'best'?

**Mr Sheehy**—Do you mean that in terms of the best interests of the company?

**Senator WONG**—Yes. Do you have a comment to make on that?

**Ms Fox**—No.

**Senator WONG**—That is probably very wise. Thank you.

**CHAIRMAN**—There being no other questions, thank you Mr Sheehy and Ms Fox for your appearance before the committee and your contributions to our inquiry.

[11.48 am]

**SIMONS, Dr Robert George, National Manager, Strategic Research and Social Policy, The Smith Family**

**CHAIRMAN**—Welcome. We have before us your submission, which we have numbered 25. Are there any alterations or additions you wish to make to the written submission?

**Dr Simons**—No, I just have my opening statement, highlighting points from that.

**CHAIRMAN**—If there are no alterations or additions, I invite you to make a brief opening statement. At the conclusion of that, we will move to some questions.

**Dr Simons**—Thank you. The Smith Family has actively been forging strong and mutually beneficial relationships and ultimately partnerships with Australian businesses, particularly over the last 10 to 15 years. We support businesses by sharing ways to use social responsibility as a competitive advantage so that real results may be achieved of benefit not only to the businesses and their staff but also and most importantly to the local communities in which those businesses are located. Our submission discussed the partnerships that we have cultivated through an illustration of corporate responsibility, the impact these have had in facilitating societal outcomes and the ways in which these relationships can be enhanced in the future.

This presentation today focuses on five key messages which we believe sum up the main points in the submission and the evidence in support of them, which has been distilled. The first message is that there is in fact a greater awareness of and demand for corporate social responsibility among government, business groups and local communities in Australia and around the world. CSR in Australia is receiving increasing attention both within and outside the corporate sector for several reasons. Firstly, the global reach, influence and wealth of businesses have grown, creating a new public awareness and pressure for greater business responsibility. Political liberalisation has also prompted the creation of a more politically aware, organised and vocal civil society. Secondly, governments have proposed changes to the means of support for the provision of social services and for all nonprofits, including an increased emphasis on broader collaboration with the corporate sector through alliances and partnerships. In addition, a range of tax incentives to encourage philanthropy and promote such partnerships has recently been introduced in Australia.

Thirdly, the distinction between company shareholders and community stakeholders has become progressively blurred. Increasing levels of investment by superannuation funds have effectively transformed average citizens into investors, many of whom are expressing more and more interest in company policies and performance, thereby increasing a company's accountability and reporting responsibilities. Finally, employees have begun to demand that their workplaces have sound ethical values and positive community interactions. As we noted in the submission, 81 per cent of Americans surveyed in 2004, for example, confirmed that a company's commitment to a social issue is important in making their decision about where to work, while 67 per cent suggested that failure to commit in such a manner could result in them being less loyal to their job at that company.

Our second message is that CSR is not incompatible with business interests—that is, making profit—and is in many instances beneficial to company performance. CSR is often given practical expression through instances of corporate philanthropy. While this approach has societal value, if it is unrelated to an appreciation of core community values and needs, the effect is one of a dilution of efforts, lacking true commitment and sustainability. Many companies are reluctant to move beyond this model because of a firm belief that CSR is inherently incompatible with business interests and that corporate social spending comes at the expense of economic results. Recent evidence has found this to be untrue, with companies that engage in CSR benefiting from improved financial performance, enhanced brand range, increased sales and reduced costs, among other things. In the words of Dr David Morgan:

Corporate social responsibility is central to sustainable profit creation. Leaders who successfully manage social, ethical, environmental and other non-financial drivers help ensure a stable, resilient company that is better placed to deliver sustainable shareholder value.

Our third message is that there is, we believe, a great potential for community business partnerships—which are sometimes referred to as the social coalition—in contributing to the achievement of mutual goals and the need for more partnerships like these in Australia. Over the past five years CSR in Australia has taken on distinctive characteristics when compared to developments in Europe, the UK and the USA. Let me say that if there is anything that represents a slight shift in focus from the original submission it is in this third message, about driving home the opportunity that is here.

The social coalition prompted by the Prime Minister's community business partnerships scheme is a form of CSR that moves beyond isolated instances of corporate philanthropy to strategic, longer term and active partnerships. For example, the Smith Family's partnership with Colgate-Palmolive started in 1995 and is based on supporting local communities. Developing regional Australia has been the foundation of the partnership with Westpac/Challenge Bank. Harnessing both knowledge and financial capital underpins our work with Mallesons Stephen Jaques, while opening up opportunities for disadvantaged Australians to learn and realise their potential through technology has been the focus of our partnership with Cisco Systems Australia.

At the Smith Family, we believe that the social coalition not only represents a distinctive tradition of corporate responsibility emerging in Australia, it can also be considered a new model with a potential to provide CSR leadership internationally. Investment in its development holds out significant opportunities for all players in the social coalition—corporations, not-for-profits and governments. Despite the range of evidence underscoring the benefits of community business partnerships, it would appear that Australian companies still need encouragement in utilising this approach to CSR. A survey of 76 of Australia's largest companies in 2000 found that more corporate dollars are allocated to sponsorship than to any other community involvement initiative, with community partnerships attracting just 16 per cent of the budget. This is not to say that the motivation is not there, for the same survey pointed out that CEOs were keen to increase their community partnerships, if a little unsure as to how to do so.

The fourth message quite simply is that not-for-profit organisations such as the Smith Family are able to model a donor leverage effect by stretching the value of the funds they receive through targeted interventions. I will not go into the detail of that—it is clearly stated in the submission—but, effectively, \$1,000 invested by an employee delivers an estimated \$37,000

community benefit through TSF's early intervention program, as a point in illustration. That can be illustrated in other ways also.

Finally, the fifth message is that business success is now more than ever intertwined with the quality of local institutions and customer demographics, increasing the prerogative for companies to fully integrate CSR and partner with non-profit organisations to achieve societal change outcomes. It is no longer feasible for corporations to avoid CSR as a bad business decision. The future of Australia is linked to its corporate future and as such CSR is less of an option than a given in the current environment. On a global scale, the sheer weight of the corporate role in wealth creation and the footprint associated with this creative process make responsibility and accountability from many different perspectives inevitable. The Smith Family's research and evidence have shown that long-term sustained partnerships have a greater chance of addressing complex societal issues and are less likely to create dependent, unequal relationships between partners.

In conclusion, the Smith Family supports and encourages the position that the time has arrived for a greater number of Australian companies to move from viewing CSR as a minimum standard to an integrated component of strategy and operations in providing leadership in the continuing development of a distinctive model of corporate social responsibility, which I have referred to already as the social coalition. Indeed, the business and community environments are right for such a development, we believe, and the Australian community as a whole would benefit from such a move.

**CHAIRMAN**—You have referred to the benefits derived from the Prime Minister's Community Business Partnership scheme as being important for corporate responsibility in Australia. You are obviously seeking a continuation but also an expansion of the public promotion of corporate responsibility. Could you outline your vision of the way in which the government can broaden its involvement in this aspect of public responsibility?

**Dr Simons**—My response will have two parts—firstly, what we have learnt over the last seven years in particular in trying to do this and, secondly, how we think the government can further add to this. We realised very early on in the piece that, despite the attractiveness of the development of corporate partnerships as opposed to corporate sponsorship or corporate philanthropy, quite a bit of culture change was required for us to be able to move all of our eggs into one basket, so to speak, in the development of our corporate relationships. So it would be very helpful if the government, in addition to initiatives like those already taken with the provision of awards, were to consider other possibilities of communicating the profile of successes with greater impact than is presently the case. The awards are fine as far as they go but we would like to see some way of communicating in a more consistent and regular fashion the importance of this, and work with a number of organisations in doing so.

**CHAIRMAN**—One of the proposed initiatives in your submission is the use of partnership brokers to facilitate partnerships between corporations and community groups. Can you tell me how these currently operate, how successful they have been and how that might be expanded?

**Dr Simons**—Again I can appeal to an experience that we had at the Smith Family as the platform from which we proposed the suggestion. That is the attraction of different skill sets, which we have been involved in for the past 6½ years, specifically into our own organisation.

There was a time when 85 per cent of our staff came from a social work background. I would say we are much closer now to 60 to 65 per cent in the corporate sphere. We consider that an immense advantage in developing the types of skills that are needed to relate to the corporate sector and to speak the same language.

So it does seem that if one were able to identify and leverage people who have been in the process of developing these skills—obviously our group is not sufficient to get the type of impact we are talking about here today—and who have had experience in this area, and to share the experience and the lessons learned from that process, that could be one way of doing it. For example, the model used by Microsoft in developing the Unlimited Potential network sought, first of all, to identify where there were already community technology learning centres around Australia that could form a network into which more resources could be leveraged. It is a similar type of thing: identify the people, develop a map and then bring them together to create greater impact.

**CHAIRMAN**—Can you outline for us some of the difficulties that you experienced in engaging corporations in corporate responsibility activities and how, perhaps, you have overcome them or how they can be overcome?

**Dr Simons**—Whether the initiative started from our side or from a corporate—and Microsoft provides a good example of that: we were approached by Microsoft; we did not approach Microsoft in this regard—what we found was that there was still a very labour intensive period that had to be gone through, even after an MOU might have been achieved with agreed contributions from both sides and you thought you were speaking the same language and aiming for the same objectives. It took an awful lot of time to arrive at the point we are at now, where we are actually moving forward quite smoothly. The lesson there, I suppose, is simply not to assume that you have understanding before you have tested that understanding in moving forward. The second lesson is to be prepared for the investment that will have to take place on the part of the not-for-profit in the process, as well as the investment that is coming from the for-profit, because it is considerable on both sides and initially neither side probably realises fully what that investment is.

**CHAIRMAN**—You also indicated in your submission that corporate responsibility measures are beneficial as a long-term corporate strategy from the point of view of the corporation. Given the ‘short termism’ that tends to have been evident in corporations with short-term executive appointments, pressure for short-term financial results and the like, how can corporations be encouraged to focus on that longer term successful business outcome which you say would emanate from corporate responsibility involvement and, perhaps, the longer term sustainability of the corporation?

**Dr Simons**—Here Westpac provide an excellent example. It was back in 1999 that they provided \$1 million of growth capital whereby we could begin to move the Learning for Life programs into rural and regional Australia. We simply did not have the capacity to do that at the time. Following upon that initial growth capital, and then a subsequent investment in the second year, let us assume that at the top level of Westpac there were changes. We also set in train a number of levels of initiatives to engage staff at different layers throughout the organisation. So what I am saying here is that the layering—once you have the significant investment that is going to provide a platform from which you can see a longer term outcome develop—stays with

the corporation until that, in fact, is realised. That provides your window of opportunity to begin to develop at different levels. The way the different levels have developed is specifically through the involvement of mentoring and other forms of tax deductible giving by the employees within Westpac. At this stage there are at least three or four different layers on which Westpac, as a corporation, is involved with the Smith Family as part of a corporate partnership.

**CHAIRMAN**—So your particular interest in corporate responsibility relates to what you call the partnerships or what might be defined as business philanthropy?

**Dr Simons**—Yes.

**CHAIRMAN**—How does your organisation relate to the broader issues of corporate responsibility? Indeed, as a not-for-profit organisation, how do you exhibit those broader aspects of corporate responsibility in your own operation?

**Dr Simons**—One of the key ways is that, before we undertook the change agenda that has been driving our shift from a traditional welfare organisation to a social enterprise with a preventive early intervention strategy focusing on education and lifelong learning, the very first task was to look at our corporate governance. We developed a model that we believe to this day is cutting edge in the not-for-profit sector. That was a proactive move to make sure that if we were going to talk about corporate responsibility we had all of the previous or prior work that needed to be in place within the Smith Family situated there.

**Ms BURKE**—So do you report on that?

**Dr Simons**—Yes.

**Ms BURKE**—I understand you have taken an approach of generalising this social responsibility issue, but I suppose that when we report these things there are environmental and employee issues and all of the rest of them. How do you marry up those competing interests to say someone gets the gold star? I know that sounds silly, but you would know what I mean. Is there an overriding issue in your mind that is greater or do you look at the whole impact of these issues?

**Dr Simons**—Let me try to respond to that question by making reference to not only what in some people's minds is the totality of the Smith Family, namely, our social enterprise. This is also an opportunity to say that the Smith Family has a commercial enterprise. That has been part of the outcome of having been founded by businessmen. Most people are not aware that we were in fact founded by businessmen. One of the aspects of that was sustainability of funding and investment to diversify the funding base to make sure we can keep up what we are on about.

We have had to look at the perspective of our commercial enterprise, which is a non-woven textile industry, and then also at what we do in the social enterprise to make sure the governance procedures and the workplace culture are reflective of best practice. In both cases it has involved a different set of social and environmental factors to keep in mind. With the commercial enterprise, if I can refer to that momentarily, one of the things we had to realise is that the collection of clothes, which used to be part of the emergency help component, which is being phased out, was no longer a viable way to assist the disadvantaged in Australia. It did not make



sense as people could buy clothes more cheaply at Target and other places, plus it cost us more to process some of these clothes. The whole purpose of the commercial enterprise is to support what we are doing as a social enterprise. So we have not only had to go through—and are still going through—the massive culture change involved in bringing about a shift to focus on what was one of three activities in the commercial enterprise but we have also had to acquaint ourselves with what was happening internationally so that we did not have a sunset industry that was not going to be able to support what we were doing socially.

We set up a series of expectations with our social enterprise. We have a long-term outcome and goal that we are working on. It is not going to look very good and we are not going to do much to sustain the trust of the community if we go bust, so to speak. The commercial enterprise is one component whereby we have had to address the issue of governance. That is as well as addressing it in the social enterprise. In both areas the range of issues that are customarily associated with corporate responsibility have all been touched on in combination.

**Ms BURKE**—If I were to ask one of your staff, how do you think they would rate you? Would it be a good place to work but also acknowledging your social responsibility? I know that is an unfair question, but I think people forget to look at it from that angle.

**Dr Simons**—What I will comment on directly will be the staff that I know in the national office for the social enterprise here in Sydney. I can honestly say that with the change to which I referred before, with the different skill sets that we have attracted into the organisation, there is a genuine and sustained level of excitement, enthusiasm and interest in what we are doing. People from the corporate sector, as would be no surprise, undergo a salary cutback to come on board to work with us. We believe we have salary scales that are very competitive within the not-for-profit area, and they have to be to attract the right people. But people who come to us are doing so because they believe what we are on about.

If we go to the commercial enterprise, in the commercial sector it is the senior people that I would be most familiar with and they are there for a comparable reason to that which I just referred to in the social enterprise. We have had challenges, shall we say, in trying to bring some of our more junior levels of staff along with us in some instances, particularly when they may not understand the strategic shift that we are taking, but we believe we have also worked very closely with our HR departments, both in commercial and social, to assist in facilitating that process so we can bring people along.

**Ms BURKE**—On the partnerships you have had with the various corporations, some of these are wonderful programs and I commend you on them, but do they have longevity? Are they like: ‘We will pick the thing, we will do it now, we will feel good and it will be over,’ or are there some really long-term goals coming out of them?

**Dr Simons**—First of all, we recently did a study on community sponsorship as opposed to donors for our Learning for Life program and we were very pleased to find out the number of sponsors that we have on our Learning for Life program over a 10- to 12-year period in some instances. What we have identified is that the idea of developing a relationship not with the children and young people in the context of their families over a period of time for clearly identified goals and objectives is something that is attractive to the community, and we are seeing the results from the students and the children on the basis of the research that we have

been carrying out for the past three years with the Australian Council for Educational Research. We are evidence based and we are evidence guided and led in how we do this. I might take this opportunity to say all of the research that the Smith Family engages in is for no other purpose than program development and social policy development. It is program development oriented.

In terms of the lasting impact, because we have taken a life-cycle approach we started out with the limitations of the Learning for Life program, which went through the primary, secondary and tertiary components of schooling. We have now moved into the early years through our involvement as a facilitating partner in seven communities for children sites. So we have a long-term approach using education/lifelong learning as a preventive strategy towards building up the skill base of all of the participants in our program so that they do not become disadvantaged in an intergenerational way. The infrastructure that I am talking about here speaks for itself—we are not just a flash in the pan.

**Ms BURKE**—I was talking more about the corporations, not the Smith Family but the people who partner with you, as to whether sometimes it is just nice for their annual report as opposed to being a commitment. That is what I was getting at: not your commitment to it but the commitment of the people you have partnered with.

**Dr Simons**—That is one of the critical points that Senator Chapman raised before in relation to our involvement with the corporations—their appreciation for the long-term impact that we are working for. That is why we are trying to attract long-term investment, not just for pilot projects that are one-offs.

**Senator BRANDIS**—I want to congratulate you on what I thought was an extremely thoughtful presentation. What comes across loud and clear to me from what you have said and the anecdotal evidence you have given from the experience of your own organisation is that there does not seem to be any particular narrowness or mean-spiritedness among corporate Australia when it comes to an awareness of their social responsibilities, particularly, obviously, in those firms who have engaged in the sorts of partnerships and other philanthropic endeavours you have described.

**Dr Simons**—I think it is fair to say that, once we and the corporations that we have been dealing with arrive at a similar place, there is not. I would not describe any of the people we have been working with as mean-spirited, but there is a question of education, learning and culture change. We have undergone culture change and, when corporations are moving towards a partnership focus, that also entails quite a degree of culture change.

**Senator BRANDIS**—So, if I can use my own language, I suppose there is an advocacy issue and an issue of coming to an understanding of just what can be achieved by corporates in partnerships with charities and organisations such as yours?

**Dr Simons**—Clearly. The advocacy is not simply about speaking to a disinterested observer but about exciting the interest and motivation of the corporates to be engaged in something they can see has value for them as well as for what we are on about.

**Senator BRANDIS**—Do you find that, when a corporate becomes involved in one of these partnership projects, there develops a real enthusiasm for the objective of the program, not just at

the board level but among the staff of the corporate as well, and that they adopt it with passion almost?

**Dr Simons**—That is clearly the case. Let me give you a specific example. Within the last three months, we have taken on a full-time national manager of corporate volunteers. This is to handle the offers of volunteering we receive from the staff of the corporates with whom we relate. Five weeks ago, we were overflowing with offers. In one sense, this is the usual situation, because we always get many more offers than we can handle for all of our Christmas activities. But I am not just talking about those activities—a whole set of activities that have been projected for the next six months have been filled. That is because they are coming from the corporates that we have been dealing with. Messages have begun to seep through the organisation. Once that happens and people get an understanding, you get the attraction—you get the motivation.

**Senator BRANDIS**—Is it your general impression—and I appreciate that this can only be an impressionistic matter—that the culture of corporate Australia broadly is, more and more, changing towards hospitality—towards the sorts of philanthropic activities you have described?

**Dr Simons**—As you have rightly said, this comes from the perspective of our experience, but do not forget what I said about how labour intensive it has been to arrive at this point. There not only appears to be an openness and willingness to move in this direction but, going back to the point I made in my third message, I think there is also an incredible opportunity, if we can communicate it adequately, to make that threefold investment from the corporate, not-for-profit and government sectors on the development of a new model which has an awful lot to offer in terms of where we can go with this.

**Senator BRANDIS**—And that feeds back to the point I made to you earlier about advocacy.

**Dr Simons**—Yes.

**Senator BRANDIS**—Are you familiar with the work on this by Professor McGregor-Lowndes of QUT?

**Dr Simons**—Very much so.

**Senator BRANDIS**—He is the leader in the field, isn't he?

**Dr Simons**—Yes.

**Senator BRANDIS**—The other thing that struck me loud and clear from your submission is that all of these happy and beneficial developments are occurring within the existing legislative framework. I note that you are not calling for any amendments to the Corporations Act, but I wonder whether you have turned your mind to or are aware of research that is directed to the question of whether amendments to the tax act could be made to incentivise these sorts of partnerships?

**Dr Simons**—I am not prepared to comment on that specifically, but we have done and continue to do that. Our company secretary addresses those questions in greater detail. In relation to the Australian Charities Foundation, we were very much in the process of the move

towards the workplace giving changes that came about as a result of that, and we see that as an important area to continue focusing on.

**Mr BARTLETT**—I want to take that one step further. Dr Simons, is it your view then, following on from that, that the way to further encourage business partnerships, cultural change, CSR et cetera is through education, greater awareness of competitive advantage and further cultural change rather than legislative change in terms of reporting requirements or directors' responsibilities?

**Dr Simons**—From what we have done and the scope of the way our submission was framed, I would have to say yes to that question. I am not in a position to comment on the law in more detail. When we approached our company secretary about possible contributions to this, there was nothing forthcoming. I am not necessarily opposed in general or in abstract to that, but we have not arrived at that point ourselves.

**Senator BRANDIS**—You have not identified a problem with the law as it currently operates for what you are seeking to do?

**Dr Simons**—No.

**Senator WONG**—Do you perceive a distinction between the notion of philanthropy, which is obviously worthy, and the concept of corporate responsibility?

**Dr Simons**—What we were trying to say in the submission is that philanthropy can be—in the experiences we have had of it—fairly ad hoc and short term. It does not have to be and there is nothing wrong or negative about philanthropy, but if one becomes interested in longer term outcomes that need sustained investment from a number of areas then corporate partnership and response and corporate partnership as an illustration of corporate responsibility is something that we are very much interested in.

**Senator WONG**—I am sorry that I had to pop out for the first part of your evidence. In terms of this corporate partnership, do you try and engage companies to do work with you that is relevant to their core business—as opposed to a bank making a contribution to an orphanage; a bank actually making a contribution to financial literacy?

**Dr Simons**—I have two examples. I mentioned earlier Microsoft and our partnership with them in the Unlimited Potential network of community technology.

**Senator WONG**—I think I have heard you speak on this previously.

**Dr Simons**—Okay, but let's take the bank. We are presently working with ANZ in the continuing development of the Saver Plus and Money Minder pilots. Obviously, you can see the mutual benefit there. The whole idea of the partnership is that that is precisely the point. We have identified an area where there will be a mutual takeaway—no pun intended.

**Mr BARTLETT**—Do you have a view about what might represent world's best practice when it comes to government encouragement of CSR? For example, I note that in Great Britain

there is a minister for corporate social responsibility. Are there other examples that this committee should be looking to as world's best practice?

**Dr Simons**—Earlier in relation to the chairman's question, which I will connect with your observation, he asked me whether we saw anything the government could be doing to promote the social coalition. Certainly, increasing the visibility and the designation of a ministerial post would be one way of doing that. I think we would feel quite positive about that.

**Mr BAKER**—Following on from Senator Brandis, I was encouraged when you said that the outstanding success of the corporations was from a voluntary perspective. You mentioned an example with the ANZ. Can you give further examples? Would you agree that on a voluntary basis where corporations become involved it is a mutual win-win compared with an onerous burden of regulation?

**Dr Simons**—One other very striking example is our relationships with Shell Australia and Rio Tinto. With Shell Australia, the interest that they have expressed in our pre-literacy program 'Let's Read' has been phenomenal in relation to their seeing the interface between outcomes from that program and the communities in which they are working. Perhaps an even more cogent example is our relationship with Rio Tinto, where with our work in Western Australia and with Indigenous communities Rio Tinto are very keenly aware of the need to be able to tap into an employable, well-educated and well-prepared Indigenous population for their work in many different areas. We are also working with a number of other mining companies as part of broader consortia in WA with that end in mind. So, in the case of the mining companies, the need for employable skilled staff is clearly related to our objectives to improve the retention and achievement rates of the Indigenous communities with whom we are working. The Let's Read strategy, which focuses on children in the nought to five category and their parents for the development of pre-literacy skills and to stimulate the brain development of the child prior to school, is another example where we were able to have a meeting of minds in moving forward.

**Mr BAKER**—Thank you. I congratulate you.

**Senator WONG**—Going to back to the issue of philanthropy and core business, when you deal with a partner you are engaging them in relation to a specific set of activities or a joint project where there is some mutual benefit. You do not necessarily take an interest in what might be the other aspects of corporate responsibility—how they deal with their suppliers and what, if any, ethical considerations they apply to their supply chain, their employees, their environmental footprint and all those issues. I am not being critical of that; I am just making an observation. The partnerships are reasonably specific.

**Dr Simons**—However, I would say that we would not be in partnership with any of those groups if our perspective and our analysis of where they were at identified major problems in that area. We do not want to be seen as collaborating with people who are not responsible in the broader sense.

**Senator WONG**—It is certainly no criticism of you, but that is from your perspective of what you may or may not want to be associated with.

**Dr Simons**—That is exactly right.

**Senator WONG**—You do not necessarily try and spur them. It is not your business to try and say, ‘Actually, there are a whole range of other things that your business might do.’ That is essentially the company’s business.

**Dr Simons**—That is right.

**CHAIRMAN**—Thank you for your comprehensive presentation. It has been very useful.

**Dr Simons**—You are very welcome.

[12.30 pm]

**KIRKLAND, Mr Alan John, Treasurer, Australian Council of Social Service**

**O'DONOGHUE, Mr Philip John, Deputy Director, Australian Council of Social Service**

**CHAIRMAN**—Welcome. We have received your submission, which we have numbered 70. Are there any alterations or additions you wish to make to the written submission?

**Mr Kirkland**—No.

**CHAIRMAN**—I now invite you to make an opening statement, at the conclusion of which we will have some questions.

**Mr Kirkland**—If the committee is happy, I will make a few comments and then hand over to Philip O'Donoghue to also add some comments as part of our opening statement. Our submission and our comments today focus on a few issues. One is the issue of corporate social responsibility in general and the other is the issue of how that applies within the community services and welfare sector, for which ACOSS is the peak body.

In opening, we would like to make a few conceptual points about corporate social responsibility. The social part of it is quite important for us in that a lot of the early thinking around corporate responsibility has focused on environmental responsibility, which we see as being extremely important, but there has been a lot less development, literature and research and fewer initiatives around social responsibility. Where there have been initiatives focusing on social responsibility, they have tended to focus on the role of corporations as employers, which again we would see as important, but we would argue that corporate social responsibility needs to be even broader again. It needs to encompass issues such as the role of corporations as major players in regional communities and as players able to influence community wellbeing and community development. Corporate social responsibility needs to be seen within that broader frame.

We would also say in general that corporate social responsibility tends to have been seen as a separate area of work to notions such as good governance and it is often pursued by separate units within corporations. In our view, corporate social responsibility should be seen as part of good governance. I think that Australia has got a long way to go in terms of integrating corporate social responsibility initiatives into general decision making and good governance in corporations.

We distinguish between corporate social responsibility and minimum standards, which I know is one of the issues that the committee is looking at. We believe that both are important but we think that corporate social responsibility is about setting a higher benchmark for performance than just minimum standards. At the same time, we believe that the minimum standards that exist in areas such as minimum wages, equal opportunity, antidiscrimination laws, environmental protection, competition, consumer protection and other similar areas are critical and need to be retained.

In particular, we note that in a number of those areas the legislative frameworks place obligations on directors individually as well as placing obligations and the risk of penalties on corporations, and we see that balance as being critical. Without having some risk of penalties for the individual in some of those matters there can be very little sanction, particularly if a company goes out of business. The main points we would like to make are initially about corporate social responsibility, for which I will hand over to Philip in a moment, and then I would like to come back to some issues about how corporate social responsibility applies to the not-for-profit sector. I will now ask Philip to make some comments on responsibility.

**Mr O'Donoghue**—I am going to make some reference to some research that we helped manage through the Department of Family and Community Services. I understand that the report was distributed to members. What that research is showing is that there has been some general improvement in corporate social responsibility activities by the business sector, which is obviously welcome. We think there are some issues that the committee should consider for fostering that continuing development and some drivers suggesting that there is a need to do so. In particular, we think it is worth while clarifying and developing the responsibility of directors to facilitate corporate responsibility activities. Our understanding is that it should be accepted as a legitimate function of corporations, rather than a corporation's sole or exclusive responsibility being to enhance shareholder value.

It is clear from the research that we undertook for the Department of Family and Community Services, via the Prime Minister's Community Business Partnership, that some businesses operating in the for-profit sector do not accept that as their responsibility. In fact, on page 34 of that report it charts and estimates, based on a random sample of Australian businesses, the number of businesses that are making donations. Twelve per cent of Australian businesses do not believe that it is their responsibility to make donations. There is some evidence there that admittedly a minority of Australian businesses are questioning whether or not their role is to engage in a socially responsible way, at least in the form of donations.

There is a need for some clear and agreed terms and systems to ensure that corporate responsibility activities are accurately measured and monitored. Through that research, an effort was made to replicate the research done by the Australian Bureau of Statistics some three years before. It was hampered for a number of reasons, including that there is no agreed terminology for accounting for such activities. This means that the committee and the community, including the business community, are largely blind in terms of details of activity there. There would seem to be some benefit in getting some agreed terms, definitions and systems for monitoring activity on a regular basis.

It is also quite clear that, in both the for-profit and not-for-profit sectors, a number of characteristics need to be taken into account when looking at corporate responsibility activities. Size of entities is one of them. Larger corporate entities are significantly more active than smaller ones in a range of corporate responsibility activities, although smaller businesses, because of their sheer weight of numbers, actually account for most activity. However, we found through that research that their ranges of community engagements were greatly different based on size. Size also reinforces another key characteristic: essentially, metropolitan versus nonmetropolitan. Larger businesses tend to be based in metropolitan areas and smaller businesses in regional areas. So any failure to take that into account is likely either to be underestimated or to prejudice activity based on a spatial dimension.



Alan will talk in a moment about some of those issues across sectors, namely between the not-for-profit and for-profit sectors. One of the findings of that research was that both the industry within which businesses operate and the function that they perform within the marketing channel of that industry are determinants of the extent and nature of corporate social responsibilities. Generally speaking, businesses that are engaged in direct customer service provision are, not surprisingly, more actively involved in a range of corporate social responsibilities as a way of enhancing their reputation. The engagement of those that are back-of-office in nature is somewhat less. Again, this is worth keeping in mind, as any overall increase in corporate social responsibility does not necessarily reflect community need; it is more likely, in the first instance, to reflect the predisposition of those businesses that are doing well in the economy or are large at any point.

We agree with other submissions made to the inquiry that the committee should consider mechanisms for ensuring that the conduct of corporations operating in Australia is consistent with their operations overseas and are mindful that, for many, this is occurring in jurisdictions where government has far less capacity to monitor, regulate and influence the behaviour of corporations, particularly in developing countries.

I would like to add a small addendum to the comments Alan made regarding minimum standards. A broad factor that is changing suggests the need to review those as well, because they are fundamental to corporate responsibility. Right now, the government is engaged in major legislative reform in relation to both industrial relations and welfare to work. This is going to have the effect of transiting large numbers of disadvantage, jobless people into the labour market as a condition of income support, and lowering their income.

This will include large numbers of people with disabilities and sole parents seeking employment, so the legislative and other programs related to equal employment opportunity, reasonable adjustments and family friendly arrangements for those cohorts in the community should rise to reflect the proposed very substantial increase in the number of people seeking employment, largely with business, who will face the need for reasonable adjustments, less discrimination in employment and so forth. I will hand over to Alan to talk a bit about the non-profit sector.

**Mr Kirkland**—Just a few final words. As I mentioned in relation to not-for-profit organisations, there are many organisations in our sector that are keen to take up corporate social responsibility initiatives and are possibly already doing so. There are a few things, though, that distinguish them from companies operating for profit. One is that directors are almost always unpaid or voluntary, yet they carry the same weight of responsibility, which needs to be taken into account when you are looking at additional responsibilities. Many organisations are small, with extremely limited resources, and are entirely reliant on government funding that often does not keep up with CPI. That means they have very limited control over their purchasing practices and very little market power, which places them in a more difficult position when it comes to issues such as where products come from.

A further issue is that the legislative environment is very complex, so organisations may be operating under the Corporations Act as companies limited by guarantee. They may equally be operating under state associations incorporations legislation, and in other areas they may be subject to a mix of state and national funding responsibilities and legislation. That means that the

general compliance costs of running an organisation in the not-for-profit sector are often higher and are often borne in some part by volunteers. I think many organisations are willing to engage in corporate social responsibility but they require more information and support than many private sector corporations in order to achieve that shift. A further issue that complicates it is that there is a lack of a common accounting standard for not-for-profit entities, which means that it is very difficult to benchmark their financial performance and it is even more difficult to benchmark their corporate social performance.

**CHAIRMAN**—Thanks very much. In your submission you suggest that the Corporations Act might be amended to ‘include a statement that it is not unlawful for corporations to engage in activities that promote corporate responsibility’. You refer to some American state jurisdictions that have made this sort of provision. How do you propose that such a statement, which would presumably be non-binding, would change the way that corporations approach corporate responsibility? A related question is: is there a danger that directors might use this as another safe haven, as it were, for irresponsible decisions on the financial side?

**Mr Kirkland**—To answer the first question, I think that the change it would achieve would be to put to bed the debate about where the boundaries of corporate social behaviour are, particularly where they involve expenditure. I am sure the committee is well aware from the progress of the inquiry today that there is still an active debate. It is probably not as great as it was a few years ago, but there is still an active debate about directors’ duties and where the boundaries are for spending money, engaging in activities and devoting staff time to activities that are not absolutely core to the profit-generating activities of the company. That is a debate that is often played out or pushed by institutional investors, so it is very much alive and active.

Obviously some corporations have decided that that is not an issue and have developed very positive initiatives. What we are saying is that if you made it clear that there is no bar under the Corporations Act then you would put that debate to bed. As to whether it would encourage more irresponsible behaviour, we have seen that it is difficult to frame legislation to prevent all forms of irresponsible behaviour. That is the history of the Corporations Act. But I think that a well-intended provision—one that is clearly intended to encourage positive social behaviour—is probably less likely to lead to irresponsible behaviour than other amendments that might arise.

**CHAIRMAN**—In your experience, particularly based on your recent report, *Giving Australia: research on philanthropy in Australia*, are there trends evident towards more strategic and longer term corporate philanthropy as part of corporate responsibility?

**Mr O’Donoghue**—Yes, it is one of the encouraging things. The best comparison to make with the earlier ABS study is the nature of corporate activity and the proportion of business giving. Donations, sponsorship and community business partnerships are the three main categories that the ABS collected three years prior and that were repeated through that study. Basically, it shows that there has been a reduction in the amount of sponsorship as a proportion of business giving, an increase in the proportion of community-business partnerships, and some increase in donations as well.

Particularly, the community-business partnership is a somewhat more sophisticated and more sustainable form of engagement by business with the non-profit sector because it tends to take into account business strategy rather than the very traditional approach in this area, which is

essentially CEO-favoured charities, where the owner-manager gives to a charity of their preference. Then when the personnel turns over there is a loss of that support because it is not really integrated.

**CHAIRMAN**—You also referred to the multiplicity of different mechanisms under which non-profit organisations secure legal status as being a detraction from a sound framework for transparency and the like. Do you have any suggestions as to how that can be overcome and perhaps the non-profit sector can be more encouraged to embrace corporate responsibility—if lack of it is a consequence of the multiplicity of structure?

**Mr Kirkland**—We are aware that there is an initiative at the moment to reduce red tape for business and certainly some of the principles that are being applied to that approach could very easily apply to the not-for-profit sector in that many of the issues—such as registration of names and registration of corporate entities under the state and territory versus federal legislation—arise for not-for-profit organisations. I guess if some of that work were extended to examine the amount of red tape applying to the not-for-profit sector that would be one useful initiative.

The other useful initiative would be one that I touched on earlier, which is some work on common accounting standards for not-for-profit entities. At the moment we have quite inconsistent and perverse results from applying the common accounting standards to not-for-profit entities. For example, major accounting practices have radically different views about how to treat grant income when they are auditing accounts of not-for-profit organisations. That means that there is a lot of time spent arguing over how things should be treated. It also means that there is transparency within a particular view of how you apply the accounting standards but you cannot compare the ways in which two organisations have been audited and have reported. I think some government support for moves towards a common accounting standard for not-for-profit entities would be very positive.

**Senator BRANDIS**—Is that work under way? Are you aware of whether any of the professional accounting bodies have in prospect a project to recommend a common set of such accounting standards for not-for-profit organisations?

**Mr O'Donoghue**—I am not aware of any accounting organisations doing so.

**Senator BRANDIS**—What about governments?

**Mr O'Donoghue**—There are some public policy initiatives of some note in this area—mostly occurring at a state level. The Department for Victorian Communities is undertaking a project which is consulting about the legal frameworks that necessarily underpin accounting and auditing requirements and the establishment of entities in the non-profit sector. The Queensland government as well is doing some work around a non-government project that is looking at some of these issues. In particular, the Queensland University of Technology's Centre for Philanthropy and Nonprofit Studies has had a rolling research program in this area. In the work that I am most familiar with, they accumulated the funding requirements for non-profit organisations from just the Queensland government agencies. They did not look into the requirements of local government or the Australian government. They found that there were several hundred different definitions of salaries being applied.

Essentially, every public servant who is administering a program to a non-profit organisation, in a ridiculously inefficient way, makes up their own guidelines for funding. This is a corollary to what Alan was saying in that it occurs in the non-profit sector. It is very common, particularly in the community services and welfare sector, where a lot of functions are funded by government at all levels for delivery, to have a whole range of quite inconsistent accounting and reporting requirements that create an administrative burden on organisations that are often quite small. It also increases the risk for voluntary and unpaid committee and board members or directors, who can get quite anxious about their legal and financial responsibilities for small entities that face a great deal of risk. The increasing insurance cost has been a driver for concern about risk at all management and governance levels in our sector as well.

**Senator BRANDIS**—Mr Kirkland and Mr O’Donoghue, are you urging the committee, when we come to deciding what recommendations we make to government, to recommend that there be a common set of accounting standards adopted for not-for-profit entities—in relation to the philanthropic sector, at least?

**Mr Kirkland**—Yes, the not-for-profit sector. I guess the point I raised is in relation to my comments about how corporate social responsibility applied to not-for-profits, but it is also important in terms of the role of corporates in that the way in which a lot of corporations engage in social responsibility is by supporting not-for-profit organisations. They need to make decisions about which ones to support which requires transparency and comparability.

**Senator BRANDIS**—Sure. I see your point. So not only would it be intrinsically efficient to do that but it would also have the additional beneficial consequence of making it easier for these partnerships to be created.

**Mr Kirkland**—I believe so, yes.

**Senator BRANDIS**—Mr Kirkland, I did not quite understand you a little earlier. Were you advocating that there should be a two-tier level of directors and senior officers’ duties as between corporate and not-for-profit entities?

**Mr Kirkland**—No, I would not have put it in quite those terms. What we were saying is that if there are moves to encourage a greater shift towards corporate social responsibility, there needs to be recognition that for many not-for-profit organisations they will be slower in making that shift and they may require additional information and support in order to be able to do that.

**Senator BRANDIS**—But you accept that the same legal and fiduciary duties should be common to profit and not-for-profit corporates.

**Mr Kirkland**—I think probably the number of duties that applies is probably a bit too broad for me to answer that question on the spot. In broad terms, we are comfortable with organisations that choose to become companies limited by guarantee to fit in with the Corporations Act. But, as part of reducing red tape, it would be beneficial to actually complete the review of the legal frameworks applying to not-for-profits, which would include not only the state and territory legislation but also the application of the Corporations Act to not-for-profit organisations.

**Senator BRANDIS**—I must say, as a more general comment, Mr Kirkland and Mr O'Donoghue, you give corporate Australia a pretty good scorecard, which pleases me. I see, for example, that in the chart on page 5 of your submission the survey of social attitudes places major Australian companies considerably ahead of churches, the public service and courts in terms of the public's respect, which is encouraging. I also note, Mr O'Donoghue, your observation that not only is the level of corporate philanthropy increasing but also the mode of corporate philanthropy by more and more adopting partnerships is a more beneficial and sophisticated—I think that was the word you used—mode of corporate philanthropy. Hence, I suppose that begs the question: why do we need to change the law? The only person at the coalface we have heard from today, if I can use that expression, was Dr Simons from the Smith Family who did not think we needed to change the law at all. The current regulatory and legal framework was, he thought, very congenial to the favourable developments you have described.

**Mr O'Donoghue**—There are a number of factors underpinning the trends in some of our research and that of others. Minister Patterson, at a function the other day when talking to the Giving Australia research, made the similar observation that one of the fundamental factors underpinning increasing giving in Australia has been more than a decade of economic prosperity and that this is one of the main drivers, together with a larger population and a larger economy generally.

**Senator BRANDIS**—I am sorry to interrupt. I do not know if you heard his evidence but Dr Simons also was of the view that there is a discernible change in the corporate culture in this country towards a greater awareness of and willingness to participate in philanthropic activities. Is that your experience too?

**Mr O'Donoghue**—We think there is some research to underpin that in the Giving Australia project. Whether it means that we need to rest on our laurels in terms of continuing legislative reform is a different matter. The reference I made to finding that a significant minority of business not seeing it as their role is suggesting that there are some traditionalists in that area.

**Senator BRANDIS**—It is a free country. People do not have to give away money if they do not want to.

**Mr O'Donoghue**—They do not have to; this is true. In fact, we are not requiring that either. It would seem that in giving the only people who are forced to do that are the unemployed people in Work for the Dole in volunteering. No, really what we are suggesting is that there should be—

**Senator BRANDIS**—You will lose us if you make cheap partisan points.

**Mr O'Donoghue**—Okay, fine. It is a longstanding policy of ACOSS but you are quite right: it is a bit of a furphy. We are looking at wanting to continue to facilitate—it is useful. Realistically, there is always some risk of economic downturn and so that may well be the test of corporate Australia's commitment to activities as to whether or not it is a 'good time' activity or not. We do not have good systems for collecting information right now. We can, in general, say it has been improving but, in particular, we are hampered by the absence of good information, or even some minimum collection of that, to allow for monitoring. From the community services and welfare sector one of the major beneficiaries of corporate philanthropy actually is our sector. And we will, of course, be the sector that will, in the first instance, be directly under the gun if

there were any change in economic circumstances. So any risk to community support will be felt first and hardest at the same time as we will face more demand for our services. So we have some interest in at least knowing what is going on in some detail.

**Senator BRANDIS**—It sounds to me that you have an interest in the continuity of the status quo.

**Mr O'Donoghue**—We would like to see a continuing development of corporate social responsibility; this is true. There has been development. We have argued that we think that there would be some benefit in facilitating that and keeping it informed.

**Mr BOWEN**—I have two questions. The first relates to corporate social responsibility in its wider definition than just philanthropy. The second, specific question is to you as an organisation which represents, indirectly, perhaps the most impecunious in our society. How do you think our financial institutions are rating in their broader corporate social responsibility? I am particularly thinking of lending criteria and encouraging people who perhaps can ill-afford more credit to take more credit. I know this has been an issue in previous years. Do you have a view that our financial institutions are improving or are not improving?

**Mr Kirkland**—That is a difficult question to answer but certainly anecdotally, through direct contact with organisations that provide advice and support to people on very low incomes, there are constant stories of people being given access to credit cards and loans in circumstances that are difficult to believe, where it is clear that they have very limited capacity to repay or, if they do have a capacity to repay, it is going to be stretched over a period of 60 or 70 years. So it is difficult to say whether there is a trend one way or another, but certainly there are very questionable lending practices still going on.

**Mr BOWEN**—You think it is still an issue? Your organisation would say it is an issue?

**Mr Kirkland**—Absolutely.

**Mr BOWEN**—You probably will not have a response to this but I think, in particular, there is an issue where banks and financial institutions might have a policy that this not happen, but then employees are given sales targets where they must sell a certain number of credit cards in any particular week and it does not really matter whom they sell them to as long as they reach their target. But that is just an observation.

I want to clarify something that you said, Mr O'Donoghue, and there is also an oblique reference to it in your written submission. Are you saying that this committee should recommend particular steps to be taken in relation to Australian corporations that operate overseas, in particular in developing countries where perhaps environmental and social regulation is not as high as it might be in developed countries? You did make reference to it in your verbal submission and there is an oblique reference to it in the written submission. I am trying to clarify what you are actually asking us to do, if anything.

**Mr O'Donoghue**—It is oblique because our own policy development in this area is not detailed. With much the same logic that says that directors have responsibilities that should be broadly similar between the not-for-profit and profit sectors, we also think that Australian

business entities operating in Australia should have similar obligations when operating elsewhere. It is 'good for the goose, good for the gander' logic, essentially. We have not given detail as to how that might be acted upon because it goes beyond our expertise.

**Senator WONG**—I understand that the *Giving Australia* report will be annexed to the Department of Family and Community Services submission. We do not have the report before us at the moment, but thank you for referring to it. It was primarily focused on donations and philanthropy in that reasonably narrow sense, wasn't it?

**Mr O'Donoghue**—It covered donations—no-strings-attached contributions to non-profit organisations; sponsorships—badging—with some kind of reputation and promotional benefit for business, which is nevertheless associated with material benefit for non-profit organisations; and community-business partnerships, which are obviously more sophisticated. So it includes that array—in cash, goods and services.

**Senator WONG**—It seems to me that you can look at corporate responsibility in a range of ways. Whilst donations, philanthropy and the sorts of activities about which you have spoken might be an aspect of that, we are also talking about how we encourage companies and corporations, in their core activities, to integrate the consideration of stakeholder interests—broader community interests. I do not want to have an argument in this committee about industrial relations issues, but you touched on the issue of how companies are going to treat their employees et cetera. Is that something ACOSS has looked at, or have you been primarily focusing on the *Giving Australia* framework around corporate responsibility?

**Mr O'Donoghue**—We have been engaged in some of the more comprehensive frameworks that you have referred to through participation as a research partner in the Reputex survey of corporations.

**Senator WONG**—I noticed that.

**Mr O'Donoghue**—We have some familiarity with Global Compact and GRI international frameworks. There is benefit in there being some kind of agreed framework for the collection of information about activity because, as you rightly pointed out, it extends beyond both the minimum requirements covered in other legislation, and philanthropy as such, down to good customer service and other practices—

**Senator WONG**—Or lending criteria, as Mr Bowen talked about.

**Mr O'Donoghue**—Yes. There is no agreed framework within which these activities might be monitored, reported and the subject of informed community discussion and debate.

**Senator WONG**—You can help me interpret your graph. I am not going to comment about where politicians are, because we are always low!

**Senator BRANDIS**—They are just ahead of journalists, Senator Wong; that is all you need to remember.

**CHAIRMAN**—Note that they have increased significantly during the life of the Howard government.

**Senator WONG**—Do really want to have that discussion?

**CHAIRMAN**—Look at the graph.

**Senator WONG**—Is that a core statement or a non-core statement?

**CHAIRMAN**—It was just a reflection on the graph.

**Mr BOWEN**—I do not think that is what it says, but I do not think we should get into that debate.

**Senator WONG**—Senator Brandis was looking at chart 1, which actually ranked major Australian companies reasonably well at about 38 per cent. Where do business executives appear on chart 2?

**Mr O'Donoghue**—They are clustered down with the other occupations of federal MPs, journalists and union leaders. More recently, they have been joined by bank managers and lawyers.

**Mr Kirkland**—Specifically, it is fourth from the bottom.

**Senator WONG**—What this tells us is that just over 20 per cent of the people surveyed regarded positively the honesty and ethics of business executives. Is that a reasonable summary?

**Mr O'Donoghue**—That is correct.

**Senator WONG**—We all know that polls and surveys et cetera depend on what is being asked, but it does not seem to correlate, does it? Major Australian companies do 10 or more per cent better than business executives.

**Mr O'Donoghue**—There are lots of ways of interpreting surveys. I would encourage the committee to look at two aspects of those two charts. The second chart is useful because it shows trends over time. Trends over time are more revealing than a point in time chart. We can see what has been happening.

**Senator WONG**—And it appears that the lowest point for federal MPs was in 1998.

**Mr O'Donoghue**—Chart 1 is essentially a point in time survey. It would be interesting to see if the ANU gives us data over time. Here, you should look more at the comparisons rather than any one result. The significant thing to notice is the first four institutions listed there. I think you should add the 'quite a lot of confidence' rating to the 'great deal of confidence' rating because that accentuates that there is something of a cliff in confidence that drops by the time you get to major companies. In other words those large public institutions such as the defence forces, statutory authorities, such as universities, the ABC and you can add charities into that grouping, taking those two together, rate very highly but then there is a sharp drop and you get a bundle of



institutions including major companies, federal parliament and others that drop somewhat there. It is suggestive of some characteristics—

**Senator BRANDIS**—Come on Mr O’Donoghue, that is a bit unfair. The major companies are in the first half of the graph.

**Mr O’Donoghue**—They are doing okay. I am really just saying that it is a little bit safer with only point in time data like this to do some comparisons between the groups rather than to look at any one group, including charities for that matter. It does come down to the nature of the question.

**Senator BRANDIS**—You are the one that is putting the evidence forward.

**Mr O’Donoghue**—Yes, correct.

**Mr Kirkland**—I think the point is that if you look at them, charities are up close to 60 per cent and there is then a big drop if you add the two groups together.

**Senator BRANDIS**—But everybody loves charities and most people love universities. I love the ABC and everybody admires the defence forces. That is not a fair comparison really.

**Senator WONG**—We are going to put you in a room with Senator Santoro and this graph, Senator Brandis! Mr O’Donoghue, would you like to finish?

**Mr O’Donoghue**—Probably just looking at both of those figures and the reason we included them for the committee’s consideration—obviously, interpretations can vary—is that there are some reasons to want to shore up the perception of business and associated occupations generally in the community because it is an important part of the economy. It is why we are encouraged by there being increased corporate responsibility generally. We want to sustain and continue to develop that because that confidence and trust is essential to our economy and wellbeing.

**Ms BURKE**—Some of the corporate responsibilities you and others have mentioned are the notion of partnership and cooperation. While some of that has been fantastic a little bit has also come down to staff having to give their paid time, use their paid leave and all the rest of it. There has been feedback from other quarters that says, ‘Yes, we love doing it; we’re more than happy to do it but then we have to come back the next day and catch up on the work we missed out on.’ The organisation is getting kudos for a staff member giving up their paid day whereas the staff member is not getting kudos for that. Has there been any analysis of it because it seems as though corporations are getting brownie points for making their staff do extra work?

**Mr O’Donoghue**—There are employee volunteering programs that usually badge that. Reputex work showed that a small and growing number of large corporations have formalised programs, typically involving the release of paid time for engagement with non-profit organisations. Generally, a day or two a week is the norm there, it is not a huge number. Corporations indicate that it is a combination of reasons for doing so not just about reputation and promotional reasons but also about contributing to the community. For some, there are work force issues where older employees, who are often highly skilled and knowledgeable, are

looking to change their balance between work and other engagements in the community. It is a way that employers can reflect that, often with the explicit desire to retain them as employees because of their experience and knowledge.

The issue of workloads building up through absences is a reasonable macroconcern. I am not aware of any research that could quantify that. I suspect employee volunteering programs are relatively small. There are not very many large corporations doing them. It is generally only for a day or two a week. You would probably need more specific investigation to see how widespread that issue might be.

**Ms BURKE**—Most people who are participating generally give the feedback that they are really enjoying it, they actually like doing it, they like connecting with their communities and they like feeling that they are doing something. The downside is that they return to work and the work has grown. One example that comes up and is often cited is that they actually have to use their own leave—which is a bit rich. If the company is paying them to be there, that is fine, but if they are having to use their own leave, well—but you do not need to comment on that.

**Mr Kirkland**—I can add some comments on that issue, if you do not mind. I think that the type of corporate volunteering or staff volunteering program where everyone knocks off on the one day and they all go out somewhere and do something is not very sophisticated and is probably not likely to have any great social impact. The more sophisticated programs allow employees to do it at a time that suits their needs and their community's needs. In many cases it is probably going to be more meaningful if corporations allow employees to take time off to go and volunteer for a school P&C or a school sports carnival or to do something that is connected to their kid's life, which will be at a different time rather than all going off to the same place and painting fences for a day, which is the more simplistic approach and is probably not going to have much impact.

**Ms BURKE**—That seems to be the way on which more emphasis is being placed, as opposed to direct donations. Are we seeing a decline in direct donations? Are we seeing an increase in other ways of corporations donating, such as in-kind donations as opposed to direct financial assistance?

**Mr O'Donoghue**—I do not think we actually are.

**Ms BURKE**—It would be interesting to know. I can leave it for now if you want to take it on notice. It would be interesting to see if there is an increase in that sort of area.

**Mr O'Donoghue**—One of the issues that is arising for non-profit recipients of business giving in these forms is that employee volunteering programs tend to be of relatively short durations and you have to have tasks that are suited to that kind of contribution. They do not always readily exist for some. The average hours of volunteering in the community are generally dropping. This is presenting management issues as to volunteers for the non-profit sector because volunteers, particularly retiree baby boomers, younger people and employee volunteers, prefer a relatively short and discrete kind of activity, because of that shorter duration on average, and it is a little bit less industrial in nature—some soup kitchen type of charity volunteering work readily lends itself to this.

**Ms BURKE**—One of the things along this line is the notion of how these things should be reported. If we go down the path of saying that for corporations—both not-for-profit and for-profit—there should be reporting, do you believe there should be a standard formatting of reporting? If so, would you be in favour of the GRI guidelines being the ones that are utilised? Have you got a view on which set to adopt?

**Mr Kirkland**—I do not think we could advance a view in favour of any particular set. But clearly there is a policy interest in consistency because, unless you have actually got a set of standards and some agreement on a consistent set of standards then you just cannot compare any of the information that comes out the other end.

**Mr O'Donoghue**—International instruments have the benefit of allowing for some comparison with Australian activity, companies' activities overseas or with other overseas corporations. The GRI's are among the ones more widely used internationally.

**Ms BURKE**—You have mentioned the welfare to work issue. One of the things that is picked up in the graphs in your submission is the decrease in employment of people with disabilities. There has been a sharp decrease in that, particularly within the government sector although it is also across the board. I am not talking just about Commonwealth, state and local government; there has been an actual decline across the board. At one stage post the International Year of the Disabled employment went out but now it has just gone down again.

Would this be a way to measure good corporate citizenship, for corporations to show they are not just saying they employ disabled people but are actually putting in active programs to employ disabled people and, once they have employed them, to assist them to stay in the work force? It seems that finding work for disabled people is not a measure or an issue that people talk about, as opposed to just saying to disabled people: 'You've got to go out and work.' Is it an area that you have explored or looked at? How could you measure it? I have tried to get some stats on this and it is actually very hard to drill down to find where these people are employed and what programs are actively in place to assist them.

**Mr Kirkland**—It is extremely difficult, and that places us in a similar position in terms of suggesting where to go. But you would hope that the employment of people with disabilities and the length of employment of people with disabilities, their retention in employment, would be one of the issues that corporations would be reporting if they are reporting on corporate social responsibility.

**Mr O'Donoghue**—Isn't it the case that many human resource development practices, particularly for larger businesses, are actually designed to prevent the employment of people with disabilities who may increase workers compensation liability? In some cases the discrimination is almost systematised as a result of a workers compensation insurance driver. I note that recently the Australian state governments gave some consideration to a more comprehensive national scheme for dealing with workers compensation and other insurances associated with people with disabilities. It is a great tragedy that we do not have the New Zealand model, which is well worth looking at—it saves everybody costs and it is focused on return to work and prevention. Given where we are now with these kinds of factors, explicit programs designed to include people with disabilities in workplaces as employees are needed in order to try and get around some of these problems.

**Mr Kirkland**—I think the employment rates have fallen so much that we would recognise that there may well be goodwilled employers out there who really do not know where to start, whose understanding of disability is so poor that they would not know how to go about designing a recruitment process, let alone supporting someone in a job. That is why those support programs are so critical if we are to achieve a shift, which the legislation will require if we are to see people successfully engaged in the work force.

**Ms BURKE**—A lot of not-for-profit organisations might not have a lot of money but some of them have a lot of employees. In relation to some of the practices you would like to see from the corporates, the for-profit organisations, would you say that the not-for-profits that you know and deal with—the large ones that employ people rather than use volunteers—have good corporate practices themselves for their staff as well as for their corporate responsibilities?

**Mr Kirkland**—As within any sector, you would find some variations in practice. I think that, in general, not-for-profit organisations try to do well by their employees. The salary levels are so low and the funding levels are so low that you have really serious labour force issues, so when you find a staff member you want to try and retain them. But it would be unfair to say that there is not a variation in practice across the sector.

**Mr O'Donoghue**—We basically do not know, either. The Australian census does not collect information on the nature or extent of disability. The ABS's disability, ageing and carers series is the only one produced every five years that gives us any kind of substantial data on work force participation by people with disabilities; it does not disaggregate its data by sector of employment, although it does by industry. We know by industry that, for example, the community services sector including government is a relatively good employer of Indigenous people, mostly public sector employment in community service occupations. We just do not know in relation to people with disabilities at all.

**Senator BRANDIS**—Mr O'Donoghue, you said earlier that one of the reasons there had been increasingly generous corporate behaviour in relation to corporate philanthropy was the fact that business is so profitable—or words to that effect. It would be right, wouldn't it, that charities and not-for-profits who may be engaged in partnerships or otherwise the recipients of contributions from corporates would be the first to suffer if businesses became less profitable? In other words, in a business's discretionary expenditure probably the first to get chopped in hard times is going to be their charitable or philanthropic contribution.

**Mr O'Donoghue**—Possibly. Commonsense suggests that that is likely.

**Senator BRANDIS**—You would think so, wouldn't you?

**Mr O'Donoghue**—We have so little information generally in this area—and it is worth acknowledging that the Howard government has done a great deal to improve the information that we have generally about giving across the community. The small encouragement about the community business partnerships is that they are more sophisticated engagements, and one hopes they will be more sustainable. It is likely to vary from area to area and from industry to industry or place of business within industry, because together with size these are the key factors, but in general one would expect that if there were a reduction in business profitability

there would probably be a reduction in all costs to business, including community engagement activities.

**Senator BRANDIS**—My point is that the community engagement activities will probably be the first to go.

**Mr O'Donoghue**—That would be my suspicion, yes.

**Senator BRANDIS**—Which brings me to the point I wanted to make you—and I do not think this is controversial: the more you regulate business the more there is a regulatory cost. This committee has to make some decisions about whether we make recommendations that will, in a practical sense, result in yet more regulation. Isn't there in fact a risk to the charitable sector, which is the most discretionary of businesses' donations, that if we increase the cost to business of extra regulation it might produce the result that there is less money to give to charities?

**Mr O'Donoghue**—We are not expert in measuring the impact of regulation on profitability.

**Senator BRANDIS**—No, I am not suggesting you have done an empirical study.

**Mr O'Donoghue**—The issue would be: what is the long-term benefit for any measure? I would direct the committee to a reference in our submission to the work of Goldsmith and Samson of the University of Melbourne on sustainable development—a slightly different concept from those that we have been talking about—which very much takes a longer term view. If we have good information systems, even if they were required of business to collect but attached to existing systems for the collection of information, I doubt whether the burden of administration that we fear would have any significant drag effect, but it would greatly increase the information that we would have. It would be consistent information and over time that would allow benchmarking between businesses and industry and, with good public policies to facilitate it, we would be able to assist—for example, in the impact that any reduction in economic activity might have in these fields—in a way that we cannot now. My inclination would be to look at those in the longer term. With the no bar provision that we are suggesting should be given some consideration, it would not be a requirement; it would just be a facilitating mechanism and I do not think it would have those consequences.

**Senator BRANDIS**—I was rather moved by Mr Kirkland's comments about the effect of red tape on the not for profits. Although one would expect the profit-making sector of the corporate community to be able to more readily afford to absorb the costs of red tape or additional regulation, that does come at an incremental cost to the first line of expenditure that as a matter of discretion could be reduced, which would be charities—that is my point.

**Mr O'Donoghue**—I understand. There is some logic in that.

**CHAIRMAN**—I thank the witnesses for their appearance and their contribution to our inquiry.

**Proceedings suspended from 1.24 pm to 2.35 pm**

**BAXT, Professor Bob, AO, Chairman, Law Committee, Australian Institute of Company Directors**

**BERG, Mr Tony, AM, Member, Corporate Governance Committee, Australian Institute of Company Directors**

**COLEMAN, Mr Michael, Chairman, Reporting Committee, Australian Institute of Company Directors**

**EVANS, Mr Ralph, Chief Executive Officer, Australian Institute of Company Directors**

**FARRELL, Ms Kathleen, Member, Law Committee, Australian Institute of Company Directors**

**CHAIRMAN**—Welcome. We have before us your submission, which we have numbered 73. Are there any alterations or additions you wish to make to the written submission?

**Mr Evans**—No, thank you.

**CHAIRMAN**—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

**Mr Evans**—Thank you for having us here today. AICD has 20,000 members. They represent directors of large companies but also directors of small companies and those of not-for-profits, charities and the like; some government enterprises; some people who are aspiring to be directors but are not yet; and some people who are reporting to boards rather than being company directors. So we have a diverse membership from right across Australia—all the states and territories. Our main activities are in education and information. We run the biggest program of specialised director education in the world and last year we held 500 events for our members across Australia, bringing them information about directorship matters. We are supported by the three honorary committees of experts that are represented here today, and our aim is to develop a standard of professionalism among directors in Australia and to help the corporate form to work well and maximise its contribution to the economy.

AICD is strongly behind responsible corporate behaviour and our view is that there is no need to change the law to incorporate social responsibility, as was put in our submission. It is inherent already in the requirement in the Corporations Act for directors to act in the best interests of the company. To succeed, a company must have employees who are willing to make their contributions, customers who want to buy the products it makes or services it provides and suppliers who are willing to do business with it. Directors know this. In acting in the best interests of the company, they take these factors into account. Any codifying or mandating of corporate behaviour or even reporting on social responsibility is unwise because businesses are so different that no framework is likely to be able to cope. The behaviour of the companies is not likely to change as a result and the outcome would just be another lot of redundant red tape.

I think the Hardie case that perhaps lies behind our being here today is exceptional and should not be the basis of a change in the law affecting thousands of companies. By a long series of steps the company found a way to separate itself from a large and very long term social liability which it considered to be a legacy no longer relevant to its current business. In the end, a community solution was found to this very serious problem through negotiations between the company and the New South Wales government. We support this. We want to see the agreement completed and implemented as soon as possible so that the asbestos sufferers will receive their compensation. I would like to ask Tony Berg, as a practising director of some experience, to follow on from me.

**Mr Berg**—Let me start with a few statements that I think nobody would take huge exception to and that will then underlie the points that I would like to make. The first one is that companies need to be profitable to be viable. You go on from there and good management focuses on long-term profit rather than just short-term profit—again to be sustainable and viable in the long term. Longer term profitability and viability in turn depend on accommodating a range of interests—as Ralph said, those of the customers to generate sales; those of the community, particularly to generate brand loyalty; and those of employees for their support. Just imagine that you have a call centre with disaffected staff. In fact, I called one this morning about a credit card matter. The staff were totally disinterested and, in fact, almost offhand. That does not encourage me to continue to have a credit card with that company. So having enthusiastic employees is good for business.

Managing companies is complex and there are a lot of competing demands. For the purpose of looking at corporate social responsibility I think one should think about making these decisions in a spectrum that encompasses mandatory requirements through to what might be called best practice. In a lot of areas there are laws and regulations that set the minimum standards of what you have to comply with and what you have to do, but most companies go beyond those minimum standards because it is in the interests of their long-term profitability and it is in their enlightened self-interest in pursuit of long-term sustainability. Some companies go to best practice. They do in these CSR areas not because it is an end in itself but because they believe it will help them generate a competitive advantage.

It might be helpful if I give a couple of examples. With regard to occupational health and safety, there are laws that provide minimum standards for what you have to do. But I think it is fair to say that most companies offer conditions and amenities to their staff that are well above those minimums. Why do they do that? They do so because they want to attract better workers who are enthusiastic about their business and who do not create the sort of atmosphere that was created by the call centre employee I spoke to this morning. With regard to best practice, a lot of companies in this area might be classified as employers of choice—for example, Cisco and Macquarie Bank. People clamour to work for those companies, so they obviously get a more enthusiastic workplace, and that works better for the company.

Let me give another example. With regard to the environment, there are a range of laws and regulations that cover minimum standards for emissions, the disposal of waste and so on. But a lot of companies want to show that they observe higher standards than that, in part to build their reputation and in part to enhance their brand. For example, Rio Tinto put a lot of store in the rehabilitation of their mining sites. That is good for business because they hope to win the approbation of government and communities when they want to open up new mining sites.

When I was with the part of Boral that is now Origin Energy, we deliberately invested in some solar energy technology research, working with the ANU, because we could see the need for clean energy. But this was a very long-term investment and we were certainly not looking for a short-term pay-off.

With regard to Indigenous issues, Normandy Mining was an example of best practice. They came up with a number of programs for the Indigenous communities they worked with and for Indigenous communities generally. Again, this was done with a view to helping them develop new mining sites. What I am illustrating here is an enlightened self-interest situation.

If I can use the example of philanthropy, the area that I know best is the arts. There are a large number of major companies in Australia that are members of AbaF, the Australian Business Arts Foundation, which encourages companies and arts organisations to work together for mutual enhancement. A very good example of that is Sun Microsystems, which had a long-term principal sponsorship of Musica Viva Australia. Sun felt that not only was it really helping chamber music in Australia, regional touring of groups and a program called Musica Viva in Schools but it was also enhancing the Sun Microsystems brand, and that was good for business for them. I think these quick examples show that corporate social responsibility is alive and well. While I was preparing these comments, I saw that in Monday's *Australian Financial Review* a group called Community Caring Awards had an advertisement which said, 'Create customer loyalty'. The advertisement was about working with them to win community caring awards. The fact that the system as it is now can have a community group advertising in the corporate community for support illustrates that.

My conclusion is that the current Corporations Act does outline directors' duties in an effective way and it provides for the flexibility of companies to pursue CSR initiatives because it is in their interests to do so. I believe the system is working very well. Individual companies can choose the initiatives that are best suited to their own needs and aspirations. Codification in any way of CSR requirements would merely encourage a tick-the-box compliance type mentality. I think there would be a possible loss of innovation, smart solutions and taking of initiatives in these areas. It would also be likely to divert attention from long-term goals and sustained profit. It is best to let companies find their own way to long-term profitability and, as you can see from the examples I gave, they do pursue CSR initiatives as a result.

Finally, I worry that increased regulation, focus on corporate governance and focus on a compliant culture is going to divert Australian companies from innovation, from bold initiatives and from a willingness to chance their arm from time to time. Such a culture would lower growth, productivity and income in Australia and consequently it would reduce our capacity to do good in the environment, in philanthropy and in better working conditions.

**CHAIRMAN**—In your submission you argue that changes to the Corporations Act could upset the direction currently followed by directors in terms of the priorities they apply in making decisions when there are competing interests involved in corporate decisions. Others have argued that this concept of perhaps upsetting investor confidence as a consequence of that is somewhat misguided and that a pluralistic approach impacts beneficially on corporations and therefore on shareholders. What is your view on those conflicting concepts?



**Mr Evans**—I will hand to my legal colleagues and my practising director colleagues in a second, but I think the essence of that is about serving two masters. When you are acting in the interests of a company, you think through what the needs of that company are for its future, particularly for the longer term future, and prioritise the various different interests in a sensible kind of way. If you have to take these other things into account, it is going to be very difficult to make coherent decisions and I think performance will suffer. Kathleen may wish to add to that.

**Ms Farrell**—At the moment, when directors make decisions they are able to look at a path forward against a target that they set. By and large, the priorities that you need to put in place are not truly in competition because you need each of the assets that you are talking about—your employees, the customers you are dealing with, suppliers and the communities you are operating in—to have at least an acceptable level of buy-in; otherwise, your strategy will be frustrated. So, when you are putting together a strategy, you may act on a continuum, depending on where you are, where the cycle of the economy is and a whole range of other factors, but perhaps it is overstating it to say that you look at competing interests while you do that. It is like: if you want to build a building, you have to have bricks, water and elements to put lifts in—you have to do a whole range of those things—and you do not get a building without all of them. So you do not regard those assets as competing; they are part of the building as a whole.

Where life becomes more difficult is at the point where companies are of doubtful solvency. In those circumstances, the issues of CSR that some people talk about become much more difficult, because at that point you do have genuine competition. If the company is about to become insolvent then clearly distinct creditors' interests take the fore and you are dealing with immediate and short-term issues necessarily rather than long-term issues. I think our law already deals well with those series of priorities, by and large, although I recognise that there are some issues around that which have currently been referred to CAMAC and are perhaps not within the scope of this inquiry.

**Prof. Baxt**—One of the problems in trying to put it in the context of competing interests is to forget that companies operate in a whole range of regulatory fabrics. When those companies that Kathy talked about decide that they are going to build a new building, they know they must have compliance with occupational health and safety, environment protection, trade practices, income tax and that they will have competitors. The whole fabric of our law drives the way in which directors operate. They do not just consider the issues in terms of, 'Are we acting in the context of this decision in order to just make profits for the company?' They are looking at it in very broad terms. Once you start creating obligations, requirements, that they should take into account other interests—the interests of creditors, employees or whomever it might be—you start creating a tension which, I believe, undermines the fabric we have built up over the years and you create a prospect that decision making will become very chancy. People will start saying, 'We'd better not do this because we have an issue here that may be raised by a particular group.' Kathy is completely right in saying that when insolvency is around the corner, when it is an issue, that becomes a factor, but it goes beyond that.

The great problem to me, which still has not been answered by any people who want to support CSR, is: who is going to enforce it? How are you going to enforce it? Is ASIC going to enforce it? You have just heard from ASIC as to what they think about this proposal. They are finding it difficult enough to enforce the current laws that they have in place. How are they going to enforce this law? Which directors are they going to sue and sue successfully if it is

argued that they have not taken into account their corporate social responsibilities? We start creating a diversion in the way in which the law has been built up over the years. We undo the fabric of the whole legal system. It is not just corporate law that is at risk; it is the rest of the laws. I think we need to approach this particular issue—if we see an issue—from a different viewpoint, and we have raised some of the issues in our submission.

**Senator WONG**—I presume when you said ‘people who want to support CSR’ what you were meaning was people who argue for a change, a positive duty to—

**Prof. Baxt**—A positive obligation, yes.

**Senator WONG**—Not the broader concept.

**Prof. Baxt**—No.

**Senator WONG**—Do you have a difference of opinion from Mr Evans who, I think, essentially is saying they are doing it already?

**Prof. Baxt**—I think Australian companies have a wonderful record in that regard. We have seen plenty of examples.

**Senator WONG**—I was wanting to clarify, Professor.

**CHAIRMAN**—In your submission, you expressed the view that there should be no change to directors’ duties. Then you have a fall-back position saying that, if there is to be a change, the best change would be to remove the word ‘best’ in the phrase ‘in the best interests of the corporation’.

**Ms Farrell**—The terms ‘the best interests of the company’ and ‘the interests of the company’ have been used interchangeably in case law. One of the dangers of codification is that you pick a formulation that might have been used in one case, sometimes loosely, sometimes not—and that element that talks about ‘the best interests of the company’ was introduced in amendments. At the end of the day, I think courts are already interpreting it in the same way as common law would have had us do it in the past. On the other hand, this was an opportunity to say to you that, in truth, when case law talked about this, it was talking about the interests of the company, not picking the one at any given time that might be the very best.

That is the argument that is concerning, particularly because, at the end of the day, cases are heard often five years after the events which occurred and society has moved on. Five years later, you usually have the benefit of hindsight. You know what actually was best as opposed to people’s opinion at the time, looking at it with foresight rather than with perfect hindsight. At the end of the day, I guess that amendment would be useful, but we are really much more concerned, in truth, that these provisions of the Corporations Law, in essence, be left alone. They have been a very durable framework for the development of companies now for a very long time—that set of baseline common law duties that are reflected there. We are really quite concerned that if people start tinkering with them one way or another we are going to very slowly unwind something that has served us well and flexibly against changes in society that have occurred during that time.

**Senator BRANDIS**—Can I make this observation out of what Ms Farrell said. I suppose to the extent to which there has been any movement in the law it has been to read the language more widely with the passage of the years so that by judicial development the obligations upon directors and senior officers of corporations have expanded, although the statutory language has not changed. Would you agree with that?

**Ms Farrell**—I would agree with that. I think case law has supported the profession of a director as a development over time, rather than the gifted amateur who might occasionally turn up. That was probably the only thing he could do wrong—it usually was a he—at that point a very long time ago. The case law and the sections of the law that currently reflect it have been a very flexible instrument for society's own expectations to very slowly be represented through that building of the body of law.

**CHAIRMAN**—It seems to me from the comments you have just made that the amendment you are suggesting is more in the context of a general improvement to the provision relating to directors' duties, rather than something that is directed at corporate responsibility issues.

**Ms Farrell**—I think that is right.

**Prof. Baxt**—It might be argued by some directors that that would give them the greater flexibility which they fear they do not have under the current drafting. I think that is a misconception on their part and I do not think it is one that is supported by the law, but if it does remove that fear, then it is a positive move to ensure that companies that want to continue to embrace CSRs can do so. I am sure they will continue to embrace them and to expand on them, and will do so without fear of a possible challenge by shareholders who say: 'You are breaching your duties. You're not acting in the interests of shareholders.'

**CHAIRMAN**—Some submissions have argued that there should be an enabling amendment to the effect that directors may have regard to stakeholders other than shareholders. What is your view of that?

**Mr Evans**—The problem we see with that is that it is a slippery slope that soon goes from 'may have' to 'should have' and then 'must have'. You would be likely—

**Senator WONG**—Is that a political or legal slope?

**Mr Evans**—It is a political slope that, with great respect to the members who are here, might be irresistible in some situations—to just touch it up a bit more and move it along that slope towards being obligatory, which we think would be a very bad thing. Bob, do you want to comment further on that?

**Prof. Baxt**—I think it is part of a trend, not just in this area but in all areas of the law—a very regrettable trend—in relation to what seems like a good idea in relation to a particular problem. Where it is felt that we need to reverse the onus of proof, for example, it has now become standard. It is in every piece of legislation that you get. There is an automatic assumption that in certain areas you are going to have a reversal of standard of proof. The other day I was talking to a group of young people on corporate governance. I said, 'One of the things I want you to take away from my talk, the thing I am most passionate about, is that Australia still has as its

fundamental fabric that you are innocent until you are proven guilty.’ I am seeing a change in that. I agree with Ralph that one of the problems with changing some of these things is that you start moving the way in which the law is interpreted so that it becomes very simple to start inserting that in pieces of legislation where you perceive there to be a problem.

**Mr Berg**—I am concerned about that in that, even if it does not go down the slippery slope, saying that directors may have the ability to look at these other issues gives them an out to pursue things other than the long-term profitability and long-term viability of companies. We had the famous example of a managing director who engaged in a lot of philanthropy for his own aggrandisement as opposed to the interests of the company. Such a clause would condone those kinds of actions. I think it is very dangerous.

**CHAIRMAN**—Chartered Secretaries Australia proposed the inclusion of a replaceable rule to the effect that a clause be inserted in the company constitution to permit directors to take account of the interests of stakeholders other than shareholders. That is in a similar vein, but it is a different approach.

**Ms Farrell**—If a company came to me with that as a proposal, I would counsel them to go very carefully. The reason for that is this. The provision that the UK has adopted specifically names certain groups that the directors are entitled to take into account in the interests of the company. The question then comes up as to whether, if you adopt that sort of provision in your constitution, you are thereby putting into question your capacity to look at people who are not named, whereas today, with the flexibility of the law that we now have, you do have that level of flexibility about what you are doing. I would say to somebody who came to me, ‘Are you in fact, by another route, trying to limit your directors rather than making them more free?’ At the end of the day, I think that is what that does.

**CHAIRMAN**—What is your view of the request by the minister for the environment, Senator Campbell, to the ASX, to develop a standard reporting framework for non-financial information in Australia, including whether the GRI is appropriate for this?

**Mr Evans**—At the moment, we are working in collaboration with the ASX Corporate Governance Council and other members of that council to respond to that. We only have a preliminary view so far, but it would be that a framework that could take into account the needs of companies, ranging from mining explorers to large banks and holding entities for real estate, are so varied that it is almost impossible to think of a reasonable framework that would add any value and not become an exercise in box ticking, which would be of very little value to anybody.

Where there may be something that is worth doing would be in the context of risk. Already ASX principle 7 requires companies to have a very competent policy with regard to the management of their risk. That takes into account specific things that might affect the future and the wellbeing of that company and its surrounding community. It enables them to identify certain things peculiar to that company without starting with a great long list like the GRI. I think that might be better, but it is a work in progress at the moment.

**CHAIRMAN**—Thanks. Are there any further questions?

**Senator WONG**—Firstly, I thank you for your submission and for the issues that you have brought to the committee. I say at the outset, Mr Evans, that I think that if all directors took the view that has been expressed in your submission and by Mr Berg about the long-term interests of the company, there would probably not be as much community concern about this area. I want to pick up on something Professor Baxt said. Quite rightly, I think, he said that some of your members fear that they do not have the flexibility under the current law to have regard to non-shareholder concerns. I will say at the outset that I think there is a fair weight of evidence on Professor Baxt's side in terms of the people's view of what the law is, but the reality is that some of your members, and certainly some in the corporate community, do have a view that is a very narrow construction of how they perceive their role as directors. Given that, what do you think could or should be done?

For the purposes of this discussion, I would like to take positive duty off the table, because I think we have clearly got the message about that. I certainly understand where you are coming from. Rather than focusing only on that, I am more interested in having a discussion about the question 'if not that, then what else?' That is in the context of the situation that Professor Baxt, I think quite rightly, points out—that is, that the view that you have about what the current legal test requires a company to do is not necessarily one that is shared across the community of directors.

**Prof. Baxt**—Could I start the ball rolling by suggesting that the first thing to do is to make sure that you educate the community about what the true position is. There are some people who are still out there banging the drum about these issues. The institute is doing a great job—and I am very pleased to be involved in the work that it is doing—of educating the community in that particular context. The judges are also doing it. The chairman has talked about the way in which the law has developed. All you need to do is look at recent cases in relation to the duties of care and skill in this area and you will see just how quickly the law is responding to what the community expects. The message is getting through in that particular context.

We make a suggestion in our submission in regard to those who are very timid in this particular context. We suggest that they look at the decision in the Edwards case and see if the law might be dealt with in that particular sense. What worries me in creating a positive duty—

**Senator WONG**—I suggested that we take that off the table for the purposes of this discussion, Professor, not because I want to stifle you on it, but because I am very familiar with the views of your organisation and I have to say that I am sympathetic to the argument that has been put here today. If possible, I am interested in engaging with you in a discussion that is not entirely defined by you worrying that that is where I am coming from, I suppose.

**Mr Evans**—Two members of our panel would like to contribute.

**Mr Berg**—I want to say briefly that, over a number of years, I have been on a number of boards and I am racking my brain to think of one instance where a director has said, 'We cannot do such and such because it isn't the primary purpose of the company.' In other words, when issues about philanthropy or the environment and so on have come up, I cannot remember one instance of a director saying that that was in effect *ultra vires*. I think these things sometimes come up when the community says, 'Why didn't you do that?' It might be a convenient excuse, but I have actually never seen an example of it.

**Senator WONG**—There are some who argue it reasonably publicly, Mr Berg, but I am not going to get into naming particular companies.

**Ms Farrell**—Can I approach it in a slightly different way?

**Senator WONG**—Sure.

**Ms Farrell**—There are two parts I want to talk about. One is that we all have individual appetites for risk. It is one of the reasons why some investments are good for some people and they make a lot of money. Other people put their money in the bank in the thing that is the lender of last resort and therefore has 0.1111 per cent interest attached to it.

**Senator WONG**—But it is safe.

**Ms Farrell**—But it is safe. It is part of our community and it is a necessary part of our community, I think, that our various appetites for risk are able to be accommodated. It is true that that means that some people do not go to the full extent of their potential, and there is a real role for many of our institutions, government, the AICD and others to help educate them and bring them along to an understanding of educated risk. But, at the end of the day, some people are always going to be timorous and some people are going to be brave. I do not think we should necessarily overaccommodate the more timorous of us in the same way as you do not leave unfettered the most brave for a community to operate in a particular fashion.

There are a couple of things in the submission that I think are hopeful along the lines that you are talking about. ASX's Corporate Governance Council has not been in operation very long but it is interesting to look at the disclosures that companies are making. I expect those disclosures over the next couple of years to become much more fulsome. By example, that means that lots of companies are now talking about the community projects that they engage in, the things that they do to attract and keep staff and what they have seen as particularly referable to their industry. So you see lots of people in the mining industry talking about environmental challenges that governments put out and how they engage with their community. A company that has not seen their peers doing it before will be increasingly encouraged to do it also. If you want to be seen as a good corporate citizen with nice shiny shoes, well brushed hair and part of the club, who is entitled to act in particular ways—

**Senator WONG**—You have upset Senator Brandis, Ms Farrell.

**Mr BAKER**—Not a good move.

**Ms Farrell**—you will create a peer pressure around those people to make them engage more broadly in things that they perhaps in the past have not. I think there are other things that were useful out of CLERP 9, and one of the examples I gave was the encouragement of electronic communications with shareholders. I have a personal plan: one of these days I will persuade the government to amend the law so that you do not have to send annual reports out on paper unless someone asks you to, as opposed to the other way around at the moment. I think that will save a lot of trees. But there are lots of things that over time can lift people's awareness of their impact on the environment—that is almost a silly example but it is not really. If you have got 400,000

shareholders of Telstra and you are sending them all an annual report that is a lot of trees that are dying for not necessarily a good cause.

There are lots of examples where governments have challenged, for instance, bankers in relation to bankers engaging in financial education. It is in their interests to do it. They are well positioned to do it. The government gave a challenge which was not binding, and they were able to elect how flexibly they wanted to do it to get there. I think there is a whole range of ways in which we can influence not only companies but also individuals to have a broader concern and to act on it, and not necessarily by dealing with the Corporations Act.

**Senator WONG**—I want to ask about your negativity about an enabling or permissive provision, Mr Evans. I understand your political concern that something that says ‘you may’ may become ‘you should’ or ‘you must’ but I think there is a very substantive policy difference that would have to be crossed to do that. Apart from that, is that one way—I am certainly not suggesting it is the only—you can deal with the view that has been promulgated by some and to which Professor Baxt referred that exists amongst some of your membership and some of the director community that perceives and construes its role as being a very narrow one?

**Mr Evans**—The loudest voice on this subject has come from James Hardie, who have put themselves into an extraordinary situation, having moved from the asbestos business into a new kind of business, now in a new country, with their shareholders mainly American and with a holding company in the Netherlands. They saw themselves as unable to pay out money to their asbestos sufferers in Australia because it is not relevant to the continuing business that they are now in or the interests of their shareholders. That is a very unusual situation that I would not expect to see replicated. I certainly hope we will not see it replicated. That has been the loudest case of that kind.

We have not seen cases where we would be persuaded that a permissive rule or law would actually add anything. As we have been saying, we see the companies—and directors, who have to act in the interests of the company—thinking already about the surrounding social situation of the company. To give them permission to do so would not add anything. Perhaps my colleagues can add to that.

**Mr Coleman**—The only comment that I would make is that my focus here is primarily on the reporting aspects of it. In relation to the reporting side of corporate social responsibility, as Kathleen has indicated, we have seen a number of different reporting models already emerge. A number of those reporting models have reflected all of the things that Ralph and the others have been talking about. There is an automatic demand in the community for these types of issues. Those types of entities that want to be seen to be good corporate citizens are in fact reporting, and they are reporting in ways that suit them and suit the community. So everything to do with the reporting side of things is being supported by the other comments that are being made—that is, there is no real need to change.

**Senator WONG**—Two issues arise out of that. First, from a government or parliamentary perspective, how long do we wait? Do we look at this again in two years, four years et cetera? That is a minor point. If you are saying that essentially the market will deal with this, what sort of time frame do we look at? The other issue is one that Mr Berg raised and that I want to go back to. It is the idea that directors should act in the long-term interests of the company and have

some regard to long-term value. There is a lot of pressure on directors, managers and companies for short-term returns, given the way investment markets operate. That is not necessarily consistent with the sort of message that you have articulated. I want to talk about the pressures on directors and managers. What are they and are they consistent with the sort of articulation of long-term value and the role of directors that you have outlined?

**Mr Berg**—You are right in that there are a lot pressures in the market for short-term performance. Companies are being encouraged to give guidance as to what their results will be and then obviously there is a lot of pressure to meet the guidance that has been given. The markets have tended to punish companies that fall short of profit forecasts, whether they have given the guidance or whether it has just been the market forecast. Their share price is often punished quite severely when they fall short. Inevitably amongst top management and boards there is quite a focus on that short-term performance. There are a lot of practitioners and academics who do not like that as a trend. I for one do not like that as a trend. It goes against the longer term business building and longer term profitability issues. I am not sure that there is much that one can do about that. And, by the way, there are often cycles in these things. What is in vogue in this decade might fall out of vogue in the next. I would leave things be. It is an issue, but I am not sure what we can do about it.

**Mr Coleman**—Can I expand on that a bit. It seems to me that the whole issue of reporting is complicated, and there is no doubt in my mind that entities exist for their long-term survival. The sheer fact that some shareholders may trade in and out of their shares in those entities and that those shareholders may be impacted by short-term results does not take away from the fact that, in my experience, most companies and directors are attempting to manage their whole existence for their long-term good. We should not be allowing ourselves to be confused by activities that happen in the marketplace. Not all shareholders are necessarily trading their shares day to day. In fact, a very large number of shareholders have investments in companies for long periods of time.

**Senator WONG**—Mr Berg made a very good point when he said that the market can punish companies on a short-term basis.

**Prof. Baxt**—Could I just pick up on a couple of points that Senator Wong has raised. I do not understand the question where you say we will look at things in two years. I do not know what we are measuring here. Are we measuring one or two more James Hardies? What I would say to the directors of James Hardie is that they are wrong. They are wrong in the law and they should go and test that. If I am wrong on that, there are other avenues, such as the amendments to 1318 or expansion of the business judgment rule.

**Senator WONG**—I was actually responding on the reporting issue. The suggestion from Mr Coleman, I think, was that we ought not to mandate reporting and that essentially—and I think Ms Farrell was saying the same thing—the market would to some extent. I agree with that. Certainly there is evidence of this. I agree that there has been improvement, and the market will improve in terms of reporting against a range of factors other than financial factors. I was simply making what I suppose is a political point, that there is pressure through a growing awareness of these issues broadly in the community. If you are saying that the market will deal with it, I would ask: what are you saying to us on this side of the table—that we should look at this again in two,



four or six years when it comes to the simple issue of reporting? I am not suggesting that it is not difficult; I am talking about the issue of reporting against community or social issues.

**Prof. Baxt**—Can I respond to that, because it is all part of the same answer, if I may say so. The market will respond and the regulators will respond if there are perceptions that companies are rorting their shareholders et cetera by not reporting, by not disclosing. There will be amendments made to the legislation to require more reporting and more disclosure in a way that may or may not be meaningful. I want to make one point that Kathy did not pick up directly in response on your ‘may’ suggestion. Once you create an option of this kind in the law, you create opportunities, which will be wonderful for me as a lawyer, for more litigation, more challenges—for actions to be brought saying, ‘You should have taken into account the words “may”; you didn’t give sufficient weight to that and we think that you haven’t behaved in an appropriate fashion.’ I do not think that this community wants to see that kind of fruitless litigation pursued. On the other hand, if directors fail in their duties to act in the best interests of the company, let there be challenge in the courts by both the regulator and shareholders, because they can get the funds to fight these cases.

**Ms Farrell**—If I could just address that, I cannot tell you whether it is three, four or five years. I am now old enough to understand that anybody who thinks that they can plan ahead of time for more than next week is fooling themselves a bit. I think that we will see a reasonably rapid growth even if it is not in full sustainability reporting. At the moment many of the measures for full sustainability reporting are very much directed at global companies or companies with very big capitalisation that have primarily developed those measures. There are not that many companies in Australia that fall into that category. Once you are out of the top 150 or 200 companies, you are beginning to get companies of a size where many of those measures are increasingly irrelevant and hard to deal with.

The other part of this, I think, is that sustainability reporting is not just about a list of measures you might expect to see in an accounting standard or one of the schedules to the Corporations Act. It is about a reflection of how a company’s culture has changed. If you look at even a company like BHP Billiton, about seven or eight years ago they were primarily talking about occupational health and safety and environmental reporting against obligations to do that. I think that generated within that company, as they went global, a requirement to measure that and then to perform more broadly. They realised that they needed to engage in a wider dialogue within their company and outside. I think that is the sort of journey that companies do go on in the development of that.

I did a scan of the top 200 companies—or I had four people do it for me; I do actually have a life—in their last set of reports recently. It is interesting to see companies quoted in the submission. Amcor said: ‘We realise there is a social pressure now to deal with reporting of this kind. We are not quite sure how we are going to do it, but we have started trying to formulate that.’ I do not think they are on their own. I think quite a lot of that is beginning to come through. I think that, as companies get used to reporting against recommendation 7.1 and 7.2 of the ASX Corporate Governance Council’s guidelines, we will start having a much crisper focus in that area.

**Mr BAKER**—Professor Baxt and Ms Farrell, I think you briefly stated that you were very satisfied about the great work that Australian companies are doing in relation to CSR. Looking at

the statistics moving forward, do you have any ideas about how they can be encouraged to have greater commitment to non-financial reporting? Recent KPMG research indicated that 23 per cent of Australia's top 100 companies published stand-alone reports on non-financial performance compared with 32 per cent in the US, 71 per cent in the UK and 80 per cent in Japan. So we really are lagging behind from a global perspective. For all of the arguments—and I do not want you to be defensive about why we are not—how can we encourage further education? If they are not reporting in a non-financial aspect, how are they actually focusing on that aspect initially and further developing that approach?

**Mr Evans**—Can I field that initially. I think we need to recognise the structure of our market. Comparing our top 100 companies with the top 100 in Japan is not a like comparison. We are a very much smaller country and we have a very skewed stock market, as Kathleen said a little while ago. There are only about 300 companies worth above \$60 million. At the top end they are worth \$40 billion or so, but they tail down very quickly. I think if you look at companies of a comparable size you will find reporting on this sort of subject at least as good as international standards. But when you start going down the size range it tails off, as it does in other countries.

**Mr BAKER**—I accept your argument, but what are your ideas on how we can encourage more of it and be proactive, not reactive?

**Ms Farrell**—I think there is focus in the ASX Corporate Governance Council on responding to Senator Campbell, but generally principle 7, which deals with risk, is talking about not only risks that are important financially but also non-financial reporting risks. It was interesting to see that, for item 7.2, which is the one that requires a sign-off by the CEO and CFO in relation to risk generally, people were very comfortable giving that sign-off in the financial area and they were not initially comfortable in the non-financial reporting area. There has actually already been an improvement in that area and I am expecting that that will be a significant push to companies to do it.

Now that the ASX Corporate Governance Council's recommendations are in place, there is a framework for companies to be reporting things that many were doing but not formally reporting. So I do see quite a strong seed for the generation of encouragement to companies to move forward. As I said, in our submission there is that statement from Amcor, which says, 'We understand the environment now to be one where we have to start moving towards this.' You also see it in the development of some of the work that people like Goldman Sachs are doing at the moment, looking at this whole area of reporting. Probably the best impetus is going to come from investors themselves. I think that is already shaping and I expect to see more of it.

**Mr BAKER**—It was mentioned before that, if they showed a proactive approach, they actually take ownership. Therefore, a lot more is achieved than in trying to defend an argument and taking it from a reactive perspective.

**Ms Farrell**—That is right.

**Mr Coleman**—I know that report reasonably well. It is important to recognise that that 23 per cent that you quoted does reflect completely voluntary reporting in Australia. Most of those other countries have limited forms of mandatory reporting. Even though they do have levels of mandatory reporting, the mandatory reporting that they do provide is itself quite limited. It is just

whether or not you have certain things in place. I think that report also highlights the fact that the level of voluntary reporting has grown exponentially in Australia just in the last 12 months. Picking up on Ms Farrell's point, as we actually move further and further down this path, I am sure you will find that there are a significant number of Australian companies that do adopt this form of reporting voluntarily.

**Mr BAKER**—I understand your argument, but the main thrust of the question was how we can encourage more companies—and not as a defence—to move down this line of non-financial reporting so that they are actually thinking about it.

**Mr Evans**—May I suggest that it would be quite a good idea not to encourage too much. I think the public limited company is an incredibly regulated device these days. We are seeing in this country and in other countries an explosive growth of other forms of business investment vehicle—private equity, hedge funds, trusts and the like—which are escaping the regulation. They are there partly to escape the regulation, because it is very heavy. It may well be that these entities overtake the stock market in value before very long. It may be that many of them are very well run, but some of them represent a danger to the investing public. I would caution against overregulating the public company if it leads to the money going elsewhere into a more dangerous and harmful situation.

**Senator WONG**—Mr Baker's question, though, was about encouragement. Is it your position that encouraging increased reporting of this on a voluntary basis is not a good policy objective?

**Mr Evans**—What I am suggesting is that for the parliament to do it is not necessary. Firstly, it is happening already, as Kathleen outlined, and, secondly, it may tend to be obligatory in a way that causes more difficulty than good.

**Senator WONG**—I do not think that was what Mr Baker was asking.

**Mr BAKER**—No, I was asking about encouragement. I am not talking about legislation; I am talking about encouragement.

**Mr Berg**—I have just a couple of thoughts. First of all, I think I read something that Michael Chaney, the President of the Business Council, said recently. I think it was that 80 of the top 100 companies that are members of the Business Council actually put out a CSR report. It might not be a stand-alone report, but it would certainly be part of the annual report. So I think we have moved to 80 per cent if I understood his comments correctly. In terms of encouragement, one of the thoughts that you have given me is that I remember back in the seventies companies put out very bare-bones annual reports. I forget which organisation it was, although one of my colleagues will probably remember, but an organisation decided to come up with annual report awards.

**Mr Evans**—The Australasian Reporting Awards.

**Mr Berg**—Yes.

**Ms Farrell**—It was the Australian Institute of Management many years ago.

**Mr Berg**—That is right—it was the AIM who proposed these annual report awards. Can I say, in parenthesis, that all the legislation about annual reports has just made them impenetrable. I spend part of my time trying to read annual reports and it is very hard to get any decent information out of all the boiler plate that is in them. But what the annual report awards did was to make annual reports understandable to the average person reading them, because they were judged by practitioners who said: ‘Is this a good annual report? If I get this annual report can I understand it?’ This was back in the seventies, and over a relatively short period of time the standard of annual reports increased phenomenally. So I would encourage initiatives of that kind in this area, as opposed to a legislative or regulatory response.

**Senator WONG**—So what happened with the awards?

**Mr Evans**—That is still going.

**Ms Farrell**—It is not with the Institute of Management anymore.

**Mr Evans**—It has a life of its own. It is called the ARAs—Australasian Reporting Awards. It has matured and there has been lots of legislation that has affected annual reports. As Tony says, they have become enormously thick and unwieldy.

**Senator BRANDIS**—I want to go to a different topic, perhaps the other dimension of corporate social responsibility about which we have heard some evidence today, and that is corporate philanthropy. Mr Evans, I suppose you are the best person to ask this question of. Is it apparent to you that there has been a change or somewhat of a change in the corporate culture in this country in recent years towards greater participation by corporations in philanthropy and, in particular, in cooperative ventures with individual charities and other beneficiaries?

**Mr Evans**—Yes, I think that is correct. I go back to the example that Tony quoted a little while ago of the Australian Business Arts Foundation, ABAF, which has done a very good job in educating companies and, in that case, arts bodies—but the same could apply to other kinds of charities—to work out ways in which their mutual interests can be brought together so that a company might engage in a long-term sponsorship of a theatre company or music or something of that kind which fits into its corporate identity program and what it is doing with regard to making itself an attractive place to work or to do business with. So these things are related to the business of the companies and therefore within the range of acting in the interests of the companies. But it has become more sophisticated, and I think we see quite a flourishing of those kinds of collaborative arrangements happening today.

**Senator BRANDIS**—I do not mean to direct this exclusively to Mr Evans; others may have a view as well. To what do you attribute that change in the corporate culture? Is it merely that companies are more profitable? Is it because there is a greater awareness of broader civic obligations? What do you think?

**Mr Evans**—I will hand over to Tony, because of his knowledge of this, but can I just say that the process is more sophisticated than it was. It is not just a matter of dishing out money to one’s favourite: you happen to like the cello so you endow it in some way. It is now much more the case that these programs are related to what the company is trying to do in developing its own identity and presence in the community over a longish period of time.

**Senator BRANDIS**—So there is a happy coincidence of self-interest and philanthropic endeavour, is there?

**Mr Evans**—The people promoting this, I believe, have learnt how to marry the interests of the companies and the recipient bodies much better than in the past. Tony, would you like to take that up?

**Mr Berg**—Yes. I think that is right. First of all, I think companies feel that the community and their employees—

**Senator BRANDIS**—A lot of these things are employee driven, aren't they?

**Mr Berg**—Yes. Sometimes now you get employees that you are recruiting asking you what you do in these areas, because they want to feel proud about the organisation that they join. So there is that positive pressure.

**Senator BRANDIS**—I remember years ago I was a director of an aid agency in Australia—it was UNICEF, in fact—and it had a good reputation and we had corporate people beating on the door wanting to be associated with our name. In discussing with some of those people what they had in mind it was evident to me—this is in the 1990s—that it was almost a fashionable thing among corporations to have a good charitable partner.

**Mr Berg**—Yes, I think that is right. One of the great initiatives that is happening at the moment—and I forget exactly what it is called; the government has helped to facilitate this—is where employees can give money to their favourite charities and it is taken out of their salaries, so they do not have to claim the tax deduction back. It is an encouragement for companies to work with their employees to make these charitable gifts.

**Mr Coleman**—It can be on a one-for-one basis.

**Mr Berg**—Yes. Often the company will say, 'Whatever you give, we will supplement it one-for-one' or whatever. Again, it is a mutually reinforcing thing. The company will do it because their employees want it. The employees feel proud to be part of the organisation that does that sort of thing.

**Mr BOWEN**—Can I clarify that. Are those donations pre-tax? Is that what you are saying?

**Mr Berg**—Instead of getting your salary and having the PAYE tax taken out—therefore, you only get the net amount and then you are giving a gross amount—the gross amount goes straight from your salary. The tax is dealt with immediately.

**Mr BOWEN**—So it is pre-tax?

**Mr Berg**—Yes.

**Ms Farrell**—Can I address that. It is really interesting in that scan of the top 200 to see how many have programs, certainly for donation matching but also for time allowance for volunteering. The willingness to volunteer is seen as a good attribute in an employee. The

willingness to allow an employee to do it is seen as a good attribute in the employer. I also think that a sustained period of prosperity has helped.

**Senator BRANDIS**—I suppose the point that I made to others this morning I should make to you. This beneficial development has happened without any change of the law but merely as a result of good economic times and an emerging corporate culture which favours philanthropic activity. Would you agree with that?

**Ms Farrell**—Indeed. I think there is a really important point here as well. Many of these programs are matched to the business that the companies do and in which they are experts. From that viewpoint I think the governor of only being allowed to be philanthropic in the interests of the company has actually served a good purpose because, where companies are expert in an area, they are the best placed to meet the needs of the groups that they are helping. Just giving money away is often very unfocused and does not engage a broad spectrum of staff. I think it helps the morale of the whole community for that broader expertise form of giving to be there.

**Prof. Baxt**—Can I suggest that education has played a very significant part in this. It is not just formal education; it is all different types of education. The education comes from looking at the performance of our leaders—our business leaders and political leaders. The media plays a very significant part in relation to that. All of these things work together. We now live in a world where instant news is there from all over the world. We are seeing things happening and people are encouraged by what they see in other areas as well.

**Senator BRANDIS**—You might be interested to know that ACOSS of all people put some figures before us this morning that showed that major Australian companies have a better reputation in the eyes of public opinion than churches, the public service or the courts.

**Senator WONG**—But I am afraid that business executives were closer to journalists and politicians.

**CHAIRMAN**—I thank each of you for appearing before the committee and for the contribution you have made to our inquiry.

[3.45 pm]

**PURCELL, Dr Noel, Group General Manager, Stakeholder Communications, Westpac Banking Corporation**

**WILLIAMS, Mr Timothy, Senior Adviser, Corporate Responsibility and Sustainability, Westpac Banking Corporation**

**CHAIRMAN**—Welcome. We have before us your submission, which we have numbered 94. Are there any alterations or additions you wish to make to the written submission?

**Dr Purcell**—No, there is not.

**CHAIRMAN**—I invite you to make an opening statement, at the conclusion of which I am sure we will have some questions.

**Dr Purcell**—Thank you. I would like to start by thanking the committee for the chance to contribute to what is a crucial debate on the role of business in society. With the committee's agreement, I would like to briefly run through Westpac's own experience and then respond to the committee's terms of reference. Westpac of course is a major Australian corporation, a major Australian bank, and we have had very direct experience with the changing societal and community expectations for corporations. We were certainly forced to confront this in the late 1990s. Along with others in the industry, we faced reputation problems and real public criticism for our practices.

This forced the board and the management at Westpac to set aside the rhetoric and to look at our practices in the light of these expectations, which were clearly extending well beyond the financial dimension. For us, the starting point at the time was managing risk. From this, we moved on to understand how stakeholder interests impact on and drive sustainable value right across our business. We now appreciate that while business has more economic power and has been given more rights than ever before, with this comes the obligation to act responsibly. Rights and responsibilities go hand-in-hand in our view. At the same time, we recognise the successful management of reputation, social, environment and other non-financial drivers is fundamental to our corporate resilience and that it requires that the interests of all relevant stakeholders be taken account of. Importantly, taking account of interests of stakeholders other than shareholders in this way is not in conflict with the primary obligation of directors—namely, to advance the wellbeing of shareholders in both the short and long term. In doing so, directors are simply and clearly exercising their discretion to the benefit of the company.

Our corporate responsibility focus now is very much on driving shareholder value by supplementing our existing business strategies with sustainability linked products and services. Our overall aim is to maximise the tangible as well as the intangible value of Westpac over the medium to long term. Managing these so-called intangibles, which these days account for around 70 per cent of the total Westpac market value, is all about managing the real non-financial drivers of capacity, performance and value within the company. For example, improving our reputation and social licence to operate, reducing regulatory and other risks,

improving employee commitment—and so it goes on. At the same time, we believe that this way of working contributes to a more sustainable society.

Let me now briefly comment on the committee's terms of reference. My first point is that progressive companies like Westpac already do take account of the interests of stakeholders other than shareholders. Our shorthand for this at Westpac is simply doing the right thing, and by this I mean: behaving in a responsible, ethical and trustworthy manner; accepting responsibility to manage the direct and indirect societal and environmental impacts of our own business activities; understanding and then responding to genuine stakeholder priorities; and, importantly, being prepared to make short-term trade-offs for the sake of longer-term future gains; and last, but not least, having a commitment to transparency and accountability. Doing so, we believe, is at the heart of the primary obligation of companies to maximise returns to their shareholders on a long-term sustainable basis.

We also believe that organisations are already regarded by the community, and this includes shareholders, as having responsibilities that extend well beyond their statutory responsibilities. In this sense, legislation is lagging contemporary practice. However, given the progress in voluntary uptake of responsible business practices in Australia, together with the existing legal frameworks, we see no requirement for additional prescriptive legislation or regulation at this time. There is already extensive existing regulation and legislation covering the interests of stakeholders. We believe that specific social or environmental concerns should be dealt with through specific legislation on those matters, if it is necessary, rather than by changing the corporate law act.

Westpac also take a fairly expansive view on directors duties and we do not believe that further clarification is required. In any event, the major challenge to additional law or regulation in this area is how to define corporate responsibility obligations which can appropriately capture the specific issues in each sector and organisation and which will not conflict with existing common law and statutory duties of directors. More fundamentally, it is difficult, if not impossible, to mandate good values based business behaviour through legislation or regulation—and there are plenty examples of that. In the future if there is inadequate corporate progress in adopting responsible business practices there may be a case for considering non-prescriptive type approaches. The recently introduced requirement for operating and financial review in the UK provides one example of a non-prescriptive approach.

In relation to the committee's interest in non-financial reporting, although good progress has been made, and with some exceptions, Australian companies still lag global best practice. For our part, Westpac has produced five stakeholder impact reports or sustainability reports—whichever language you want—which tightly complement our financial reporting. We do this for two reasons. First, the board sees itself as having a mandate for the oversight of corporate performance, and so it does. This means the directors themselves must ensure they properly understand the true value drivers, risks and opportunities within our business. Second, shareholders and other stakeholders should have access to the information they need to fully assess the company's performance.

The fact is that only part of the information needs of directors and stakeholders is met by the traditional accounting paradigm and accounting reports, hence the need for additional non-financial measures. However, again we believe that prescriptive, regulatory driven reporting



frameworks are premature. The global reporting initiative, for example, has developed with widespread multi-stakeholder input and is rapidly developing as the non-financial reporting standard. We believe that further experimentation and engagement between corporations, financial accounting bodies, financial market participants, regulators and other stakeholders should in fact be encouraged as part of this broader global debate on corporate responsibility and reporting issues.

As my final point I would like to emphasise that we see the need to promote better engagement by mainstream financial markets around corporate responsibility and sustainability performance as particularly important. This is, as we see it, a crucial piece of what we call the demand side of sustainability and has the potential to really drive the uptake of responsible business practices. Thank you for the chance to make those opening comments.

**CHAIRMAN**—Thank you, Dr Purcell. Do you have anything to add, Mr Williams?

**Mr Williams**—Not at this stage.

**CHAIRMAN**—Given the quite comprehensive involvement Westpac has in corporate responsibility, have you done a cost-benefit analysis of your corporate responsibility activities?

**Dr Purcell**—The story on that would be in the early days. Of course the board was very concerned as to whether this was actually adding value for the company, and quite rightly so. At the end of the day, all that we do in this area has to be something which is to the benefit of the company or takes account of stakeholder interests and particularly the shareholders' interests. So early on we did do quite a lot of cost-benefit analysis on some of the early things we did, but I have to say we quickly moved away from being prescriptive about that in any sense. It became fairly obvious that everything we touched in this area was value adding. I can say right to this point there is nothing Westpac have done in our journey over what is getting close to 10 years with this which has not been shareholder value adding. I do not think we know of any case. There can be situations where there is a very short-term cost—for example, energy efficient devices in buildings—but the payback period is so rapid that it quickly turns into being a bottom line plus.

**CHAIRMAN**—So your conclusion is that your financial bottom line has improved over the eight years?

**Dr Purcell**—Substantially.

**CHAIRMAN**—But in part as a direct result of your CSR activities?

**Dr Purcell**—Absolutely. And the benefits we would see are not just the direct financial bottom line benefits but particularly the lowering of risk for the company and improving its resilience.

**CHAIRMAN**—In your submission you note that Westpac's Community Consultative Council, which is made up of community and government organisations relevant to your social and environmental impacts, plays a critical role in focusing Westpac's overall stakeholder

engagement program. Can you perhaps give a bit of an elaboration on the role that the council plays in CSR activities?

**Dr Purcell**—Yes, it plays a very important role for us in terms of dealing with a particularly important issue to make sure that we are in fact focusing on issues which are material to our stakeholders. The major role of that consultative committee is to tell us what they believe are the material issues in the community—for example, issues to do with the ageing of the population, given we are a very large employer, and what our role will be in that mature aged employment; issues to do with estrangement and social breakdown et cetera, which politicians are certainly well aware of in their electorates; issues to do with financial literacy; climate change issues and so on. They set out to us, because they are a full cross-sector, what they see as being the issues within their various stakeholder bases which may be relevant and which they would like to see a response from our corporation on in terms of how we are conducting our business practices.

**Mr BAKER**—Dr Purcell, I presume Westpac have stand-alone socially responsible investment prospectuses.

**Dr Purcell**—We do.

**Mr BAKER**—Do you have any quantitative data on the relationship between those funds and a normal share fund or a property fund—whichever?

**Dr Purcell**—If you look at the performance of the SRI funds compared to balanced funds, then pretty much whether you look at them over one month, six months, 12 months or three years, they have at least matched the performance and in many cases have outperformed. But there certainly does not appear on the relatively short history—

**Mr BAKER**—We were only talking six or seven years?

**Dr Purcell**—SRI funds have been around probably a bit more than that—maybe eight years. So far, certainly the better managed ones seem to perform as well as non-SRI funds. So there does not appear to be any erosion of investor returns. That is looking at them pretty much like a balanced SRI fund.

**Mr Williams**—Clearly this is the big question—whether or not managing this way leads to better financial outcomes. There have now been a series of meta-analyses, which have finally begun to look at this question comprehensively. Consistently the response is that there is at least no penalty for managing this way.

**Mr BAKER**—Because when you start analysing a balanced fund, which is middle of the range and lower risk than particular specific direct investment, it is very encouraging.

**Dr Purcell**—It is. I want to emphasise that I think history is relatively short in terms of the global cycles we have been through. If you look at the Dow Jones Sustainability Index and track that since the early nineties, it has performed by about 30 per cent compared to the Morgan Stanley Global Index. So if you invested in the index of large global companies—a population of about 4,000 of the largest global companies—compared to those that are included in the Dow Jones Sustainability Index, the out-performance in that period is about 30 per cent. It has been a

bit cyclical, but again the time period in investment terms is relatively short. In all the studies Tim referred to—there are literally hundreds of individual ones that have attempted to look at their correlation between companies who have so-called better sustainability performance or rankings—the overwhelming finding is that there is a positive correlation; it is sometimes weak, but you have to look very hard to find one with a negative correlation.

**Mr Williams**—It is interesting to reflect on the Dow Jones Sustainability Index that is put together by the SAM Group in Zurich. In the model they use, they endeavour to identify, out of the largest global companies, the companies that are best at managing risk and best at identifying business opportunity from the sustainability ethos. That drives their model. It is good to see that reflected in those performance outcomes.

**Mr BAKER**—It is very encouraging when you start comparing return risk. If it is a middle-of-the-range fund and a specially balanced fund, it is a very great marketing tool.

**Mr Williams**—Absolutely.

**Mr BOWEN**—Dr Purcell, I was interested to read in your submission that stakeholder interests are built into performance appraisal and remuneration in your management team. How far down the management team does that extend? Does it cover branch managers?

**Dr Purcell**—We look at it holistically. As far as we are concerned, corporate responsibility goes to every element of what we do every day, so it is about how we manage our people, key customer parameters and so on. So, absolutely, in that sense, it goes straight down. We have broader measures, though, which pick up the overall performance of the company, and that goes down from David Morgan to the next two levels. That is a corporate responsibility type objective. In every business unit, if you are in a certain part of the business where there are elements of occupational health and safety, they will have specific occupational health and safety objectives. The branch manager will have employee commitment and engagement measures which are specifically about how well they manage from a leadership point of view. We measure that through things like a people leadership index and so on. It picks up those parameters.

**Mr BOWEN**—I imagine that Westpac, like most other major banks, has requirements on its tellers, for example, to reach certain sales targets. Until 10 years ago, a teller would be doing their job if they served their customers. Now, probably all four banks have requirements that tellers need to sell a certain number of credit cards and other products. What happens in a branch in Western Sydney with a very impecunious customer base, where people are clearly struggling? I could name probably 15 suburbs, some of which would be in my electorate. How does that marry with social responsibility if you are requiring a teller to sell X number of credit cards a week, even though that teller may very well know that the person does not need a credit card and, indeed, that credit card might present an undesirable temptation to a person who is already in financial bother? I would ask that question of any bank that was appearing before us.

**Dr Purcell**—It is an excellent question. Firstly, tellers these days are very restricted under FSR as to what they can advise on and sell. They have to be accredited to do so. I will go straight to the heart of the issue. It is a very important issue and one that we discuss at board level, in the corporate responsibility and sustainability committee. If you wind the clock back, we can all remember the days when a large part of the community had zero access to credit.

They could do some lay-bys, and that was about it. They were disenfranchised in terms of being able to do many things that others take for granted. So you have this cross-over: at what point do you take the safe course completely and say this to large groups? For example, do you screen pensioners and say that they should not get a credit card? Or do you take a risk based approach to it, but a responsible one, and look at ability to service, history and so on?

We have responsible lending codes in place, and we try as best we can, on the information base we have, to make intelligent decisions. I assure you that there is no mileage for anybody in making a bad loan, because of the social consequences for the individuals affected and also because of the consequences for the shareholders. The incentive system in the bank is not about making crook loans, but we are in the risk business and we certainly cannot pre-empt the circumstances of someone who may have credit—they might lose their job or there might be other unforeseen circumstances. Credit losses do occur, and the real test is how well we manage that, in those circumstances. We are very conscious of the issue of unsecured consumer credit and what has been the burgeoning growth of credit to people who previously would not have had access and their ability to manage that. It is a big issue.

**Mr Williams**—There is just one point more broadly. Clearly, the issue of consumer debt was raised by the Community Consultative Council. On that basis, we are looking at that in a holistic fashion as one of our sustainability priorities.

**Mr BOWEN**—You may or may not be able or willing to answer this question: if you have two branches of the same size and with the same customer numbers, one in a very—for want of a better word—‘poor’ area and the other on, say, Sydney’s North Shore, would a teller at, say, the Mosman branch have the same performance indicators for selling credit as a teller at the Doonside branch in the poorer area?

**Dr Purcell**—No. Let me emphasise that tellers do not sell; they are there to service transactions.

**Mr BOWEN**—They refer.

**Dr Purcell**—I think that has even changed. These days, the branches are structured in a rather different way. In fact, within the branch there are people who are trained to sell, so the referral is made to someone who is there. But it would be silly and it simply would not work, for example, to have the same target for new home lending in the eastern suburbs of Sydney as in south-east Queensland, in terms of a technical branch, where there is a growth corridor versus a mature area. Certainly we do market segmentation and finetune that. My answer is that, of course, we do that. Again, as an organisation, we are well aware of the risk involved with what simply is called ‘debt flogging’. In fact, it is a path to nowhere.

**Mr BOWEN**—I will go to the separate matter of relationships with employees. I think all four major banks, again, have had very, shall we say, ‘robust’ relationships with their union and employees over the last 10 years. I do not have first-hand knowledge of it, but I understand that Westpac recently cancelled EBA negotiations. Would that be looked at corporately? For example, I do not know your structure, but you would be responsible for corporate responsibility and not for industrial relations, I imagine. But would the industrial relations section run that past

you and ask, 'Are we taking a corporately responsible approach in cancelling these negotiations in good faith?'

**Dr Purcell**—Absolutely. For the record, the background to that is simple. We negotiated for 15 months but were unable to reach agreement. During that process, we said that the employees would not be impacted. We passed on two rounds of four per cent salary increases. We increased paid paternity, maternity and carers leave from six to 12 weeks. So we kept our progressive policies going all through that process. It is probably for that reason that we have not had any employee agitation about the whole situation. It was pulled off the table simply because of an inability to get agreement.

The existing EBA is still in place. It still exists and we are progressing and moving things forward, like workplace child care et cetera. It is in our interests to be a preferred employer, which we are. People say that their No. 1 criterion for choosing Westpac, if they have equal choices, is our corporate responsibility credentials. Being a preferred employer is critical to our organisation. We are in a war for talent already and not to realise and manage that would be silly. But the answer is that I am certainly involved in all of that, yes.

**Senator BRANDIS**—Dr Purcell, coming from Westpac, I find this particularly interesting. As you touched on rather gently in your opening, Westpac is a bank which perhaps 15 years ago had reputational problems. But it seems to me that, in the time since, it has lived down those problems, so perhaps it can speak with more authority than most about the relationship between profitability, corporate health and social responsibility. Basically, I hear from your evidence that that relationship is not just notional but also palpable. Is that your point?

**Dr Purcell**—Absolutely.

**Senator BRANDIS**—The other thing that comes through loud and clear is that this development—the undertaking of greater social obligations—has been a voluntarily assumed one. I take it that when you say that you are not just speaking for Westpac but making an observation generally about corporate culture in this country.

**Dr Purcell**—It was voluntarily assumed, but let me tell you that at the time it did not feel voluntary. We felt that our staff and customers were pretty much dictating that we had to change—

**Senator BRANDIS**—I am sorry; perhaps I chose my words poorly—

**Dr Purcell**—but it was voluntary in the sense of there being no regulation.

**Senator BRANDIS**—When I say 'voluntarily assumed', I mean 'not imposed by law'. Sorry, I cut you off. What are the drivers? Elaborate for me, please.

**Dr Purcell**—The driver is enlightened self-interest. I think we as a company were very concerned at the time. It is not a comfortable situation when there is a breakdown in the trust of your employment base in the company. The broader community were pretty much in open revolt about bank practices at the time, particularly around rural branch closures, lack of transparency in fees and charges, access to banking services for the disadvantaged in the community and so it

went on. I guess we came to the realisation that those things just were not going to go away; that there was something fundamentally wrong with our practices, and we bit the bullet and made some dramatic changes.

At the time—in early 1998—we announced we would not leave any more rural towns; we would have a moratorium on branch closures in rural and regional Australia, which we have stuck to to this day. We introduced the basic bank account into this country. That was a very difficult issue for Westpac, particularly with directors' responsibilities, because it is a form of income transfer. Here we were, in effect, cross-subsidising a welfare group who were getting their pensions paid into bank accounts but having difficulty accessing those accounts and having fees and charges on them. In our enlightened self-interest, when we put it all together, we thought our social licence to operate and the support of the community for our practices were more important and would pay dividends for us. So we decided—and it was a very hard decision—to introduce fee-free banking for anybody on a health care card, welfare payments et cetera, which is literally up to five million Australians.

**Senator BRANDIS**—Speaking now not just about Westpac but generally about large Australian corporations, is it your impression—and I appreciate this can only be an impressionistic answer—that there is a greater, more top-of-mind awareness of issues of corporate social responsibility these days than has been the case in the past and that that awareness is being put into practice among corporates?

**Dr Purcell**—There is certainly increased awareness. There is nowhere to hide anyway, so they have to be pretty deaf if they are not hearing. I think the majority of large Australian companies have got the message. I think many, in their own ways, are still finding the best ways to respond to that. While a company like Westpac feels fairly comfortable these days in responding to the challenges of reporting under the GRI and so on, it is a very difficult initial journey. There is no training school in this; it is like you go straight into the A-league. If you are going to do it, you are expected to report on a huge array of non-financial parameters, and many of those may not be material to the company, which is one of the challenges we have in the evolution of this. In some of this, the whole concept of materiality has been lost.

That being said, I think there has been quite good progress. There is a long way further to go yet. The number of companies that are now doing some form of sustainability reporting is growing each year, and those reports are getting much more detailed and comprehensive. A growing number of companies have started sustainable supply chain work, like us. We require our suppliers to undertake sustainability assessments. It is a carrot rather than a stick; we do not care how bad their performance is when we start measuring, but they have to agree to embark on an improvement program. If they do not, ultimately we will change suppliers. That gets down into mid-sized companies as well. It has been really encouraging how positive that whole process has been at getting more people to adopt and see the value of it. The inevitable response we get, after the shock of having to do it, is: 'Thank God you got us started on this. We are driving so much value out of this.' It is quite amazing.

**Senator WONG**—Thank you for your submission. It is useful in this area for the committee to move away from the macro policy level and be presented with some very clear evidence about how a company has integrated or sought to integrate this into its systems. So it is very useful for us. There are three issues I want to raise. One is the issue, Dr Purcell, that you have just touched

on, which is the supply chain. Perhaps you could take this on notice, but I could not find in your submission much detail on what you require of suppliers.

**Dr Purcell**—Mr Williams can give you more detail, but, basically, we started with the top 100 suppliers. They account for about 80 per cent of our total supply chain, which is roughly \$2½ billion of expense base. We literally developed a sustainability questionnaire that went through workplace practices, what they were doing in terms of market behaviour, occupational health and safety matters and environmental risks, for example. It was pretty easy to identify what the material issues were. If they were a wardrobe supplier to Westpac—in other words manufacturing Westpac’s wardrobe—we knew what the material issues were, such as issues to do with where they were getting their labour from and where the manufacturing was occurring and what risks might be in that.

The supply chain risks carry right through to an end-user like us. So it is in our enlightened self-interest to take risk out of our supply chain. So that is what we started with. We developed a process in which they undertake sustainability assessments and we feed back reports, basically, on how well they do on that. In our next social report coming out you will see the results of where they rank in performance. And then we sit down with them and embark on a process of self-improvement.

**Mr Williams**—In essence, it is quite simple. The objective was to apply what we do to our supply chain, given that we have 10,000 or so suppliers, so we can have a total impact as much through our supply chain as our lending and investment decisions and our own footprint. The process is reasonably straightforward. It has been applied to the top 100 suppliers by spend. And then it applies to any procurement decisions—any new suppliers who come to Westpac are assessed against this process. It has been designed to be fairly straightforward and the whole process is owned by our procurement professionals. Surprisingly, there was limited resistance to and a lot of goodwill around the process. We have committed to help suppliers improve their performance.

**Senator WONG**—Is there negotiation in terms of the issues that you want them to report to you on? Or do you determine from your end as the end-user that your risk analysis means that you need them to report on A, B, C, D et cetera? I am trying to get a sense of how much it is imposed by you, essentially, as the customer in this context, and how much it is negotiated.

**Mr Williams**—From the outset it was designed to be a developmental process to improve both Westpac and the suppliers’ mutual social, ethical and environmental benefits. That was always the understanding. We had a look at different ways of making it work. In essence, the model is that all suppliers are judged against the same criteria, and they are multiple social, ethical and environmental criteria—the same sort of criteria that would be part of the Dow Jones Sustainability Index, and the same sort of criteria that we report against in our own non-financial reporting. We determined that it is really the subset of social, ethical and environmental issues which are pertinent to any company.

Beyond that, we would also look at the specifics of the category—of the supplier’s business and so on—to see if there were overarching issues which we needed to consider at the same time. So the assessment is applied to all companies which go through this process in a similar fashion. The negotiation is in terms of any remediation that is required by the supplier. So it is a

developmental process. It is designed to give the supplier an opportunity to benchmark their performance. Then we sit down with the supplier to discuss results and determine what they can do, whether or not the performance is appropriate and what they can do to improve their performance, in a practical way. We make available resources, both through Westpac and through third parties, to help them to improve their performance to an appropriate level.

**Senator WONG**—Perhaps you could take this on notice for consideration. Obviously, there are things that would be commercial in confidence. I am not interested in who it is; I am interested in looking at some documentation which sets that process out clearly.

**Mr Williams**—Sure.

**Dr Purcell**—Most of it is publicly available on the web site. We will send the committee a set of materials on this.

**Senator WONG**—That would be useful.

**Dr Purcell**—Part of the question was, ‘Do we send inspectors in?’ I should emphasise that, no, we do not. There is a lot of trust in this. In fact, our evidence is that people will self-assess very accurately. The really interesting thing is how quickly they get to the point of saying, ‘We were not managing the stuff we should have been, and managing this is actually changing the company quite substantially for the better.’

**Senator WONG**—One of the issues you raised in your submission is the key role or opportunity that is presented by better engagement by mainstream financial markets. I think essentially what you are saying is that investors should be looking at a whole range of factors when considering the companies in which they invest, both financial and nonfinancial. I have two questions about that. The first question is: how do we encourage that, particularly given that we have had some discussion today about the short-term nature that is inherent in a fair few mechanisms in the market? The second question is: given your views as to the premature status of non-financial reporting in industries currently, where do we go with that? If you are saying that we really need to get this important information then these are two impediments, I suppose.

**Dr Purcell**—The first thing is that it is difficult, otherwise it would be happening. It is difficult for a number of reasons, but I think a number of things are going to happen. There are quite a number of Australian companies which are very committed to this way of conducting their business. All of us are actively putting it into our investment presentations and talking to the market about where the linkages are and why shareholder engagement leads to lower employee turnover. It costs us about \$50,000 or \$60,000 to replace somebody, basically, by the time they are trained, accredited and brought up to standard. We are talking about why paying maternity leave is a positive value generator for us compared to where we were, and how that has absolutely increased the return-to-work rate and retention. We are talking about why these things drive value in the company. Companies which are engaged in this have, in their own interests, tried to educate the market about the value linkages here. So that is one process which is happening. The large players in the investment management industry have formed various groups and started a process of working together to try to develop better value evaluation models which incorporate some of this data. That is a very difficult thing to do. They have struggled to really get good financial evaluation models let alone incorporate these more intangible factors.



Having said that, there are number of initiatives under way. Tim is involved in several, and we are certainly assisting on them. They are happening both domestically here in Australia and globally. But, to be honest, it has some way to go. I think, at the end of today, markets will ultimately be driven by the fact that this produces better investment outcomes in the long run. The more the evidence grows, to the extent to which you can model and take account of these factors—and it will produce a superior investment performance—the more that will drive the behaviour.

**Senator WONG**—I agree with you. I guess the issue is whether the—

**Dr Purcell**—The chicken and the egg.

**Senator WONG**—information is perfect. Information is imperfect and perception is imperfect. So if people do not believe that these issues do drive long-term value then—

**Mr Williams**—Exactly. As an ex-stockbroker, I find this a fascinating question which I am really engaging in. The difficulty is that typically the analysts want demonstrable causal models. They have a financial model which looks very closely at the performance of the company and models the performance of the company. They go through that process and that gives them the outcome as to how they perceive the value performance of the company. They already make qualitative assessments anyway about leadership, strategy, the quality of the company's relationships—

**Senator WONG**—They are probably doing it anyway.

**Mr Williams**—and what the feeling is when you walk through the front door. So the process is happening anyway. The difficulty is in trying to extend that very formal causal modelling to those more intangible factors. We are a long way from understanding how that all works. As Dr Purcell said, we can at least demonstrate, where we can, those formal linkages in our own value chain, educate our investment markets about that and then begin to talk about the more intangible issues like reputation and so on. Our sophistication will develop over time.

**Dr Purcell**—I think the encouraging thing is that two years ago there was SRI activity in those firms that specialised, but nothing much else was happening. Then the Who Cares Wins initiative, which is part of the Global Compact group, got together. Today I have lost count of the number of different groups working on this, including several in this country.

**Mr Williams**—There is a new group called the Society for Knowledge Economics, which essentially is a multisector approach to begin to ask: how do we move beyond the financial paradigm? We know that the accounting paradigm is a way of looking at a company's value and that there is a whole lot of a company's value that is not included within that, so what is the next model we go to? Ultimately, it is to look at the notion of societal value: how do we begin to really think about a model that will totally encompass organisational or societal values? It is a huge question. There are people involved from state and federal governments, accounting bodies, academia, corporations and so on.

**Dr Purcell**—Then there are the third-party rating organisations that keep growing in terms of who had metrics. They attempt to put a measure on this and sell it to the market as input into

developing investment indexes. So it is growing. Compared to two years ago, this is a dramatic change, but the truth is that there is a long way to go before it is mainstream.

**Senator WONG**—One of the issues we have been asked by the Senate to look at is the issue of directors' duties. I do not think we have covered that. Perhaps we can ask that it be taken on notice. One of the views that has been put—and you refer to it in the submission—is that there are some who would argue that the current directors' duties take a fairly restrictive view of what that means. Westpac, obviously, in how it views the best interests of the company, does not take a fairly restrictive view of that. One of the issues we have been asked to consider is whether or not there is any clarification of the Corporations Law required to allow directors to take into account the longer term and non-shareholder stakeholders.

**Dr Purcell**—I will try to speak for the directors. They do not feel constrained at all in doing so. In fact, under the existing directors' duties there is a requirement to do so. They could not possibly be looking at the interests of the company if they were ignoring those factors.

**Senator WONG**—I do not advocate the narrow view. I think the issue is that some people see it that way.

**Dr Purcell**—We do not feel that there is a necessity to get prescriptive about trying to specify the elements you need to take account of, and that was in my opening comments. It is very difficult because of how they vary by sector, how they vary by industry and so on. It will be very difficult to get prescriptive about it, but we think it is unnecessary at this point to do so. There is ample latitude to consider long-term issues. There is ample latitude to incorporate the interests of other stakeholders, beyond shareholders, in how you assess what is in the enlightened self-interest of the company.

**CHAIRMAN**—As there are no further questions, we thank you very much for your appearance before the committee.

[4.30 pm]

**ZAPPALA, Dr Gianni, Director, Orfeus Research and Adjunct Professor, School of Economics and Politics, University of Sydney**

**ACTING CHAIR (Senator Wong)**—Welcome. Thank you for appearing at the hearing today. You may give an opening statement if you wish.

**Dr Zappala**—Thank you for the opportunity to appear before the committee. I will give you some background to the paper that formed the basis of my submission. It is a couple of years old now. When I reviewed it before the committee hearing I thought that some of the key points I made in that paper are relevant, particularly to some of the terms of reference, so I decided to submit it in any case.

As to how the paper arose, I was asked to develop a unit on corporate citizenship at the University of Sydney for their Master of Public Policy. It was in that context of looking at the relationship between this area and policy, hence that paper very much focuses not so much on the business case for corporate citizenship, which I think already has quite a substantial literature, but more on the relationship between government and the role of policy and this area, which I think was underdeveloped, not looked at and underresearched at that point.

What I did in the paper was outline what I termed the public policy case for corporate citizenship. There were four key pillars to that, which I will not go into because I do not think they are so important for the purposes of this exercise. In terms of the public policy options that I outlined, I think there were essentially three. One option was really to do nothing in terms of government. The critics in particular argued that case. The second option was really the one around regulation and legislation, which in part is what this committee is looking into. Within that area there is, of course, this distinction between hard law and soft law. Then there were the third and fourth pillars, which I termed the non-regulatory activist model. That is the model that I supported then, and I still largely do.

I think corporate citizenship has developed historically as something which is primarily voluntary in that it is about companies choosing to go beyond the law in the way they interact with society and manage their impact with a range of stakeholders. Although it is voluntary, there is an important role for government to play in that area, I believe. It is more a supportive and enabling role in this area than a strongly legislative role. Hence, as I said in the covering letter to the submission, in the first instance I think the Australian government should adopt a non-regulatory activist approach to corporate responsibility by adopting some of the recommendations that I listed on page 19 of the report. I will stop there and give you the opportunity to ask questions.

**ACTING CHAIR**—Unfortunately, my photocopied document is slightly incomplete. I will say that I was very interested to see that you had done this paper. It had not been brought to my attention before the committee considered its inquiry. It certainly does outline a range of the options available and it is highly relevant to the committee's inquiry. I suppose what I would be most interested in is an outline, perhaps in a bit more detail, of why you decided that non-

regulatory activism was the way to go. From a politician's perspective I can certainly understand that it is easier to engage and act rather than regulate. I think if you have been here today you will have heard that there is obviously a very strong view from some sectors that regulation is not the way forward. I have to say that I have some sympathy with that. It seems to me that it is very hard to regulate changes in culture or regulate for high standards of ethics. I would be interested in hearing what you mean by non-regulatory activism.

**Dr Zappala**—From the perspective that, as I said, this area has developed historically as a voluntary thing that companies do, there is always danger regulating something which is as diverse as social behaviour. The environmental dimension of corporate citizenship or sustainability is probably the 'easiest' one to regulate, because there has developed a degree of standardisation and consistency across what we mean around impacts on the environment. Similarly with financial considerations. In the social area there is still not a great deal of consistency or agreement among the different stakeholders and groups about what exactly we are talking about, so it is quite difficult to measure. Different companies, because of the nature of their activities, will often have very different impacts on the group. In the mining sector, for instance, key stakeholders would be Indigenous communities that are often owners of land where the mining company wants to have operations. Financial companies have a whole range of very different working environments.

That is one key reason why regulation is difficult in this area. I would not portray my position as being against all forms of regulation in this area; it is more one of, given where this area is and where Australian companies and not-for-profits and other organisations are, it might be premature to regulate. I would much rather see government taking a more proactive role to encourage certain companies and organisations to behave or act—or even to be aware in some cases—in some of these areas and to lead by example in some of its own agencies and give that some time to embed within the culture. In some ways it would be good for government to animate this whole area a little bit more and then perhaps, once it is more embedded in the culture, there may be some scope or some firmer arguments for regulating, particularly in the area of social and environmental reporting.

**ACTING CHAIR**—That really coincides with some of the evidence we have had about the nascent or premature stage of non-financial reporting and the lack of agreement or consistency around those metrics. I am interested also in the reference on page 19 to the UK experience and the suggestion, which is consistent with something that has been going through my mind, that you can in fact kill the process of encouraging notions of social responsibility through heavy-handed intervention. Perhaps you would like to comment on that? It seems to me that if you do intervene too early, in the sense that you regulate well beyond where people—and by people I mean legal personalities—are actually able to engage, you actually can set things back, because they then tend to go to a compliance approach.

**Dr Zappala**—Yes. I think that is one of the key dangers or risks of regulating in this area and regulating too early. The UK experience is an interesting one. I believe the strong non-regulatory activist role that the government there took led to proposed regulation not being passed, despite the debate being quite advanced and vocal in the UK for several years. One of the reasons why the core bill did not get through was that the government had already been doing quite a lot in this area. So the awareness of companies and organisations was quite high.

**ACTING CHAIR**—I do not think you have gone beyond 2003 in your submission in terms of the UK's initiatives in this area?

**Dr Zappala**—No.

**ACTING CHAIR**—Obviously you have plenty of other work to do, but we would be interested in some examples post your paper or, if they are not in your paper, of the non-regulatory activism engaged in by the UK or other governments.

**Dr Zappala**—Sure.

**ACTING CHAIR**—I would be keen to look at some practical examples of this.

**Dr Zappala**—The best place to see those is on the UK Department of Trade and Industry's web site. They have a gateway—I think it is called the UK government's gateway to CSR—where they list the UK's policies in this area, their policies at regional levels and all the initiatives that the various government departments are involved with. The CSR Academy has now developed to a greater stage than when this paper was developed. The government provide a lot more support in the area of training, skills for managers and accreditation of practitioners in this area. Those are the kinds of things they are doing. And of course the very fact that they have a dedicated unit and minister plays a big role in the profile that CSR has.

Another interesting example comes from the US. It was not as successful, and it is not in the paper, but it is an example of non-regulatory activism. It was put forward by the Democrats in the US in the late nineties and, again, it was a voluntary thing, using the carrot rather than the stick. If corporations did certain things—for example, gave a certain percentage of their profits to training or acted in certain ways—then they were given certain tax advantages and certain procurement advantages in government tenders. That is the kind of practical example that I think can be developed that takes a more enabling or carrot approach rather than a hard law or stick approach.

**ACTING CHAIR**—We might get Dr Marinac and his staff to help us with that, rather than putting you to more work.

**Mr BOWEN**—Dr Zappala, I take it from your submission that you would regard the UK as having world's best practice in terms of non-regulatory activism?

**Dr Zappala**—At the moment, yes.

**Mr BOWEN**—Are there any other jurisdictions you think the secretariat and the committee should be having a look at?

**Dr Zappala**—Some of the countries in Europe also have interesting examples. The Scandinavian countries have tended to follow, as is their tradition, more of a regulatory role. In France, as I am sure the committee would know, companies of a certain size listed on the French stock exchange need to produce reports; similarly in South Africa. I think it is still early days to try and get a sense of the impact of that regulation on companies—you generally need a longer time frame, particularly with an area like this. For the Australian context I always try to find

examples other than the UK, because we do tend to rely on UK examples for a lot of things, but in this case I do think they have led the field. There is another country that has now appointed a CSR minister and I think it is a European one.

**ACTING CHAIR**—Perhaps if you recall that you might email the committee secretariat and let them know. I would appreciate that. Thank you very much for your attendance and, again, apologies for the delay.

**Dr Zappala**—Thank you.

[4.44 pm]

**TURNBULL, Dr Christopher Soren Shann, Principal, International Institute for Self-Governance**

**ACTING CHAIR**—Welcome. I understand you have been invited to make a statement because you are not able to attend the hearings next year.

**Dr Turnbull**—That is right. I will be overseas in February and March, so I thank the committee very much for allowing this appearance. I have a written statement I would like to table which I would like to talk to, rather than reading it out. Basically what I am presenting is to introduce a self-enforcing strategy for corporate responsibility and to provide incentives by simplifying and reducing the burden of corporate law for those companies which change their corporate constitutions to introduce compelling self-enforcing processes which are better than what the law presently has.

I make five recommendations. Recommendation 1 is that there is no need to change the directors' duties, as discussed earlier in today's hearings, but we need to provide incentives for companies to change their constitutions. Corporate constitutions provide directors with excessive and inappropriate powers. The old saying that power corrupts and absolute power corrupts absolutely allows them to not take corporate social responsibility seriously. I suggest in my submission that those companies which adopt constitutions for setting up stakeholder advisory councils be exempted from various parts of the Corporations Act, which is designed to protect stakeholders, shareholders and so on.

We have heard evidence that Westpac believes it is good value having consultative councils. In America, Ralph Nader set up what he called citizen utility boards for the utilities there. I suggest that corporate constitutions provide the facility for the employees, customers, suppliers or other appropriate common interest groups to set up advisory consultative councils to provide feedback to the directors on what the stakeholders' interests are. I have put the arguments for this on the next page of my statement.

Senator Wong mentioned that there is no way you can regulate people's culture, but there have been experiments in America which show that people's values, behaviours and cultures change according to the institutional context in which they operate, so to change people's sensitivities you change the power game. The power game is defined in the corporate constitutions and, if a corporate constitution allows employees, customers, suppliers and other stakeholders to have their own consultative councils—like Westpac and other organisations have—which are independent of management and not there at the grace and favour of management to provide a loyal opposition to whatever the directors believe is in the best interests of stakeholders, it is a way of getting feedback.

If those consultative councils were recognised in the law, you could say, 'Let's relieve directors' duties.' In point 4 of my statement, I give the arguments for how these consultative councils would relieve directors of their duties and improve competitiveness. It reduces their reporting duties, because the stakeholders would do the reporting for the company rather than

the directors. It avoids directors having conflicts of interest and reporting their own actions or inactions. I believe all this talk about having more reporting is a bit of a nonsense, because directors have a conflict of interest. It is better for those who want to be protected to do the reporting and to say what is going on.

Having stakeholders doing the reporting also avoids the need for social and environmental auditors to verify directors' reports, as the stakeholders elected independently of management become the auditors. It establishes a loyal opposition to the hegemony of management information to inform directors independently of management about management and the business. At present, there is no systemic way that directors can get that information to carry out their duties, which leads us to the next point. That is that it provides non-executive directors a credible systemic process to carry out their duty to monitor and direct management with due care, diligence and vigilance and discover when their trust in management might be misplaced. It provides feedback and feed-forward information to improve competitiveness. It provides a means for management to learn about problems before the directors. It provides senior management with independent feedback on the performance of their subordinates in managing the business and its responsibilities. It avoids the need to adopt a one-size-fits-all approach to reporting standards. It provides a mechanism for stakeholders to protect themselves privately.

Having stakeholders doing the reporting also avoids the need to report on matters on which no action is required. At the moment we have excessive corporate reporting. A lot of shareholders do not read all of the reports, and we do not want to burden corporations by having even more stakeholder reports. It is exception reporting by people whose self-interest it is to blow the whistle if there is a concern. As somebody stated earlier, it creates peer group pressure for the directors to take account of things. It decreases the volume of public reported information but increases its scope. It enlarges the citizen constituency of corporations to enrich democracy and it also improves the legitimacy of the political licence for corporations to exist.

I have two specific examples in recommendations 4 and 5. Recommendation 4 is that corporate constitutions establish a democratically elected shareholder committee to control the auditor, with no audit report being accepted if any control or influence of the external auditor is exercised by the directors, the audit committees or management. This is because the purpose of the external audit is to provide shareholders with a check on directors. This is being lost. The ASX Corporate Governance Council says that you must have an audit committee controlling the auditor. But it is the shareholders who appoint the auditor and it is to the shareholders that the auditor reports. The inconsistency and paradox is that it is the directors who control the auditor, which negates the purpose of having an auditor. So the shareholder advisory council would take control of the audit and provide higher integrity.

Point 5 is a concern of the ACTU about employee entitlements. How do employees look after their entitlements when the textile company or Ansett goes broke? I suggest that the unsecured creditors have the power in the corporate constitution—not in the Companies Act—to request the auditor to provide a balance sheet of the company on an ongoing concern basis. This is commonly done by bankers when they want to look at the security of their floating charges. An audit report on an ongoing account basis tells unsecured creditors, like employees with their superannuation entitlements, whether they will get paid out if the company goes bankrupt. That is an early warning system to tell the shareholders to put in more money or to set up a suitable trust fund.



Recommendation 3 is that the minister in charge of corporations obtains reserve power to allow stakeholders of record in exceptional circumstances to appoint the directors when the directors have not undertaken corrective action regarding public health, safety, environmental risks or damage. If that sort of thing was on the statute books now, I am sure that the James Hardie settlement would have been completed some months ago. Public opinion is clearly against the James Hardie directors, who, Professor Baxt says, are wrong in law. If the Treasurer had that sort of reserve power, I am sure that by now he would have exercised it and the matter would have been settled. That is about my only additional suggestion regarding the Corporations Law. All my other suggestions are based on changing corporate constitutions and providing incentive for companies to adopt those self-enforcing processes in their corporate constitutions so that, if they adopt them in a credible way, they are exempted from various provisions of the company law, which will simplify the burden of the Companies Act. That is the basis of my statement.

I would add one last thing. Regarding the sorts of suggestions on corporate constitution that I am advocating, I asked at the annual general meeting of Telstra whether the chairman would introduce them into Telstra as a role model. He invited me to write him a letter. Rather than write him a letter, I wrote an open letter to the minister in charge of Telstra, Senator Helen Coonan. If you would accept that, I would be happy to table that also.

**ACTING CHAIR**—When you say that is an open letter, has it been distributed and is it available publicly?

**Dr Turnbull**—Yes, it is on the web. It is published on the Henry Thornton web page. It has been sent to Senator Coonan and to Telstra.

**ACTING CHAIR**—Because it is already in the public domain and so is accessible to the committee and to anyone else, I am advised by the secretary that it is not necessary to table it.

**Dr Turnbull**—Thank you.

**ACTING CHAIR**—I have only one very brief question. How did you describe the consultations?

**Dr Turnbull**—Self-enforcing.

**ACTING CHAIR**—Stakeholder consultations?

**Dr Turnbull**—Stakeholder committees or councils.

**ACTING CHAIR**—Stakeholder councils did not in fact simply reflect the voting strength of existing shareholders?

**Dr Turnbull**—The shareholders would not have a vote.

**ACTING CHAIR**—So it is only stakeholders that have a vote?

**Dr Turnbull**—Only stakeholders and only stakeholders on record, because companies have—

**ACTING CHAIR**—Sorry, I thought you mentioned the facility for shareholders and other stakeholders of records.

**Dr Turnbull**—Yes. So you would have different committees. You would have a shareholder committee; you would have an employee council, only elected by employees; you would have a consumer council, only elected by customers; and a supplier council. In Telstra you might also have a dealer council. They have those sorts of things now informally, but they all exist at the grace and favour of management rather than being embedded in the corporate constitution. So they are allowed to tell management only what management wants to know.

**ACTING CHAIR**—Thank you very much, Dr Turnbull, for your evidence, which is much appreciated. That brings to a close today's hearing.

**Committee adjourned at 4.56 pm**