

Friday 9 February 2007

Mr Eric Mayne
Chair, ASX Corporate Governance Council
C/- ASX Regulatory and Public Policy Unit
Level 7, 20 Bridge Street
Sydney NSW 2000

Dear Mr Mayne,

Re: Submission to the Review of the Principles of Good Corporate Governance and Best Practice Recommendations

Thank you for the opportunity to contribute this submission to the ASX Corporate Governance Council (ASX CGC) Review of the Principles of Good Corporate Governance and Best Practice Recommendations. The Australian Centre for Corporate Social Responsibility (ACCSR) welcomes this review by the ASX CGC.

ACCSR is an independent corporate social responsibility (CSR) advisory, research and training firm. Our services facilitate improved corporate social responsibility through consulting on CSR policy, strategy, capabilities and programs, provision of Australia's leading executive development learning programs in CSR, and CSR research and evaluation. Our mission is to help business become more socially responsible. We take a managerial approach towards corporate social responsibility based on strategic management and organisational development perspectives. Improvement of competitiveness and risk management are central to our approach to corporate social responsibility.

The ASX CGC review follows two recent public inquiries into corporate responsibility. The PJC and CAMAC inquiries clearly established that there is no legislative impediment to corporate social responsibility. They also clarified that there will not be any move towards a mandatory approach to corporate social responsibility in Australia. The PJC and CAMAC reports endorsed an approach to corporate social responsibility that might be called "enlightened self-interest".

Both reports suggested that the ASX CGC could positively influence corporate approaches to managing social and environmental risk through its principles and best practice recommendations, especially related to Principle 7 disclosures. Indeed, the ASX's own review of corporate governance disclosures (2005) recognised that corporate disclosures of sustainability information required for an assessment of social and environmental risks is ad hoc and inconsistent.

In this submission we will address:

- Threshold issues for the ASX CGC
- Options to encourage better reporting of sustainability/CR risks
- Likely impact of our recommendations on listed companies and investors

Threshold issues – Yes, it is your business

The concept of corporate social responsibility arises from debates about the purpose of business and the responsibilities that arise as a consequence of its purpose. These same debates inform concepts of corporate governance.

Since the 1930s it has been argued that attention to corporate social responsibility is a natural consequence of a separate legal personality and limited liability¹. This view is based on factors such as the separation of ownership from control in large modern corporations, together with their increasing size, resource control, power and impact.

The concept of corporate social responsibility recognises that corporations have broad-ranging impacts on others beyond their shareholders, and are therefore accountable in a range of ways to such others as are affected by their activities. Companies also face diverse sources of risk from these impacts which can have a material impact on corporate performance.

Herein lies the link between corporate responsibility and corporate governance. As noted in our research report to the Australian Council of Super Investors,² companies have become adept at managing economic, political and technological risk, and now face new challenges in risk management from social and environmental issues. This challenge flows from increased uncertainty in business due to structural changes imposed by globalisation: the advent of large extended enterprises made up of independent units but with tremendous pressures for coordination and growth; rapid rates of change in technology and information flows; and problems in managing scale.³

Kytle and Ruggie (2005) describe social risk as occurring when “an empowered stakeholder takes up a social issue area and applies pressure on a corporation (exploiting a vulnerability in the earnings drivers – e.g., reputation, corporate image), so that the company will change policies or approaches in the marketplace”.

They point out that social risk can arise from what appears to be a sound business decision; for example, the quest for cheaper labour to drive down costs may introduce social risk if the decision causes the company to run foul of labour rights watchdogs. Social issues can enter the corporate arena and increase risk through any of a corporation’s stakeholders. Social risk entry points are summarised in Figure 1.

The processes by which companies are directed and controlled will influence the manner in which a company is able to identify sources of social and environmental risk, and develop policies and procedures that will ensure accountability to shareholders for managing those risks and thereby meet fiduciary duties.

Therefore, guidance to corporations on sustainability/corporate responsibility reporting, especially related to disclosure of material social and environmental risks, is most certainly within the purview of the ASX CGC.

Indeed, we would argue that the failure to encompass guidance on non-financial reporting in the principles and recommendations would constitute a failure to meet the Corporate Governance Council’s own objectives of providing practical guidance for listed companies.

¹ Dodd Jr, E. M. 1932. For Whom Are Corporate Managers Trustees? *Harvard Law Review*, 45(7): 1145-63.

² Discussion Paper: **Corporate Social Responsibility. Guidance for Investors** (2005). By K Coghill, L. Black & D. Holmes

³ Kytle, B., & Ruggie, J. G. 2005. **Corporate Social Responsibility as Risk Management: A Model for Multinationals**, Corporate Social Responsibility Initiative Working Paper Series, Kennedy School of Government, Harvard University.

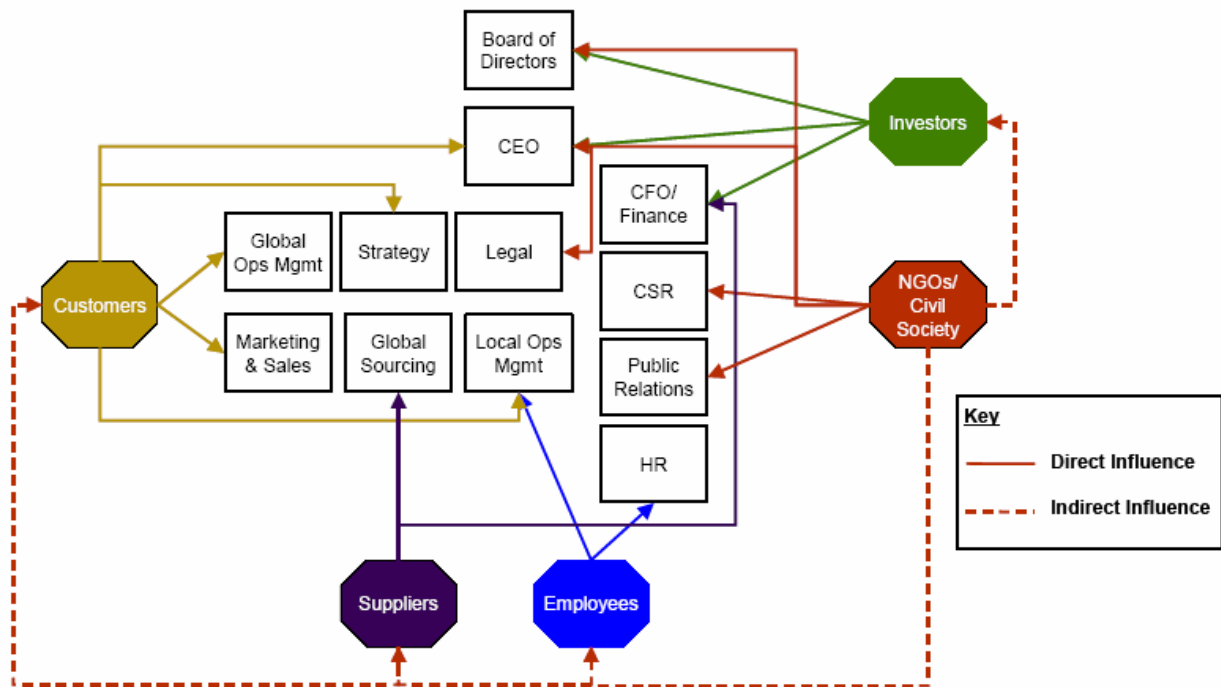


Figure 1: Sourced from “Corporate Social Responsibility as Risk Management: A Model for Multinationals”, Kytte, B. & Ruggie, J. G., 2005

Options to encourage better reporting of sustainability/CR risks

The ASX CGC Explanatory Paper and Consultation paper nominated two potential options for its role in sustainability/CR reporting; additional guidance on voluntary reporting (option A) or a reporting requirement with an “if not, why not?” obligation (option B). This is essentially a question of how far to go, and how fast.

Investors are increasingly demanding increased disclosure of companies’ social and environmental risks. For example, Mercer’s annual “Fearless Forecast” (2006), says investment managers, especially those outside the US, expect that an increasing proportion of their institutional clients will want environmental, social, and corporate governance issues integrated into investment decision making over the next three years. This survey also finds that corporate governance, environmental and social issues are very likely to affect capital markets in Australia over the next five years. Climate change, employee relations, sustainability and environment are among the increasingly material investment issues, while human rights and health issues will remain material over that time.

The appetite of investors for greater disclosure of sustainability investment risks is demonstrated by the huge uptake of the Carbon Disclosure Project. The Investor Group on Climate Change, which manages the Carbon Disclosure Project in Australia, represents Australian investors with \$200 billion under management, and membership is rising. Last year, investors wrote to ASX 100 companies for the first time to ask for information on how companies are managing climate risk. This information is currently not provided by companies in a systematic or comprehensive way under the current ASX listing rules or Corporate Governance Principles and Best Practice Recommendations. Fifty seven companies responded, a very good response rate for the first year. Response rates are likely to rise in future years, following international trends. Of the respondents, 94% of respondents recognise the potential for climate change related issues to impact future earnings, liabilities or the company’s general risk profile, but the level of preparedness to effectively respond to climate change was far lower.

Clearly, investors desire a greater level of disclosure of social and environmental impacts and risks than is currently facilitated by the current listing rules and disclosure guidance.

We often hear (and we agree) that culture change is essential to enable companies to understand and act appropriately on their social and environmental impacts and opportunities. However, culture change does not occur without a stimulus. An incentive structure for culture change would be effectively created by the “if not, why not” disclosure option, without imposing a mandatory burden on companies.

Culture and structure are highly inter-dependent constructs. Human action creates structures that in turn, transform human action. We see that phenomenon very clearly in organisational experiences with corporate responsibility/sustainability reporting.⁴ The act of reporting encourages self-reflection and analysis that in turn leads to new ways of thinking and managing.

Given the market’s desire for greater and more consistent disclosure of sustainability and corporate responsibility issues, and the effectiveness of increased disclosure on corporate efforts to manage and ameliorate environmental and social risks, we recommend in favour of Option B, that Council introduce an additional “if not, why not?” reporting requirement in Principle 7 with guidance, involving additional reporting obligations for companies.

Likely impact of our recommendations on listed companies and investors

We believe investors will welcome the introduction of additional reporting requirements, because it will give them greater insight into the performance drivers of the companies in which they invest. Because environmental and social issues and risks are generally longer term in nature than some of the financial drivers of performance, the additional reporting requirement is likely to encourage longer term horizons of investors and therefore provide more stability for companies as they pursue strategies that address these risks.

Many of the larger companies will welcome the guidance provided by the additional reporting requirement as it will provide boundaries and criteria against which to prepare information that they currently report in many different and unsystematic ways.

Many smaller companies will be encouraged to reflect on and describe their social and environmental risks for the first time. There is no doubt that for some companies, this will be more work than they are used to. However, an “if not, why not?” reporting requirement need not be onerous, as it can be dealt with in a concise narrative form that does not require the development of additional sophisticated data collection systems that might be used by larger companies. As investors will value this information, smaller companies will soon find that any misgivings will disappear.

In summary, the Australian Centre for Corporate Social Responsibility has argued in this submission that it is a natural and proper role for the ASX Corporate Governance Council to address issues of corporate responsibility and sustainability reporting. The most effective course for the ASX CGC to take in its current review of Principle 7, related to disclosure of risk, would be to introduce an additional “if not, why not?” reporting requirement to facilitate the consistent and effective disclosure of environmental and social risks and opportunities.

Yours faithfully



Dr Leeora D Black
Managing Director

⁴ Black, L. D. 2004. *How Companies Manage for Good*. Unpublished Ph.D., Monash University, Melbourne.